California Resources Corporation

Third Quarter 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

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PRESENTATION

Operator
Good day and welcome to the California Resources Corporation Third Quarter 2021 Earnings Conference Call. All participants will be in a 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 today's event is being recorded.

I'd now like to turn the conference over to Joanna Park, Vice President, Investor Relations. Please go ahead.

Joanna Park
Welcome to California Resources Corporation's third quarter 2021 conference call. Participating on today's call is Mac McFarland, President and Chief Executive Officer; and Francisco Leon, 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 on our Investor Relations section of our website, www.crc.com. These slides provide additional information into our operations and third quarter results. And we've also provided information reconciling non-GAAP financial measures discussed to the most directly comparable GAAP financial measures on our website as well as in our earnings release.

Today's conference call contains certain projections and other forward-looking statements and these statements are subject to risks and uncertainties and may cause actual results to differ. Additional information on factors that could cause our results to differ are available in the company's 10-Q and 10-K. A replay will be made available for 30 days following the call on our website. And as a reminder, we've allotted additional questions--time for question and answer at the end of our prepared remarks. We would ask that participants to limit their questions to a primary and one follow up. With that I will now turn the call over to Mac.

Mark McFarland
Thank you, Joanna, and good morning, good afternoon, everyone, and thanks for joining the call. In honor of Veterans Day, we would like to thank all of those women and men who served and continue to serve our great nation. Thank you for your service.

In the third quarter, we continued our strong performance, maintaining production of low carbon intensity oil, demonstrating our disciplined investment and generating significant free cash flow. I'd like to thank the employees of CRC for their dedication to make all of this possible during the pandemic. Their strong and consistent performance has enabled us to generate $328 million of free cash flow year-to-date and announce the following.

First, we are updating our annual free cash flow guidance for the year, which we are increasing to a range of $460 (million) to $510 million. Second, I am pleased to announce that the Board has approved a dividend of $0.17 per share payable in the fourth quarter of 2021 and has extended $250 million share repurchase program until the end of the second quarter of 2022, thus highlighting CRC's dedication to shareholder returns.

I'd also like to point out that even with the strong cash returns to shareholders, we still expect to have over $325 million of cash on our balance sheet at year-end. And lastly, we continue to advance our commitment to the energy transition in the sector. Building upon our carbon management strategy, CRC has adopted a 2045 Full-Scope Net Zero Goal for Scope 1, 2, and 3 emissions. This puts us among a handful of industry peers to include Scope 3 emissions in our Net Zero goals and puts us on a timeframe five years sooner than most, which aligns us with the State of California's 2045 net zero ambitions.

CRC's low carbon intensity production combined with our unique asset position in carbon management opportunities are the key differentiators which allow us to have a clear line of sight to achieving the Full-Scope Net Zero Goal. Said simply, CRC provides low carbon intensity fuel for today and net zero fuel for the future. When we couple our unique position with the economic incentives available in California, CRC's opportunity stands apart even further because we have the opportunity to reach our Net Zero Goal economically.

As previously disclosed, Carbon TerraVault's near term focus targets up to 200 million metric tons of storage potential or injection of up to 5 million metric tons per annum by 2027. This represents nearly double our Scope 1 and 2 emissions and provides a clear direction to meaningful progress toward our goals. As I said before, we do not expect it to be easy to achieve, but these are our goals. They are ambitious and we are committed.

As we committed before, we have submitted our second permit to the EPA for 26R reservoir's plan, combined with our initial permit for the A1/A2 reservoirs at Elk Hills. These make up an approximately 40 million metric ton projects for Carbon TerraVault I and supports our goal for first mover advantage in California and the U.S. when it comes to carbon management. We continue to have discussions with various emitters as we stated before, and we are targeting an announcement on these advancements in 2022.

On the solar side, we are progressing our partnership with SunPower on 24 megawatts of behind-the-meter solar projects at the Kern Front and North Shafter fields. This is an addition to the previously announced 12 megawatt project at Mount Poso and advances projects on a total of 36 megawatts of the up to previously announced 45 megawatts Behind-the-Meter.

Again I'd like to thank the employees for their dedication and hard work. Our operations team continues to deliver strong results on our maintenance and development programs, which have exceeded expectations from a cost and type curve perspective. Thank you for being here today, and I'll turn the call over to Francisco.

