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CVX - Q4 2013 Chevron Earnings Conference Call

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OVERVIEW:

CVX reported 2013 earnings of $21.4b or $11.09 per diluted share. 4Q13 earnings were $4.9b or $2.57 per diluted share.

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PRESENTATION

Operator

Good morning, my name is Jonathan and I will be your conference facilitator today. Welcome to Chevron's fourth-quarter 2013 earnings conference call. At this time all participants are in a listen-only mode. After the speakers' remarks there will be a question-and-answer session and instructions will be given at that time.

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

John Watson - *Chevron Corporation - Chairman & CEO*

Thank you, Jonathan, and welcome to everyone to Chevron's fourth-quarter earnings conference call and webcast. On the call with me today are Pat Yarrington, our Chief Financial Officer, and Jeff Gustavson who is our General Manager of Investor Relations. We will refer to slides that are available on Chevron's website.

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

Turning to slide 3, I want to begin by highlighting some of our strategic accomplishments for the year. We had our lowest ever days away from work rate continuing our improvement over several years now. We have been the industry leader on this metric since 2010.

Our financial performance in 2013 was solid. Once competition results are fully analyzed we expect to once again post the highest Upstream cash and earnings margins per barrel compared to a broad set of peer competitors. Our strong cash flows and balance sheet allowed us to fund our capital program and capture new resource opportunities while maintaining competitive shareholder distributions.

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In our Downstream business we started commercial operations of a 53,000 barrel per day vacuum gas oil FCC unit at the 50% owned Yeosu refinery in South Korea. We made significant progress on the construction of a 25,000 barrel per day premium base oil plant at the Pascagoula, Mississippi refinery here in the US.

We expect to reach mechanical completions toward the end of the first quarter and will then ramp up to full capacity during the second quarter. In addition, we've also advanced our Oronite expansion project in Singapore.

Our CPChem affiliate, our 50% owned chemicals joint venture, announced final investment decision on a $6 billion US Gulf Coast Petrochemical Project.

In our Upstream business we achieved startup and first shipment from Angola LNG. Production began at the Papa-Terra project in Brazil. We also startup North Rankin-2 in Australia which maintains production capacity at the Northwest shelf LNG project.

We made substantial progress on our major capital projects at the end of January. Gorgon is currently about 76% complete while Wheatstone is about 27% complete. Similar to prior quarters, we have posted a number of photos highlighting our construction projects on these two important facilities on our Chevron investor webpage located at Chevron.com.

We also continued construction activities for our projects in the Deepwater Gulf of Mexico, the Jack/St. Malo hull is now moored at its offshore location and is on schedule for startup later this year. Big Foot is expected to be towed to location in the third quarter, with expected startup next year.

We reached final investment decision for the Alder developments in the UK North Sea as well as for Moho Nord in the Republic of the Congo.

We had a very busy year from a resource capture standpoint successfully acquiring an interest in a discovered resource opportunity in Argentina to develop and explore the Vaca Muerta shale. And we also closed on our entry into the Kitimat LNG project in Western Canada where the resources will come from new positions in the Horn River and Liard basins.

We acquired additional shale and tight resource acreage in the Cooper basin in Australia and the Duvernay basin in Canada, the Permian basin in the US as well as in the Ukraine. We also grew our exploration portfolio by acquiring positions in the Kurdistan region of Iraq, Australia, Brazil, Morocco and in the Deepwater Gulf of Mexico.

Our one year reserve replacement was 85% bringing our three year replacement ratio to 123%. We're proud of our performance this past year. With that I'll turn it over to Pat who will take you through the financial results. Pat.

Pat Yarrington - *Chevron Corporation - VP & CFO*

Thank you, John. Slide 4 provides an overview of our financial performance. The company's fourth-quarter earnings were $4.9 billion or $2.57 per diluted share. For the year earnings were $21.4 billion, this equates to $11.09 per diluted share. Return on capital employed for the year was 13.5% and our debt ratio at year end was 12%.

2013 marked our 26th consecutive annual dividend increase with an 11% growth in the quarterly rate. This demonstrates our confidence in our future performance and is consistent with our priority of rewarding shareholders with sustained and strong dividend growth.

In the fourth quarter we repurchased $1.25 billion of our shares bringing the full-year share repurchase total to $5 billion. In the first quarter of 2014 we expect to repurchase the same amount.

Finally, Chevron's 2013 total shareholder return was 19.2%. We continue to lead our peer group on total shareholder returns for the three-year, five-year and 10-year period.

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Turning to slide 5, cash generated from operations was $10.5 billion during the fourth quarter. This was the strongest cash generation quarter of the year. For the full year cash from operations totaled $35 billion reflecting the continued cash generating strength of our portfolio.

Cash capital expenditures were $11.6 billion during the quarter and $38 billion for the full year. We had a very successful year in our resource acquisition efforts as John just mentioned. At year end our cash balances totaled $16.5 billion giving us a net debt position of $4 billion. The company continues to move towards a more traditional capital structure.

Turning to slide 6, I'll compare results for the fourth quarter 2013 with the third quarter 2013. As a reminder, our earnings release compares fourth quarter 2013 with the same quarter a year ago. Fourth-quarter earnings were $4.9 billion; $20 million lower than the third-quarter results.

Upstream earnings were down $240 million reflecting lower liquids realization and higher exploration and operating expenses. Partially offsetting were favorable foreign exchange movements of $490 million.

Downstream results edged up $10 million between quarters. Higher margins and favorable inventory affects were mostly offset by the absence of gains on asset transactions and higher operating expenses. The variance in the Other bar largely reflects a favorable swing in corporate tax items during the quarter.

