Berry Petroleum Company Transcript

FIRST QUARTER ENDED MARCH 31, 2008 EARNINGS TELECONFERENCE

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Speakers:
Robert F. Heinemann - President and Chief Executive Officer
Ralph J. Goehring - Executive Vice President and Chief Financial Officer

Robert F. Heinemann *- Berry Petroleum Company - President & CEO*

Thank you, good day. Let me remind you that we are conducting the call under Safe Harbor provisions. Today, Berry Petroleum Company posted its first quarter results for 2008. Net income was $43 million, $0.95 a share for the quarter, compared to $18.9 million or $0.42 per share in the first quarter of 2007. This year's results included a $0.08 per share increase from a combination of the gain on the sale of an asset, abandonment of three wells, exploration costs, a correction arising from a multi-year royalty adjustment and an ineffective commodity hedge. Discretionary cash flow was the highlight of the quarter and was a company record of $101.7 million, up 113% compared to $48 million recorded in the first quarter of 2007. Oil and gas revenues rose by over 60% to $164 million, compared to last year's number of $102 million. Our realized price of $60.43 a barrel was 38% higher than the prices for the comparable quarter last year. Production was 28,070 barrels per day, up 10% from our Q1 2007 production of 25,490 barrels a day.

The company is reaffirming its outlook for 2008 production of between 29,500 and 30,500 barrels of oil equivalent per day. We're averaging over 28,700 BOE/D for the month of April and expect to average over 29,000 BOE/D for the second quarter. As we have previously discussed, Berry plans to invest $295 million of capital in 2008 to develop reserves in the range of 22 million to 32 million BOE of additional reserves at a finding and development (F&D) cost of $10 to $12 per BOE. Our plans remain on track at this point to meet those deliverables. A total of $173 million or about 60% of the total will be targeted at developing our drill-ready oil projects at the diatomite, at S. Midway, Poso Creek and Brundage Canyon, and for the longer term benefit of the company approximately the other 40% will be used to develop our gas resources in the Piceance and DJ Basin. I next want to summarize some highlights of our major growth areas for this year. In the diatomite in California, we have embarked on a full-scale continuous development program with this asset and expect to continuously drill here over the next four-plus years. Over 70 new producers have been drilled since last October. We have just recently started to bring these wells online as the necessary infrastructure was installed to adequately steam and produce the wells. We will nearly triple our producing well count this year from 80 wells at the end of last year to approximately 240 wells by the end of 2008.

Our steam generation capacity, which stood at 10,000 barrels of steam per day (BS/D) at the end of last year, will increase to 25,000 BS/D of injection by the end of 2008. The additional wells, steam and supporting infrastructure should enable us to increase production which is now at almost 1,800 barrels a day after averaging 1,400 barrels a day for the first quarter. We expect to exit at over 3,000 barrels a day by year end 2008. At Poso Creek in California, the accelerated development and expansion of the steam flood has worked very effectively for us, helping us to bridge the gap between the production decline associated with our legacy assets in California and the ramp-up of production from the diatomite. This year's plans call for further expansion, including the addition of a fourth steam generator, drilling 28 producers and expanding the flood. To date, 26 of the 28 producers have been drilled and the steam generator was installed in February. In the first quarter, we did not receive adequate electrical power at Poso Creek from utility companies, which did have a slight impact on our production for the quarter. We have now installed a temporary generator recently and production has responded; it is currently up to 3200 barrels a day. Remaining producers in the steam flood pattern injectors will be drilled over the next few months and should help further improve our production.

In the Piceance in the Rockies, we're currently drilling our 20th well of the year and 90th well since Berry acquired our original acreage in early 2006. We're operating four rigs and continue to drill Mesa wells in the 14 to 16 day range. Production increased 15% over the fourth quarter of 2007, although we continue to be impacted by intermittent downstream shut-ins. Current production is 16 million cubic feet per day (MMcf/D). We expect significant gains over the next quarter as we move into the prime summer completion season. As we have consistently reported, the production of the wells is as expected, with the 30 day initial production (IP) rates slightly above our target of 1.2 MMcf/D. Over the past two years, Berry has reengineered every aspect of our Mesa drilling and has made significant investments in the needed infrastructure to support our operations. We are now realizing improved economic returns as our process for developing this long-term asset continues to improve and as realized natural gas prices strengthen. 2008 continues to shape up nicely for Berry, based on our development plans, unprecedented high commodity prices and the returns from our capital investments. With that, let me turn it over to Ralph Goehring for some more financial detail. Ralph?