Francisco Leon

Thanks, Mac. Good afternoon, everyone, and thank you for joining us on this call. As Mac highlighted, CRC continued its strong operational and financial performance in the third quarter of 2021. During the quarter, CRC produced 102,000 net barrels of oil equivalent per day and 62,000 net barrels of oil per day, resulting in modest growth year-to-date in both gross and net oil production. This is largely due to our inventory of high return, quick payback maintenance projects, and is also supported by only $98 million in drilling, completion, and workover capex year-to-date. With much of our backlog addressed at current prices, we're beginning to increase our development program to a more normalized level.

In September, we added a third drilling rig in our Los Angeles Basin and year-to-date our development program has brought online 58 new wells. In the third quarter, we were running 35 maintenance rigs and were able to bring online an additional 216 maintenance wells as part of

our previously announced shift of capital from drilling to downhole maintenance. In Q3, this shift allowed us to return to production an additional 2,600 BOE per day, while sustaining our controllable operating costs.

Our commodity realizations remain strong across all of our streams with oil realizations at 100% of Brent, NGLs at 73% of Brent and natural gas at 126% of NYMEX. Realizations are expected to remain healthy across all three hydrocarbon streams, particularly for natural gas, which has seen a large increase in the second half of the year. The rise in natural gas prices increases CRC's operating costs, which I will discuss further shortly. However, it is important to recall that CRC benefits from this increase, since we realized higher prices on the sale of natural gas, which we also produce.

Moving on to the cost side of the business and as shown on Slide 9, our third quarter 2021 G&A cost rose sequentially quarter-over-quarter and averaged $5.44 per BOE. This is primarily due to increased compensation-related items. Our third quarter 2021 operating costs, excluding PSC effects, rose by $1.69 per BOE, compared to the second quarter of 2021, primarily due to the rise in natural gas prices. We purchased natural gas, which is used as fuel for our steam flood operations and to generate electricity from our Elk Hills Power Plant.

Excluding the effects of higher natural gas prices on our cost structure in the third quarter of 2021, our operating costs on a per barrel basis were in line with the first two quarters of this year which is a true testament to the operations teams ongoing efforts to manage costs that we control. When we look at the effect of natural gas pricing in total, we can see the benefit we derive as the largest natural gas producer in California and the positive impact on our margins.

Year-to-date, CRC produced an average of 160 million cubic feet per day and purchased less than half of that amount for our internal consumption. As we show on Slide 10, for every dollar rise in realized natural gas price in the fourth quarter, we expect to see incremental revenue of $15 million, more than offsetting the incremental operating cost of approximately $7 million.

During the third quarter, CRC reported an adjusted EBITDAX of $242 million, our highest quarter since we exited bankruptcy a year ago. Furthermore, this year's modest capex requirements helped to generate $131 million of free cash flow in this quarter, our best quarter so far this year, and $328 million of free cash flow year-to-date. Results reflect strong operational performance, higher commodity pricing, and higher margin electricity sales from our Elk Hills Power Plant.

Underpinning CRC's strong financial performance has been our successful drilling program. Our 2021 development program has predominantly been focused on the Mount Poso, Elk Hills, and Buena Vista fields, with a combined program IRR of over 90%, by focusing on high value, high-margin horizontals, we have seen large capital efficiency improvements across the fields. Currently, about 90% of our drilling efforts are focused on these promising horizontal opportunities, reflecting stronger economics and lower capital intensity needs.

Due to the strength of the drilling program to date, along with the rising commodity prices, we accelerated certain projects to the fourth quarter of 2021, which were previously scheduled for 2022, including adding a fourth rig in the Buena Vista Shale, and incremental workover opportunities. As a result, we are adjusting our guidance to account for changes in our activity in the current price environment as we look toward our year-end.

We are raising CRC's total net production guidance by approximately 2% at the midpoint to 100,000 BOE per day and also increasing capital investments to a range of $180 (million) to $200

million and increasing free cash flow guidance by approximately 8% to a range of $460 (million) to $510 million. The combination of our strong operating results and streamlining of our asset portfolio continues to enhance our financial strength.

Earlier this month, we closed on the sale of the majority of our Ventura basin operations, which was our highest operating cost area. This helps bolster our already strong liquidity position. Post-closing, our cash balance as of November 3 was $280 million, bringing our pro forma liquidity to approximately $639 million. Our updated guidance takes into account the sale of our Ventura basin operations. I'd also like to point out that the preferred interest held by Benefit Street Partners was redeemed in September, further simplifying our balance sheet and financial flexibility.

To conclude, CRC continued to demonstrate our commitment to prioritize shareholder returns. As of November 5, CRC repurchased 3.1 million shares for $104 million for an average share price of $33.99 per share, which represents an over 25% discount to our current share price. With $280 million of cash in our balance sheet, our strong financial position has further optionality with our shareholder return strategy. As Mac mentioned, the Board has approved a quarterly dividend of $0.17 per share payable in the fourth quarter. When annualized, this will equate to approximately $56 million in shareholder returns.

