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EDITED TRANSCRIPT

CVX - Q3 2015 Chevron Corp Earnings Call

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OVERVIEW:

Co. reported 3Q15 earnings of $2b or $1.09 per diluted share.

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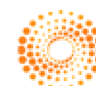

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PRESENTATION

Operator

Good morning, my name is Jonathan and I will be your conference facilitator today. Welcome to Chevron's third-quarter 2015 earnings conference call.

(Operator Instructions)

As a reminder, this conference call is being recorded. I would now like to turn the call over to Chairman and Chief Executive Officer of Chevron Corporation, Mr. John Watson. Please go ahead.

John Watson - *Chevron Corporation - Chairman & CEO*

Thanks, Jonathan. Welcome to Chevron's third-quarter earnings conference call and webcast. On the call with me today are Pat Yarrington, our Vice President and CFO who you know very well, and Frank Mount, our General Manager of Investor Relations. We will refer to the slides that are available on our website.

Before we get started please be reminded that this presentation contains estimates, projections and other forward-looking statements. We ask that you read that cautionary statement that is on slide 2.

I will now turn the call over to Pat who will take you through our financials briefly. Pat.

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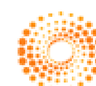

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Pat Yarrington - *Chevron Corporation - VP & CFO*

All right, thanks John. I will be presenting four slides on third-quarter results. Our normal earnings and production variance slides are available in the appendix section of the presentation which is available on our website.

Starting then with slide 3, an overview of our financial performance. Third-quarter earnings were $2 billion, or $1.09 per diluted share. Excluding foreign exchange and impairments, earnings totaled $1.9 billion, or $1.01 per share.

On this basis third-quarter results were modestly better than second quarter despite a much weaker oil market. This reconciliation is also available in the appendix.

Cash from operations for the quarter was $5.4 billion. Our debt ratio at quarter-end was just under 19%.

During the third quarter we paid $2 billion in dividends. Earlier in the week we declared $1.07 per share dividend payable in the fourth quarter. This takes our 2015 annual dividend to $4.28 per share and makes 2015 the 28th consecutive year where we have increased annual per share dividend payments.

Turning to slide 4 cash generated from operations was $5.4 billion during the third quarter and nearly $15 billion year to date. Downstream cash generation strength was sustained in the third quarter while Upstream cash flow fell, commensurate with an approximate 20% drop in global oil prices between quarters.

As of September 30 working capital FX reduced 2015 operating cash flow by $2.3 billion. Year-to-date proceeds from asset sales were $5.4 billion, bringing our total over the last seven quarters to more than $11 billion. We are tracking very well against our four-year asset divestment target of $15 billion.

Cash capital expenditures were $6.8 billion for the quarter, $800 million lower than second quarter. Year-to-date cash capital expenditures were $22 billion, down $3.6 billion or 14% compared to the same period in 2014.

At quarter-end our cash and cash equivalents were $13.2 billion and our net debt position was $22.6 billion. Debt issuance through nine months has amounted to $8 billion.

Slide 5 compares current-quarter earnings with the same period last year. Third-quarter 2015 earnings were approximately $3.6 billion lower than third-quarter 2014 results.

Upstream earnings decreased $4.6 billion between quarters, virtually all of this related to significantly lower realizations between periods. Downstream results increased by $824 million, primarily driven by higher margins and favorable foreign exchange effects, partially offset by the absence of third-quarter 2014 gains on asset sales. The variance in the other segment was mainly lower environmental reserve additions, in particular the absence of a reserve taken last year in the third quarter related to a closed mining operation.

I will now compare results for the third-quarter 2015 with the second quarter of 2015. Third-quarter earnings were $1.5 billion higher than second-quarter results. Upstream earnings increased by $2.3 billion, primarily reflecting the absence of second-quarter impairments and other related charges worth $2.6 billion.

Lower realizations reduced earnings between quarters but a favorable swing in foreign exchange and lower exploration expenses were largely offsetting. Downstream earnings decreased $745 million, mainly due to the absence of a $1.7 billion in asset sale gains recorded in the second quarter.

The current quarter also saw stronger margins and volumes, particularly in the US, favorable foreign exchange impacts as well as lower operating expenses and positive timing effects in the face of declining prices. The variance in the other segment was primarily unfavorable tax items, partially offset by lower corporate charges.

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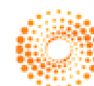

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John will now provide an update on our current priorities and focus areas.

John Watson - *Chevron Corporation - Chairman & CEO*

Okay, thanks Pat. Turning to slide 7, I would like to start by reinforcing that our priorities, financial priorities are unchanged. Our first priority is to maintain the dividend and grow it as a pattern of earnings and cash flow permit.

As Pat mentioned we announced our quarterly dividend earlier this week and are very proud of the fact that we've increased the annual per share payout for 28 consecutive years. Back in March we committed to delivering free cash flow to cover the dividend in 2017. At the time the futures market was envisioning $70 prices in 2017.

Today the futures market is lower but our intent remains the same. Our goal is to balance our cash equation by completing projects under construction and reducing capital spend and operating expenses to levels consistent with the current market conditions.

We will also continue to divest assets where we can obtain good value. We will achieve this while operating all our businesses safely and reliably.

I will address each topic on this slide on the slides that follow. First, moving to an overview of the market it is clear that low prices have reduced upstream earnings for the sector and for Chevron we're no exception. Prices are low because the market is producing more than consumers want but the markets are showing signs of rebalancing.

Using Wood Mac data this chart depicts worldwide liquid supply with the black line and demand in red. The blue represents the shortfall from or surplus to inventory. In the early part of the decade the pattern was clear, supply could not keep up with demand in part because of supply disruptions in the Middle East and North Africa.

The success of shale in the US and some growing production from Iraq allowed the market to rebalance for the first several months of 2014. However, note the spike in production when the Saudis increased production and the shale growth continued its surge in late 2014.

The resultant 2 million barrels per day surplus has pushed prices down. Suppliers are adjusting.

World production peaked in turn down last month. US production, particularly shales, has peaked and is now in decline. We expect this trend to continue and accelerate at current prices.

