

# **CNX Resources Corporation (CNX) Q2 2024 Earnings Call Transcript**

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**Body**

CNX Resources Corporation (CNX)

Q2 2024 Results Conference Call

July 25, 2024 10:00 AM ET

Company Participants

Tyler Lewis - VP of Investor Relations

Ravi Srivastava - President of New Technologies

Alan Shepard - Chief Financial Officer

Navneet Behl - Chief Operating Officer

Conference Call Participants

Bert Donnes - Truist

Zach Parham - JPMorgan

Leo Mariani - ROTH

Michael Scialla - Stephens

Jacob Roberts - TPH

Noel Parks - Tuohy Brothers

Presentation

Operator

Good morning, and welcome to the CNX Resources Second Quarter 2024 Q&A Conference Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference over to Tyler Lewis, Vice President of Investor Relations. Please go ahead.

Tyler Lewis

Thank you, and good morning to everybody. Welcome to CNX's second quarter Q&A conference call. Today, we will be answering questions related to our second quarter results.

This morning, we posted to our Investor Relations website, an updated slide presentation and detailed second quarter earnings release data such as quarterly E&P data, financial statements and non-GAAP reconciliations, which can be found in a document titled 2Q 2024 Earnings Results and Supplemental Information of CNX Resources.

Also, we posted to our Investor Relations website, our prepared remarks for the quarter, which we hope everyone had a chance to read before the call, as the call today will be used exclusively for Q&A.

With me today for Q&A are Nick DeIuliis, our President and CEO; Alan Shepard, our Chief Financial Officer; Navneet Behl, our Chief Operating Officer; and Ravi Srivastava, President of our New Technologies Group.

Please note that the company's remarks made during this call, including answers to questions, include forward-looking statements, which are subject to various risks and uncertainties. These statements are not guarantees of future performance, and our actual results may differ materially as a result of many factors. A discussion of risks and uncertainties related to those factors and CNX's business is contained in its filings with the Securities and Exchange Commission and in the release issued today.

With that, thank you for joining us this morning. And operator, can you please open the call for Q&A at this time.

Question-and-Answer Session

Operator

[Operator Instructions] The first question comes from Bert Donnes with Truist. Please go ahead.

Bert Donnes

I just wanted to start it off on the New Tech division. It looks like 2Q was a bit above the run rate for the full year guide. Is that still ramping? It looks like you're at 4.5 Bcf. Just wondering if that's leveling out? Or are you ramping up throughout the year?

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Ravi Srivastava

This is Ravi. So I think the volume that we saw in Q2 is kind of in line with the projection that we have given out for the whole year, between 15 Bcf to 18 Bcf. We got 4.5 Bcf in Q2.

I think the numbers that we saw in Q2 is -- the volume was on the higher end of it, the pricing was slightly better. And as we talked about it last quarter, like some of the transactions make kind of flex slip quarters depending on when the volume was produced as opposed to when the transaction takes place.

So there's no change in our annual free cash flow guidance. So it will stay in that same range of around $75 million for the year-end. The volume should stay in that same range, probably 15 Bcf to 18 Bcf as we guided earlier.

Bert Donnes

And then the -- just moving real quick to the deep Utica. It sounds like the first 2 wells are in line with expectations. Could you guys maybe give some details just in comparison to your Marcellus wells, maybe a rough well cost or maybe how the 1-year cumes look or anything like that?

Alan Shepard

This is Alan. Those wells, they're still pretty early. So all we're going to say at this point is that they are absolutely meeting expectations on both the cost side and the well performance side. So we're pretty excited about them. And we'll provide more kind of a detailed look at those as we move forward in the next couple of quarters.

Operator

The next question comes from Zach Parham with JPMorgan. Please go ahead.

Zach Parham

I guess, first, I just wanted to ask on a line item on the income statement. Your other revenue and operating income came in ahead of expectations this quarter, and it was up $23 million quarter-over-quarter. Can you just give us a little detail on what drove that increase in revenue?

Alan Shepard

Yes. Some of that's what Ravi talked about earlier, including there is the environmental attribute sales, which were a little bit higher this quarter than last. Additionally, we had a pretty good [Indiscernible] quarter on water revenue. So we've made some investments over the last couple of years in terms of water handling. We've been able to offer those services to third parties, so we had a really good quarter supplying water to some third-party fracs, which drove that number.

