Amplify Energy: 3Q 2019 Earnings Script

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Operator

Welcome to Amplify Energy's Third Quarter 2019 Investor Conference Call. Amplify's operating and financial results were released earlier today and are available on Amplify's website at www.amplifyenergy.com. During this presentation, all participants will be placed in a listen-only mode. Today's call is being recorded. A replay of the call will be accessible until Wednesday, November 20th by dialing 855-859-2056 and then entering conference ID #8498729 or by visiting Amplify's website, www.amplifyenergy.com.

I would now like to turn the conference over to Martyn Willsher, Senior Vice President and Chief Financial Officer of Amplify Energy Corp…

Martyn Willsher

Good morning and welcome to the Amplify Energy conference call to discuss operating and financial results for the third quarter of 2019. We appreciate you joining us today. Ken Mariani, Amplify's President and Chief Executive Officer will begin the call by updating our stakeholders on our merger integration effort and follow up with comments on our third quarter operating results. I will follow with an update on our return of capital programs and our third quarter financial results.

First, we would like to remind you that some of our remarks may contain forward-looking statements and are based on certain assumptions and expectations of Amplify's management team. These remarks reflect management's current views with regard to future events and are

subject to various risks, uncertainties and assumptions. Although management believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to be correct and undertakes no obligation and does not intend to update these forward-looking statements to reflect events or circumstances occurring after this earnings call. Forward-looking statements include, but are not limited to, our statements about and discussion of, fourth quarter 2019 guidance. Please refer to our press release and SEC filings for a list of factors that may cause actual results to differ materially from those in the forward-looking statements made during this call. In addition, the unaudited financial information that will be highlighted here is derived from our internal financial books, records, and reports. For additional detailed disclosure, we encourage you to read our Quarterly Report on Form 10-Q, which we expect to file later today.

Also, non-GAAP financial measures may be disclosed during this call. Reconciliations of those measures to comparable GAAP measures may be found in our press release or on our website at www.amplifyenergy.com.

Please note that due to the closing date of the merger in early August, operational and financial results from Midstates in July were excluded from our consolidated third quarter GAAP financials. However, in order to provide our shareholders with a more complete picture of our third quarter results, unless specifically identified, the operational and financial results discussed on this call will be pro forma for the merger and will include the July results for Midstates as though the assets were consolidated for the full period of third quarter 2019.

With this in mind, I will now turn the call over to Ken Mariani. Ken…

Ken Mariani

Introduction

Thank you, Martyn. I appreciate our stakeholders joining us today. My remarks on this call will provide an update on the integration of our recent merger with Midstates, our operational performance in the third quarter and our guidance expectations for fourth quarter 2019.

Midstates Merger Integration

Since the closing of the merger on August 6th, 2019, the Amplify team has been working diligently to integrate the assets and systems acquired through the merger. As we have mentioned previously, capturing synergies of at least $21 million was integral to the value of the merger, and I'm happy to report that after completing most of the integration work, we feel extremely confident that we are on track to realize that goal. In addition, based on our progress to date, we expect that these synergies should be largely realized in the fourth quarter 2019 and fully realized by the first quarter 2020. Martyn will provide additional detail on our G&A outlook later on this call.

Operations

Turning to operations, we generated $31.5 million of Adjusted EBITDA in the third quarter, which was slightly above the midpoint of our guidance range of $28 million to $34 million. This result was a testament to strong management of lease operating costs, which offset lower realized prices during the quarter.

Production for the third quarter averaged approximately 32,700 Boe/d, which was also slightly above the midpoint of our guidance range for the quarter. These results were accomplished despite weather interruptions that impacted our Oklahoma operations and a reduction in gas and NGL volumes from our Eagle Ford area due to high gas sales line pressure. The most significant production item during the quarter was our decision to modify the process for stripping out NGLs at our Bairoil field due to weak NGL pricing. While the Bairoil NGL stream has always been very heavy (primarily C5), the extraction of the lighter liquids has resulted in a

less valuable product to the market. Due to this inefficiency, the Company has decided to strip out less of the lighter liquids from the gas stream and sell the remaining product as condensate instead of NGLs. As a result of this adjustment, NGL volumes are reduced by approximately 900 Bbl/d with an offsetting increase in oil volumes of 810 Bbl/d. The increase in net price realizations of 25-30% for the condensate, corresponds with a proportional revenue increase and will more than offset the overall volume reduction of approximately 90 Bbl/d.

