

FINAL TRANSCRIPT

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CVX - Q2 2008 Chevron Earnings Conference Call

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PRESENTATION

Operator

Good morning. My name is Matt, and I will be your conference facilitator today. Welcome to Chevron's second-quarter 2008 earnings conference call. (OPERATOR INSTRUCTIONS). As a reminder, this conference call is being recorded. I will now turn the conference over to the Vice President and Chief Financial Officer of Chevron Corporation, Mr. Steve Crowe. Please go ahead, sir.

Steve Crowe - *Chevron - VP & CFO*

Thanks, Matt. Welcome to Chevron's second-quarter earnings conference call and webcast. Jim Aleveras, General Manager of Investor Relations, is on the call with me.

Our focus today is on Chevron's financial and operating results for the second quarter of 2008. We will refer to the slides that are available on the Web.

Before we get started, please be reminded that this presentation contains estimates, projections and other forward-looking statements. We ask that you review the cautionary statement on slide two.

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I will begin with slide three, which provides an overview of our financial performance. The Company's second-quarter earnings were a record \$6 billion or \$2.90 per diluted share. Our second-quarter 2008 results were up 11% from the second-quarter 2007. Higher crude oil prices benefited our upstream performance, but had a negative impact on our downstream business. The second quarter of last year included a \$500 million net gain on the sale of an investment and redemption of debt. Second-quarter 2008 earnings rose over 15% compared with the first quarter of 2008, which Jim will discuss shortly.

Return on capital employed for the trailing 12 months was 23%. The debt ratio was below 8% at the end of June. Capital and exploratory spending was \$5.2 billion for the quarter. In addition to the \$2 billion of stock buybacks, we increased the second quarter dividend 12%.

Jim will now take us through the quarterly comparisons. Jim?

Jim Aleveras - *Chevron - General Manager, IR*

Thanks, Steve. My remarks compare results of the second-quarter 2008 with the first-quarter 2008. As a reminder, our earnings release compared second-quarter 2008 with the same quarter a year ago.

Turning to slide four, second-quarter net income was \$800 million higher than the first quarter. Starting with the left side of the chart, higher crude oil and natural gas realizations benefited the Company's worldwide upstream results. At the same time, the significant increase in crude oil prices adversely affected the downstream segment. The variance in the residual other bar primarily reflects higher charges at the corporate level for environmental remediation and tax adjustments.

Slide five summarizes the results of our US upstream operations, which improved by about \$590 million between quarters. Higher crude oil and natural gas realizations benefited earnings by \$775 million. Chevron's average US crude oil realization was up about \$24.30 per barrel between consecutive quarters. This was less than the nearly \$26 increase in WTI spot prices between quarters since much of our Gulf of Mexico crude oil production is priced on a lagged basis. Production volumes were down 2% between quarters, largely due to operational downtime and normal field declines. This reduced earnings by \$30 million. Higher operating expenses reduced earnings by \$70 million. Fuel, steam and utility costs increased as did maintenance expenses. The other bar is the net of everything else, including various gas marketing effects.

Turning to slide six, international upstream earnings for the second quarter were about \$1.5 billion higher than the first quarter's results. Higher oil and gas prices increased earnings by nearly \$1.3 billion. Our average unit realizations per liquids rose by \$24.30 per barrel between sequential quarters, about the same as the average Brent spot price increase.

An increase in liftings contributed \$130 million to the second quarter. Liftings were up primarily in Tengiz, the UK and China. Overall liftings were roughly on balance for the first half of the year after our under-lifted position in the first quarter.

Operating expense reduced earnings by \$90 million, mainly in the UK, Kazakhstan and Indonesia. The other bar reflects the net of many unrelated items. The largest item was a favorable swing in foreign exchange effects. Among the offsetting items, exploration expense was higher in the second quarter.

Slide seven summarizes the change in worldwide oil equivalent production, including volumes produced from oil sands in Canada. Production fell by 62,000 barrels per day or 2% between quarters. US production declined 13,000 barrels per day due to operational downtime and normal field declines that I mentioned.

Outside the US, overall production dropped 49,000 barrels per day in the second quarter. However, we estimate that the impact of higher prices reduced production by about 75,000 barrels per day between sequential quarters. So absent price effects, volumes would have been up between quarters. I will elaborate on this in a moment.

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Indonesia production was impacted by prices, but the largest effect was the absence of the one-time benefit of a favorable gas unitization agreement that we discussed on the conference call last quarter. While gross production at Tengiz continued to ramp up with our expansion project, both Tengiz and Karachaganak net volumes were affected by higher prices.