Ralph J. Goehring ***- Berry Petroleum Company - CFO & EVP***

Good morning. Let me start with revenues. Bob provided the revenue growth from oil and gas. Our total revenues this quarter increased 58% over the first quarter of 2007. This reflects in large part the impact of increased oil and gas volumes and increased prices. A portion of the increase was also due the renegotiation of an ongoing royalty, about $2.3 million in the quarter, and a one-time adjustment of $10.5 million related to correcting an error in our royalties payable. Compared to fourth quarter of 2007, total revenues increased 21% from $153 million to $185 million. Excepting these royalty adjustments, the majority of this increase resulted from increased oil and gas prices. Discretionary cash flow for the quarter increased $53.4 million, over 100% from the first quarter of 2007 to a record $102 million; compared to the fourth quarter of 2007, discretionary cash flow increased $30.8 million or 43%. We are on target in funding 100% of our 2008 capital expenditures of approximately $295 million through our internally generated cash.

We are revising our guidance numbers today and in our Form 10-Q to reflect a West Texas Intermediate (WTI) price for oil of $100 per barrel and a Henry Hub price for natural gas of $10 per million British Thermal Units (MMBTU). Based on these price assumptions, we would expect discretionary cash flow in 2008 to approximate $400 million. Operating costs for oil and gas were higher in the first quarter of 2008 by 11% to $16.30 per BOE compared to the fourth quarter of 2007 at $14.70 per BOE. The majority of this increase was due to higher steam costs resulting from higher fuel costs. Our fuel gas was up 30% in the first quarter to $7.94 per MMBTU over the fourth quarter. You've heard us say this in previous discussions and talks and presentations, but let me reiterate that we are gas balanced, whereby one dollar move in Henry Hub (HH) pricing impacts our bottom line by less than $3 million. We do see higher gas prices impact our cost structure, as happened in this quarter.

Based on the revised price deck of $100 WTI and $10 HH, we project our operating costs average in the rage of $17.75 to $19 per BOE for the year. Our production taxes increased in the first quarter of 2008 over the fourth quarter of 2007 by 23% to $2.34 per BOE. This increase is due to impact of higher commodity prices. With our higher pricing assumptions, we expect production taxes to range between $2.20 and $2.70 per BOE in 2008. Looking at depreciation, depletion and amortization (DD&A), our DD&A was $10.60 per BOE in the first quarter of 2008, down 3% from $10.94 per BOE in the fourth quarter of 2007. This is in line with our expectations. We expect our 2008 DD&A costs to average between $10 and $11 per BOE. Our general and administrative (G&A) expense in the first quarter of 2008 was $4.46 per BOE, compared to $4.24 per BOE in the fourth quarter of 2007. This is within our guidance. However, we did write off our previously capitalized legal and accounting fees related to the formation of our MLP to approximately $0.6 million. We have decided to not go forward with the MLP, given ongoing capital market conditions. In 2008, we expect our G&A costs to average less than $4.50 per BOE. I might mention that this estimate does include our estimated costs for relocating our corporate headquarters to Denver this summer. We expect our effective tax rate in 2008 to approximate 38.5%.

