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Transcript

Jeanine Wai (Barclays Research):
Good morning, everyone. It's nice to see so many faces so early. We're in for quite a treat this morning. We have Jeff Gustavson, who is responsible for Chevron's North American Exploration and Production Mid-Continent business unit, which include the Permian. Chevron has assembled a tremendous acreage position in the Permian at 1.7 million unconventional net acres, which has a huge royalty advantage, and targets producing 900,000 barrels a day in the Permian by 2023.

Today's format, we'll have shorter prepared remarks and then we'll move to Q&A, which is always really fun. We're going to have a breakout session as well in the Riverside Room on the third floor for about 20 minutes, so you can get out all of your questions then if you're shy during our time in here. I'm jealous, because I love going to breakouts myself.

But okay, without further ado, I'm going to hand the mic over to Jeff. Jeff?

Jeff Gustavson (VP, Chevron North America Exploration & Production Mid-Continent):
Thanks, Jeanine. Good morning, everybody. I don't know if my remarks will be short, but I'll do my best. I'm going to start on a little bit of a somber note. I want to express my own and our company's condolences for what happened over the weekend in the Midland-Odessa area. I know you're all aware of that. We have, of course, a lot of employees that live and work in that area. I've been in that area very long time, terrible tragedy that occurred in West Texas, and just wanted to say our hearts go out to all of the families of victims, the friends of the victims, who were impacted by this just awful event. And Chevron will do whatever we can to support the local communities as they try to work through this over the coming months. I thought that was important to start with that in light of the events last Saturday afternoon.

Moving on to my presentation, so I've attended this conference several times in the past when I was the General Manager of Investor Relations. Many of you may have met me then. It's great to be back. Great conference, Jeanine, and I'm honored to be able to represent a very different business unit that that I'm now working with and many of the hardworking employees and contractors from our Mid-Continent business unit.

This business unit manages a very large oil and liquids-rich asset base in the Mid-Continent of the United States. But, of course, right now what we're most focused on are our significant interests in the Permian Basin, our assets in Texas and southeast New Mexico. I'll be focusing on those Permian assets during today's presentation and Jeanine's Q&A session but would like to start off by highlighting our company's broader value proposition while also touching on some of the aspects of Chevron's upstream portfolio. And many of these slides you will recognize from past corporate presentations.

Moving to slide two, and before we get started, just please be reminded that the presentation contains estimates, projections and other forward-looking statements. Please review the cautionary statement on the slide in front of you and important information for investors and stockholders included therein.

Moving to slide three. Chevron offers a winning value proposition. Our consistent discipline, financial priorities - commitments to our investors, combined with our strong competitive advantages, drive attractive shareholder returns. Everything starts with maintaining and growing the dividend, which was increased more than 6% earlier this year. We have a low dividend breakeven, and we're on track to make 2019 the 32nd consecutive year where we have increased the annual per-share dividend payment.

This dividend growth is supported by funding a disciplined capital program, where our investment choices are driven by portfolio value and risk-weighted returns. Our portfolio is advantaged with its liquids weighting, lower cost of supply, greater flexibility, and much lower execution risk. Past investment decisions are driving strong free cash flows today.

The strength of our balance sheet is unmatched, and we are returning surplus cash to shareholders through our buyback program. We expect to return $13 billion this year through dividends and share buybacks, equating to a total shareholder yield of about 6%.

Moving to slide four and our upstream portfolio, we have a strong position in many key hydrocarbon plays around the world. The map shows our most important producing assets, which are generating strong returns and industry-leading performance. Our value proposition is anchored by Chevron's diverse and advantaged upstream portfolio. This portfolio is competitively advantaged, with long-lived, low-decline assets anchored by future short cycle, high-return investments, particularly our shale and tight investments that carry a much lower degree of execution risk.

The pie chart on the left shows our diversity by asset class. The number of barrels in the shale and tight category has increased significantly, as you can see on the chart, and now represents about one-third of our upstream portfolio. The majority of this wedge comes from the Permian, but it also includes a growing source of new production from our other shale and tight assets, including interest in the Marcellus and Utica in Appalachia, the Kaybob Duvernay in Alberta, Canada, and the Vaca Muerta in Argentina.