Turning to our production outlook for 2008, total OEG production for the first six months of 2008 was 2.57 million barrels per day. During this period WTI prices averaged just over \$110 per barrel. Our production target for 2008, which assumed \$70 per barrel of WTI, was 2.65 million barrels per day. Absent the price effects under production sharing and variable royalty agreements, our production for the first half would have been on track with our full-year production target of 2.65 million barrels per day. This production level reflected strong base business performance without significant contributions from several 2008 major project start-ups. Our project startups will increase production during the second half of the year, and adjusting for price effects, we expect to meet or exceed our volume target for the year.

Steve will provide a brief update on our major projects at the end of our presentation.

We reviewed our rule of thumb as prices have moved far above \$70 per barrel, and we believe the rule of thumb is still applicable at the current price level. That is to say a \$1 per barrel increase in prices leads to about a 2,000 barrel per day reduction in our net production volumes for the year. However, I would like to re-emphasize the caveats we have given you about this rule of thumb. The calculation of price impacts includes many variables, including the interaction of prices and costs, very specific contract thresholds and terms, and so forth. The rule of thumb is our best estimate of the impact for 2008, but results will vary when making comparisons between periods.

For example, because certain thresholds were met in the second quarter, the rule of thumb does not work when comparing the first and second quarters of 2008. Each dollar change in price had an impact of over 3,000 barrels per day in this particular comparison. We will continue to update you as we move through this very volatile price environment.

Turning to slide eight, our US downstream operations moved from breakeven to a loss of about \$680 million in the second quarter. Industry refining margins improved in the second quarter, although marketing indicator margins weakened, particularly on the West Coast. On balance indicator margins suggest a \$305 million benefit. WTI prices rose more than \$38 per barrel from the end of the first quarter to the end of the second quarter. This compares to an increase of less than \$6 per barrel during the first quarter. This truly extraordinary crude price spike in the second quarter reduced US downstream earnings by \$490 million between quarters. The \$490 million is shown on the bar labeled Timing Effects.

Of the \$490 million, about \$280 million reflected the impact of provisionally-priced foreign crude. This crude is priced on a delivery basis, although we take title to it when it is lifted. We typically have about 13 to 15 million barrels of provisionally-priced crude in transit to the US West Coast. These barrels are effectively marked-to-market at the end of each period.

The second timing effect accounted for \$110 million of the \$490 million change between quarters. We used derivatives to convert crudes, including crudes that are not provisionally-priced from the acquisition price to the price at the time they are run. As prices went up dramatically during the second quarter, this resulted in derivative losses.

The balance of timing effects between quarters reflected a number of supply-related activities, including mark-to-market losses on derivatives related to a long-term contract.

Moving to the next bar, we had an unfavorable variance of \$300 million between quarters due to refinery shutdown effects. Almost all of these were planned shutdowns, and we previously cautioned that 2008 would be a heavy planned shutdown period for us. The adverse \$300 million variance reflects both the direct operating expense and the lost margin capture as we purchased more expensive feedstocks and intermediates during the refinery shutdowns. Most of the difference between quarters was due to our Pascagoula refinery where both the No. 1 crude unit and coker were down during the second quarter.

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Planned shutdowns at El Segundo and Hawaii were much smaller factors. Our 2008 maintenance schedule indicates that essentially all of our major US planned shutdowns were completed in the first half of 2008. Excluding the operating expense related to refinery shutdowns, other OpEx was \$145 million higher in the second quarter. Many factors were involved here, including higher fuel costs.

The other bar on the chart is an unfavorable variance of \$56 million, which primarily reflects minor pipeline impairments.

Turning to slide nine, international downstream earnings fell \$300 million from the first quarter's results. Refining indicator margins improved while marketing margins were mixed across our international geographic areas. On balance Company margins were a \$185 million benefit between quarters. Volumetric effects were a \$25 million adverse variance. This primarily reflected the unplanned shutdowns at the Pembroke refinery in Wales. We estimate the overall impact of all international refinery downtime between quarters to be an unfavorable variance of \$32 million, which reflects OpEx as well as volume and feedstock impacts.

As we saw in the United States, international downstream timing effects were a major factor in the adverse change between quarters as the price of crude and petroleum products increased very significantly over the course of the second quarter.