Switching to the development side, Amplify successfully completed the Bairoil expansion project in October 2019, which was in line with our budgeted timeframe. We have initiated the additional gas recycling at the plant and have started the process of bringing the previously shut-in wells back online. We will update our stakeholders on the results of the expansion on a future call, but as a reminder, the Company's previous guidance called for oil production to increase by approximately 900 Boe/d, with the increase fully realized over a twelve to eighteen-month period following the project completion.

Lease operating expenses in the third quarter were $35.4 million, or $11.75 per Boe, which was below the low end of our guidance range of $11.90 to $13.20 per Boe. This result was accomplished due to a company-wide focus on cost containment, and the initial impact of our efforts on the Oklahoma assets.

Capital spending for the third quarter was approximately $24 million, and below the low end of our guidance range of $26 million to $30 million. The reduction in capex was primarily due to a reduction in expected maintenance capital costs in California and East Texas, and reduced capital workovers activity on our newly acquired Oklahoma properties.

Fourth Quarter 2019 Guidance

Earlier today we issued our guidance expectations for the fourth quarter of 2019, including forecasts for production, capex and free cash flow. We are currently forecasting fourth quarter production of 29,900 to 33,100 Boe/d. We anticipate production increasing with the start of our Bairoil plant expansion project in the fourth quarter of 2019, offset by production declines across

other areas of the company. Despite the anticipated quarter over quarter production decline, the midpoint of Amplify's Adjusted EBITDA forecast for the fourth quarter 2019 is $32.5 million and higher than pro forma Adjusted EBITDA for the third quarter 2019 of $31.5 million. This guidance is driven by our focus on cost containment and stronger realized pricing expectations.

Our revised capital forecast range for the fourth quarter is $8 million to $12 million, with approximately $6.5 million of the capital spending allocated to our Bairoil plant expansion and rod-lift conversion program in Oklahoma. We also anticipate spending a small portion of our fourth quarter capital budget to participate in a drilling opportunity in East Texas. We believe this to be a low risk opportunity with attractive economics, which will allow us to further evaluate and delineate this area. The remainder of our capital budget will be allocated across our portfolio on maintenance type projects including capital workovers and facilities projects.

Lastly, our free cash flow, which we define as Adjusted EBITDA, less capex and cash interest expense, is expected to be in the range of $16 to $21 million in the fourth quarter of 2019. This implies approximately $22 million of second half 2019 free cash flow generation, using the midpoint of updated fourth quarter guidance. The strong free cash flow generated in the fourth quarter of 2019 will be used to return capital to shareholders and pay down our outstanding debt.

Outlook

As we enter the final quarter of 2019, I am excited by what we have accomplished during the year and what the future holds for Amplify. The successful Midstates merger and integration demonstrates the value creation potential of our operating platform and has significantly increased our optionality for future acquisitions and mergers. While current commodity prices and overall oil and gas industry sentiment continues to be a headwind, we believe that it also creates opportunities for us to continue executing on our consolidation strategy. In addition, it appears that our differentiated strategy on free cash flow generation and return of capital is starting to be appreciated by the market, with Amplify's share price up nearly 70% since the closing of the merger on August 6th, which compares very favorably to a 2% decline in the XOP index over that

same time frame. This favorable market support combined with our continuing strong operational execution will further enhance our ability to deliver on our goal of meaningfully increasing shareholder value.

With that in mind, I would like to turn the call over to Martyn to discuss our financial results…

Martyn Willsher

Thank you, Ken. I'd like to first provide an update on our return of capital programs, followed by an update on our third quarter financial results, liquidity and hedging positions.

Return of Capital Program Update

Amplify paid its quarterly dividend of $0.20 per share (or $8.2 million) on September 18th to shareholders of record on September 4th. The upcoming quarterly dividend of $0.20 per share will be paid on December 18th to shareholders of record as of the close of business on December 4th. This implies a dividend yield of approximately 11% based on our closing share price of $7.48 on November 1st.

Amplify also initiated an open market share repurchase program at the closing of the merger, with Board approval to repurchase up to $25.0 million of the Company's outstanding shares of common stock. Since the inception of our open market share repurchase program, the Company has repurchased approximately 2.4 million shares of common stock at an average price of $6.06 for a total cost of approximately $14.5 million (inclusive of fees) as of November 1st. As a result, Amplify continues to have $10.5 million of repurchase capacity available under our program.

Financial Results

Moving on to our third quarter results, Net Cash from Operating Activities was $(7.4) million. This is a GAAP number that excludes July results for Midstates and was further reduced by one-time transaction and severance costs, along with a significant change in working capital.