Turning to slide five. Our upstream production story looks at how our new production offsets base decline rates, contract explorations and assets sales, providing our overall five-year production outlook. We've guided to a steady compound annual growth rate of 3% to 4% over the next five years at a flat $60 a barrel Brent price. This includes the impact of expected asset sales and the effect of the contract explorations in Indonesia and Thailand in 2021 and 2022.

With the majority of our new production coming from a portfolio of shale and tight assets, especially the Permian, our growth is disciplined and ratable, with strong returns and lower risk. It is important to remember that we always view production as an outcome, not a driver, of our investment decisions. This includes our disciplined approach to high-grading our portfolio, including monetizing assets, which brings value forward for our investors.

Moving to slide six, we not only have the capability to grow production, but are also replacing reserves organically. We grew both production and reserves last year, and we have a large high-quality resource base to support high-value growth well into the future. The chart on the left illustrates our five-year reserve replacement results where we've added more reserves than we've produced and sold over multiple years. Our shale and tight portfolio is a key contributor here. These are high quality reserves with lower risk, lower breakeven costs, and higher returns.

Our reserves-to-production ratio shown on the chart on the right demonstrates that our portfolio is resilient through the price cycle and is stable, another competitive differentiator. To sum all of this up, our strong balanced upstream portfolio means we don't need to inefficiently ramp up capital spending or chase lower return investments, including overpriced corporate acquisitions, to restock our resource base. This is fully aligned with the corporate priorities I highlighted previously.

Turning to slide seven, and what is my favorite topic, our strong position in the Permian, which continues to get better over time. This large legacy asset underpins the attractiveness of our broader resource base and is a key component of our value proposition for investors.

At our Analyst Meeting in March, we highlighted the increase in this resource base to over 16 billion barrels of oil equivalent driven by appraisal success, the application of technology, improved development planning, design and, ultimately, our performance. These factors have increased the economic value of our acreage, which has more than doubled over the past few years under a flat price assumption. We have had great success in consolidating our land position through swaps, the creation of joint ventures farmouts, and sales. This is a critical focus area for our organization given the huge value uplift associated with these transactions. Our long lateral inventory increased by 1,600 wells over the 2017 to 2018 period, and we have continued to add to this inventory this year.

Moving to our production outlook for the Permian on slide eight, our Permian shale and tight production continues to track the guidance we provided at our 2019 Security Analyst Meeting earlier this year. In the second quarter, production was just over 420,000 barrels of oil equivalent per day. Production increased by over 150,000 barrels a day, a 55% year-on-year increase, the equivalent of adding a medium-sized E&P company to the business unit and to the Chevron portfolio. Although this curve and our consistent progress against it is something our organization is very proud of. I would like to restate that we view this as a product of a lot of hard, smart work and of disciplined investment decisions combined with efficient competitive execution performance across our business. We're not driven by production outcomes, but by value creation and returns for the company.

About three-quarters of our Permian production is liquids, and half of our production is crude oil. We expect these proportions to continue through the forecasted period based on our current development plans. The legacy nature of our assets provides us an advantaged royalty position across the Permian. This royalty benefit [actual royalty rate is lower than the standard royalty rate] is shown in the dotted blue wedge in the chart. We have an additional royalty advantage in the Permian shown by the hash blue wedge, which are the royalty barrels we received from acreage we've leased to other producers. These barrels reflect past decisions to bring value forward and have allowed us in many cases to accelerate development without Chevron capital.

Turning to slide nine and what is my favorite Permian slide -- we are focused on value, not volume, and our organization is laser-focused on increasing our productivity while reducing our unit costs. This slide shows the progress we've made in both regards over the past several years. As shown on the top left, we continue to drive higher estimated ultimate recoveries for each well by optimizing well spacing, landing zones, and completions designs. Moving to the bottom left, the lateral length of our wells continues to increase, driven by our core-up strategy in existing and new development areas… and is expected to approach 10,000 feet, on average, for our wells planned to be drilled next year.