Zach Parham

And then also just wanted to ask on the CNG business. You mentioned that CNX had provided some CNG to a third party in July. Can you give us any detail on who that third party is, and maybe a little bit more color on what the opportunity set to provide CNG for third parties looks like and any potential revenue impact in the second half of the year?

Ravi Srivastava

I mean the third-party opportunities, they exist in all sort of sectors, whether it's e-fracs, whether it's power generation, whether it's industrial use. So I mean, we've been pursuing all those opportunities.

The third-party revenue, it's not material for our 2024 guidance change. I would say like we're continuing to develop that business opportunity and we'll have more to share on how this shapes up for 2025 guidance, but nothing material to change anything in 2024 yet.

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Operator

The next question comes from Leo Mariani with ROTH. Please go ahead.

Leo Mariani

Just wanted to follow up a little bit more here on New Tech. So obviously, you mentioned getting the CNG bids deployed to a customer in July. And I guess you've got some other aspects that get kind of rolled off in the second half, kind of from the AutoSep OFS business. I was hoping if you could just kind of characterize what some of these initial offerings to customers are? Are these like customer trials, beta tests? Are you actually getting kind of paid for these? Or are these just kind of like very small test cases and then I guess in the success case and perhaps the customers would take on these products and offerings and then kind of ramp up next year?

And obviously, you talked about revenue a minute ago. It sounds like relatively immaterial this year, but would you expect it to be more significant in '25, they're going to start to kind of move the needle a little bit next year on these 2 businesses?

Ravi Srivastava

Yes. So we're excited about both the businesses. I think they both solve key problems on the AutoSep side of things. I mean, it's a technology that transforms our -- the flowback operations, which is the key step in our oil and gas production value chain.

And if you ask me how flowback has been done in the past, the conventional flowback is kind of analog, manual cost-intensive, lots of emissions. And the technology that we have developed completely transforms that. So we're very, very excited about the solution that we offer. It's from an environmental standpoint, from a cost standpoint, automation, safety standpoint. So we've been using the technology ourselves. So we don't really need to do a lot of tests. We've been doing that on our own pads for the last couple of years. We're using the technology on all of our pads this year and going forward.

And the engagement with third-party customers have -- it's been ongoing for the last couple of months ever since we announced the JV, and there's a lot of excitement. And we expect to have customer sales at -- in the back half of this year, like the magnitude and all that stuff, we'll share more as we have more details. And we expect the AutoSep part of it, that flowback part of it, to be a more meaningful contributor to the 2025 opportunity for us.

On the CNG side of things, again, like again, we have a technology that we have developed in-house that uses this Geobaric Energy to produce compressed natural gas without any mechanical compression. So it's cost effective. From an emission standpoint, it's terrific. And a lot of folks are looking for a solution like that, where we have constraints on pipes and how you get a power energy solution in the form of CNG to different industrial applications. So I think it checks a lot of boxes.

And the third-party sales that we had, the revenue was real. It's not material, but we expect to transact on many such deals in the future. And then -- and as we do that, we'll provide more guidance to you guys.

Leo Mariani

I know, obviously, like you said, there's no guidance, but just from a high level, I mean, is the impact of these two businesses going to start to show up in the financials next year, so we'll start to kind of notice it on the investor side?

And then I also just wanted to confirm that as you look out the next couple of years, do you see those two businesses is not really requiring CapEx? So as you ramp it, it's kind of all gravy on the free cash flow for the most part?

Ravi Srivastava

Yes. I think we do expect that one more than the other as a more meaningful contributor to revenue and cash flows for 2025. And I mean, both of these are going to require capital investments, and we will provide color on all that stuff as the plan for 2025 takes form. But yes, I mean, we expect both of them to start contributing meaningfully from 2025 onwards.

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Operator

The next question comes from Michael Scialla with Stephens. Please go ahead.

Michael Scialla

I know you talked about the 11 deferrals that you're still planning on bringing online early next year. Just curious if you are, in addition to that, curtailing any production at this point? If so, can you say how much?

Alan Shepard

This is Alan. We're not curtailing any additional production. We're running just above kind of our hedge book with the margin safety that we need around that production profile to make sure we don't dip below the hedge book.

Yes, again, the plan is to make a call on whether or not to grow production next year based on how pricing develops. I think there's a lot to be seen for the rest of the summer in terms of national production levels and kind of in-basin usage and things like that before we're ready to make that decision.

Michael Scialla

You mentioned as well the progress -- some progress, I guess, on coal mine methane being allowed under 45V hydrogen tax credit. Any sense for the time-line there on any of your projects, if that were to move forward?