Two-thirds of the \$225 million shown as timing effects was related to long-haul sales of equity crude and refined products. For select cargoes we often use derivatives to lock in a margin above the cost of transportation. During periods of rapidly increasing prices, this can lead to derivative losses. The majority of this timing effect is related to delivered sales of Partitioned Neutral Zone equity crude and exports of refined products from our Pembroke refinery to third parties.

The balance of the timing effect is primarily due to losses on derivatives used to convert crude pricing to the time of refinery run. There was also a factor involved here regarding the changes in inventory.

The next bar shows operating expense was a \$140 million unfavorable variance between quarters. A number of different items affected the various geographic regions, there was not a pattern to the components of the \$140 million change.

The other bar shows a \$95 million reduction between quarters, and this primarily reflects lower foreign exchange gains, as well as an adverse swing in tax items.

Slide 10 shows that earnings from chemical operations were \$41 million in the second quarter compared with \$43 million in the first quarter. Results for olefins fell on lower margins and volumes, as well as higher operating expense. Aromatics results were also affected by lower volumes and higher operating expenses. Additionally shutdown activity reduced aromatics' results.

The other bar on this chart shows a favorable \$26 million variance between quarters. This reflects the absence of a \$40 million environmental provision we mentioned on last quarter's conference call, partly offset by lower additive margins.

Turning to slide 11, which covers all other, second-quarter results were net charges of \$580 million compared to net charges of \$255 million in the first quarter. The \$210 million variance reflects environmental provisions related to legacy Texaco and Unocal downstream assets. Since these assets were sold prior to Chevron acquiring their parent companies, the impact is included here rather than in the downstream segment.

Tax items were an \$80 million unfavorable variance. The other bar reflects the net of many unrelated items.

Before I turn things back over to Steve, I'd just like to briefly recap the second quarter's results.

First, upstream results were very strong, in line with the indicators in our July 10 interim update. Second, we experienced a sharp decline in downstream performance due to timing effects and refinery downtime as we discussed in the interim update.

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Finally, as we projected, chemical results were flat between sequential quarters, and our all other charges were significantly higher than the standard guidance range due to environmental remediation charges.

That completes my variance analysis for the quarter. Back over to you, Steve.

Steve Crowe - *Chevron - VP & CFO*

Thanks, Jim. Before opening the call to questions, I would like to highlight the significant progress we have made on some of our major capital projects. Please turn to slide 12.

First up is our Agbami project, offshore Nigeria. Yesterday we announced that Agbami had begun production. Chevron is the operator with a 68% interest in this world-class deepwater project. Agbami's initial gross OEG production is expected to quickly ramp up to more than 100,000 barrels per day. We anticipate this reaching 250,000 barrels per day by the end of 2009.

In the UK our partner recently announced first production for the Callanish-Brodgar fields also known as the Britannia satellite development.

At the Tengiz field in Kazakhstan, our phased expansion remains on schedule for full facilities start-up this quarter. The first phase, which began late last year, added nearly 90,000 barrels per day of total production during the second quarter. The second phase of production is now complete, and we're doing the major turnaround, final tie-ins and commissioning.

As a result, there will be a brief drop in production of about 25,000 barrels a day in the third quarter with full facility startup. We anticipate the project will add 240,000 barrels a day of production, increasing Tengiz's total capacity from 300,000 to 540,000 barrels per day.

In the Gulf of Mexico, we completed our plan to retrofit and tension all eight mooring lines on our Blind Faith facility. We're continuing with commissioning work, having installed all four of the risers. We expect startup later this year. It is difficult to be more specific about the timing as weather could impact our commissioning efforts.

In Australia the Northwest Shelf fifth LNG train, is in the midst of commissioning with an anticipated first cargo in the fourth quarter.

In Brazil our Frade project is on track for a 2009 start-up.

At our Tahiti facility in the Gulf of Mexico, the production spar hull has been moored, the installation of subsea flowlines and risers is nearly complete, and the first of three major topside modules was installed last week. We expect to install the other two topside modules this quarter. The Tahiti project remains on schedule for first production in the third quarter 2009.

In Angola our Tombua Landana project is also on schedule for first production next year.

In summary, our major projects are on track to deliver significant new volumes.

Well, that concludes our prepared remarks. We will now take your questions. One question and one follow-up per caller, please. Matt, would you open up the lines for questions?

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QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). Our first question from Arjun Murti, Goldman Sachs.