Demand is strong as low prices provide stimulus to consumers in the US and elsewhere, leading to annual growth of 1 million to 1.5 million barrels per day. Markets will likely rebalance at some point next year. Those seasonal demand patterns are apt to blur the exact timing.

With a new equilibrium will come price recovery which is one of the levers that will help balance our cash equation. While we're confident in a price recovery the timing of course is uncertain. We're taking actions that will allow Chevron to compete effectively in a low price environment while positioning us effectively for value growth over the longer term.

Turning to slide 9, a second lever to help us balance cash flow is volume growth. As most are aware we expect to see a significant inflection point over the next two years as a number of major capital projects move from being cash consumers to cash generators. Gorgon and Wheatstone are obvious contributors but the list is long starting with Lianzi in West Africa.

Over the next several quarters we expect a progression of startups that will include Angola LNG, Mafumeira Sul, Moho Nord, Sonam, all these are in West Africa. Chuandongbei in China, the Bangka development in Indonesia, Alder in the North Sea, the Chevron Phillips chemical project on the US Gulf Coast and of course three trains at Gorgon and two trains at Wheatstone.

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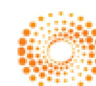

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Our strong shale and tight portfolio, particularly in the Permian gives us low-cost, short cycle investment opportunities that nicely supplement production growth from the major capital projects. In the shale and tight class are focuses on highgrading our investment opportunities to maximize returns and cash flow. We like our portfolio diversity which when market conditions improve will provide growth opportunities.

Turning to slide 10, we're in the final stages of commissioning systems to allow startup of train 1 at Gorgon. At the plant our focus is on starting up the process units ahead of commencing liquefaction and LNG cooldown cargo is planned to arrive in mid-December to assist in cooling down the LNG tanks and associated facilities prior to first LNG export.

The Jansz-Io field subsea infrastructure is fully complete. We have opened the first two wells to the Jansz pipeline, confirming the full operability of these subsea systems. Our current outlook for loading the first LNG cargo is early 2016.

We are continuing to make good progress on trains 2 and 3 with all train 2 and nine of 13 train 3 modules installed and hookups underway. At Wheatstone all subsea infrastructure and over 100 kilometers of flow lines have been installed. Hook up and commissioning of the offshore platform continues on plan.

All nine wells are drilled to the top of the reservoir with four of nine wells now completed and subsea trees installed. At the plant 17 of the 24 modules required for first LNG have been delivered and all refrigeration compressors and gas turbine generators have been installed. Installation of all pipe racks and electrical switchgear buildings on the product loading facility is now complete as is startup of the power systems and the plant operations center.

We are still targeting the first LNG cargo by year-end 2016. However, we continue to work to mitigate Wheatstone's schedule pressures from previous delays and module delivery.

We've posted some new pictures today. And I encourage you to look at them on our investor website at Chevron.com.

Turning to slide 11, another lever to deliver free cash flow is reduced capital spending. As indicated during our March Analyst Day we have significant flexibility in our capital program as we complete projects under construction. Given the near-term price outlook we are exercising more discretion in pacing projects that have not reached final investment decision.

We are also negotiating cost reductions from suppliers. Overall our investment programs are being set at levels that will enable us to complete and ramp up the projects under construction, fund high return, short cycle investments, preserve options for viable long cycle projects and finally ensure safe, reliable operations.

We expect capital exploratory spend in 2016 to be in the range of $25 billion to $28 billion, down from $35 billion this year. We expect further reductions in 2017 and 2018 into the $20 billion to $24 billion range depending on business conditions.

Of specific note the plan does include funding for the wellhead pressure management and future growth project at Tengiz in Kazakhstan which has undergone rigorous engineering and readiness reviews based on our learnings from other projects.

Turning to slide 12 to another cash flow improvement lever, we're working on reducing costs across the Company and are beginning to see the results. Compared to prior year-to-date periods enterprise operating costs are 7% lower, in the third-quarter to third-quarter comparison are 12% lower.

On another basis year-to-date Upstream unit operating expenses are down 13% versus last year. At this point we've identified spend reductions of approximately $4 billion on an annual full run rate basis. About half of this is coming through organizational reviews and portfolio rationalization and about half working through the supply chain.

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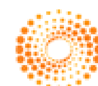

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On the organizational side lower investment activity, portfolio changes and efficiency reviews across the Upstream, Gas and Midstream and the corporate and service company groups are expected to result in employee reductions of between 6,000 to 7,000. A similar number of contractor reductions are anticipated over this same period.

Supply chain initiatives including rate reductions, greater equipment standardization, project re-scoping and timing optimization are expected to contribute approximately $2 billion also on an annual run rate basis. An example, we're leveraging our enterprise spend for drill pipe across the Company and we're seeing cost reductions of up to 35%. These supply chain benefits will show up as lower operating expense, lower capital expenditures and lower cost of goods sold.

Finally, we're seeing efficiency improvements throughout the organization which are driving improved value capture. As an example, in the last year we had seen the drilling cycle time from spud to rig release reduced by 55% within our Permian horizontal drilling program.

Turning to slide 13, a final cash flow lever is asset sales. These are a normal part of portfolio work and contribute proceeds to help manage the balance sheet. We divest assets that no longer have a strategic fit or where we no longer see the cost effective application of our technology, where future investments do not compete for capital within our portfolio and where we can obtain good value. So there are a number of drivers on asset sales.

As you know we made a commitment to generate $15 billion from the asset sales program from 2014 through 2017 and over the last seven quarters we've made real good progress and achieved $11 billion of this goal. From today out through 2017 we could see another $10 billion in sales proceeds. There is a range around this new expectation because of uncertainties on future market conditions, we're only going to sell assets where we can obtain good value.

Turning to slide 14, we expect to end this year within the production guidance range we provided back in January. Over the next couple of years you will see the growth projects we've talked about for some time come onstream.