As illustrated in the upper right, both of these efforts are a key factor to driving sustained reduction in our unit development and production costs. The other factor is our obsessive focus on improving our capital and operating efficiencies, that is, getting more for every dollar spent. Our large, non-operated position provides us with a difficult-to-match competitive advantage to benchmark and learn in real-time from other operators in the basin.

The chart on the lower right shows that the royalty benefit alone leads to returns that are about 10 percentage points higher than a comparable well subject to the standard royalty burden. Our intent is to be highly competitive in our execution across the value chain and to then use our advantaged royalty position to target the very best financial returns in the Basin.

Slide 10 shows that we're making progress towards that objective. Assuming the same reference prices communicated previously [at the 2019 Security Analyst Meeting], we expect to be free cash flow positive next year, guidance we first provided at our 2018 Security Analyst Meeting and expect our operational cash flows to grow to nearly double the level of our C&E expenditures by 2023. In short, our production growth outlook, combined with our cost focus and discipline, should drive significant free cash flow growth in the coming years.

Our earnings are also expected to strengthen, exceeding $4 billion in 2023, which drives returns on capital employed of about 30%. These financial results are delivered by an optimized, ratable factory with relatively low execution risk. Doubling our production while generating leading returns on capital and positive free cash flow further demonstrates why this is such an attractive investment opportunity for the company and its shareholders. While we are excited by the financial future and value growth aspects of our Permian position, we are always focused on meeting these objectives in an environmentally and socially responsible manner.

Slide 11 highlights a few of these areas among many others where we are doing just that. We built a strategy early in our Permian development to manage our greenhouse gas emission levels. A key piece of this involves undertaking the right infrastructure planning and development across the value chain to avoid, wherever possible, the flaring of natural gas in order to produce. Recent competitive data shows we are leading the industry in this area. We are also investing in renewable energy sources to help power our operations, recently signing a green power purchase agreement that will provide us with 65 megawatts of electricity from renewable sources.

We use brackish and recycled produced water in lieu of freshwater. More than 98% of the water used in our well completions in the Permian Basin comes from these sources. And finally, we are working hard to ensure the communities located in West Texas and southeastern New Mexico both benefit from high levels of industry investment and are able to manage some of the pressures this investment have placed on local infrastructure. Chevron is a founding member of the Permian Strategic Partnership, or PSP, which is a coalition of Permian producers, service companies, and midstream service providers that are partnering with communities and the governments that support them to do that over the long-term.

To wrap up, slide 12 recaps how Chevron is positioned to win in any environment and how we differentiate ourselves from our competitors. I frequently close my presentations, both internally and externally, with this slide because I'm excited and proud of where our company is positioned competitively. And second, I think, the four elements of the Chevron story tie very well to what we are doing in the Permian, as they should.

As a company, we've built an advantage portfolio that's delivering strong cash flows. Our balance sheet is strong, and we have a low dividend breakeven price, positioning us to win in any environment. We follow a disciplined capital investment approach and have superior capacity to return cash to our shareholders.

Our Permian assets and future plans support these elements, and our Permian story is comprised of the very same ones. We have an advantaged acreage portfolio driven by its size, scale, diversity and legacy; in other words, low royalty characteristics. Our breakeven continues to decrease, and we follow a highly disciplined, returns-driven approach when funding existing and new development areas. This approach, which has been consistent over time, positions us well to provide superior cash returns to our shareholder, Chevron, which can then be returned to our investors.

That concludes my prepared remarks. And I think now we'll take a few questions from Jeanine. Thank you.

Jeanine Wai:
All right, so I'll kick it off with a couple of questions, and then we'll open it up if you all have any. Again, we also have the breakout room after this in Riverside, upstairs on the third floor. All right, this is going to be fun. Thanks Jeff.

Okay. So, in the current commodity environment, and as the industry has transitioned from exploration to development mode in the shale plays, the lowest-cost operator often wins. And you anticipate in the Permian, one of your slides, I believe, said that Chevron's per-unit development and production cost is anticipated to step down in 2019, improve a little bit more in 2020, and then maybe improve further from there. You also mentioned that you do great benchmarking data that says, as of 2018, Chevron was competitive with their non-op partners. So, from our

perspective, there has been a lot of buzz and a lot of questions about what we're calling "major mojo" in the Permian since you're bringing scale, balance sheet, and project management that we haven't seen before into the basin.