Our healthy free cash flow generation allows us to continue to self-fund our capital needs and will allow us to fund our carbon management activities as we continue to evaluate alternative capital deployment options benefiting our business. Please note that we have provided detailed analysis of our quarterly financial and operational results in our 2021 guidance in the attachments to our earnings release. Thanks and I'll now turn the call back over to Mac for closing remarks.

Mark McFarland
Great. Thank you, Francisco. CRC has a uniquely positioned asset base that allows us to provide the needed energy today and to meet the goals of tomorrow with the Net Zero fuel of the future. CRC continues to exhibit disciplined capital investment in our asset base, which is low decline and low carbon intensity and provides resilient cash flows. We remain committed to our cash flow priorities of building upon our carbon management business and shareholder returns. We've made progress on both with two important announcements: our commitment to a 2045 Full-Scope Net Zero and a quarterly dividend. Thank you again for your interest in CRC and thank you for joining us on today's call. With that, we will now open the line for questions.

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question-and-answer session. To ask a question, you may press “*” then “1” on your touchtone phone. If you’re using a speakerphone, we ask that you please pick up your handset before pressing the keys. To withdraw your question, please press “*” then “2.” Today's first question comes from Scott Hanold with RBC Capital Markets. Please go ahead.

Scott Hanold
Thanks. First, congratulations on the target to Net Zero Scope 3. I think you're one of the only oil and gas companies to have a good visibility toward that, so congrats on that. My first question, yeah, my first question is probably for Mac and maybe Chris. Just, I understand the sensitivity around the discussions with emitters, but can you give us some sense of, based on your discussions, what are you all hearing from them in terms of the interest level, key criterias that

they're looking for, and just some sense of where the interest is in playing the opportunity? Are they looking to, you know, participate in any of the start--to end of the process or are they just looking to find a solution in--in whatever is the easiest?

Mark McFarland
Scott, Chris is here with us, so I'll let him jump in. But let me just start by saying that I think that, at least as we consider opportunities for sources, we are working with people who are interested in reducing their overall carbon intensity of the products that they make. And so therefore, being able to hopefully either avoid having to produce LCFS credits or creating a product that has a premium associated with it due to lower carbon intensity. So that is the high level. But I'll let Chris jump in and provide some additional comments.

Chris Gould
Yeah. So I think that's great context, and of course that's going to vary by source. There are some emission sources when you start to look at how do they price their downstream product, whether they're a conventional refiner or a renewable refiner or any other source out there, they are all going to have unique attributes. And so I'm encouraged in the work in the discussions that we're having with each of them and it really speaks to the model that we have approached our go-to-market, which is allowing for the flexibility in these very early stages to engage with these emission sources and be able to tailor with them to the types and the needs that they need, where they can monetize the low carbon intensity of their product. So very much advancing the ball across those different sources, Scott, and very encouraged with the response that we are receiving.

Mark McFarland
Let me just add on to that. So with the LCFS construct that's in California, obviously, people can either view that as a carrot for the economics, which have to pay for the capture through the injection system or the stick, if you will, if it eventually becomes somewhat of a penalty to have to buy credits for the deficiency. That's one avenue.

The other one I would tell you is, obviously you've seen and we've included a slide on the proposed changes to 45Q. We also see in addition to those that are LCFS eligible, we also see increased interest in non-LCFS that are 45Q with the uptick in 45Q that might be interested in sighting greenfield type opportunities. So I think there are the Brownfield opportunities that are LCFS compliant and the greenfield opportunities with the increase in 45Q that is driving a lot of interest.

Scott Hanold
Got it. And could you just mentioned on just the last part of that question was whether they're interested in actually the capture process, doing part of the capture process and then having you sync the CO_2 from their transport and sync or is there any interest of them taking some of the opportunity here as well?

Mark McFarland
I think, without getting into any one particular discussion, it's all over the map. It depends on the source. It depends on the capital funding. It depends on a lot of variables there, Scott. I think that there are some that say, “You know what, provide an entire solution for me” and there are some that say, “Hey, I'd like to deploy capital and put it to work and possibly look at things that look more like a partnership around the capture system, et cetera.” So it really spans the gamut as we laid out on our October 6 Carbon Update on that business model. It really does cut across all those different business models.