Gorgon and Wheatstone and Angola LNG are collectively expected to provide the majority of our volume growth. This growth will not be realized at one time as there is a ramp up over three years and there is variability depending upon start date. We expect offshore projects, the majority coming from West Africa, also to be a significant part of our growth.

Our projected shale and tight ramp up is steady though the current price environment is expected to lead to a slower pace of growth than we anticipated at our March Analyst Day. Similarly, our future base business spending is influenced by the current environment and its impact on economics and partner funding capabilities. We anticipate lower base business spending and as a result expect to see higher decline rates compared to our more recent pattern.

Under these assumptions we're anticipating a 13% to 15% increase in production from year-end 2015 to a range of between 2.9 million and 3 million barrels per day in 2017. In 2018 we expect volume growth momentum to continue largely because of project ramp up schedules.

Note this range excludes the impact of divestments. Their specific timing is difficult to predict.

Actual production growth is also dependent upon production sharing contract effects and the Partitioned Zone restart timing. We will issue further guidance for 2016 production as we normally would in January.

Turning to slide 15 that brings me back where I started. We like the go-forward prospect for energy as we are constructive on the long-term price outlook but sober about the current realities of lower prices. We have consistent and clear financial priorities.

We are taking significant action to balance the cash equations and cover the dividend with free cash flow by 2017. We expect to deliver volume growth and emerge on the other side of this downturn leaner and better. All of our actions are geared toward delivering value through dividend growth and stock price appreciation.

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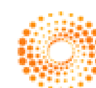

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That concludes our prepared remarks. We're now ready to take some questions.

Keep in mind that we have a full queue, so please try to limit yourself to one question and one follow-up if necessary. We will do our best to get all of your questions answered. Jonathan, please open the lines for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Phil Gresh, JPMorgan.

Phil Gresh - *JPMorgan - Analyst*

Hi, good morning. John, thanks for the full update here. My first question is that one of the criticisms I continue to hear from investors about big oil is that most of the companies in the industry are just trying to manage to dividend coverage at a point in the cycle rather than through the cycle.

And I fully appreciate Chevron has a full stable of capital projects over these past few years so the spending flexibility is very high. But I was hoping you could just help us tie this new capital spending guidance to what kind of underlying capital spending would be required to keep production flat or what kind of long-term growth rate do you think Chevron could achieve using this lower capital base?

John Watson - *Chevron Corporation - Chairman & CEO*

You know it's a fair question. We do try to invest through the cycle. We got into a period at the early part of this decade where we had some good projects that were frankly stacked up on top of one another.

We thought it was the right time to take Gorgon forward. We had good contracts in place and frankly it was somewhat countercyclical when we started in 2009, very late in 2009. Wheatstone very similar, we thought it was a good market and we needed to move that one as well.

We also had Gulf of Mexico projects that from following the moratorium in the Gulf of Mexico came on we started at the same time. So we went through a period of capital spend that was pretty high. We thought these were very good projects but there's no doubt that we were going through a period of heavy capital spend and we kept our balance sheet pretty strong to enable us to withstand the ups and downs that we see in the market.

Now we saw prices rise dramatically and then we've seen them come back down a little harder than we thought. So we do have to manage through this cycle but I think we've been able to weather that pretty well. We are completing the projects that we've got.

We're working to preserve the options that we have on some of the nice opportunities we have going forward. But we do have to live within our means here. And if you look at, as you know very well, when we look at the pattern of dividends it's a nice smooth pattern with increases over 28 years.

The pattern of earnings is a lot more volatile during that period depending upon commodity prices. So we do invest through the cycle with some of these long projects. We have to be able to do that.

But we have had a period of heavy spend that we've had to go through. So there is an adjustment when prices go from $100 to $50 and we're just having to deal with that. But certainly we're investing through the cycle but making some adjustments to deal with the low prices we've got.

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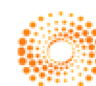

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Phil Gresh - *JPMorgan - Analyst*

Is there a specific growth rate you think you can achieve with this new spending base?

John Watson - *Chevron Corporation - Chairman & CEO*

Certainly we're going to see disproportionately strong growth through 2017, frankly into 2018 that we think will be very good. Long-term, overall hydrocarbons are growing in the 1% to 1.5% range and so that's probably a more reasonable expectation going forward. But frankly we make our investment decisions based on what we can do that is economic.

If you look at the history for companies our size, growing at something significantly greater than where aggregate demand for oil and gas is growing is pretty hard to do. And frankly we'll be guided by what we think we can do economically. We will give you a little bit more information on what we think post-2017 as we finalize our business plan.

We're still grinding --the reason we gave you a range on some of these capital numbers is we're still grinding through that business plan right now to be sure we strike the right balance. And that level of spending will dictate what the growth will be in some of the out years.

Just so you have some confidence, though, I made specific comments on the future growth project, the wellhead pressure management project, in Tengiz as one example of investing through the cycle. And that's a significant project which we're working through final details with government and partner.

But we're doing a lot of early work on the project and that's one as we take final investment decision we won't see the production from that until the next decade. So that and other investments will provide growth going forward.

Phil Gresh - *JPMorgan - Analyst*

Thank you.

Operator

Paul Cheng, Barclays.

Paul Cheng - *Barclays Capital - Analyst*

Thank you. Hey guys, good morning. John, two questions.

One is really short and let me go for that first. With the cutback in the CapEx you're saying that the base operation decline rate will be higher. I think for the last five years you guys have been about 3% to 4%. Do you have a new number for us?

John Watson - *Chevron Corporation - Chairman & CEO*

Yes, actually we've been better than that. Our base business has been more like 1% or it's been less than 2% certainly during that period and we see it being more like 3%. And so frankly if you take just the difference between about 1% and 3% and apply it to our base level of production you get a little bit lower production than you might have seen otherwise.

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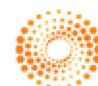

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Paul Cheng - *Barclays Capital - Analyst*

Excellent. Second one is a little bit more strategic I think. If we look at the hallmark for Chevron has always been under LNG, deepwater megaproject development.