On slide 7, our US Upstream earnings for the fourth quarter were $223 million lower than third-quarter's results. Lower realizations decreased earnings by $165 million, consistent with the decline in US crude oil price indicators.

Lower production volumes reduced earnings by $35 million mainly due to planned maintenance activity in the Gulf of Mexico and cold weather disruptions in the Mid-Continent region. The Other bar reflects a number of unrelated items including higher operating expenses and unfavorable tax impacts partially offset by lower exploration and DD&A expenses.

Turning to slide 8, International Upstream results were just $17 million lower than last quarter's results. Realizations decreased earnings by $60 million consistent with the decline in Brent prices between quarters.

Higher exploration expenses, mainly driven by the write off of an exploration well offshore Canada, and higher geological and geophysical expenses across multiple areas, decreased earnings by $190 million. A combination of higher operating expenses and DD&A lowered earnings $150 million between periods.

The Other bar reflects a number of unrelated items including the absence of asset sale gains and favorable tax affects from the prior quarter. A favorable swing in foreign currency effects increased earnings by $490 million. The fourth quarter had a gain of about $300 million compared to a loss of about $190 million in the third quarter.

Slide 9 summarizes the quarterly change in Chevron's worldwide network equivalent production. Production declined 9,000 barrels a day between quarters. Our shale and tight assets contributed 7,000 barrels a day mainly from new production in the Marcellus region in the US and Vaca Muerta in Argentina.

External constraints lowered fourth quarter production by 12,000 barrels a day reflecting lower demand in Thailand and in Bangladesh as well as weather-related disruptions in the US. The base business and Other bar include the impact of normal field declines which are partially offset by higher production from Agbami in Nigeria.

Slide 10 compares full-year 2013 net oil equivalent production to that of 2012. Production declined by 13,000 barrels per day in 2013. Production averaged 2.6 million barrels per day for the year, 98% of our original guidance. This was driven primarily by the slower ramp up at Angola LNG, more expensive turnaround activities and lower gas demand than anticipated in several countries.

Base business declines and asset sales reduced production by 49,000 barrels per day between years. Our base business operations delivered strong performance for 2013. Our base decline rate was lower than our target of 4% providing significant barrels and value.

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Growing volumes from our shale and tight resources in the Permian and in the Marcellus regions in the US contributed 25,000 barrels per day. Our shale and tight production grew more than 15% in 2013.

Incremental production from our major capital projects contributed 11,000 barrels per day driven by the Angola LNG startup, first oil from Papa-Terra in Brazil and the ramp up of production at the Usan field in Nigeria.

Turning now to slide 11, US Downstream results were up $16 million between periods. Stronger margins increased earnings by $95 million mainly due to lower crude costs. West Coast refining margins also benefited from the completion of planned maintenance activity in the third quarter at our El Segundo, California refinery.

Gains on asset sales contributed about $90 million less in the fourth quarter than the third quarter. The Other bar reflects a number of unrelated items of smaller impact.

On slide 12, International Downstream earnings were nearly flat between quarters. Margins improved earnings by $20 million. Higher refining margins in Canada on lower crude cost and improved marketing margins in Australia, were partially offset by lower refining margins in Asia, where we have seen weaker demand and ample supply.

Higher operating expenses decreased earnings by $60 million principally from maintenance, repairs and transportation. The Other bar includes a number of unrelated items including favorable year-end LIFO impacts, partially offset by lower trading results and an unfavorable swing in foreign exchange impacts.

Slide 13 covers All Other. Fourth-quarter net charges were $312 million compared to $522 million in the third quarter, a decrease of $210 million between periods. A favorable swing in corporate tax items resulted in a $162 million benefit to earnings while corporate costs were $48 million lower this quarter.

For the full year this segment had net charges of $1.6 billion putting us in the lower end of our $400 million to $500 million guidance range per quarter. We believe this quarterly guidance range for the All Other segment is still appropriate going forward.

With that, I'm going to turn it back over to John for a few comments on 2014. John.

John Watson - *Chevron Corporation - Chairman & CEO*

Thanks, Pat. Turning to slide 14, in December you'll recall we announced a $39.8 billion capital program for 2014, $2 billion lower than 2013. We expect 2013 to be a relative peak spending year and 2014 to represent the peak year for LNG spend as our two Australian LNG projects move closer to production.

This program also supports our large Deepwater Gulf of Mexico developments as well as ongoing development and ramp-up activities in the Permian basin in the US. We're also investing in longer-term projects in Kazakhstan, Canada and West Africa which will drive profitable growth for many years.

Importantly, planned spending is directed towards our profitable base business assets throughout the world as well. This includes significant activity across several producing regions in North America as well as in Thailand and Indonesia amongst others.

Our Downstream investments for 2014 are geared toward enhancing reliability and energy efficiency, feedstock flexibility and the production of cleaner transportation fuels. We are also funding major capital projects related to our Chemicals business.

Our Oronite expansion project in Singapore is planned to start up in 2014. And we'll begin ramping up construction activities on the US Gulf Coast Petrochemicals Project which recently reached FID and is planned to start up in 2017.

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We have an attractive portfolio of investment opportunities which we'll continue to fund in a disciplined fashion to grow enterprise value and fund shareholder distributions.

On slide 15 our net production outlook for 2014 is 2.61 million barrels oil equivalent per day based on an average Brent price of $109 per barrel which was the same average price as 2013. This outlook does not assume OPEC curtailments, material and security or other market impacts.

Our full-year estimate for 2014 includes modest production ramp ups at Angola LNG, Papa-Terra and in the Permian basin. These are expected to be partially offset by declines from our base producing assets where we continue to assume an average decline rate of approximately 4%.