Arjun Murti - Goldman Sachs - Analyst

Thank you for the project update. I was wondering if you could provide a similar update on some of your exploration plans. I guess in particular the status of some of the key lower tertiary projects, Jack in particular, St. Malo. If you could provide an update on your exploration in general, but most notably the lower tertiary that would be helpful. Thank you.

Steve Crowe - Chevron - VP & CFO

Well, we're looking at Jack and St. Malo presently. We have another well that will be completed later in the year. We're giving consideration as to whether or not we can tie back those two projects, Jack and St. Malo, one of which came from Unocal and one of which is a legacy Chevron one and consider developing the two of them in tandem.

We will have more to say about the progress of the lower tertiary as we get a little deeper in the year and can probably give you a more definitive update on our next conference call.

Arjun, did you have any follow-up questions?

Arjun Murti - Goldman Sachs - Analyst

Are those expected to be sanctioned this year? Does the fact that you are considering a joint development speak to any disappointment or update in terms of the resource potential at either or both together?

Steve Crowe - Chevron - VP & CFO

I think the consideration of joining those two projects together really speaks to the opportunity to reduce costs in the current environment and produce them in tandem as a more efficient way of developing the resource.

Arjun Murti - Goldman Sachs - Analyst

It is an efficiency consideration?

Steve Crowe - Chevron - VP & CFO

Primarily.

Arjun Murti - Goldman Sachs - Analyst

And I'm sorry do you think -- will we expect a sanctioning decision this year, or is that an '09 or later kind of thing?

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Steve Crowe - *Chevron - VP & CFO*

That will be outside of 2008.

Operator

Neil McMahon, Sanford Bernstein.

Neil McMahon - *Sanford Bernstein - Analyst*

Just really on some of the numbers in today's call that Jim ran through on the variance analysis, looking at the OpEx reduction both in the US but more importantly in international, which is a bit strange given higher royalties in an inflation environment.

I was wondering to what extent -- well, first of all, really why that OpEx reduction took place from the first quarter to second quarter and in particular, related to what is going on in Kazakhstan with some of your partners in the Karachaganak field seeing increased charges associated with changes in the fiscal terms in that country.

Steve Crowe - *Chevron - VP & CFO*

Let me give a first correction I think, Neil. As Jim was going through the variance analyses, say, on the US upstream, we indicated on slide five that operating expense was higher in the second quarter in comparison to the first quarter by about \$70 million after-tax, mainly reflecting, as you would expect, higher fuel costs and utility costs along with higher maintenance. So actually the costs were higher in the second than in the first quarter.

Jim Aleveras - *Chevron - General Manager, IR*

With regard to the international upstream, you will see OpEx down a little bit, but the biggest factor there was simply a number of different things in our various UK, Kazakhstan and Indonesia operations.

Neil McMahon - *Sanford Bernstein - Analyst*

I am just sort of struggling why it is dropped given the fact that the BG on their conference call were talking about the fact that under duress, or maybe that was not the word they used, they were paying new taxes associated with the fiscal change in Kazakhstan. That is all. It seems strange that you have gone down, whereas they went up.

Jim Aleveras - *Chevron - General Manager, IR*

Well, perhaps it is a semantic issue here. When we're showing OpEx as a negative, what we're saying is it's a negative to P&L. We start with our income from the first quarter, and we end with our income in the second quarter. So when OpEx is a negative, what it means is it is a deduction from our earnings in the second quarter.

Neil McMahon - *Sanford Bernstein - Analyst*

Right. I understand that. But you did say that it went down. That is all.

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Jim Aleveras - Chevron - General Manager, IR

No, we said OpEx was a negative. If you look at the international upstream chart, it is a negative \$90 million to earnings. So that is OpEx actually going up; it is reducing earnings by \$90 million.

Neil McMahon - Sanford Bernstein - Analyst

Okay. I thought you said a few minutes ago that if things got better in Kazakhstan, but that is fine.

Maybe as a follow-up then just on the environmental charge under corporate, maybe you could just walk through that since you did say you had disposed of those assets, or maybe my hearing is totally gone.

Steve Crowe - Chevron - VP & CFO

Well, as we had foreshadowed in the interim update on July 10, certain of the environmental provisions or obligations that we have that are connected with legacy operations of Texaco or Unocal we still are obliged per certain of the contractual arrangements to affect the environmental cleanup or remediation.

It so happened that here in the second quarter for primarily the Unocal but also Texaco operations that are no longer operated, they have been disposed of, certain events have occurred where we thought it was appropriate for the accounting rules to recognize the increased liability. So that was the fundamental driver for that increase of \$210 million between the first and second quarters of this year.