But I think the market is concerned this type of development, the supply cost curve has increasingly to its the last several years at the high-end of the industry and that also that the recent cost division that they have not seen as much comparing to the soft cycle. So the question is do you agree with that view and is concerned that the hallmark of the Company what you're good at and up to be at the high-end of the supply cost curve? And if you sort of agree with that, what initiative that Chevron is taking to try to improve your cost curve position so that they will become say at the top quartile or top half at least?

John Watson - *Chevron Corporation - Chairman & CEO*

That is a philosophical question and I will give it a few comments. First I think it's true that onshore costs have come down more than offshore costs. So I think that's just factually true particularly in the United States but also around the world.

So rig rates and service costs, things of that sort. So that certainly is true.

It's also true that some short cycle based business spend traditionally has lower cost once you have infrastructure in place and it's certainly true that some of the shales are low-cost. I think what's important, though, is if you step back and look at the market overall it's a 95 million barrel a day market.

The shales are about 5 million barrels a day and there is a decline curve that's very rapid in the shales but also of course in every other producing asset. It's going to take contributions from all asset classes to meet demand. So we're going to need all forms of supply.

What we're doing is trying to take on cost reductions and get better everywhere to take cost down. And we've been able to do that. We've shown you some charts periodically, and offshore is about 25% of worldwide production, and deepwater production continues to grow and will continue to make contributions to worldwide supply.

But if you look at drilling and completions technology we've talked about things like the single trip multizone frac pack which is just more efficient way of getting in and out of the hole to do work. If you look at ocean bottom nodes work that we're doing, that really gives us better seismic imaging on the ocean floor subsea systems and boosting technology, all these things are bringing cost down.

In fact, in our Gulf of Mexico operations, our deepwater, we've been able to reduce drilling days significantly. Our drilling days per 10,000 feet are down 25% over the last two years. So we've been able to take those costs down.

I think you're also likely to see the work that we did in the Gulf of Mexico to consolidate holdings, for the industry to collaborate to create hub class developments will also help with economies of scale. So I think you'll see bigger hubs, but I think all classes of assets at the current low prices will have some spending that will fall out.

So some of your points are true, but I think you'll see costs over time come down everywhere and of course these projects are over a long period of time. LNG are 40-year projects, so you have a different lifecycle to these things as well. Some of the long cycle LNG tend to be, because they are long cycle, tend to be a little bit lower than in RORs but they have a very long life in cash flow. So they have a little different characteristic to them.

Paul Cheng - *Barclays Capital - Analyst*

Thanks very much.

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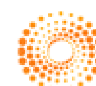

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Operator

Ed Westlake, Credit Suisse.

Ed Westlake - *Credit Suisse - Analyst*

Good morning. Thanks for all of the color. Just on the opening remarks I think you said slower ramp up on projects.

I presume that's going to be LNG just looking at the cartoon which you put in the presentation in terms of LNG volumes. Maybe just a bit of a color around Gorgon and Wheatstone. Thanks.

John Watson - *Chevron Corporation - Chairman & CEO*

Well we said that the ramp up would take place over time. The key is getting them started and getting first LNG and then the ramp up will take place over time. So all I was trying to say with the ramp up is they will take place over the next three years.

My comment wasn't so much about the ramp up as it was that there will be a start date. Just in terms of what we're expecting I indicated that Gorgon will see first cargo in the first quarter. I had updates yesterday afternoon on both Gorgon and Wheatstone, I was pleased with the progress that I heard.

I gave you some of the key points that are kind of proof points to where we're headed there. ALNG will start up early next year as well. There's no secret that this has been a challenge as we've worked through some of the engineering issues.

But once that gets started, I think we've addressed some of the engineering issues that we encountered. There were also some technical bulletins that were issued by the technology owner and we took care of those as well during this downtime. So ALNG will start up early next year as well and my update on Wheatstone, the key issue there has been module delivery.

We had some modules out of Malaysia that were late, and the team is working very hard to mitigate schedule there. What I mean by that is with some delay in modules we're really now looking at both construction timing and some of the startup and commissioning work that will need to be done.

We've taken a close look at all the other projects that have been done in Australia and elsewhere on the east coast of Australia and Gorgon and really looking to see if we can take time, taking time out of those schedules by really taking all the best practices that were effective in those projects to keep us back on a fourth-quarter 2016 startup schedule. So the work is progressing well. The point in having a range on production is really that a quarter one way or another when you've got projects that could go up to 200,000 barrels a day at full capacity makes a difference and so it's just reflecting that reality.

Ed Westlake - *Credit Suisse - Analyst*

Yes, okay. Second question is on cash flow maybe for Pat or John. So you can see this year you've done $17.2 billion before working capital so you could gross that up and say $23 billion.

Obviously you've got these new projects so they will add cash and your cash CapEx is going down, sorry, your overall group CapEx is going down to $20 billion to $24 billion. So you can see how the dividends are sustainable in sort of this year conditions. So that works fine.

It's still a long way away from the cash flow that was presented a few years back at higher oil prices. So I guess my question is is there anything this year in the cash generation of the Company that you feel has underperformed because I guess the downstream has been pretty strong. Maybe it's startup costs in some of these projects.

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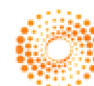

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John Watson - *Chevron Corporation - Chairman & CEO*

Actually I think if you look at our cash flow and the rule of thumb that we gave you for the effect of oil prices was roughly $350 million after-tax and earnings and cash flow for every dollar per barrel. And you multiply that by the change in barrels I think you'd find our cash flow is better than what you might expect by that rule of thumb. Now we're trying to diminish or reduce that rule of thumb by taking on costs and other things to get better at what we do.

But I think you'd find that between those rules of thumb for oil and gas, I think you'd find that it'spretty consistent with that and in fact it's better because our downstream has performed so well. So the grim reality is when you have oil prices in the 40s as we saw in the third quarter as you look across the sector, particularly in the United States, it's tough sledding and if you've got natural gas prices where they are in the US, it's a challenge. But we're taking it on by reducing cost.

You saw some of the pretty aggressive actions that we are taking around the world to size the organization at the right level. And we think if we get some recovery in prices you'll see a nice pop from that. But I can't control prices, I can only control my cost and spend.