Scott Hanold

Got it. Understood. And as my follow-up question, just on the shareholder return, maybe this one's, Mac, for yourself, but also Francisco. But as you step back, you initiated a dividend, you have a stock buyback. You've also made a statement of wanting to utilize 50% of your free cash flow to get toward that Scope 3 Net Zero. Can you, at a high level, discuss a couple of things? One, where do you go from here on that shareholder return proposition? Because even if I take half of the projected $2.5 billion, it's still leaves you a lot of flexibility going forward. So if you add some commentary on that.

And then, as you in the second part of the question is with the 50% sort of allocated to getting toward that Scope 3 Net Zero, like, you're looking to potentially use your upstream free cash flow, but and this is probably for Francisco, but as you look across the other maybe cheaper sources of capital, what is the opportunity to utilize that to lean more into giving it back to shareholders?

Francisco Leon

Yeah, Scott. This is Francisco. I'll take the question first. So we have to start with, actually as we said in the script, we're projecting cash of $325 million by the end of the year. So really good accumulation of cash this year and that's post--we're already over $100 million put to work on the SRP and the dividend that we're going to pay out in a few weeks. So the cash flow--potential cash flow generation of the business continues to deliver. And as we discussed earlier, the framework is to first invest in the core business, and we're going to invest less than 50% of our discretionary cash flow into maintaining our core business.

So then you have 50% remaining. We'll split it in roughly half between shareholder returns and investment in our carbon management business. Right now, we like the value proposition to the investor to put a dividend forward, but we're also going to keep the share repurchase program alive. So we'll have two different avenues to returning cash to shareholders. I like the optionality that the share repurchase program gives us. I still see a lot of value in our stock and we're going to continue putting dollars to work to buy back our shares.

But it's something that we'll continue to assess and it gives us an opportunity to pull back at some point. But right now, we're going to be entering the year with both of them open and we'll see what the market dictates. And so we'll allocate accordingly to that 50%. There are two frameworks to do it now, two particular paths to do it.

And then, the carbon management business, we see a a ramp-up of investments over the next few years. Right now, we're talking to emitters who are making the initial steps to creating this new business segment, that's going to ramp up naturally, as you get closer to FID and as you get closer to making a decision on a go or no-go for the capture system or the pipelines or the storage tanks. So naturally, you're going to see a progression from potentially heavier weighing in the first few years to shareholder returns in terms of the proportions and then the ramp up in carbon management. So there's a little bit of timing associated with the split of capital.

What we're seeing is the financing side of the equation is maturing rapidly. There is a lot of good sources and from private equity to government loans, to the bond market being attractive to participate in the carbon management business. Now, we said we're not afraid to put our balance sheet forward and we may use some of the cash that we're generating toward these initiatives. But to me the best point to negotiate, the highest potential negotiating leverage is to have cash on the balance sheet that then unlocks the financing sources.

I don't want to commit to only one way of doing this and say we're definitely going to put this much money to work by this date because you could find a cheaper source of financing, we'll definitely do that. And I think that this stage is set for us to be able to have a lot of different options and then just optimize on the best financial structure as we try to pursue the carbon management business.

Scott Hanold
Got it. So in theory, if you all were able to find that cheaper source over time, the shareholder return would take up a larger portion of that free cash flow. Is that what I'm hearing?

Francisco Leon
Yes, I would say, yeah, shareholder returns ultimately, we have discretion on what that incremental source of where that cash goes to. We'll see what the best avenue is, but--so I don't want to commit to all kind of shifting back in that instance where it is more of a, you're saying, well, what if this happens and trying to provide some feedback. But ultimately, we'll see. The shareholder return aspect of our business is going to be there given our very low capital intensity assets and the type of assets that we own.

But there is going to be opportunities, and whether it's acquiring a bolt-on near Elk Hills, for example, we might put the cash forward toward that end, and we might see really good value there. So don't want to box us in to just saying, "Yeah, if you get sources of financing in carbon management it all flicks back to shareholder returns. We're going to look at it, we're going to explore it." If that's the best avenue, we'll do it. But we also have dry powder to do other things with it.

Mark McFarland
So Scott, just to add a bit from my perspective, what Francisco said is absolutely true. What we have is a framework and we're committed to both sides of the--after we spend and reinvest in maintaining BOE production, both sides, shareholder return and carbon management, we're committed to both. But what we have is, because of the strong cash flows of the core E&P business, we have ultimate flexibility and we've demonstrated that now for three quarters. I think Francisco is saying projecting out into the future we remain committed, but we remain flexible. And as we see opportunities we have the ability to either return the cash to shareholders or invest in projects that we think are shareholder accretive.