Our focus is on managing the decline rate related to our base business, which is performing very well, and on executing with excellence those elements which are expected to add material production volumes in the years ahead.

Our long-term production growth outlook is compelling, profitable and will add value. It is driven by five large projects -- Angola LNG, Jack/St. Malo, Big Foot, Gorgon and Wheatstone -- which in total will add over 500,000 barrels per day of net new production to Chevron at full capacity.

In 2015 will see the start up of Gorgon and Big Foot and additional ramp-up of Jack/St. Malo. We look forward to providing more details on our key projects and production outlook at our upcoming security analyst meeting.

Thank you. That concludes our prepared remarks. I appreciate you listening in this morning and your interest in the company. We are ready to take some questions. Keep in mind that we do have a full queue, so please 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 line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Doug Terreson, ISI Group.

Doug Terreson - *ISI Group - Analyst*

My question is about capital discipline and specifically the decline in returns on capital to around 14%, which I think places that result at its lowest level in many years. And on this point, John, you talked about the importance of value creation, and you always do actually, but also making hard choices in capital allocation when you were in New York recently.

And so while I recognize that you have to complete investment in these megaprojects, I wanted to see what the Company is doing to address this issue from a corporate planning perspective, or whatever you deem relevant, to ensure that this value creation process is optimized.

John Watson - *Chevron Corporation - Chairman & CEO*

Sure, good question, Doug. Certainly we did announce a capital program, as I said, of $39.8 billion, it is a significant program and it largely reflects the good queue that we have. Doug, when I reflect on our Company and our capital discipline, you know we have a wide lead in profit per barrel, some $5 a barrel not just over the majors but over independents and others.

So we have had discipline over the years and the projects that we have in the queue we think will also add to earnings going forward. Now it is true that the cycle time for some of the projects that I mentioned, those big five that I mentioned, is long. And so there is capital that is not yet on production in the queue.

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Notwithstanding that we actually expect our Upstream business to have the second highest return on capital employed this year despite that high level of pre-productive capital. So I think we've got good discipline on these projects, we have got a good record of doing it.

Now inside the Company we are cognizant that there has been a significant increase in the cost of goods and services across the industry. Since the middle of last decade costs have more than doubled and there are some hotspots around the world. So we are looking very closely at the projects that are in our portfolio.

Naturally we are going to continue with the projects that are under construction. But you've seen a couple of areas where we have made some choices. The Rosebank project in the North Sea, we think that is a good project, a good resource, but costs came in just higher than what we felt were appropriate. So we are taking a hard look at that project, reviewing it, seeing if we can make the economics more attractive.

The Vietnam gas project, we have worked -- we and frankly Unocal before us worked for more than a decade to try to make that project a success. Haven't been able to do that just yet. So I think that we are really doing what we can.

I'd tell you also and the US we have scaled back our spending on gas, as you might expect. So the volume that you will see from gas in the US will be less than we might have planned a few years ago. The only area where we are spending on gas in any appreciable amount is in the Marcellus where we have a carry that enables us to continue to spend.

So all of those things plus outreach that our employees are making with vendors and contractors and frankly just belt-tightening in general, which is a big focus for us right now and will be a message that I will be sending in my worldwide conference call with employees in a couple of weeks, are the kinds of things that we are working on.

Doug Terreson - *ISI Group - Analyst*

Okay, those are all great points. And so let me just ask one more. So have you guys quantified what your level of pre-productive capital is, however you guys define it, and how that compares to normal today, John?

John Watson - *Chevron Corporation - Chairman & CEO*

We do. And I will make you a promise that Pat Yarrington will show you a fair amount of information on that when we come back in March. But, Doug, it is at a high level right now.

Doug Terreson - *ISI Group - Analyst*

Sure. Okay, great, thanks a lot.

Operator

Doug Leggate, Bank of America-Merrill Lynch.

Doug Leggate - *BofA Merrill Lynch - Analyst*

If I could take one and my follow-up please. Your production outlook (technical difficulty).

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John Watson - *Chevron Corporation - Chairman & CEO*

I can't hear you, Doug.

Pat Yarrington - *Chevron Corporation - VP & CFO*

Doug, you have cut out.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Hi, can you hear me now?

John Watson - *Chevron Corporation - Chairman & CEO*

If you speak up.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Yes, I will try and speak up, sorry. So, John, your production trajectory for 2014 I think has taken some folks by surprise in terms of the fact that it is basically flat year over year. Has something slipped or changed there or are Street expectations too -- just wrong? Or can you basically give us an idea when you expect the inflection point in production? And I've got a follow-up, please.

John Watson - *Chevron Corporation - Chairman & CEO*

Sure. As I indicated, our production guidance for 2014 is 2.61 million barrels. And really a couple of things to talk about. One, our base business has been performing very well. So we are continuing to invest in the base and frankly we have seen some declines that are less than we would expect. But we do use our standard 4% decline estimate for the base business, the underlying business for 2014.

Beyond that it's a function of ramp ups that we have on major capital projects. And there are really a couple that fall into that category. One is Angola LNG and the other is Papa-Terra in Brazil that Petrobras operates.

We've got a couple of wells in Papa-Terra but it's -- the ramp up takes place, it's really a two part project that will take place over the course of this year and we take operator guidance in setting that estimate.

Angola LNG ramp up is less than we would have expected a couple years ago. And this might be a good time for me to talk about that project. Our share of production from Angola LNG is 60,000 barrels a day net at full capacity. We have had about five cargoes last year; I think we have had a couple that we have lifted this year. But we've been working on some technical issues on the front end of the plant with the dehydration unit.

Remember this is an associated gas project, meaning there is variable feed coming from different facilities. We have had some technical issues on the front end of that plant. And so, our expectation is it will not ramp up to full capacity this year, it will likely be more like 30,000 barrels a day if we run it about half capacity this year with a full fix in the first part of 2015 and then ramp up to full capacity after that.