So, what do you think Chevron is doing differently from other smaller operators or independents in the basin? And maybe if you can ballpark the cost or productivity advantages that you think your scale, technology or project management expertise affords you?

Jeff Gustavson:
Great question. I'm not going to provide a specific estimate on the advantage. We've shown some great benchmarking information. We obsessively benchmark all of the competitors operating in the Basin and we use a structured performance improvement process to catch them where we're behind and get to top quartile results. That's really what we're focused on, cost discipline, returns, and value creation.

I'd say I have a lot of respect for a lot of the operators that are working in the Permian. We partner with many of these companies. We've learned a lot from these companies over the years. There's a lot of best practices that are shared between us and our partners. And we really appreciate those relationships that we have.

I think -- and I like "major mojo." It's a great term. I think what might be different about Chevron, for me it starts with the asset. It's a very large, diverse legacy asset. Its size allows us to prioritize and really focus on the best areas, using all of those learnings from a large non-op position that we rely upon. The legacy nature [of the asset], meaning it's low royalty, a lot of our acreage is either held by production or owned outright, the fee mineral acreage allows us to take a measured, disciplined, deliberate approach to development. We're not under a rush in most of our areas out in the Permian.

The other piece, that maybe the majors have an advantage and is coming from the large company that supports us. We rely on the corporate balance sheet right now to fund our operations and can see through some of these short-term cycles that we've experienced and not dramatically scale back investments. We can move people into and out of our operations from all over the world, bringing lessons learned from all of these assets that they support elsewhere. And that goes both ways. We can learn from the other shale and tight assets. I mentioned those in the presentation where we have operations. And those learnings go both ways. We have a dedicated technology projects and services organization in the company that's centralized, that supports us [Mid-continent or Permian?] with cutting-edge technology and project management in other ways.

And finally, it's a very long value chain in the Permian. Volumes are big. They don't stop in Midland or Waha. They won't stop in Houston or the Gulf Coast. We have a midstream organization. We have a downstream organization. We have an LNG trading organization. We have a chemicals company. All of those things will also help drive the best returns for our shareholders.

Jeanine Wai:
One of your slides described the Permian as a factory, a ratable factory. Are you at an optimized point yet? And if not, what needs to happen and where are the opportunities for the most improvements?

Jeff Gustavson:
We've made a lot of progress, as you can see on the slide, but I think you can always and we're always looking to be better, right? And so, I think you can always further optimize what we're doing. We are very pleased with our well performance results over the past few years. We've shown that in the EUR increases on the slide. I'm very pleased with our cost of finding and development, our completions performance. The cycle time and costs have improved dramatically over the last year, up to 18 months. I'm very pleased with the way we operate these assets and the focus

that the very large group has on reliability and some of the environmental factors that I spoke about. I'm very pleased with facilities performance and how that's improving. We're always focused on all of those items to see if we can get even better.

I think drilling has been a key focus area for us over the past year, and we're showing really great progress in that area as well. But then you step back, there's no asset that I've seen that has so many different functions that has to work in lockstep, in concert, completely aligned, focused on the right metrics that bring everybody together with such speed.

That's really where there's more of an optimization opportunity to make that factory, that you asked about and that I spoke of, really as ratable and as predictable as possible. And that extends beyond just the upstream operations into that long value chain that I spoke of previously.

The last optimization opportunity, and I think this is industry-wide, is in the application of technology. We've made a lot of progress there, but I think we're really in the early innings of that story, digital technology and some of the other subsurface technologies, to improve recovery from the shales that we're producing in the Permian.

Jeanine Wai:
Okay. And if you don't mind just digging in one layer there, so can you discuss your development plan in terms of sequencing? Is the plan to develop one bench at a time, multiple benches at a time? We had a discussion this morning about hitting all horizons.