Scott Hanold
Understood. Appreciate the color.

Operator
And our next question today comes from Leo Mariani with KeyBanc. Please go ahead.

Leo Mariani
Hey, guys. Just wanted to ask a question on the fourth rig that you're adding here. Just wanted to get a sense, as you guys look into 2022, do you think four rigs is the right number to roughly achieve your goals of holding roughly flattish in 2022, or do you think there may have to be an additional rig that may have to come in here?

Francisco Leon
Yes, Leo, this is Francisco. Yeah, we ramped up from one rig to four here as we exited the year and we like that entry point into 2022. As we guided, before we talked about it, we see once this backlog inventory is no longer there, we're going to switch more dollars to capital and we see the maintenance capital of our business about $275 million. So that implies somewhere between four

to five rigs. We feel really good about the four rigs that we have right now going into the year. Shawn Kerns is here with us, our Head of Operations. I don't know if you have anything to add?

Mark McFarland
Shawn M. Kerns
I just want to be clear, the $275 (million) includes, it's not just D&C, it's a capital number. But, yeah.

Shawn M. Kerns
Yes, I'll just add, Francisco. The four-rig program is very consistent with what we've been drilling this year in 2021 and so we have our plans laid out and we'll just roll into 2022 with that four-rig program.

Leo Mariani
Okay, thanks. And then, just additionally, wanted to see if you could provide a little bit more color just around the commercial progress on some of the negotiations with some of these industrial emitters. This might be a bit of a tough way to frame it, but just wanted to get a high level sense if there's any way to like ballpark, quantify, like the number of, like very serious conversations you're having. Is it just a handful, or is it like 50 conversations with emitters? And then, just wanted to get a sense, have some of these discussions progressed to a fairly late stage? How would you maybe characterize how far you are down the road on some of these key discussions?

Mark McFarland
Yes, good morning, Leo. It's Mac. What I would say is, I'd probably go back to some statements we said before that, if we signed everything up, we would be way over subscribed for Carbon TerraVault I. I think that the discussions are advancing. I think that we, based on the continuation of discussions, would stick with our type curve, it's still being the type curve that we see, that we put out on October 6. So it's been affirmation of continued affirmation and continued interest in Carbon TerraVault I.

Leo Mariani
Okay. And apart from Carbon TerraVault I, I know obviously, you guys have plans to do more of these class VI sequestration projects. Did the discussions also potentially look at other sites down the road? I'm just trying to get a sense of what the size of the opportunity can be here. Is there just a lot of folks looking at some of the other fields in the future that it get to be permanent as well?

Mark McFarland
In short, the answer is yes. But again, I'll go back and say, Leo, that what we described before is we put Carbon TerraVault I together, we filed the permits on it but we're focused on the next 160 that get us to 200 million tons. Chris is here. Chris has been working with the team to prioritize our opportunities as we said we thought we have a fair amount of unique assets that we can convert into Carbon TerraVault II, III, IV, or V and to get us somehow, in some form or fashion, get us to 200 (million) metric tons that we're focused on first. But, Chris do you want to provide some insights on that?

Chris Gould
Yeah, I think those conversations in addition to CTV I are occurring. We are active. We have our focus on, as we talked about, we submitted the EPA permit application for 26R. We want to deliver on what we promised and committed to on CTV I, but in parallel with that with the goals that we've put out, our 200 million tons, we are advancing in discussions with scoping out different sources

across those geographies and prioritizing where we think the next set of opportunities are. So that is to say, we're working on it. We are not stopping with CTV I. We're focused on that, but we're progressing at the next 160.

Mark McFarland
And just to add a quick overlay to what Chris said. We have teams that are advancing the permitting and the defining of the next tons to get us to 200. But concurrent to that, we also have commercial engineering and operations teams that are working on the source of CTV I. And concurrent to that, as we structure through and where we hope to get with a project, we are working, and Francisco and the finance organization are looking at opportunities for how to finance that either through the debt or equity markets. So all of it's going on concurrently, and we're excited about the prospects.

Leo Mariani
Okay, thanks guys.

Mark McFarland
Thanks Leo.

Operator
And our next question today comes from Kalei Akamine with Bank of America. Please go ahead.

Kalei Akamine
Hey, good morning guys. Can you hear me?

Francisco Leon
Yes. Hey, Kalei.