So that is probably one of the factors that might be influencing the estimates that are out there. Beyond that we have got Jack/St. Malo, which we are very pleased with, which will be starting up late in the year. Obviously you only get a partial year's production from a later in the year start up, but that will start up nicely.

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So I think it is more likely that the inflection point will come next year than this year. I don't think that is inconsistent with the guidance that we gave, if you go back to 2010, in the sense that we said we would grow roughly 1% between 2010 and 2014 and then 4% to 5% a year thereafter ramping up to our larger targets. But understanding the performance of ALNG has impacted 2014 to be sure.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Thanks for the answer, John. My follow-up very quickly to Pat is, a move to a normal balance sheet structure, Pat, it looks to us that your cash burn is about $10 billion a year. Is it realistic that you add $30 billion by the -- to your balance sheet by the time you hit your targets in 2017? And I will leave it there. Thanks.

Pat Yarrington - *Chevron Corporation - VP & CFO*

Yes. Doug, that will all be a function really of what realizations are, what is happening from the crude market standpoint fundamentally. But if you assume no significant change from where we are today from a realization standpoint, and acknowledge what the production growth will look like and what cash from operations could look like, we would expect to add additional borrowings to our balance sheet of reasonable size over the next couple of years.

So we are starting with a very low leverage rate, 12% right now, and there is a lot of capacity that we can utilize to not only fund the business activity, reinvest in the business, but also continue on with strong shareholder distributions.

John Watson - *Chevron Corporation - Chairman & CEO*

Let me offer a couple other comments if I could -- if I could on that one. You know our cash C&E this last year in 2013 was about $39 billion. That included some acquisitions. We expect fewer this year and the cash spend is about $35 billion this year. In addition, asset sales were relatively low last year.

We expect modestly higher asset sales going forward. We're doing some rationalizing in the Midstream business, part of the ordinary course of business, and we have a few things we're looking at in the Upstream portfolio.

Remember most of the cash drain you are referring to is planned, orderly to restore our balance sheet back to a more leveraged structure and is largely a function of share repurchases that we are putting in place. Our intention as we get to at least start ramping up production of course as to get to a point where we not only cover C&E but also cover the dividend.

Our policy on dividend has been to grow that dividend commensurate with the ongoing pattern of earnings and cash flow over the long-term. So we are in this period where we have relatively high spend, we're generating good cash, but we expect cash generation to increase and, as we go forward, we expect the cash consumption to attenuate as we roll into higher levels of production.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Thanks, folks, I appreciate the answers.

Operator

Ed Westlake, Credit Suisse.

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Ed Westlake - *Credit Suisse - Analyst*

Just coming more I guess back to the US. I mean your CapEx in the Upstream and your outlook is sort of relatively flat. I mean I appreciate there are some really big projects in the Gulf of Mexico. But you have this emerging shale position not just in the US, also obviously up in Canada. Maybe talk about why you are not getting after that more aggressively? I actually saw some really good well results from you guys down in the Permian this morning.

John Watson - *Chevron Corporation - Chairman & CEO*

You want us to spend more, Ed?

Ed Westlake - *Credit Suisse - Analyst*

In that area potentially. But what stops you, or --?

John Watson - *Chevron Corporation - Chairman & CEO*

Well, a couple thoughts. I don't know whether you -- we have got a couple of different shale plays going on in Canada, one is in the Duvernay which is liquids oriented and we have drilled -- I think we are on our 13th well up there and have had some good success. And we are looking to develop and develop that at a good pace.

Our approach to the shales is to make sure we understand what we have got and to play in an orderly fashion so that we can keep costs in line commensurate with the production that we can generate. So I do agree with you, we have had some good results from those wells.

The second of course is the Horn River and Liard Basin which is gas to support the Kitimat project, which there will be additional drilling in the Liard this year to delineate those holdings. And of course that production would be associated with -- over time with an LNG project at Kitimat.

Ed Westlake - *Credit Suisse - Analyst*

And I was also referring to the Permian obviously where you have got a huge acreage position. It just feels that if that was in the hands of an independent they would be gung ho after it. Whereas it feels that, perhaps due to corporate CapEx constraints, you guys or maybe delineation are going a little bit slower.

John Watson - *Chevron Corporation - Chairman & CEO*

Well, I know that is what the independents tell you. What I'll tell you is we work very hard to put together a really sustainable and capital efficient plan over time. Having said that, we drilled some 460 gross wells in 2013 which was more than we had planned.

We have got 26 rigs working in the basins there; about half of those actually are non-op rigs as well as our own rigs. And I think you will see that we are ramping up activity pretty nicely. In March George will show you some charts that will give you a better feel for that. But I think you will see a nice ramp up both in the number of rigs and in production that will come from that area.

Remember, one of the things -- we do try to be efficient with our capital, we are focused on making good returns. And so, we do want to be sure that we can do it in a low-cost fashion and do it in a way that will generate the kind of financial results overall that will keep us leading.

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I mentioned earlier that we lead in earnings per barrel relative to the majors, but we also have a big lead in return on capital and return per barrel relative to a lot of the independents as well. So we may not go as fast as some of the independents, but I think it is the right way for us to move forward.

Ed Westlake - *Credit Suisse - Analyst*

Thanks, John.

Operator

Paul Cheng, Barclays.

Paul Cheng - *Barclays Capital - Analyst*

John and Pat, maybe I have two questions, both of them is somewhat higher level. One is from a capital allocation standpoint. Obviously the last several years the Company has been going after a lot of the legacy long-term megaprojects, which is great once that they complete.