As Ken mentioned earlier, Adjusted EBITDA for the third quarter was $31.5 million, which was slightly above the midpoint of the guidance range of $28 to $34 million. This result was driven by lower than forecast lease operating expenses, offsetting some lower price realizations for gas and NGLs primarily in the Oklahoma region and to a lesser extent, our East Texas region.

Pro forma G&A for the third quarter was $28.2 million, which included $12.8 million of transaction costs, $6.4 million of severance costs and $1.2 million of non-cash compensation expenses. Excluding the merger related expenses, cash G&A was $7.8 million, or $2.60 per Boe, which was below the midpoint of our guidance. We expect that the majority of our transaction-related costs are now behind us, and that recurring cash G&A will be approximately $7.0 million in the fourth quarter of 2019 and trend down to $6.5 million beginning in the first quarter of 2020. We will continue to look for additional cost reduction opportunities and anticipate that we may be able to further reduce G&A as certain subscriptions and other costs acquired with the merger roll off in 2020.

Free Cash Flow, which we define as Adjusted EBITDA, less capex and cash interest expense, was approximately $3 million for the third quarter, which was at the high end of our guidance range. This was driven by strong operating results, coupled with lower than forecasted capital expenditures and cash interest expense.

Fall 2019 RCF Redetermination Update and Liquidity

Due to the merger closing, Amplify's Fall redetermination will be completed slightly later than usual in the fourth quarter. At this time, we anticipate a decrease in our borrowing base due to a market-wide reduction in bank price forecasts since the Spring redetermination, however, despite this decrease, Amplify will maintain more than sufficient liquidity moving forward and we will be generating significant free cash flow in future periods that will further increase our liquidity position.

As of November 1st, 2019, Amplify had total debt of $278 million under its revolving credit facility, with a current borrowing base of $530 million. Amplify's liquidity was $261 million,

consisting of $11 million of cash on hand and available borrowing capacity of $250 million (including the impact of $1.65 million in outstanding letters of credit). Moving on to our latest hedge position…

Hedging

Since our last earnings call, Amplify has opportunistically added to our hedge positions and has also restructured a number of our hedges to reflect the change in our Bairoil production mix from NGLs to condensate. In addition, Amplify has assumed all of the positions in place at Midstates through the merger. Our new hedge positions are primarily a combination of swaps costless collars and three-way collars. These positions allow us to lock in a certain percentage of our future cash flows, but we are also able to maintain additional upside while limiting our downside. We are approximately 72% hedged for the remainder of the year based on our fourth quarter midpoint production guidance of 31,500 Boe/d. As of November 1st, our hedge mark-to-market value was a net gain position of $20 million. Amplify's third quarter 2019 hedge presentation contains additional details on our current positions and was posted on our website earlier today under the investor relations section.

Summary

We believe that our positive third quarter financial results demonstrate the strength of the organization's capabilities, with strong results despite a challenging commodity price environment. We are very enthusiastic about our cost containment initiatives and believe that there will be additional opportunities to reduce overhead costs and operating expenses moving forward.

This concludes our prepared remarks for this morning's call, and we would now like to invite analysts and investors to ask any questions they have for the management team. Operator, please open the line for any questions…

Q&A

Operator

At this time, I would like to remind everyone that if you would like to ask a question, to press star one on your telephone keypad now. Again, ladies and gentlemen, that's star one for any questions. We will pause for just a moment to compile the Q&A roster. Okay, we do have a question from Jeff Grampp with Northland Capital. Please, go ahead.

Jeff Grampp

Good morning guys.

Martyn Willsher

Good morning, Jeff.

Jeff Grampp

I was curious, maybe if you can, if you could talk about the acquisition side of things for you guys and maybe if we bifurcated it into that, you know, a smaller asset level packages versus the bigger type of Midstates deals, any traction or what can you just talk about what you're seeing on maybe the bid-ask spread side of things, or just overall kind of your thoughts and what you're seeing there?

Ken Mariani

Yes, thank you, Jeff. The question is with regards to kind of the A&D market in general and obviously, we have an ongoing effort to continuously monitor the markets and we are seeing quite a bit of assets on the market and you know, what I call mature producing type assets. And we are obviously focused on not just doing a deal but doing a good deal that's aligned with what we call our internal scorecard.

And we're looking at, you know, assets that are similar in nature to what we already have. We're looking at assets that we can use our operating expertise to maybe extract incremental free cash flow from, so we are seeing, you know, quite a bit of assets on the market and mature producing basins, obviously, with this Fall borrowing base season, we think there'll be continual pressure on companies to divest themselves of these type assets.