Ravi Srivastava

On the 45V timing, I think there are a lot of guesses out there when it's going to come out. But I think we expect the guidance to come out in Q3, Q4 for a time frame, and eagerly looking forward to what comes out in that tax policy.

Michael Scialla

Could you say if it is favorable, when you could start moving forward on any of the projects that you have contemplated?

Alan Shepard

That will be made based on what the guidance is. So ideally, the more favorable the guidance, the more quickly we can get moving on implementing some of the big projects that we're interested in participating in. That's all going to be guidance dependent.

Operator

[Operator Instructions] The next question comes from Jacob Roberts with TPH. Please go ahead.

Jacob Roberts

Ravi, I was wondering if you could give us more insight into the range and pricing you're seeing on the Tier 1 credit market as you monetize those? I know you just mentioned that we should expect a pretty steady state volume and value from here. So I'm just trying to square that with the historical ranges that the PA, Public Utility Commission publishes on those Tier 1 credits, which may be the wrong market to be looking at, but I'm just wondering if there's an aspect that is keeping the value you're realizing more normalized over time?

Ravi Srivastava

Yes. So I think the PA, PUC Tier 1 REC values, I think it's publicly disclosed, like what's coming out. I think the range that we've seen this year is, I'm going to say between $33 to $36 per megawatt hour-ish which translates into a certain dollars an MMBtu. So don't ask me to do the math live on a call, but the value for the credits have expressed in $36 per megawatt hour, and it's -- I think it's been in that range of $33 to $36-ish all year, and that's what -- that's what we're forecasting that's the range it's going to stay in over the next -- the remaining two quarters.

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And going back, if you go back a few years, I think it's been on a trend up 3 years ago, I think it was in a $17-ish per megawatt hour range, and it's come up over the last couple of years, and it stayed at this level. And we expect it to stay at this level. If anything changes, our guidance will reflect the change in the impact it's going to have on our cash flows.

Jacob Roberts

And then maybe just in general, kind of doing some back of the envelope math. If I look at -- back to Q2 '23. At that time, you had 2026 hedged around 50% to 55%, I believe. And then looking at today relative to 2027, that's sitting 10% to 15% lower, let's call it, maybe 40%. Just wondering if that level is how we should be thinking about the business over the back half of this decade? I know it's a long time off, but I believe you mentioned on the call the willingness to go lower on the hedge book over time. But just wondering what that ultimate comfortable level may be?

Alan Shepard

Yes, I think we've been pretty consistent in the [indiscernible] we're trying to implement on the hedge book the last couple of quarters, which is one, we want to be 80% roughly hedged going into any given upcoming year. And then beyond that first 80%, we've been looking to shorten up the duration of the book. So you've seen this have kind of sort of less hedge activity over the last few quarters as the book has come in.

Operator

The next question comes from Noel Parks with Tuohy Brothers. Please go ahead.

Noel Parks

I apologize if you touched on this earlier, but I just wondered, could you just talk a bit about service costs, what you're seeing on -- both from both vendors and materials. Just wondering if you've seen any shifts of equipment out of the basin? I feel like we're not hearing much on that front these days.

Navneet Behl

On the service cost side, what we've seen is service cost staying flat for first half of the year. And we -- our projections are they're going to stay almost flat for the next half of the year, too.

Noel Parks

And I just wondered -- I mean, it's been such an unusual cycle when we look from pre-pandemic, pandemic effect and then the inflation afterwards sort of in services and then more broadly, macro. And it seems that we were kind of on this path of the leverage kind of remaining almost entirely in producers' hands or largely on pricing just as -- just from capital discipline really holding pretty much across the sector. Is that -- essentially you think we're back there? And I mean in your modeling, do you -- I guess maybe I'd ask what's the sort of worst case most highest inflation scenario you entertain when you look to model rest of the year, next year and so forth?

Alan Shepard

Yes. We generally think about the basin as balance right now. There hasn't been a lot of change in rig activities from our basin in the Pacific going back to coming out of the pandemic era.

So the inflation we saw in '22, we attribute mostly back to the macroeconomic inflation, just across wage gains and other things across the general economists' thus to anything that was particular to our basin dynamic. So when we think about it going forward, it's more of what do we expect national inflation levels to do because we don't see an uptick in activity in our basin on the producer side.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Tyler Lewis for any closing remarks.

Tyler Lewis

Thank you again for joining us this morning, and please feel free to reach out if anyone has any additional questions. Otherwise, we're just speaking with everyone next quarter. Thank you.

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Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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