But from a portfolio management standpoint is there a point that you want to say maybe balance the portfolio a little bit between whether from a production standpoint or a capital standpoint between the megaprojects which obviously have a higher risk in terms of underlying execution and also somewhat binary in nature comparing to a more steady maybe shorter-term projects? That is the first question.

John Watson - *Chevron Corporation - Chairman & CEO*

Okay. Well, certainly we do quite a bit of work, Paul, on portfolio management to do just as you described. In fact, we try to balance the portfolio in many ways, but certainly one is the balance between the investments in long-term projects and short-term money.

We consciously took on some projects that we felt were opportunistic and ready to go with Gorgon, Wheatstone, Jack/St. Malo and Big Foot. And so, we knew that we had a heavy period of spend for those projects. But at the same time we have really maintained a very strong base business spend program, about 30% of our spend goes into smaller capital projects.

And you make a good point because I just -- for example, just happened to review our performance on small capital projects within the last couple of weeks and the returns are quite good. These are typically incremental projects, incremental drilling projects to existing assets.

And so, we do maintain that spend. In fact, the discretionary spend that we have is in that area. And we have announced a strong capital program for 2014 and my alternative was largely to cut those base business spend. And we decided not to do that.

So we try to balance both those factors so that we get strong returns on capital over time and get good growth. And we have been able to do that. Despite all the capital that is in the queue, we still from the numbers that we have we think we will maintain our second position on return on capital employed.

Paul Cheng - *Barclays Capital - Analyst*

John, is there a ratio over the next five or 10 years that you want to have 50% of the capital on the legacy megaproject and 50% on the smaller and the base business? Or there is not even a ratio that you guys consider or look at?

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John Watson - *Chevron Corporation - Chairman & CEO*

Well, we will have a higher -- I think we have advertised before that we are moving toward a higher percentage of legacy what we call legacy or very low decline projects. So that as we get toward the end of the decade we will be at about 60%.

So things like Gorgon, Wheatstone, Tengiz, Angola LNG and the like, even some of our low decline assets such as California heavy oil activity is very low decline. And we are moving to a higher level.

The plus side of that is as you get those online, the amount of spend that it takes to maintain them tends to be fairly low. So we are moving to a higher level of what you would call legacy spend projects and I think they will deliver a lot of cash and stability for years to come once we get them all on line.

Paul Cheng - *Barclays Capital - Analyst*

The second question is that over the last couple years that you have been borrowing -- or actually not since you have been borrowing money to fund a buyback, and as the balance sheet returns to more normal at what point, whether is a fixed financial ratio such as net debt to capital or interest (inaudible) ratio, the Company will start to reconsider the buyback whether or that you would continue to borrow money to fund it?

John Watson - *Chevron Corporation - Chairman & CEO*

I will let Pat talk a little bit about our philosophy on debt and the rating agencies and how much capacity we have got.

Pat Yarrington - *Chevron Corporation - VP & CFO*

Right. And, Paul, we have said for a long time now that obviously from a cash distribution standpoint the priority is on dividend. Secondly, we invest in the business and cover up the strength of our balance sheet from a pension funding standpoint and that kind of thing for the third priority. And then finally it is share repurchases that become kind of the surplus use of cash.

And we have also said several times here now that we were in an unusual net cash position for several years now. We would be moving into a net debt position, we have now done that. As I look forward we still have a tremendous amount of borrowing capacity available to us.

We believe that these -- we are very confident in the future cash generation from these projects once they come online and so we can see our steady-state here from a shared distribution standpoint on share repurchases for a while. We also see intentions to continue to grow the dividend.

We have a lot of flexibility in our balance sheet and I don't think that there is a consideration, at least in terms of steady macro conditions, that would suggest we would be trimming our share repurchases at this time.

Paul Cheng - *Barclays Capital - Analyst*

Thank you.

Operator

Evan Calio, Morgan Stanley.

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Evan Calio - *Morgan Stanley - Analyst*

John, on the CapEx, I know that the organic cash CapEx exceeded your guidance by about $2 billion. As you assess that 2014 CapEx budget what gives you confidence that you won't experience similar inflation? I mean is there anything different, any protections, conservatisms versus what happened as you -- versus how you assess 2014? And then I have a follow-up. Thanks.

John Watson - *Chevron Corporation - Chairman & CEO*

Yes, our number -- taking out the money for acquisitions that we had last year, the amount that we went over the budget I think was --.

Pat Yarrington - *Chevron Corporation - VP & CFO*

About 1 billion.

John Watson - *Chevron Corporation - Chairman & CEO*

-- lower than that. So -- and I don't know if we disclose the exact dollars of those acquisitions, but it is somewhat lower than that. I don't think we would be having the conversation about capital had we not had those larger -- those one-time acquisitions.

But candidly if we have a supplement to a project we are going to fund it in that year. In general we manage our budget pretty tightly and I have no reason to believe at this point that we will exceed the $39.8 billion that we put out there. We are sensitive to it, you are sensitive to it. So we will be watching it very closely.

Evan Calio - *Morgan Stanley - Analyst*

Similar -- and maybe this is something for the Analyst Day. As obviously organic CapEx, cash CapEx trend here is flat and you mentioned a peak LNG spend in 2014. There are a lot of your peers that are forecasting a peak CapEx. So do you see a similar overall trend based upon your current slate of projects?

And then maybe secondly -- this is the other side of the question -- is it -- it is unclear what the world looks like in two, three, five years let alone the opportunities in the asset market, M&A market, resource market, etc. I mean do you see any real ability to forecast a longer-term CapEx figure? And I will leave it at that.