Ed Westlake - *Credit Suisse - Analyst*

So it's just oil sensitivity. I understand. Thanks.

Operator

Jason Gammel, Jefferies.

Jason Gammel - *Jefferies & Company - Analyst*

Yes, thanks very much. Hi everyone.

You've already touched on a lot of the drivers here, John, but I was just trying to reconcile the new production range of 2.9 to 3.0 relative to the 3.1 million barrels a day that was presented at the Analyst Meeting. And I wasn't really clear whether the Partitioned Zone was included in the 2.9 million to 3.0 million or whether it's out because that's obviously a big reconciling factor. And then how much of it would essentially just be production being pushed into 2018 versus an actual lower production figure from declines?

John Watson - *Chevron Corporation - Chairman & CEO*

There are lots of effects that are in there. First off the biggest effect in the change versus what we've talked about previously was my comment on declines. We've taken, depending upon which numbers and the range you want to use, we've taken $15 billion of capital out of the business in the go-forward projections from 2016 and 2017 in total and that impacts, as I said, base declines.

So if you add 2% to the decline that's 100,000 barrels a day over a couple of years. So that's number one.

But to answer your question about the Partitioned Zone, that production a year ago was roughly 80,000 barrels a day. And if you look at where we expected to be in 2017, it was somewhere under 70,000 barrels a day, and that is included in both estimates. We expect to be back online by that time.

I just returned from the Middle East and I'll that tell you this has been pretty perplexing to me why we remain shut in. You have two great allies in Saudi Arabia and Kuwait who are having a disagreement over administrative matters in the Partitioned Zone between Saudi Arabia and Kuwait. It's in the Kuwaiti portion of the zone and so they administer work visas, equipment permits and things like that and they stopped issuing them.

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So we ended up shutting-in in May and so we've lost the better part of 80,000 barrels a day net to our production. And the reason I think production will come back is because the Kuwaitis themselves are actually being hurt by shutting in a gross amount of 200,000 barrels a day, half of which is theirs. They are hurt, Chevron is hurt but Saudi Arabia is able to increase production elsewhere.

So I think there's motivation for the Kuwaitis to begin issuing work permits and allowing work to continue while whatever disputes are resolved and our plan is for that production to come back by 2017. In terms of other factors that are out there, we are highgrading some of the investment that we're doing in the shales, so while the growth profile will be nice, it will be a little lower. Certainly in the gas area we've curtailed spending.

We have really gotten our cost down very well in the Marcellus. We can compete with anybody there now, but nobody makes money that I'm aware of at $1.50 gas which is where we are now and futures prices remain low. So we can compete with anybody, but for the time being we're scaling back investment there.

So these are the kinds of effects that we've rolled in as well as schedule and timing of projects. A notable change from where we had been previously, of course, is Big Foot which we show no production in 2017.

Jason Gammel - *Jefferies & Company - Analyst*

Okay, that's obviously a big factor. Great.

And John if I could just as a follow-up I think you kind of answered this in your response here but if I'm looking at the capital spend slide from again the Analyst Meeting it was looking at $32 billion or so of capital spending 2016 with some flexibility around that. Is the incremental flexibility that you've identified in the numbers you put forward today mostly coming out of that base investment which is why you're seeing the higher decline curves?

John Watson - *Chevron Corporation - Chairman & CEO*

It's a little bit of both. At $70 when we presented the information that we did to you earlier, that was with the expectation that we would be able to take costs out and that certain projects would continue. So we had funding in those out years.

Again some of it was ultimately discretionary around certain projects. Some of that has been removed or deferred in some cases and that is just reflecting the realities that we're seeing lower prices. So there is some large projects but there is also a good chunk of it that's coming in the base investment area.

Operator

Doug Leggate, Bank of America Merrill Lynch.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Thanks. Good morning everyone. Good morning John.

John, I'm wondering first of all you've given a lot of information this morning. We really appreciate that. So thank you for all the disclosure.

But when we get to 2017 let's assume your prognosis on oil prices or at least the supply-demand balance is a little bit more optimistic, how does Chevron's strategic go-forward view change in terms of perhaps re-upping into another round of large-scale projects of which you clearly have plenty of options versus staying with the short cycle I guess flexibility until this sorts itself out?

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What's really at the back of my mind is I'm curious if you feel that you've got a big enough footprint to offer you that kind of flexibility? And I've got a quick follow-up please.

John Watson - *Chevron Corporation - Chairman & CEO*

Yes, it's a very fair question. I commented a little bit earlier as you know well, Doug, we went through this period with a number of projects stacked on top of one another. I don't think you'll ever see something like that in our -- it was a series of circumstances that got us in that position.

I don't think you're likely to see that. We do have a good queue of projects. I talked about the Anchor discovery which could mature into a project and we've got others.

So we will take the best of those projects and move them forward but I think on balance you'll see a higher proportion of shorter cycle spend. Five to seven years ago we didn't really have a good understanding of our Permian Basin position for example. So you will see over time additional monies that will go to the shale developments.

And I mentioned that I had some reviews with my business units yesterday, I also had reviews with my four shale organizations which are nicely sharing their successes and the Permian is doing well. I mentioned the Marcellus is doing very well.

The Duvernay in Canada, they've taken the practices and implemented them very quickly to get down the cost curve. And we're working closely with YPF and trying to put those same practices in place. We've delineated, we know where the sweet spots are down there, now we're starting a horizontal drilling program and we expect to get better.

But I think you'll see a more balanced portfolio and I think you'll see projects that will have good economics at moderate prices as we work to standardize and take cost down. So we'll have some optionality in the portfolio and I can't envision having two big LNG projects at the same time. The Tengiz project is a significant capital project but I don't see anything like having two Gorgon and Wheatstones plus several deepwater developments stacked on top of one another.

Doug Leggate - *BofA Merrill Lynch - Analyst*

I appreciate the answer, John. My follow-up is really -- is kind of on the headcount reduction and the fact that you are now getting to the point where these major developments are coming on stream. Are there any portfolio consequences of having to amortize or rationalize a smaller headcount across a much larger portfolio? And of course, the tale changes when Gorgon and Wheatstone come on.