During the first quarter, we achieved several notable items. We did receive an upgrade in our corporate and bond credit rating from Standard and Poor's rating service and were placed on review for possible upgrade from Moody's Investor Services earlier this month. So our balance sheet and cash flow continues to improve. We are also increasing our borrowing base to $650 million from $550 million and will have it funded initially beginning May 1st, 2008 at $600 million. This action provides us with approximately $350 million of fund availability under our unsecured credit facility. We plan on filing our Form 10-Q for the quarter ended March 31st, 2008 no later than tomorrow, so that will be available soon with our new guidance numbers in it as well. Finally, this is my last official quarterly report that I am responsible for here at Berry, as I am retiring in June. I'd like to thank our shareholders and other stakeholders in Berry for allowing me to serve in various capacities but primarily in the CFO role since 1992. It has honestly been a fantastic journey, one that I have thoroughly enjoyed. Berry, as you know, is in excellent financial shape and has significant capital capacity to continue on its growth path. I know the Company will continue to excel. Those are my comments. Thank you.

Robert F. Heinemann ***- Berry Petroleum Company - President & CEO***

Thank you, Ralph. We certainly want to wish Ralph all the best in his future endeavors and recognize the many things he's done for the Company during his career here. So with those sentiments, let me open the floor up for questions. We'd be happy to answer them.

QUESTIONS AND ANSWERS

Operator

Your first question comes from the line of David Tameron from Wachovia. Please proceed.

David Tameron ***- Wachovia Capital Markets - Analyst***

Congrats, Ralph. I'm sure going to miss the quarter calls, but best of luck to you, congrats on a nice run.

Ralph J. Goehring ***- Berry Petroleum Company - CFO & EVP***

Thank you.

David Tameron ***- Wachovia Capital Markets - Analyst***

You alluded to it briefly. Can you talk a little bit about California gas prices, what your outlook is for them? And again, is there anything you can do to try to mitigate potential margin deterioration on the cost side going into the summer?

Robert F. Heinemann ***- Berry Petroleum Company - President & CEO***

Well, you know, we do look at that issue from time to time. We do look at hedging it from time to time. But the thing that we've worked hard in the company is to put in our natural hedge and when Ralph talked about a dollar change in Henry Hub translating to $3 million change to the bottom line, that takes into account a lot of factors in terms of transportation and differentials and whether it's coming into California or whether we're selling it to the east. You know, fact of the matter is, we're really comfortable with that position right now. We get two reactions on this issue. One is, gee, since you're so balanced, it's too bad you're going to miss the run-up in natural gas price. On the other hand what we would say is, because we are balanced we do not have a big deterioration in heavy oil business. So gas price moves some of the revenues around, and moves some of the profits around, but at the end of the day, the balance works very well for us.

David Tameron ***- Wachovia Capital Markets - Analyst***

All right. Bob, can you talk about macro issues in the Uinta Basin? I know Newfield Exploration had some positive comments, but can you talk about where heavy wax or the black wax oil is and kind of where the crude market is currently in the region?

Robert F. Heinemann ***- Berry Petroleum Company - President & CEO***

Well, there is a posting for black wax in the Uinta Basin. I'm not sure how realistic the posting is. It's pretty thinly traded. And of course in wintertime, it's very difficult to move the wax. The other issues here are that you take that posting price and then you add a gravity differential, depending on how the quality of your wax, and then you've got to pay a pretty steep transportation to get it to Salt Lake City. So that posting is not a real accurate reflection of the realized price that you see. Macros there, in my mind have not changed significantly. They will always look better in the spring and summer and always look a little bit worse in the late fall and winter.

David Tameron ***- Wachovia Capital Markets - Analyst***

All right. So are you still seeing like $15 WTI differentials?

Robert F. Heinemann ***- Berry Petroleum Company - President & CEO***

Well, plus then a gravity differential, then plus the transportation.

David Tameron ***- Wachovia Capital Markets - Analyst***

Yes, but just on the surface, that's a $15 number.

Robert F. Heinemann ***- Berry Petroleum Company - President & CEO***

On the surface, that's in the ballpark.

David Tameron ***- Wachovia Capital Markets - Analyst***

Okay. And one more question, I'll let somebody else jump in. In the press release you alluded to acquisitions. Can you talk -- can you give us any more detail to what you said there as far as -- sounds like oil consolidation, that would read California to me, and then you threw out potential new areas. Anything you can give us there?