Kalei Akamine
Perfect. Thanks for getting me on. Mac, I want to hit a couple of topics here and the first will be on the base business, which I feel is getting, perhaps, overlooked by the market that's really focused on low carbon at the moment. So I think the market is trying to understand how CRC fits into this new E&P landscape, which requires you to have a track record. So I'll commend you for coming out of the gates very strong this year and showing the gas returns and the capital discipline. But we want to know how long you can do it for, so I'm hoping that you can help put some parameters around the free cash capacity. So what I'm looking for is, what's the maintenance capital, what's the oil breakeven, and what production plateau does that support and how deep is the inventory to support it? So in other words, how long?

Mark McFarland
Yeah, sure. So, great question and I appreciate the interest in the core business, because it's a lot of what we do. There's a lot of conversation around our carbon management activities. But you're absolutely right. We did highlight some of this in the Carbon and Strategy Day, but not to the level of details that you asked, but we provided a five-year type projection there. I'm going to let Francisco pick it up from here and talk about maintenance capital, maintaining production. There were some assumptions there, and maybe you want to go through some of those.

Francisco Leon
Yeah. No, I'd be happy to. So Kalei, the inventory, we've always felt CRC was inventory rich and the issue what we've had since we came out of the gate, the CRC has been the balance sheet which we address this past year. So inventory looks--it's very attractive. It's not Shale. So you're

not going to hear us talk about this 24-hour IPs and move into that way of guiding to the market. So we have--for us is really good tanks, really good oil and gas rocks that we can get the oil out of the ground through waterfloods and steamflood through our primary drilling. So it's not always the drilling and completion side of the equation that solves for how attractive your inventory is, right? If you can get the oil by injecting water, that's a very attractive, very high return business for us.

Now, in the inventory, what we talked about in the past is at about four rigs, which at our current pace, we have about 10 years of inventory. We're focusing on, right, this year on some of the shallower stones in the San Joaquin Basin, but we also have a rig in the LA Basin. That's a pretty good sustained level. I mean we can expand LA Basin, but we are seeing a lot of really good returns in the shallow zones in the San Joaquin basin. So we see about 10 years of inventory. Now, that is a dynamic view when we came out and we talked about this prices were lower than they are today, price point at 86, expands inventory in a pretty significant way and if you look at our historical filings you see reserves in a much higher up to a 1 billion barrels of 3P reserves. So we see a lot of good projects there.

In terms of a breakeven, right now we see, we have a pretty attractive hedging program that's protecting, giving us a nice floor to work with. So on 2020 Q2, we see a breakeven into the $30 per barrel range before we have to pull back on the capital. So we're hedging to support the capital, to support the dividend, and we see a very attractive runway here as we go forward.

Shawn M. Kerns
Yeah. And Kalei, this is Shawn, if I could add. Speaking to our inventory that Francisco was talking about, I think a notable change that we have seen lately that's doing really well is drilling more horizontal wells. That's a little bit different than we've done from the past and we're seeing really good performance there. And when we talk about horizontals in this regard, these are un-stimulated, because the quality of the rock in California is so good. So we're able to drill these wells, target some horizontal areas in the reservoir, and we're able to be more efficient with our capital dollars going forward.

Kalei Akamine
Thank you. I appreciate that. Maybe if you could just hit the maintenance capital spending level, and I'll throw a twist on this. What do you say to those that argue that it's going to take longer to stabilize due to the inconsistent spending in the past several years and the long lead time between spending and the production response? And add to the fact that we haven't seen production hold flat for a sustained period of time.

Francisco Leon
Yeah, I think the evidence Kalei is this year. Three consecutive quarters. I understand your point, you need to have multiple quarters, but this year has been a really exceptional year from an operating perspective where we're holding production flat with lower capital. We’re below $200 million to hold it flat.

We will guide to a higher number next year, just to be clear. We are seeing about $275 million and that is only to clarify the point to hold oil production. So we do see this year as being a year where we had a good backlog of wells, we can return back to production. Next year, we'll go more into a drilling, building that wedge over time to maintain the production.

But the way to think about conventional assets and CRC assets, I understand your point that it's, you don't have the shale production that immediately comes in, but you get on the treadmill. If

you're chasing those barrels and you cannot stop production. For us, it's like a slow rising tide. If we continue to bring dollars to work in both OPEX and CAPEX, and OPEX is a very important tool that we used to invest in getting production out of the ground. If we have a sustained level of investment, what you see is one of the best decline--sort of one of the lowest declines in the industry.

So it is in the low teens, 10% to 15% decline and that allows you to project the business that's very sustainable and has high confidence in those cash flows over time. So yes, it's a different model. We are going to have to reeducate the market as to how conventional assets work. It's less of our drilling and completion. It's more about maintaining reservoir pressure and putting dollars to work there, but that also, this allows us to plan the business without worrying about if prices drop and we have to back away the drilling rig, then the production goes away. So it gives us a lot of a lot of confidence to plan forward.