So I'm just wondering if outside of the disposals you've given us so far, is there another round of portfolio restructuring that we should maybe look for at some point in Chevron's future? And I'll leave it there. Thanks.

John Watson - *Chevron Corporation - Chairman & CEO*

Yes, there are some changes that will happen in the portfolio. First, just a general comment on the people reductions. One of the large areas for reductions is in Australia. As we ramp down these projects, obviously you need fewer people. That was known, and in most cases we had -- Australia has a provision for fixed term employees. So some of those people will be coming off the payroll.

We've got a significant reorganization that's taking place in Angola and frankly, as we've gone through our business units and gone through our portfolio, we have found ways to make our organization simpler. I don't know any other way to say it. So we will be seeing reductions in a lot of different places. Some of them have already happened in the Marcellus, in the North Sea, and in our home offices. So we've seen those kinds of reductions.

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There is some portfolio work that some of it I would classify as normal as assets mature. You saw, for example, we sold our Netherland operations. Our view was that the Chad business was sort of on that -- a lot of the value had already been extracted, so we sold out of that business. And so there are assets that get mature where another operator, as you know well, there are smaller companies or others that want to grind out that last little bit of value that may take on opportunities that won't fit in our portfolio, and so sometimes there's a good match for them and we'll sell those.

Those can result in reduced employees and I expect it will. But I would classify that as a normal part of our business.

These reductions don't include any -- the reductions that were forecasted don't include a major portion of the divestitures. The divestiture portion at this point is looked at as maybe 10% of that employee reduction. I would classify it as more routine activity.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Thanks very much, John.

Operator

Evan Calio, Morgan Stanley.

Evan Calio - *Morgan Stanley - Analyst*

Good morning everybody. You've covered a lot of ground today so thank you.

John, I know other than matching the cash flows improving upon project execution is a key focus for you and Chevron, positive advances in the quarter. Can you discuss the changes you've made here and your confidence that execution will improve as you move through this key execution phase?

John Watson - *Chevron Corporation - Chairman & CEO*

Yes, you're right. We are focused on that. Jay Johnson went through some of those in a little bit of detail and Jay of course is really good on projects and I guess I would say there are a couple of things that I would highlight.

I mentioned Angola LNG earlier and that is symptomatic of something that's hit the industry, I think overall, and that is engineering and engineering maturity. And so we simply have to, in order to have a better understanding of what we're going to build, we have to advance engineering further.

So understanding pipe diameter and things down to a more granular level so that we know what materials we're going to need and we can do better cost estimates is I would say number one. And the example we've given is the Tengiz project which is a big one that we'll move forward with here, but that one we're 35% done with the engineering now and we'll be somewhere close to 50% by the time we take final investment decision. So that's number one.

But once you complete the engineering you also have to do more reviews of that engineering and I would say at a higher level taking a look at constructability of facilities so that you don't -- so that you're sure what you build really is what you want. And I'll give you an example. One of the changes we're making in Angola LNG is designing more flexibility in the front end of the plant.

It's an associated gas project and so there's greater variability in feed quality. And I think if we had done more work at the front end perhaps we would have designed that with more flexibility in mind. So those are the kinds of things that we're going to need to do.

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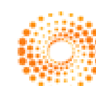

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We also have to be very cognizant of the contracting work that is -- of the kind of contract that you sign and what incentives are in that contract for the contractor. And that will dictate the level of oversight better.

We're likely, for example, on the Tengiz project to do more in the way of coordinating the activity of subcontractors on that job ourselves. So all of these things I think are going to make us better, not to mention the usual things around quality assurance that the industry has seen and things of that sort. So the answer is yes, we're working on improving execution.

Evan Calio - *Morgan Stanley - Analyst*

Great. And my second question on Anchor looks like great appraisal results.

Any comments on reservoir quality, size range or next appraisal steps? And maybe even somewhat related to Doug's question before, I mean in a down cycle do you see an advantage in developing these longer cycle assets where you can cement or secure a lower cost structure versus an onshore asset where you've benefited faster on cost savings but you will I presume they will reflate over time with a higher decline rate, maybe how do you think about that?

John Watson - *Chevron Corporation - Chairman & CEO*

Yes, we have to -- we just finished the second well and so we're going to drill -- we're likely to have another appraisal well that -- we're sort of assessing those results. It's likely to be a hub scale type development.

You recall we've said previously that hub scale assets are going to be 400 million to 500 million barrel type developments and so we feel pretty good about this one. We've got more work to do but we feel pretty good. As far as doing them off-cycle this one needs more work to do before we can progress it, so there's a cycle time to that.

Costs I don't want to give you the wrong impression. Costs have come down. Deepwater rig rates, you can get deepwater rigs a lot less than previously.

They have come down. I think the opportunity, if you talk to some of the equipment providers, they would say the industry can do a better job in standardizing to help them drive cost down.

I think the tendency is to think we can continue to extract money out of the supply chain just based on working rates down. But we also have to work with them to help them become more efficient in what they do. And finally some of the big cost reductions are in drilling efficiency which I noted earlier.

So our view, just to be clear, our view is that hub class developments in that 400 million to 500 million barrel range can be developed at moderate prices that wouldn't be out of line with the kinds of prices you all are thinking about and that tiebacks in the 100 million to 200 million barrel category can also be economic. But we're going through our plans right now doing exactly what you described and trying to decide which of these to move counter cyclically and which are just going to have to wait.

Evan Calio - *Morgan Stanley - Analyst*

Makes sense. Thanks John.

Operator

Paul Sankey, Wolfe Research.

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Paul Sankey - *Wolfe Research - Analyst*

Hi everyone. John, a year ago you were guiding to $40 billion of spending in 2017. Now you're guiding to $20 billion to $24 billion.

Can you break down what comprises that $15 billion? And just a very quick follow up as well, can you give us the start date for Tengiz? Thank you.