And again, we're going to be very opportunistic, very selective, because again, what -- our whole purpose is not just to acquire assets or increased production. It's to make strategic decisions that are accretive to our model and free cash flow generation capabilities. So again, bottom line is I think it is a target-rich market and I do think with this Fall borrowing base season, you're going to see even more opportunities out there in the market.

I know market, Martyn may have some additional insight as well, he'd like to share…

Martyn Willsher

Yeah, Jeff, I'll just add that I think there're targets on the acquisition side, but also on the merger potential as well. So, we're looking at, you know, a variety of options and we've kind of high grade the ones that we think are the most actionable. And in regards to your question about bid-ask spread, I'd say that it's so real, obviously, the kind of assets that we're looking at, you know, there's a certain price would be willing to pay in and in some cases, the sellers are still wanting more, but I think it is shrinking a little bit as people are coming to kind of more of a realization on that side as well. So more to come on that, but we're certainly in the market and looking on both the merger and acquisition side.

Jeff Grampp

Got it, thank you and was also curious on the buybacks and like you guys were really active here last couple of months on that front. I am wondering about, you know, how you guys are, may be evaluating, you know, expanding that, should you guys go through that, and then

let's say the near-medium term, and maybe how you guys kind of weigh the pros and cons of the buyback relative to, you know, the trading volumes that we that we've seen your stock?

Martyn Willsher

Yeah, I'll take that one. So, I think obviously, as we start to look at our budget for next year, we will weigh exactly what you said the pros and cons of the adding to the buyback versus paying down debt or adding to the dividend or the uses of the free cash flow on the acquisition side. So, it's kind of a balancing act but I think we'll have an update next -- on the next earnings call for something like that.

Jeff Grampp

Okay, and last one for me with the tweaks that you guys made up in the Rockies with the NGL recoveries, can you just -- maybe ballpark us and what type of improvement you need to see from the NGL market for you guys to kind of revert back to, to the status quo there, if you will? And then can you talk about operationally is that an intensive thing to do like, could you guys, you know, make that switch relatively quickly or is it really, you know, I guess from a, you know, shut-in downtime perspective, any tweaks that you guys will need to make to make that change back?

Ken Mariani

I'll take the operation part.

Martyn Willsher

Yeah, go ahead.

Ken Mariani

Jeff, on the operational side, it's a, you know, it's a relatively easy tweak, you know, basically what we're doing is adjusting the temperature of our chiller. And obviously, by adjusting the temperature of the chiller, you're either going to increase or decrease recoveries. That's essentially what we're doing, so we never want to make short-term decisions that have long-term implications. So, this is something obviously we can adjust if the market was to go back the other way and…

Martyn Willsher

Yeah, I think it's probably a $6 or $7 Bairoil type of difference right now, Jef. I mean, it's just, you know, you've heard this probably on calls across, you know, a variety of basins, you know, NGLs are just weak relatively, and we had this specific opportunity where, you know, the value of the condensate, even adjusting for the small production impact, which was basically 10%, you know, 25% to 30% revenue is significantly better than even with a 10% production decrease. So, we felt this was more than worth it. And like I said, you know, if NGLs consistently moved up kind of in that range, and has to be that range relative to the value of the condensate, then we could obviously switch back and it'd be a relatively easy process.

Ken Mariani

Yeah, and I think I'll add one thing, not to get overly technical when we talk about the mix here, it's, it's a very rich mix, meaning it's much higher percentage of heavies. A lot of times when we talk about some of these other resource places; they have a much higher component of the lighter end of the mix. This is a mature producing CO_2 flood where all the lighter ends have already been stripped out. So again, that makes it even more attractive.

Martyn Willsher

I mean, there is 70% to 80% C5 previously, it's just worth more as condensate now, as opposed to stripping out the propane and butane et cetera.

Jeff Grampp

Got it, and good to have that operational control and flexibility. I appreciate the time guys, that's all for me.

Ken Mariani

Thank you, Jeff.

Operator

Once again, ladies and gentlemen, that's star, one for any questions over the phone line. Again, it’s star, one for any questions. And at this time, there are no further questions.

Ken Mariani

In closing, I would like to thank the entire Amplify team across all our locations of business for their commitment to safety, production and relentless effort on cost containment. The seamless integration of the Midstates merger is a great demonstration of what this platform was built to accomplish, and I am very fortunate to lead such a talented and hardworking team. As always, I would like to again thank our investors for their support. We believe our strategy of combining significant generation of free cash flow and sustainable return of capital will create long-term value for our investors, and we appreciate your support today as we continue to execute on our plans.

This concludes our prepared remarks. Thank you again for joining us today and as always, please don’t hesitate to reach out to us with any questions.