John Watson - *Chevron Corporation - Chairman & CEO*

Well, it is a good question. One of the reasons -- and I've told you and others before -- one of the reasons we haven't put out long-term capital forecasts is because it is very hard to predict oil prices, foreign exchange, local content requirements, cost of goods and services.

What we have been fairly good at understanding is the competitive nature of our projects. So when we put out a long-term production forecast we have had a view that -- we know the world is going to need energy, we know that we have got projects that will compete because of the resource and general nature of the project.

And so we have been -- frankly we have stepped out quite a bit in putting out a seven-year production forecast. And I feel pretty good about that. It was harder to predict what the exact spend would be. And that is part of the reason I have been reticent to give a lot of guidance going out beyond two or three years.

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I know directionally the level of our activity and we do balance that, but I don't know what the macro environment will bring fully. And once we get projects that are under construction we're obviously going to continue them. So I have a pretty good feel obviously for what spending will be this year. And I have a pretty good feel for what spend is going to be in 2015 and 2016.

And that is why we have given you this flattening comment where we are $40 billion this year and we will be in that same range give or take for the next couple years. Beyond that the macro conditions could dictate something different.

We do try to be opportunistic when it comes to bringing resources into the portfolio. Last year I think we brought in some terrific resources into our portfolio at a good price.

As you know, we supplemented our acreage in New Mexico in the Permian area, we brought in some good high-quality assets that were referenced earlier in the Duvernay, we think the Kitimat resource is a terrific one for the long-term, Argentina we think as far as we know it is the best shale outside of North America.

So we took the opportunity to bring those into the portfolio and we don't see as many opportunities in that space this year, for example, that is why I made the comment I did earlier about spend. But over time we are in depleting resource business and you do need to add to the portfolio.

We are careful how we do that. That is how we got to our leading position in earnings per barrel. And we will continue to be careful in how we do that going forward.

Evan Calio - *Morgan Stanley - Analyst*

Maybe I could slip in just one last one on the asset disposal side. I know you mentioned in a response or your comments the Midstream sale process monetization. I mean any update or any change in your thoughts there given you're growing unconventional base and a likely associated Midstream CapEx over time? Any change whether that would be an outright sale or potentially forming an MLP? And I will leave it at that.

John Watson - *Chevron Corporation - Chairman & CEO*

Yes. In fact I will say there is a little bit of a shift. Let me be clear, we are not in a shrink to grow mode, we are not resetting the base, we are not doing anything like that, that is not what we are doing. But just as we have done in the Downstream where we have pruned the portfolio. I think Mike and his team have sold some $8 billion in assets over the last six, seven years. And those have been done in a very nice paced way to get good value.

We are in the process right now of making some sales in our Midstream business, for example. You reference MLPs, our approach -- we are not fond of the MLP structure as a way for us to hold assets, but we can sell into MLPs and get that value.

And so we have been selling pipelines and we'll continue to do so for pipelines where they are not critical to our Upstream or Downstream business, in other words more merchant type lines. We are selling lines. You have probably seen some commentary in the press to do that, we think we can get good value there.

Similarly, we do have a lifecycle for asset sales in the Upstream. And so there are some sales that are possible there. Our approach is not to talk a lot about the specific assets for commercial reasons, but I would say you will see more asset sale activity over the next two or three years in the Upstream than you have seen over the last few years.

Certainly there has been a lot of chatter about some leases that we are selling in Nigeria, those we think we'll bring to a closure later this year and get good value for those. And I would say overall in the context of some of the big headline numbers others have said our sales will be modest. But we will have a little bit more in the area of asset sales going forward.

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Evan Calio - *Morgan Stanley - Analyst*

Appreciate it. Thanks, guys.

Operator

Pavel Molchanov, Raymond James.

Pavel Molchanov - *Raymond James - Analyst*

You mentioned the ongoing reduction in domestic gas drilling and yet ironically that is the one part of your domestic production that has actually been up for the last I guess three, four quarters. Why do you think there is this disparity where domestic gas is rising but oil and liquids have been in decline?

John Watson - *Chevron Corporation - Chairman & CEO*

Well, the area that we have been investing in in the US has been in the Marcellus and it is a function of the carry. So the volume increases that you are seeing, you will recall we acquired Atlas Energy and some other tack-ons and we came in with a $1.3 billion carry. Where as we go forward it we are funding a disproportionately low percentage of the cost for the revenue that we are getting.

That carry is now down to $500 million and our strategy has been to really build out the factory model, get our full costs in line so that as we end that carry three or four years from now that we will be in a good competitive position on a cost per MCF basis once we get through that carry.

In the meantime we can afford to do the drilling. We obviously wells that are drilled when you are funding 25% of the cost and getting 60% of the revenue, I think the ratio is pretty good.

Pavel Molchanov - *Raymond James - Analyst*

Sure. Now a follow-up on Kitimat. I think you've said in the past your aim is to reach FID this year. Is that still the case? And what are the key question marks that would impede that from happening?

John Watson - *Chevron Corporation - Chairman & CEO*

Well, we are doing site clearance now. One of the things we have learned on big land-based projects is get your infrastructure in order and housing and things of that sort so that is what we are doing. We are pacing this project very carefully, as you would expect, and what we have said is that FID will be entirely a function of gas contracts and that allow us to develop the opportunity, and provide energy to Asian markets at a fair price.

And it is no secret that there is a lot in the media on that subject right now. We are actively working with gas customers today. My view hasn't changed since the view Joe Geagea described to you last year, which is LNG projects are expensive, whether they're in West Canada, West Africa or East Africa or the Gulf coast of the US or Australia. And we are going to need robust pricing in order to make those projects go.

And so there are some projects that may be build on existing facilities in the Gulf Coast of the US that are doing -- that have gone to FID and will add some capacity at maybe slightly lower costs.