John Watson - *Chevron Corporation - Chairman & CEO*

You're saying a year ago. If you're saying before oil prices dropped, yes, we were guiding to higher level of spend because we've got a good queue of projects and that would be the opportunity set that we would contemplate.

Paul Sankey - *Wolfe Research - Analyst*

Yes, I guess what I wanted to know is what projects, how much of it is cost saving, how much of it is deferred projects, which projects have been deferred, the specifics of where we got the $15 billion to $20 billion of savings from?

John Watson - *Chevron Corporation - Chairman & CEO*

It's across the board. There are some specific projects.

An example, you know we talked about the Rosebank project. We've talked about the Indonesia deepwater development project.

Both of those are not in these forecasts in terms of significant spend during the planned period. I think both projects will ultimately go.

Kitimat was on our list. We're pacing that project as well. Multiple Angola projects were in pre-FEED.

So there were a lot of projects. Bear in mind some of these projects we think will go. And it could be that they start in the third year of the plan but for now a lot of these have come out and we are going to pace them.

Paul Sankey - *Wolfe Research - Analyst*

Would I guesstimate that about half of it is cost savings from lower prices and half is deferred projects? Is that I'm guesstimating I just wondered.

John Watson - *Chevron Corporation - Chairman & CEO*

Paul, look, I don't have a precise number for it. Certainly our view of development costs for the shales have come down significantly during that period but I don't have a good breakdown for you on that. Sorry.

Paul Sankey - *Wolfe Research - Analyst*

Okay. And just the startup for Tengiz?

John Watson - *Chevron Corporation - Chairman & CEO*

Well, it's a function of when we take FID. But we will give you more details on it. But you can think of it as being into the next decade.

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Paul Sankey - *Wolfe Research - Analyst*

But just to be clear I think that you said that the spending in the 2017 number does include some Tengiz spending?

John Watson - *Chevron Corporation - Chairman & CEO*

It does, it does. We've been doing work to get the port ready. We've been doing work on site infrastructure.

One of the lessons learned on these big capital projects is that you need to take care of some of these certainly long leads in certain cases and site infrastructure and preparation work. So we're spending some money as a part of the FEED work that we're doing to get greater certainty on costs but this is a five-plus-year construction project. So you can think of it as being into the next decade and we will give you more detail after we take FID.

Paul Sankey - *Wolfe Research - Analyst*

Thank you, sir.

Operator

Blake Fernandez, Howard Weil.

Blake Fernandez - *Howard Weil Incorporated - Analyst*

Folks, good morning. Just two quick points of clarity if I could.

For one I presume that the CapEx numbers you're providing here include equity affiliate spend. I think historically that's trended around $4 billion and has been self-funding. I'm just trying to see if for one making sure that is in there and is that a fair estimate in those numbers?

And then secondly US natural gas has been ramping up pretty healthy as far as production is concerned. John you mentioned low breakeven on Marcellus, I just wanted to confirm is that the main driver of that? Thanks much.

John Watson - *Chevron Corporation - Chairman & CEO*

The answer is yes, it's $4 billion to $5 billion in equity and affiliate spend. Remember as we ramp up the Tengiz project we've got the CP Chem project, you know we've got some significant spending that's taking place in affiliates.

And your second question on Marcellus we're not shutting down activity completely there, don't get me wrong. But we're not going to be running six to eight rigs or anything like that in these kinds of conditions. Right now we've got just a couple of rigs that are running there.

Blake Fernandez - *Howard Weil Incorporated - Analyst*

Okay, and John if I could just confirm those equity affiliates that should remain self-funding, is that correct?

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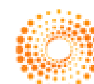

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John Watson - *Chevron Corporation - Chairman & CEO*

Not necessarily. In general the answer is yes. It's depending upon where prices are, it depends on circumstances because as the Tengiz project ramps up there is significant spend and there are loan provisions that are being worked as a part of that project, some of which will be equity partners loans.

Blake Fernandez - *Howard Weil Incorporated - Analyst*

Okay, okay. Fair enough. Thank you.

Operator

Ryan Todd, Deutsche Bank.

Ryan Todd - *Deutsche Bank - Analyst*

Great, thanks. Good morning, gentlemen. Maybe if I could follow up a little bit on some of your commentary around a longer cycle project spend.

The deferrals that we've seen, I mean I guess it comes from a combination of things which is either lower levels of operating cash flow as well as an effort to drive down project cost and improve economics. As you think going forward of where you are right now your effort to continue to defer at this point, is it driven primarily by this point by your outlook on cash flows or do you think that there's still a meaningful amount of either cost deflation on the projects or I guess the strategic engineering improvements on your end that have to happen? If cash flow should improve do you feel like you're at a point where the industry would be able to start to reinvest in those or is there still some gains to be made?

John Watson - *Chevron Corporation - Chairman & CEO*

It's a fair question. I would say a lot of it is cash flow driven right now. We're still in the final throes of our revisions to the Tengiz project cost estimates but we have a pretty good idea where that's going to land.

And we have a pretty good idea of sort of the glide path on technology and where costs are going to go for deepwater projects. But there is some uncertainty on price, and look, I know my shareholders value our dividend. I know our shareholders value increases in the dividend and I know they value us investing in high return projects. So there is some uncertainty on price and we want to be sure we've kept our balance sheet in good condition, and we want to be sure we just strike that right balance to continue to pay and grow the dividend and invest in good projects.

So we're just working through the cycle and living within our means while we take costs down. One of the things that happens if you're taking on fewer projects is the organization will focus harder on getting more efficient at what they do. And we need to do that.

We've got a very good US Upstream business but we didn't make any money in this quarter. And so we need to get more efficient at what we do, we need to look at our structures and we need to get our costs down.

And in the meantime we're going to be ready for some of the projects that I talked about earlier to move them forward. We'll have some countercyclical investment but we do need to live within our means.

Ryan Todd - *Deutsche Bank - Analyst*

Great, thanks. So then maybe if I could just get your quick thoughts on maybe on global gas demand, Asian gas demand, maybe even more in particular whether probably less that in relation to Gorgon and Wheatstone as those are contracted to a large extent, but has there been any shift

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in your view on global gas demand or Asian gas demand longer term? And how would that affect potentially your longer-term view on incremental LNG projects going forward?