Robert F. Heinemann ***- Berry Petroleum Company - President & CEO***

Well, acquisitions are not easy to do in this environment. Certainly oil acquisitions I think are especially difficult to do in this environment. So you have to seek out unique opportunities and unique situations, which we are. For us a new opportunity and a new place would probably be natural gas, where hopefully over the long haul you wouldn't see the big differentials that we've lived through in the Rockies over the last couple years. Sometimes we call that a price-favored basin. Where would that be? Maybe that's a shale play. Maybe that's Appalachia. Maybe that's Texas. And of course, as you well know, in our company we are an execution company. We're not an exploration company. So when we go into new basins, we liked to go into statistical plays or we like to partner with companies who understand the geology probably better than we do on day one. And I think that model has served us well and I don't see us moving away from that. But certainly one of the nice things about our company is we don't drill many dry holes. And we like that, and so we really like repeatable developments, physical plays.

David Tameron ***- Wachovia Capital Markets - Analyst***

On the new basin or new venture type, do you have something teed up today or is it something -- are you close on something? Should we expect to hear something soon?

Robert F. Heinemann ***- Berry Petroleum Company - President & CEO***

Well, I mean, I can't -- even if it was true, I couldn't say it. So, I mean --

David Tameron ***- Wachovia Capital Markets - Analyst***

(LAUGHTER) I thought I'd try. All right. Thanks.

Robert F. Heinemann ***- Berry Petroleum Company - President & CEO***

I would tell you, we have -- we probably have as many deals in the shop under evaluation as we ever have.

David Tameron *- Wachovia Capital Markets - Analyst*

And that's across the board, both oil, gas?

Robert F. Heinemann *- Berry Petroleum Company - President & CEO*

Across the board, evaluation -- so that's about all I can say at this point.

David Tameron *- Wachovia Capital Markets - Analyst*

All right. That's fair. Thanks.

Robert F. Heinemann *- Berry Petroleum Company - President & CEO*

Thank you, David.

Operator

You have a follow-up question from David Tameron from Wachovia. I'm sorry.

David Tameron *- Wachovia Capital Markets - Analyst*

Their loss is my gain, Bob, so I'll ask another one here. Steam generation, let's just talk diatomite. Can you give us a little more color on what you're seeing out in the field operationally-wise, how the wells are performing? Obviously, it looks like production is going to be ramping here in the first quarter or second quarter.

Robert F. Heinemann *- Berry Petroleum Company - President & CEO*

Well, everything we see so far is positive. I think this is an unconventional oil play, so that means we do learn some things as we go along. Certainly, what I would say here is that steam in heavy oil, we usually think of steam as really a means to reduce the viscosity of heavy oil, and that's certainly true in the diatomite. But there are also two other things that are associated with steam injection in diatomite. One is its creating the flow paths that we need for the oil to move to the well bore. And the other thing is, it's what creates the pressure in the reservoir. So it really drives three parts of our recovery mechanism and as we've expanded and injected more steam and moved steam around within the field, we've learned that we have to be very deliberate in the way that we do that. We just can't all of a sudden say we've got 20 new wells over here, let's go steam them and take the steam out of the central part of the asset. When we see that, we see pretty quick production response, probably a faster production decline than you see a ramp-up from steaming new wells. So the idea here in this project is -- it's really a very significant project management development plan. So we have to keep the infrastructure developed as fast as we're drilling the wells so that we can be efficient here. And that's really what we're seeing. When we drill new wells that are close to the core of the field that already has some preheating and are pressured up, the response is very strong. What we have to do is learn how to bring on incremental new steam volumes to bring up -- bring in production from wells that have already been drilled. And that's what we hope to start to see in the second quarter, and we believe we're starting to see it now.

David Tameron *- Wachovia Capital Markets - Analyst*

Okay. Good. And one more -- one more question for Ralph. If you look at your cash flow generation -- maybe this is Bob's question, but if you generate $400 million, you're spending $295, assuming you don't get any acquisitions done, what would that money go to?

Ralph J. Goehring *- Berry Petroleum Company - CFO & EVP*

Well, there's obviously you'd look at our other projects whether it would be debt relief -- I mean, there's a little piece in there that goes to dividends; some other capitalized interests also takes a wedge of that. But clearly, we would look at expanding our business through growth or acquisitions and then debt relief.