Neil McMahon - Sanford Bernstein - Analyst

Steve, can you tell us what they are or what the chances are that this sort of thing is going to happen again on some of those assets?

Steve Crowe - Chevron - VP & CFO

Well, they were a variety of things, some of which were marketing-related, operations that Unocal had that have since been sold twice. Some of them are connected with refinery and terminal locations, both legacy -- primarily legacy Texaco. And those things occur driven by events.

But you will have noticed I think over the last year or so that our recognition of environmental expenses, whether it be for currently owned and operated operations or those previously disposed of, are a bit more -- occur more regularly during the course of the year.

But it is very hard to give you a prediction as to what the ratable pace would be because it is driven by events, and they tend to come based on the situation.

Operator

Paul Sankey, Deutsche Bank.

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Paul Sankey - Deutsche Bank - Analyst

I got a little bit confused regarding your overall statements about volume for the year. You said you were at 2.537, 2.5 million and that you would otherwise have been at your target but for the PSC and other effects of 2.650. You then subsequently said that you expect still to meet the target by the end of the year, was it, or could you just clarify -- I did not quite understand what you were saying. Do you mean that you are going to still be at 2.537 by the end of the year, or you're going to hit 2.650?

Steve Crowe - Chevron - VP & CFO

I will let Jim cover that.

Jim Aleveras - Chevron - General Manager, IR

Paul, what we are saying is that we expect to meet or exceed the 2.65 that we talked about at \$70 a barrel of oil at our March meeting, but that is adjusted for prices. Right now we are in a very volatile pricing environment so if prices stay above \$70, we will come in below that, but we will give you a reconciliation back to that that will explain the PSC effects that caused it.

Paul Sankey - Deutsche Bank - Analyst

Yes, the point I was making was that you said that the current level effectively, but for those effects, the 2.5 level but for those effects amounted to the 2.6 if you like, which would then to me suggest that there's no growth in the second half?

Jim Aleveras - Chevron - General Manager, IR

No, we expect to meet or exceed -- and I will put exceed in italics if that helps, Paul.

Paul Sankey - Deutsche Bank - Analyst

Okay. I have got you I think.

Steve Crowe - Chevron - VP & CFO

So what we're saying again for those on the phone is, we're reaffirming our production guidance earlier in the year that we will have net production of 2.65 at a \$70 per barrel average price for the year. And Jim also mentioned that it still looks appropriate as you make those adjustments because of higher crude prices, a 2:1 ratio such that for every dollar increase above the \$70, you can anticipate roughly a 2,000 barrel a day reduction in net production.

Paul Sankey - Deutsche Bank - Analyst

Okay. If I could take my follow-up, you were very clear on Agbami. On Tengiz you mentioned that you will be down in Q3. Can you just give us the overall levels? You mentioned you would be down I think 25,000 a day. Could you just give us the overall levels, even at the Kazakhstan level that would be fine? And then if you could also just clarify the exit rate for '08? Because you said there the capacity I think is 240,000 a day. But if you could just clarify where you think you will be by the end of the year, that is great.

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Jim Aleveras - *Chevron - General Manager, IR*

Well, let's take the first one first. Paul, we mentioned the 25,000 barrel a day reduction in the current quarter simply to alert people that as we tie in the facilities and we bring the second generation plant on stream, we will have to reduce production a little bit as we are tying everything back together.

Paul Sankey - *Deutsche Bank - Analyst*

And that will be down to what level?

Jim Aleveras - *Chevron - General Manager, IR*

Right now we're running close to 400,000 barrels a day on a gross 100% basis.

Paul Sankey - *Deutsche Bank - Analyst*

And that is pre the 25,000, right?

Jim Aleveras - *Chevron - General Manager, IR*

That is correct.

Steve Crowe - *Chevron - VP & CFO*

That is correct.

Paul Sankey - *Deutsche Bank - Analyst*

Okay. Yes, go on.

Jim Aleveras - *Chevron - General Manager, IR*

But there will be a slight reduction in overall production just as we tie everything together and get the plant up and running.

Paul Sankey - *Deutsche Bank - Analyst*

And the exit rate?

Steve Crowe - *Chevron - VP & CFO*

In terms of the exit rate from 2008 going into 2009, it is a little too early to tell yet. We certainly have achieved as we promised the 90,000 barrel a day improvement from the first phase of the project, the sour gas injection.