Mark McFarland
Hey Kalei, this is Mac. Let me say it this way. We believe in what we're doing and the way that we build credibility, I said this during the high yield offering that we did earlier this year, I said it during strategy and I say it each quarter, we're going to build that credibility one quarter at a time. We believe that we have the inventory, we have the low decline, we have the capital discipline, and that's what we're going to execute on.

Kalei Akamine
I want to pick up on your comment about hedging. I think as you stated CRC's balance sheet is in the best position that it's ever been in. So I'm wondering on the philosophy to hedge, why do it? Is it to fund the growth in low carbon or to fund the drilling program? What's the strategy behind it?

Mark McFarland
Yes, sure. It's a good question and first, let me try to parse some things, if I may. If you look at the hedging and the mark-to-market that is flowing through the income statement in the hedging, the losses that we've seen to date and that we're going to realize cash this year as well as the forward mark-to-market losses, those are almost entirely as it, I'm stating as of September 30, those are almost entirely associated what I'll call legacy hedges that were enacted before--the trade dates were all before December 31, 2020. And they were requirement at that point in time as we exited bankruptcy and they were requirement by the RBL.

If you look at the hedging that we've done since then, which I think is more applicable to your question, it's effectively as of September 30 at the market. I know there's been some write-ups, but there are some differences on the shaping of our hedges and when they occurred et cetera. But they’re effectively at market or minimally out of the money, but why do we enter into those hedges? So we've done a couple of things. We've rolled out the strike price on the puts for next year, so that we have a higher floor. That's to protect downside.

Without getting into a view on commodity, we think that that's prudent management to stabilize cash flows that allows us to have longer rig contracts, a more stable production, more stable investment in production. It also provides stable cash flows. And this is not 100%. If you ever look at it, and it's not 100% and we hedge up to 85%--can hedge up to 85% of our crude production. But that's only 75% of our revenues. We still have NGLs, and natural gas revenues. So the hedging philosophy is to provide coverage for things like doing the carbon management, reinvesting in the business, adding a dividend. We have low decline assets, but it basically helps us smooth our investment horizon over a longer period of time.

Kalei Akamine
That's perfect. If I could sneak one more in, and this one is on CalCapture. My understanding was that the FEED study was completed in the summer. So I'm wondering what's standing between you and FID on that project?

Mark McFarland
Yeah, so the FEED study, there are some things that had to go into it that we're working through on owners costs, et cetera, and we've asked to take a second look at if the cost we've gone through with I'll call it a .05 times pencil or something. We went through, we gave it back to the engineers said go back and refine the cost estimates, sharpen our pencil is the phrase I was looking for. So we're working through that. Our views are, there are a couple of things associated with that because just--everyone I think pretty much understands, but just for sake of clarity, a third of the power plant is used for hydrocarbon production. The other two-thirds goes out the market on the California ISO.

So right now, as we understand that the way the rules are written and our interpretation is that only one-third of the carbon captured from the plant is LCFS pathway eligible. And so now, it's still--is at some levels of enhanced oil recovery that would be associated with it. You start to get the economics that could make sense. However, there are some regulatory changes. Right now, there is no avoidance of greenhouse gas emissions for capturing CO2 off of combined cycles in California.

We think that that will change over time. And if you did that right now and it changed over time we think regulations will eventually get there because it's necessary to have combined cycles on the grid and those combined cycles need to have an incentive to have carbon sequestered. That's the only way basically to have a combined cycle, you can't do it unless you're using hydrogen as a syn fuel, which is a whole other ballgame. You still have to get rid of of the CO2. So we think that there is a movement in that direction. And if we were to offset greenhouse gas emissions for the full lot of the emissions by sequestering that CO2, right now, those allowances are trading around $30, $32 a ton.

And so because it produces roughly 2 million tons, you start--2 million tons from the power plant, you start to add to the economic returns on CalCapture. So when you ask your question about FEED study, we’re refining it. When you're asking about getting to FID, I'd say we're a ways away and we need to see some regulatory changes. But we continue to think that it is coming toward us and that is a project that we continue to invest, I'll call it, early stage development dollars.

Kalei Akamine
I appreciate that. Thank you for answering all the questions and I look forward to catching up with you more on the low carbon part of the business next week at the BofA Conference.

Mark McFarland
We look forward to it. Thanks for hosting us.