And the reason why I'm asking is because I think there's a perception that the majors are pursuing really dense spacing. And the industry is learning, and we've had some fits and starts with that. So, can you just talk about how you plan on developing the different horizons? And we've seen some operators this year move to up-spacing in terms of their developments, a little bit more focus on ROR versus the NPV, we've had kind of an evolution for that.

Jeff Gustavson:
Yes. And I won't get super-specific here, but I'll provide maybe some broader context. I've gotten this question repeatedly over the last couple of days since being here. So, I think it's something that we can talk a little bit more about, going forward, leading up to our analyst meeting next spring.

But look, the answer is it depends. This is a really diverse basin, and we have a very large acreage position that spans the entire basin. There are areas where you're operating with multiple benches that all look very attractive. We don't use the term "cube development" in the company, but where benches are in communication and where they are attractive economically, they're ready to be developed, we'll co-develop those benches. Where you're in an area where you might have fewer benches, or the benches aren't as well defined or de-risked and there's not as much communication between benches, we will follow more of a drill a row approach, but you might move out in an area and focus on one bench, which leads to greater efficiencies but also comes with more facilities costs to stay in front of all that. So, we apply the best approach that works for a given area, that drives the most value for the company. And that will vary to certain degrees across the basin.

I think what's interesting about this asset, it's got a big project, major capital project feel to it, given its size, and we do want to bring some rigor, consistency, some standard to how we approach that. I think that's similar for our major competitors, but it's also a conglomeration of many smaller assets that are changing all the time, given all the activity in the basin. So, you do have to be nimble and work under different approaches over time. So, bringing those two together for us is really at the heart of the philosophy of how we develop these assets.

Jeanine Wai:

Okay. Well, I don't want to hog all the time. Are there any questions? There we go. And we're going to bring you a mic.

Unidentified Participant:
Great. Just picking up on one of your bullets to the disciplined returns-driven capital allocation, you've talked a lot about how it's implied internally in terms of opportunities within the Permian or elsewhere in terms of acquisition activity. How would you sort of reframe that disciplined returns-driven capital allocation? What benchmarks would you use for capital allocation applied to M&A in the Permian?

Jeff Gustavson:
Benchmarking as applied to M&A in the Permian?

Unidentified Participant:
Yes. What would be the key metrics you think about when you think about M&A? And do you think about M&A in the midcontinent or the Permian?

Jeff Gustavson:
Yes, so let me just go to the broad M&A question. I don't have a specific answer or something different in that regard. But on M&A, and Jeanine, we talked a little bit about this yesterday, given where the Chevron portfolio sits -- which is in a really strong position, and this goes back a number of years-- we're not under any pressure to transact. And I think we demonstrated that earlier this year, not to name any specific situations, but I think we proved that out.

That said, we're always looking. We'll take an opportunistic approach, like we always have, to M&A, and that includes what's going on in the Permian Basin. I'm not saying we will transact, but we're always looking. There's kind of three things to think about. There's got to be a strong strategic fit with any M&A that's even contemplated. And, any of the assets that are being looked at have to be competitive in what's a very strong existing portfolio. The worst thing you can do is go buy assets and have them sit on the shelf and not develop them.

And finally, it's got to make value sense for the company and our investors. When all three of those come together, if it's a large corporate or if it's a smaller assets or private acquisition, we've been shown that we'll transact, but that's the criteria we stick to, and we've always stuck to those.

Unidentified Participant:
Yes, good morning. So, my question is, is there a dark side to the major mojo? You spent most of the morning talking about optimizing corporate returns, getting more efficient, lowering your breakeven. But doesn't that really just mean lower price? And/or are you not simply saying, if I'm not going to drill at these returns, someone else is going to?

Jeff Gustavson:
It's an interesting premise. I don't see much of a dark side to being on the low end of the cost curve. We are focusing on returns and in value creation. And that really is an approach that hasn't changed for Chevron in any asset over a long period of time. Some of the broader -- certainly the shale development or the shale phenomenon or revolution, whatever you want to call it, has had an impact on the macro environment and on prices more generally. I think in that environment, and our CEO and Chairman, Mike Wirth, talks about -- winning in any environment, that's something that the industry -- all the players need to adjust to. Given where our portfolio is, I think we're doing quite well in making that adjustment. And a lot of that is built off of the anchor position that we have in one of the lowest cost basins in the world. So, I don't see the dark side in proceeding with that approach.