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Steve Crowe - *Chevron - VP & CFO*

But it will be ramping up to the expected 540,000 barrels a day on a total project. I just don't want to quote an exact number as we exit 2008 and go into 2009.

Jim Aleveras - *Chevron - General Manager, IR*

We're certainly going to expect a pretty prompt increase once we get out of the third quarter into the fourth quarter.

Steve Crowe - *Chevron - VP & CFO*

That is correct.

Operator

Paul Cheng, Lehman Brothers.

Paul Cheng - *Lehman Brothers - Analyst*

Steve and Jim, with Agbami coming on stream and also a number of projects, can you maybe share with us the kind of return and profitability on those new projects comparing to your existing one? It looked like Agbami should be extremely profitable, so I was wondering if you can shed some light.

Steve Crowe - *Chevron - VP & CFO*

Well, we typically would not talk about the economics of a specific project, which obviously get into a lot of the fiscal terms that we have in each of those operations. But Agbami will be a very profitable project for us. It will be returning cash to us on a prompt basis.

As you know, it is a light oil condensate project and ought to have a very handsome rate of return. Our expectations sort of harkening back to an earlier question on ramp-up is that we probably will see as the wells come on production reaching 100,000 barrels a day in the early part of next year. And then as we mentioned before, moving up to the 250,000 barrels a day by the end of 2009.

But I think a takeaway from that last chart that I showed in the prepared remarks is we have got a long and healthy list of projects, some of which have come on, some of which are right in the midst of being commissioned, and some are coming on and right on schedule for 2009. So I think our production, which, of course, net production will be influenced by prices and the way variable royalty mechanisms work and production sharing agreements. But these large projects are all lined up, and as you can see, it is quite a long list and probably will differentiate Chevron versus a lot of our competitors. I think it is a major difference. We have been talking about it for a couple of years now, but they are ready.

Paul Cheng - *Lehman Brothers - Analyst*

Steve, what is your current production in Agbami at this point?

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Steve Crowe - *Chevron - VP & CFO*

Well, Agbami started up literally Tuesday of this week as I recall. And so, as the wells come on, it will be ramping up. The last I saw, and it changes all the time, Paul, but the last I saw was a day or so ago, and it was about 20,000 barrels a day. But it ramps up over time. So don't put any specific number. It is a function of when the wells come on. But, as I mentioned, as they do come on, we anticipate about 100,000 barrels a day in early 2009.

Paul Cheng - *Lehman Brothers - Analyst*

Can I ask you maybe a conceptual question about the timing effect losses in your downstream operation?

Steve Crowe - *Chevron - VP & CFO*

Sure.

Paul Cheng - *Lehman Brothers - Analyst*

I understand the price finalization impact related to long-haul crude suppliers in Saudi Arabia and all that -- so that is really no big deal on that. I'm not quite sure I understand why we even use a derivative for, let's say, if you own equity crude oil, you sell it, I think what based on what you guys described it that you use derivatives to hedge whatever is the price that during that journey, that shipping time whether it is 20 days or 40 days, given that no one really can foresee what is the price direction for the next 20, 40 days, so you are arguably you have 50% of the time -- you make money 50% of the time, you lose money in that derivative trade and given Chevron has no concern about liquidity or anything, why would you even bother to do that?

Jim Aleveras - *Chevron - General Manager, IR*

Well, Paul, what we -- the reason we did that was to match the cost of crude that we purchased to the time that it is run in the refinery to get the margins for the day.

Paul Cheng - *Lehman Brothers - Analyst*

Why would you even bother? Jim, that is my question. I mean over time it makes no difference.

Jim Aleveras - *Chevron - General Manager, IR*

Well, Paul, what we're trying to do there is just lock in a refining margin, which historically refining margins have fluctuated and we want to get refining margin of the day. As we have done this especially in the second quarter during a period of very, very rapid price changes, we have seen that that has added volatility to our earnings. That volatility is something that we don't find acceptable, and we have curtailed that program to a considerable extent in the second quarter. So going forward you can expect to see much smaller effects from this.

Paul Cheng - *Lehman Brothers - Analyst*

Okay. Thank you.

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Steve Crowe - *Chevron - VP & CFO*

Let me just reiterate a couple of points in as much as the timing effects were significant and looking at our results. In light of our second-quarter results, we're looking at everything that impacts our downstream performance. But let me make it clear -- our strategy for the downstream business hasn't changed. We're continuing to work on rationalizing our portfolio, to eliminate less profitable assets and to reduce the capital employed in our marketing network, while maintaining our brand uplift. We're absolutely focused on refinery reliability and selective investments to improve refinery performance.