Operator
And your next question today comes from Ray Deacon with Petro Lotus. Please go ahead.

Ray Deacon
Yes, hi. My question was on the Elk Hills Power Plant and how much of the gas is supplied from the Elk Hills field and would you like to put your hands on a more gas resource, and is that possible?

Mark McFarland
It is effectively 100% sourced. You could talk about--it's 100% sourced, Ray. And the other thing that I would tell you, just as we look at it, so you probably see we're being very effective on our cost discipline standpoint from--on non-energy operating expenses. But the energy costs go up and that's because when we look at that as a floating price of energy, whether it'd be in the steam generators or whether be in the gas to supply the power plants, but we are a net gas producer. We generate roughly 60 Bcf of gas a year and we consume 30 Bcf of gas a year. So again, give or take, and so that's why we had a slide in there that shows the fourth quarter sensitivity to gas. So we're net gas producer. But 100% give or take, for the most part is in our field.

Ray Deacon
In your own fields. Got it. And just one more. I had read that California was going to shut in a fairly big nuclear plant this year and I was just wondering, do you think the gas market could get even tighter from here, or no?

Mark McFarland
It's hard to say. I think that if the expectation is that the plant is going to be shut down, it somewhat makes its way into the market, but Jay…

Jay Bys
Yeah, Ray, Jay Bys. The more incremental generation you add to the grid, the more support you need in the form of reliable resources. So yeah, there is a concern that more gas generation will be needed to support that incremental generation. So if that’s the case--

Ray Deacon
--Okay--

Chris Gould
--You should see-- gas prices should be well hit.

Mark McFarland
Yeah.

Ray Deacon
Got it, got it. Thanks very much.

Mark McFarland
Thanks, Ray. I think we’ve got time--

Operator
--And our next question today--yes, sir. Absolutely. Our final question comes from Eric Seeve with GoldenTree. Please go ahead.

Eric Seeve
Hey, guys. Thanks for the call. Great quarter and great to hear all the sell-side interest that's building in a great story. It was a terrific quarter. Wondering where you guys really blew the cover

off the ball was on the natural gas trading and on electricity where gross profit was well above what you guys guided to historically for those businesses. Can you maybe level set and just give an updated view on what we should expect for profitability from those areas going forward?

Mark McFarland
So look, with natural gas prices higher, obviously, if--I was going to get into electricity term. If we beat the market heat rate with the heat rate of our unit--our unit is going to expand and expand our margins by dispatching into the market with higher gas prices. And so our electricity revenues have been higher. There has been some higher demand. Obviously, there is a--hydro has been a bit depleted here. It comes from the north. So there has been increased demand of the unit. And so, increased profits and increased spreads or margins, if you will, and that's what's contributed to that.

And then as far as gas, we've just had opportunities to move gas around as we have several transport agreements and we've been able to optimize that better. We generally think that Jay and the team are going to do a good job but sometimes not everything is repeatable, but right now as we look forward, energy margins, that being the electricity that's being sold into the future, remain strong. Anything you want to add, Jay?

Jay Bys
No, I think you said one or two things changing in the California Gas market in the last 30 days. You said Yaviso (PH) Canyon capacity moved up from 34 Bcf to nearly 42 Bcf. So that should be--Winfield, should be a stabilizing element. It may be a depressing element on prices. We'll see. The second thing is, we've had a major line at SoCalGas be restored to a greater use. It's about 800,000 MMBtu per day of capacity we didn't have before. I think we've seen the market receive that very well. Unfortunately, the producer--the response has been lower gas prices.

California has got a unique circumstance. We've got a limited amount of gas supply. We've got a limited amount of gas storage, but our needs from a power perspective tend to be hinged on gas for meeting those incremental needs. So likely, this will be a volatile market for both gas and power for some time to come.

Mark McFarland
Eric, I think with Jay and obviously watching the market, there were some things that made the market tighter. There have been a couple of things announced that should relieve the market a bit. I think time will tell. I think that as we go through this, there was an interesting report that came out recently and I think the title is something to the effect of the turbulence in the--of the energy transition. And we, I think, in California or perhaps at the pinnacle of that or the forefront, whatever the right saying, we're the tip of the spear. Mix metaphors. But we're seeing it as the state moves through this energy transition that's creating this volatility. So it's really tough to predict what will happen in the years to come other than continued volatility. So with that, let me just say thanks for everyone's interest in CRC, and have a good Veterans Day.

CONCLUSION

Operator
Thank you. This concludes today's conference call. We thank you all for coming to today's presentation. You may now disconnect your lines and have a wonderful day.