But once you get to brownfields, whether it is Gulf Coast or elsewhere, I think we're going to need either oil linked pricing or pricing that very clearly will give us the kind of return we need. So I guess what I am saying is FID will be a function of gas contracts.

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Pavel Molchanov - *Raymond James - Analyst*

Are right, appreciate it.

Operator

Allen Good, Morningstar.

Allen Good - *Morningstar - Analyst*

John, you mentioned a little bit on the Downstream sales and restructuring. Just a question on that. Is that business currently sized right for Chevron. And do you see any other opportunity there to potentially reduce capital employed on the Downstream side?

John Watson - *Chevron Corporation - Chairman & CEO*

Well, our Downstream business if you look at the direction we have gone, we actually have done quite a bit of pruning over the last few years, we have basically gotten out of the disconnected marketing or marketing that's disconnected from our refining system. And then we did get out of a refinery in Europe that we think was very well-timed.

And so what that has left us with is a strong US business with good positions along the Gulf coast and through the West Coast of the US and then a strong business in Asia. We think -- we always take a look at the portfolio, but in general I think our Downstream portfolio is in pretty good shape.

I might have told you a few years ago that inland refineries or small refineries would be tough, but frankly those have been some of the most profitable with the one in Salt Lake and Burnaby, British Columbia. So I feel pretty good about the portfolio overall in the Downstream.

The capital that we are putting in the Downstream business is really geared toward the chemicals business now. We have got a base oil plant that is coming up in Pascagoula that will make us the largest top-tier base oil producer in the world.

We've got our share of the petrochemical complex that we're building with Phillips 66 through Chevron Phillips Chemical Company, that is a $6 billion project our share is $3 billion. We think that is going to be a terrific project. As far as we know we are ahead of other projects in the area.

We have got the permits and have gone to FID. Overall we think we can generate mid-teens kinds of returns in this business. And so we think it is a good one.

Allen Good - *Morningstar - Analyst*

Yes, I guess on the chemicals, I mean you mentioned a project upcoming and certainly that is a very good portfolio there. But I guess relative to the size of Chevron total it's still relatively a small piece. Do you think the market is accurately crediting you for that business?

And if not, do you think there is way potentially to monetize that through, I don't know, Phillips 66 or spinning that off separately? Or is your plan really just to hold out for the long-term and continue to build that up?

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John Watson - *Chevron Corporation - Chairman & CEO*

Our plan is to hold it. It is about 15% of our capital. We disclosed the segment information; I think you guys have sharp enough pencils to be able to figure out what it brings to us. But more importantly than that, there are some linkages in the business that I think are very important. I don't think splitting up the business makes you an independent.

We have some very significant linkages to the Downstream business. And I will give you just a couple just as a for instance. Southern California, our El Segundo refinery, we have got heavy crude going out of San Joaquin Valley, we have just augmented some facilities at the El Segundo refinery specifically so it can take more San Joaquin Valley crude. We think that is a good synergistic type of investment.

Over the years we've had high mercury crude in Asia and we have put in specific facilities to be able to capture value benefit associated with that. I think when you look in the middle of the country today, I think it makes all the sense in the world to be an integrated company.

You've had tremendous volatility in the relationship in crude pricing. And you either capture it in the refinery or you capture it on the Upstream side depending on how infrastructure moves. So -- and we are capturing that at Salt Lake. So I frankly think that the integration story for us is pretty straightforward.

Allen Good - *Morningstar - Analyst*

Great, thanks for those comments.

Operator

Roger Read, Wells Fargo.

Roger Read - *Wells Fargo Securities - Analyst*

I guess a lot of the stuff has been hit. I just wanted to kind of follow up on I guess Q4 and the Upstream in the US and if that had any implications for how we should look forward? I understand on the production side as we modeled it the realization for prices looked okay. I know as I went through -- or as you went through the presentation it showed realizations down.

I was wondering, is that a cost issue realization, sort of a net realization as opposed to just a price realization? And if so what kind of occurred in the fourth quarter and is that a one-time issue or a recurring issue, any help you can provide there.

Jeff Gustavson - *Chevron Corporation - General Manager of IR*

So, Roger, I can help with that, this is Jeff. It is not a net realization, it is a price realization. And it was consistent with the markers you see in the market for the fourth quarter.

Roger Read - *Wells Fargo Securities - Analyst*

Okay. So I mean more or less what occurred in the fourth quarter we should look at as being an issue going forward. I mean as crude prices move around that will change. But just the market conditions.

Jeff Gustavson - *Chevron Corporation - General Manager of IR*

That is exactly right.

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Roger Read - *Wells Fargo Securities - Analyst*

Okay. And then as we look forward into 2014, especially at the end of the year, say Jack/St. Malo starts up, you have got continued growth probably in California. Should we look at that as helping out the realization story in the US, North America?

Jeff Gustavson - *Chevron Corporation - General Manager of IR*

Again I guess it depends on your view of prices. So we are -- out of our US production we are about a third weighted to California prices, which obviously is separate from what is going on in the Mid-Continent. We are about a quarter weighted to Mid-Continent or WTI prices, and about a third weighted to the Gulf of Mexico.

So I mean that, as Jack/St. Malo comes on, as Big Foot comes on the weighting in the Gulf of Mexico may increase somewhat. There is not a lot of growth in the California business. And at the same time we have the ramp up in the Permian. So it really goes back to what your view of the different markers are in those three separate regions.

Roger Read - *Wells Fargo Securities - Analyst*

Sure, okay, that is helpful. And then any additional update you can provide as you look at the Vaca Muerta kind of drilling plans 2014 and 2015? When would we potentially see anything on a production side -- I know you made the comment it is a great shale, just wondering when would we maybe see something tangible that we can start to fix on?