But we're also looking at the tactical issues as Jim mentioned like the use of derivatives and other factors that sometimes add perhaps unnecessary volatility to our reported results.

Thanks for your call and questions, Paul.

Operator

Kate Lucas, JPMorgan.

Kate Lucas - *JPMorgan - Analyst*

Can you just comment a little bit on the progress of the steamflood technology that you're using or implementing in the Neutral Zone, specifically any challenges with the steamflood or the carbonate reservoir?

And then can you comment on whether you are able to source the natural gas and water without any issues?

Steve Crowe - *Chevron - VP & CFO*

Thanks, Kate. As you know, we are in a pilot project in the PNZ to see if the technology would be applicable to a carbonate formation. As far as I'm aware, good progress is being made. And, as you are also aware, we're doing that early pilot in the Partitioned Neutral Zone, which has its concession ending in the early part of 2009. This is a 60-year concession, and we are very optimistic that the concession will be extended. But it is too early at this point on the call to confirm it definitively. But all indications are from the pilot steam project that things are progressing as we had anticipated.

Thank you very much. Follow-up question, please? I'm sorry, Kate. We may have lost you there. May we have the next question please?

Operator

Eric Mielke, Merrill Lynch.

Erik Mielke - *Merrill Lynch - Analyst*

You went through most of my questions. Just a couple of quick follow-ups. In the discussion earlier with Neil on international operating cost during the second quarter, I recognized that there was an increase during the quarter. But the rate of increase was perhaps less than we would have expected. Is that because of a volume mix effect, or was it part of underlying cost improvements that you previously discussed?

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Jim Aleveras - *Chevron - General Manager, IR*

It is a combination of a number of things. If we look at our operating expense, what we're seeing is higher costs in a lot of areas, but we did have some workover costs in West Africa that affected the prior period that are not in the current period.

Steve Crowe - *Chevron - VP & CFO*

I hope that helps.

Erik Mielke - *Merrill Lynch - Analyst*

It does indeed. And then finally, just looking at politics and the fact that by the time we have the next call we will be right in the middle of the elections, we had an announcement today from one of the two candidates that they are considering windfall taxes to finance a so-called energy rebate. What are you hearing from your contacts in Washington when it comes to the outlook for taxation on US oil companies and if you have any comments on what the impact will be for the different proposals on CO2 cap-and-trade for your business?

Steve Crowe - *Chevron - VP & CFO*

Well, it is again very early with respect to the measurement of the impact of the various CO2 proposals that have been floated around for the last year or so.

As far as windfall profit tax is concerned, we have over the last year seen a number of proposals tabled. Some were windfall profit tax; some were related to use of foreign tax credits; some were connected with the sustained usability of LIFO. At this juncture up to this point, those have all not passed muster. But it is again it depends on the nature and terms of any legislation that might be forthcoming in a new administration down the road. So it really much depends on the form of any additional taxation. It is hard to speculate until you know all the details.

Do you have any other questions?

Erik Mielke - *Merrill Lynch - Analyst*

That is it for me. Thank you.

Operator

Jason Gammel, Macquarie.

Jason Gammel - *Macquarie - Analyst*

I just wanted to ask a question about the timing of the Pascagoula coker turnaround. From a historic margin capture standpoint, the second quarter would seem to be counter-intuitive for planning too much turnaround on the coker. Can you shed any light into that decision-making process?

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Jim Aleveras - Chevron - General Manager, IR

Let me take a swipe at that. The whole issue of bringing a coker down is a very, very complex issue. We're very conscious that timing is important in terms of scheduling a turnaround because of the impact on margins. If we look at the light/heavy differential as a key proxy for coker profitability, we don't find that it follows a consistent pattern between the first and second quarter.

So in the 2003/2005 period, light/heavy differentials were actually higher in the first quarter than in the second quarter. You just can't change a major refinery turnaround once you see actual margins coming through the market on a weekly or a monthly basis.

In Pascagoula, for example, the crude unit and coker shutdowns during the second quarter were very major undertakings involving thousands of temporary workers, and the Pascagoula coker had run five years since its last scheduled turnaround. We simply were not in the position to second guess the market, as the market evolved in 2008 to get the timing exactly where you would have liked to have gotten it in hindsight to capture the best margins.