Jeanine Wai:

I'll hit back on the consolidation M&A question. Inventory goes hand-in-hand with kind of what we talked about with spacing and kind of prosecute the best wells first. How much of your inventory do you think roughly maybe you have left after you hit your 900,000 BOED target in 2023?

And I guess a follow-on to that is in the past I think you've described half of your inventory being highly productive. Any context on how you define that, I guess? And are you also a consolidator in the basin? I guess you already said that you're always looking, but maybe just stick to the inventory and how you define that.

Jeff Gustavson:
Yes. I think I answered the last one with my earlier comments, or at least I went as far as I can go. On the first one, it's a good question. We've shown a curve going out to 2023 which ends at 900,000 barrels a day, but that's certainly not where the story ends. We're looking out well beyond 2023. If you think about our position, we have tens and tens of thousands of wells that had been prioritized, both operated and non-operated wells that had been prioritized. And we're working on developing that queue.

We have 2.2 million acres across the base and over 11 million bench acres, if you look at the different benches that can be developed. We highlighted; we have 16 billion barrels of resource. So, if you look at what we'll produce at current activity levels over the next few years, that's just a portion of that overall inventory. And so, the story certainly extends. The production story and the value story extend well beyond 2023. We haven't provided specific guidance if it'll grow further or if it will plateau. I think those are all some things that we'll talk more about at our security analyst meeting in the spring.

Not all of those 16 billion barrels are created equally. We do focus on different tiers in the basin. You mentioned we see about half of our acreage today as being in some of the best areas in the basin, and that's a very long queue and a very long runway. That doesn't mean that the rest of that inventory is not valuable. It's just less understood than some of the core development areas and the core benches that are being developed in those areas.

But the acreage, and if you look at the map, we've put out there which shows our acreage position, a lot of the surrounding acreage is fee acreage, so we have time to wait. We're working on those areas at the right pace and hope to make those areas move into some of the more promising development areas that are currently under development. That should give everyone further confidence that we don't fall off a cliff production-wise in 2023. It's not going to happen.

Unidentified Participant:
What is the main driver of your pace of activity in the Permian? I know that production is just an output of the process but, given the current environment, would it make sense to go at a much slower pace? I think a lot of people are saying that the majors are maybe stepping on the accelerator at precisely the wrong time, whereas everyone else is pulling back. I know you're longer cycle in your outlook, but what drives that pace of activity in the short-term?

Jeff Gustavson:
I think you answered part of the question in the question. We do take a longer-term view, and it's important to have a ratable development plan when you're ramping up and you're ramping down. Going back to that factory optimization inefficiency, it hurts that efficiency. We worked, and we made some public statements saying we were targeting 20 rigs. We thought that was the optimal level of rigs for what we can see right now, the number of development areas and the returns in each of those development areas. We ranked development areas by return.

We don't fund everything that we could fund out there. We have to draw a line somewhere. We don't have unlimited capital from our corporation. We're a part of a much bigger portfolio, but we're very comfortable with that 20-rig pace for now. I think we're always looking at whether that is the right pace. And could that number go up or down over time? Absolutely, but we'll take a very measured, deliberate approach and a value-based approach when we make those decisions.

What we're really focused on right now is making those 20rigs that support that bigger factory operate as if they're 24 rigs or 28 rigs, right? If we can bring the efficiency up on a given rig, the overall absolute rig count is really not as meaningful as some may think. So that's how we're looking at going forward. And again, in the spring we tend to lay out our longer-term development plans, and I'm sure that's something we'll touch on at our Security Analyst Meeting.

Jeanine Wai:
All right. We're out of time. So, keep the conversation going, Riverside room upstairs in the third room -- third floor, and Jeff will be there. Jeff, it's been such a pleasure and a privilege. Thank you very much.

Jeff Gustavson:
Thanks, Jeanine. Thank you, everybody.