David Tameron *- Wachovia Capital Markets - Analyst*

Okay. And would the -- I mean, you talked about the higher commodity price deck but you left CapEx at $295 million. Should I assume that there's a CapEx increase coming at some point or --

Robert F. Heinemann *- Berry Petroleum Company - President & CEO*

What we typically do, Dave, is we put our capital budget together and we have a series of firm projects and discretionary projects and those are on the $295 million; I would tell you we've moved all of the discretionary projects into the firm so we have $295 million firm. Over the course of the next quarter, we'll work up a new discretionary set of projects that will eat into some of that excess cash flow. Not yet decided how much that's going to be. That might be going a little bit faster in diatomite. It might be adding another rig at the end of the year in the Piceance. It also could be going to an additional summer rig in Uinta, so we would end up running about one and one-third rigs over the course of the year in Uinta. But at these prices and at these returns, where we have opportunities we're going to make investments.

David Tameron *- Wachovia Capital Markets - Analyst*

All right. Thanks.

Operator

You have a question from the line of Kevin Smith from Raymond James. Please proceed.

Kevin Smith *- Raymond James - Analyst*

Hi, good afternoon, fellows. Just two questions, really, but one about electricity generation costs I think you alluded to earlier. It looks like the electricity generation costs ramped up a good bit in this quarter. I assume that's due to higher gas prices. But where do you see that going forward?

Robert F. Heinemann *- Berry Petroleum Company - President & CEO*

Yes, it does have to do with our fuel gas costs, and in 2007 we benefited in electricity generation from the widening of the differential of gas in the Rockies, because we have firm transport to bring gas into California; so basically, we were able to achieve electricity price that was based on SoCal border gas price, but yet our actual fuel cost was well below that. So that's another advantage you get on the electricity side. But going forward, the basis -- the Rockies basis differential -- is stabilized and is more along its historical norm. So we do anticipate electricity generally to have a small profit or a small loss every quarter. It's not going to be very significant probably when you look at the full year.

Kevin Smith *- Raymond James - Analyst*

Okay. Thank you very much. And the second question I had is on your Piceance production growth. You know, it looks like you still had had very impressive growth from quarter-to-quarter or sequentially, but it slowed down a little bit. Was Q1 impacted very much by weather?

Robert F. Heinemann *- Berry Petroleum Company - President & CEO*

Well, of course as many of you know, we try not to talk about the impacts of weather in the company because it's going to be cold and snowy every year in Colorado. However, this was -- you know, this was probably the toughest winter in 10 years in Utah and Colorado, so it does have an impact. And of course, because of the location of our assets, when we talk about production increase in the company, we know that it's not going to be linear. We know it will be slower in the first quarter and we'll see more in the second and third quarters. That's just the nature of the development that we have and the location where the assets are.

Kevin Smith ***- Raymond James - Analyst***

Thank you very much.

Operator

You have a question from the line of Sunil Jagwani from Catapult. Please proceed.

Sunil Jagwani ***- Catapult - Analyst***

Yeah, hi, this is Sunil Jagwani from Catapult. I had a question about M&A that that already has received some focus. If I recall correctly, about two or three years ago I guess a sentiment from the company and the market was actually Berry itself would be a candidate for consolidation and -- given the private ownership to a substantial extent. What can you tell us about the -- about that possibility, recognizing that there's only so much you can say? But is that something that would you be hoping to do -- if you can give a quick comment on that. I do have a follow-up.

Robert F. Heinemann ***- Berry Petroleum Company - President & CEO***

Well, the response to the question is we have no plans to sell the company and we are building the company for the long haul, continue to add reserves and add assets. Whether someone else has interest in us, you know, we don't know and therefore we can't make comments. But we do not have an exit strategy to sell the company to someone else, that's for certain.

Sunil Jagwani ***- Catapult - Analyst***

Okay. And then just in terms of growing assets, what's the price deck that Berry would be using today?