John Watson - *Chevron Corporation - Chairman & CEO*

Well, I think you will start to see it going forward from here, we are producing 16,000 barrels a day gross, that is the 100% number. And so, one of the reasons I made the comment about it being a good investment is there is lots of oil infrastructure there now. So it is right in the middle of an oil-producing area.

YPF is doing a nice job, we are sending in some technical and other people to support them, but we have got 15 rigs running, we think over time it will get up to 19. And so we are optimistic that we will see continued growth.

I will just say, we just recently closed the transaction so it is very early days at this point. But it's -- there is probably more to come but you should start to see benefits in production here before too long.

Roger Read - *Wells Fargo Securities - Analyst*

Okay, thank you.

Operator

Peter Hutton, RBC Capital Markets.

Peter Hutton - *RBC Capital Markets - Analyst*

Actually my first question is a follow up from the last one which is about the liquids realizations in the US. And you mentioned these are in line with the benchmarks. From what I can see when I follow the trend, that is right when you are looking against the third quarter, but the third quarter had the highest discount between your average realization and WTI since the 2008 peak.

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So is it two quarters when we've had discounts of the order of something like $10 shortfall. And so I guess I'm asking the same question in a different way. Is that something we should also expect to see during the course of 2014 until you start to see more production out of the Gulf of Mexico from Jack/St. Malo? And then I had a follow-up which is actually my original question.

John Watson - *Chevron Corporation - Chairman & CEO*

I don't know if we have got anything fundamental for you. It may be right for Jeff to follow up with you off-line to see if there is something in the markers that we are not covering here. But there are some lags in pricing that take place in the US. But if you wouldn't mind, Peter, maybe we will follow up off line and see if we can get you the specifics.

Peter Hutton - *RBC Capital Markets - Analyst*

Be glad to. In the case can I just -- the question I was going to ask originally, which is on the reserve replacement rate and exploration. I think you mentioned 85% this year, which is down on the full year and one year is not a trend.

But were there any areas where you have been focusing and didn't come in in the way that you had expected? And realistically where the focus is for this year and can you give a figure of the budget for exploration spent in 2014? Please.

John Watson - *Chevron Corporation - Chairman & CEO*

Yes, actually the irony is this was a very good year for reserve replacement relative to what we had in our plan because you have -- we have based business type activity, infill drilling and the like, developments and additions, revisions off of existing fields. And we had a very good year in that area.

What we didn't have was a significant number of major capital projects that went to FID and that is why this number tends to be lumpy in any given year. So while on an ongoing basis it was less than replacing 100% of production, that is why we quote the three-year and five-year numbers which are 100% or higher. So I think that is -- I think that is really my thought for you on reserves.

Exploration this year is about $3 billion, $3.2 billion type of number this year. I will tell you one of the challenges we have had in the last couple of years is getting all of our high impact wells drilled. We have got a great queue, but we frankly in the Gulf of Mexico we have been drilling so many development wells that we have got a queue that is built up there. And so we are looking forward to -- I think we have got 14 or so high impact wells which we define as 100 million barrel or more prospects and we look forward to getting them drilled here over the next few years. But a little over $3 billion is the target for the year.

Pat Yarrington - *Chevron Corporation - VP & CFO*

I think we have time for one more question.

John Watson - *Chevron Corporation - Chairman & CEO*

One more question, Robert.

Operator

Robert Kessler, Tudor, Pickering, Holt.

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Robert Kessler - *Tudor Pickering Holt - Analyst*

Thanks for fitting me in and I look forward to the Analyst Day where I am sure we will go through more detail. But in the meantime I wanted to ask you for kind of an update on your Australia LNG cost and exposure to exchange rate. We still see volatility there.

I know you are of course further through the spend on Gorgon at 76%, which would imply less exposure to the exchange rate on the surface. But I imagine more of the spend now is local labor which I am assuming is price and Australian dollars.

So just the latest sort of leverage to that exchange rate if you don't mind and then any rethinking of your plans not to I guess hedge foreign exchange going forward?

John Watson - *Chevron Corporation - Chairman & CEO*

Yes, interesting question. Maybe the comment I will make, we have had a roller coaster on foreign exchange in Australia, as you point out. When we went to final investment decision back in 2009 the exchange rate was roughly $0.86 and it ramped up as high as I think [105] or so. And that was part of the reason that we supplemented the project.

Our view at the time was not to hedge foreign-exchange because we felt there had been a pretty strong correlation between oil prices and their currency. And so, we felt that our overall portfolio was pretty well hedged. And I think that proved to be a pretty wise decision.

When we went to FID on Wheatstone, we did so and have assumed a parity exchange rate. So that is a $29 [billion] project when we assume parity. This year our spend on the two projects is roughly $10 billion and we estimate that 70% to 75% of that spend is in Australian dollars.

So with the Australian dollar tracking under $0.90 now that is a positive for us going forward. We're out a little something on this, so we are benefiting from it right now. And -- but we don't do any hedging and I don't anticipate that we will going forward.

Robert Kessler - *Tudor Pickering Holt - Analyst*

Great. Nice to see it swing the other way. And thanks for the update.

John Watson - *Chevron Corporation - Chairman & CEO*

You bet, thank you. Okay, thank you all. In closing let me say we appreciate everyone's participation today on the call. I would like to thank the analysts for asking the good questions in this morning's session. We are looking forward to seeing you in March and I'm sure you will have lots more questions and will enjoy the material we will be presenting then. Thank you very much.

Operator

Ladies and gentlemen, this concludes Chevron's fourth-quarter 2013 earnings conference call. You may now disconnect.

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