Steve Crowe - Chevron - VP & CFO

I think I would add as well two other points. One, there was a lot of activity with respect to bringing back the other crude unit in the first quarter. So there really was not an opportunity to accelerate it by a quarter or two if you had perceived a different light/heavy differential in the short-term.

But the other point that I would make, as Jim had alluded to, almost all of our scheduled maintenance here in the US for 2008 is behind us. So we would expect to have increased refinery availability during the second half of the year.

Jason Gammel - Macquarie - Analyst

Okay. That is very helpful, guys. Maybe as a follow-up I could ask about the decline in branded gasoline sales. It looks to be down about 5% year-over-year. Is that purely a demand function, or are there some divestitures that played a role in that as well?

Jim Aleveras - Chevron - General Manager, IR

It is largely a demand function, Jason. What we're seeing is a higher amount of demand decrease in the US West Coast than we are seeing in other parts of the country. And, of course, Chevron is disproportionately exposed to the US West Coast. We have seen this in prior periods as well when California was disproportionately hit in the early 1990s as the defense contractors exited the state and in the late 1990s as the dot-com bubble burst.

In each case we have seen California rebound. Right now California is being disproportionately hit by the housing and credit crisis, and this has created what we feel is a negative consumer sentiment that is causing people to do less discretionary driving.

Long-term we're very bullish about California. We have seen California knocked down twice in the last decade. The exit of the defense contractors was a huge impact in California. The dot-com bubble was a huge impact in California, and California unemployment rates have run 1.5 times the national average.

So there's a lot of consumer sentiment going on here, and we're just in the midst of this for a short period of time. We don't know what the future holds, but in the past California has wobbled around more than the country has, but it has always come back. So we're optimistic about the future, but for the moment we're being disproportionately affected by our exposure to the US West Coast.

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Steve Crowe - *Chevron - VP & CFO*

So, Jason, just to close that off, we really don't have any divestments that are impacting the lower branded mogas sales. It is all a function of industry market demand.

Jason Gammel - *Macquarie - Analyst*

Very helpful. Thanks, guys.

Operator

Waseem Khalil, HSBC.

Waseem Khalil - *HSBC - Analyst*

I was just wondering if you could perhaps give us a little bit more information on the Partitioned Neutral Zone. I believe the lady earlier from JPMorgan was cut off, and I was just wondering if you could just perhaps give us some more information on any updates that are going on regarding that?

Steve Crowe - *Chevron - VP & CFO*

Well, I really don't have a lot of additional information to offer up. I had commented on the status and successful progress of our steamflood in the carbonate rock and also had mentioned that we have been having ongoing discussions with the Kingdom for an extension of the concession agreement which is progressing and against which we're very optimistic that we will have a successful resolution. Beyond that, I really don't have any additional information to provide to you on the call here today.

Waseem Khalil - *HSBC - Analyst*

Right, okay. I guess then if there's no additional information, there's no additional question. Thank you very much.

Operator

Doug Leggate, Quadrum.

Doug Leggate - *Quadrum - Analyst*

This is becoming a bit of a theme here. On this Partitioned Neutral Zone, I'm just curious in the event that the concession is extended, can you give any kind of rough approximation as to what the period that you would expect it to be? Because I'm expecting you would be able to book the reserves here, right, if it gets extended?

Steve Crowe - *Chevron - VP & CFO*

If the concession is extended, we would be able to book reserves. As you know, under current accounting rules, we are only able to book reserves to the extent that production would occur under the existing contract.

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As far as any of the commercial terms that are in the midst of being finalized and negotiated, I'm clearly not at liberty to discuss those now. But your fundamental premise about being able to book reserves is correct, Doug.

Doug Leggate - *Quadrum - Analyst*

Sorry, I guess I have a related follow-up. Would this be as long as the original concession, or would it be much shorter? Just ballpark would be really useful.

Steve Crowe - *Chevron - VP & CFO*

Well, the existing concession was for 60 years, and I really am not at liberty to talk about the terms of the successor if it is concluded. We will give the investment community full detail or as much detail as we can at the point of our announcement.

Operator

(OPERATOR INSTRUCTIONS).

Steve Crowe - *Chevron - VP & CFO*

It looks like we have gone through the lists of analysts who had questions for us. I think in closing, let me say how much I appreciate all of the analysts' participation, particularly asking questions on behalf of all of those listening, and thank you very much.

Matt, back to you?

Operator

Ladies and gentlemen, this concludes Chevron's second-quarter 2008 earnings conference call. Thank you for participating. You may now disconnect. Good day.

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