Robert F. Heinemann ***- Berry Petroleum Company - President & CEO***

Well, the way we've -- what we've tried to do this year, because we thought prices would be probably even more volatile -- maybe not this high, but more volatile than they've proven to be -- we started off with our capital budget with an assumption of $75 WTI and 750 Henry Hub and we run variances off that case. So typically we'll run a $75, $7.50 deck. We certainly like the company at those prices. We've said for two or three quarters now that the company would have free cash flow down to those prices. And then we look at higher prices -- Ralph told you a few minutes ago we're going to give you guidance at $100 a barrel and $10 Henry Hub. We use that to look at excess cash and then determine what we might use those proceeds for.

Sunil Jagwani ***- Catapult - Analyst***

I meant for estimates of price decks for the out years, not necessarily the 12 months. Because I'm assuming that anything you acquire today you're probably not just going to buy a decline curve, and you'll be looking for acquisitions for at least a five, if not a 10 year horizon. So what kind of assumptions would you be incorporating into making such an acquisition?

Robert F. Heinemann ***- Berry Petroleum Company - President & CEO***

Typically what we would do is look at three-year strip and then we pick a terminal price and we would argue what that terminal price might be. But today, we'd probably pick something like $85 oil and $8.50 gas for the terminal.

Sunil Jagwani *- Catapult - Analyst*

That high, huh?

Robert F. Heinemann *- Berry Petroleum Company - President & CEO*

Well, if you can tell me what it's going to be, I mean --

Sunil Jagwani *- Catapult - Analyst*

No, I understand. As you know, the majors and a lot of the other companies are still talking about long-term price decks of $60 to $70 WTI. And so far we haven't seen any deals, at least any material deals with that kind of price decks. And I'm not saying we're going to see one from you, but it's still good to know. And just my last question is in terms of, you know, your core competency being execution and not exploration, what's the company's current view about how you differentiate yourself from the various other operators on the execution front, and just what would differentiate from, say, your target?

Robert F. Heinemann *- Berry Petroleum Company - President & CEO*

Well, I think, you know, we've said for some time now that our core competency is around execution. And so what that means is that we have to develop our assets at a competitive cost. We have to drill our wells at very competitive costs. We have to make good decisions about when to bring new assets into the company. We have to look at the company against a number of different financial scenarios. We have to look at managing hedging and our derivatives to create opportunities for ourselves. You know, it's very easy to say we're going to do this better than the competition; but the fact of the matter is, the proof of the pudding is in the eating. What we would point to over the last few years, it's been our reserve growth and our F&D cost. I think we continue to bring new reserves into the company at very competitive metrics. And I think that will continue to be our goal.

Sunil Jagwani *- Catapult - Analyst*

That's why we own the stock. Thank you very much and congratulations.

Robert F. Heinemann *- Berry Petroleum Company - President & CEO*

Thank you.

Ralph J. Goehring *- Berry Petroleum Company - CFO & EVP*

Thank you.

Operator

At this time, I'm showing you have no further questions. I would now like to turn the call back over to management for closing remarks.

Robert F. Heinemann *- Berry Petroleum Company - President & CEO*

Well, we thank you for your interest in the company. I think we've had a good first quarter. We look forward to a very strong second quarter and we look forward to interacting with you in the near future. Thank you. Bye.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the presentation and you may now disconnect. Have a wonderful day.

End of call

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Any statements in this conference call and transcript that are not historical facts are forward-looking statements that involve risks and uncertainties. Words such as "will," "might," "intend," "continue," "target(s)," "expect," "achieve," "strategy," "future," "may," "could," "goal(s)," or other comparable words or phrases or the negative of those words, and other words of similar meaning indicate forward-looking statements and important factors which could affect actual results. Forward-looking statements are made based on management's current expectations and beliefs concerning future developments and their potential effects upon Berry Petroleum Company. These items are discussed at length in Part I, Item 1A beginning on page 14 of our Form 10-K filed February 26, 2008 with the Securities and Exchange Commission, and any updates to those items are listed in our Form 10-Qs filed subsequent to that date.

(Transcript edited for clarity)

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