John Watson - *Chevron Corporation - Chairman & CEO*

That's a fair question. I think overall demand is set to grow very rapidly. And I think the conventional wisdom has been that you're just going to see natural gas displacing coal and gas demand just growing in very rapid rates.

Gas has to be competitive with other options in the portfolio for these developing countries. Affordability is very much key and so while we see literally a doubling of LNG consumption if you go out 10 years versus now a very significant growth in demand I don't think that's changed. What has changed is the supply picture.

We have seen a number of projects take FID and a number of projects that are under construction and the world economy isn't growing quite as fast as we might have thought a few years ago. It's still growing but it isn't growing quite as rapidly as a few years ago. So it's a well supplied market right now.

There's still contracting opportunities out there. Customers do value security of supply. They do value having a known source of supply.

Not everybody wants to run their economy on spot gas. And so I think there are a number of buyers that want to firm up supply. And we for example signed a medium-term contract earlier this year and we think there are other opportunities to do that.

As you see slowdown in FIDs on this I think you'll see consuming countries take stock of that and start to think about additional commitments more toward, that would be more geared toward supply in the early to middle part of the next decade.

Ryan Todd - *Deutsche Bank - Analyst*

Thanks, John. I appreciate it.

Operator

Roger Read, Wells Fargo.

Roger Read - *Wells Fargo Securities - Analyst*

Yes, thank you and good morning. I guess I'd like to get a little more into some of the impacts of potential production declines from you mentioned some of the equity spending at Tengiz but think about spending on non-operated projects that you're on or non=operating legacy production and how that may impact the revised production guidance we should think about or even as a challenge in the 2018 and beyond world.

John Watson - *Chevron Corporation - Chairman & CEO*

I'm not -- is there a specific non-op question or concern?

Roger Read - *Wells Fargo Securities - Analyst*

No, not a specific one but let's just think about anywhere where you're not necessarily making the decision. You're dependent on someone else for that. How do you maybe take that into account in your forecast as a risk factor?

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John Watson - *Chevron Corporation - Chairman & CEO*

Oh yes. Well certainly we're in dialogue with operators. For example Total is operator on some of the West Africa projects that are potentially in the portfolio.

We're operator on some, they are an operator on some, so the dialogue has been pretty good. I would say the biggest area where we can get influence frankly is in the Permian where we've got some smaller companies and they are very good at what they do but their budgets can move around a little bit. But that's nothing that we can't deal with and accommodate but I would -- I don't think that's going to determine our flexibility in our capital budget.

Roger Read - *Wells Fargo Securities - Analyst*

Well I wasn't thinking so much the capital budget as I was just you mentioned earlier the underlying production decline being close to 1%, in your outlook you're thinking maybe more the 2% to 3% and I'm just wondering what would push you to the 3% or potentially beyond the 3% being these things that aren't necessarily in your full control?

John Watson - *Chevron Corporation - Chairman & CEO*

Well, I'm not going to push -- I'm not going to the change from 1% to 3% is a function of non-op decisions. Because I think everyone in the industry is doing similar things now. We've been reasonably well aligned on budgets with our partners whether we're the operator talking to them or they are the operator talking to us.

John Watson - *Chevron Corporation - Chairman & CEO*

We've got time for one more.

Operator

Doug Terreson, Evercore ISI.

Doug Terreson - *Evercore ISI - Analyst*

Good morning everybody. John, your new capital management plan appears to be one of the more direct steps towards better capital allocation outcomes that we've seen announced thus far in the super major category on these calls.

On this point I wanted to see if you'd elaborate a little bit on the drivers of the proposed changes, meaning a few minutes ago you talked about how the cyclical element which is in response to lower oil prices and the need for cash flow to cover the dividend at some point was part of it. But also is there an element of the new plan which relates to the more challenging competitive condition that appear to have been a factor for the longer-term industry returns in recent years. So the question is really what's driving the more disciplined approach to investment at Chevron internally when you guys put this together? Meaning is it cyclical, is it secular, is it both? Could you just spend a minute on that?

John Watson - *Chevron Corporation - Chairman & CEO*

Yes, truthfully I would say there's an element of all the things that you described. I think in general we were heading through a period where we had a disproportionate amount of our spend in big long cycle projects. So we were going to head to a period where we were going to be digesting

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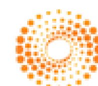

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those projects and then we would supplement those with a more ratable number of long cycle projects but then continue to invest in the base, in that new base of assets that we've acquired.

So I think that pattern is playing out. I think the issue is what can we do to enhance returns? We've said before we took down our price deck a little bit from where we were before and so there is a new reality in that sense.

Whether that's due to industry supply conditions or the US dollar or a lot of other factors that have taken commodities down, there is a new reality if you will in the commodity price environment for both oil and gas that we're seeing. The industry has been fabulously successful in providing supply. A lot of it is through shale but also elsewhere.

So our focus going forward directionally is consistent with what we would have done anyway but we've taken spend down as I commented earlier to help us really focus on getting the most out of the assets that we have and taking cost down so that we can improve returns. It's unacceptable for us to not be able to make money at whatever commodity price the market is giving us. And that's where we are.

Now I do think commodity prices will improve and I've said that but we need to improve our returns. And so I think that's the focus.

And as I commented earlier if you push the organization in that direction, I mean we're already seeing it's hard to put together a business plan right now because the organization is achieving good things in terms of getting our costs down and it's hard to be forward-looking to know exactly where all the efficiencies might come from as the organization gets more focused on making the best of the assets that they have. So maybe that's the way I can describe it.

So it's all the above including taking costs out of bigger projects going forward.

Okay, so thank you very much. I would like to thank everyone for your time today. We appreciate your interest in the Company. Jonathan, back to you.

Operator

Ladies and gentlemen, this concludes Chevron's third-quarter 2015 earnings conference call. You may now disconnect.

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