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CVX - Q1 2017 Chevron Corp Earnings Call

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OVERVIEW:

Co. reported 1Q17 earnings of $2.7b, or $1.41 per diluted share.

CORPORATE PARTICIPANTS

Patricia E. Yarrington *Chevron Corporation - CFO and VP*

Stephen W. Green *Chevron Asia Pacific Exploration and Production Co. - President*

CONFERENCE CALL PARTICIPANTS

Alastair Syme *Citigroup Inc, Research Division - MD and Global Head of Oil and Gas Research*

Anish Kapadia *Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD, Integrateds and Upstream Research*

Blake Fernandez *Scotia Howard Weil, Research Division - Analyst*

Doug Leggate *BofA Merrill Lynch, Research Division - MD and Head of US Oil and Gas Equity Research*

Doug Terreson *Evercore ISI, Research Division - Senior MD, Head of Energy Research and Fundamental Research Analyst*

Ed Westlake *Credit Suisse AG, Research Division - MD and Co-Head of the Global Equity Oil and Gas Research*

Evan Calio *Morgan Stanley, Research Division - MD*

Jason Gammel *Jefferies LLC, Research Division - Equity Analyst*

Neil Mehta *Goldman Sachs Group Inc., Research Division - VP and Integrated Oil and Refining Analyst*

Paul Sankey *Wolfe Research, LLC - MD and Senior Oil and Gas Analyst*

Phil Gresh *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

Ryan Todd *Deutsche Bank AG, Research Division - Director*

Theepan Jothilingam *Exane BNP Paribas, Research Division - Research Analyst*

Paul Cheng *Barclays PLC, Research Division - MD and Senior Analyst*

PRESENTATION

Operator

Good morning. My name is Jonathan, and I will be your conference facilitator today. Welcome to Chevron's First Quarter 2017 Earnings Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I will now turn the conference call over to the Vice President and Chief Financial Officer of Chevron Corporation, Ms. Pat Yarrington. Please go ahead.

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Good morning, and thank you, Jonathan. Welcome to Chevron's first quarter earnings conference call and webcast. On the call with me today is Steve Green, President, Chevron Asia Pacific Exploration and Production Company. Also joining us on the call is Frank Mount, General Manager of Investor Relations. We will refer to the 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 cautionary statements on Slide 2.

I'll begin with a discussion of our first quarter 2017 results, Steve will provide an update on upstream activities with an emphasis on the portfolio he leads in the Asia Pacific region, then I'll conclude with a recap of key messages from our March 2017 Security Analyst Meeting.

Turning to Slide 3, an overview of our financial performance. The company's first quarter earnings were $2.7 billion or $1.41 per diluted share. Excluding foreign exchange and special items, as detailed in an Appendix slide, earnings for the quarter totaled $2.3 billion or $1.23 per share. Cash from operations for the quarter was $3.9 billion and included about $1 billion in working capital consumption. Excluding working capital, cash flow from operations was $4.8 billion.

At quarter end, debt balances stood at $45 billion, approximately $900 million lower than where we ended 2016. On a headline basis, this means a debt ratio of approximately 24%. On a net debt basis, where debt net of cash totaled $38 billion, our debt ratio stood at approximately 20%.

During the first quarter, we paid $2 billion in dividends. Earlier in the week, we announced a dividend of $1.08 per share payable to stockholders of record as of May 19. We currently yield 4%.

Turning to Slide 4. We intend to be cash balanced in 2017 at $50 Brent prices, and this slide demonstrates that we are nicely on our way to delivering that. First quarter 2017 net cash generation of $900 million incorporates the impacts of growing operating cash flow, reduced capital spend and proceeds from asset sales. Operating cash flow reflects improved realizations and high-margin volume growth.

Deferred tax effects were approximately $600 million, and affiliate earnings exceeded affiliate dividends by approximately $700 million.

TCO did not pay a dividend during the first quarter. That is more likely a second half event.

Additionally, working capital requirements consumed approximately $1 billion in the quarter. If you look back over several years, you will generally see a pattern of working capital consumption in the first quarter and often the second quarter, resulting from the timing of tax and variable compensation payments as well as inventory builds. The historical pattern also shows reversal in the second half of the year, and we expect that reversal pattern to hold again this year.

Cash capital spend for the quarter was $3.3 billion, approximately $2.3 billion or 40% less than the first quarter of 2016. Reductions come mainly from finishing our major capital projects under construction, pacing and high-grading future investments and realizing efficiency gains, along with higher cost reductions.

First quarter asset sale proceeds were $2.1 billion, primarily from the sale of our geothermal assets in Indonesia.

Turning now to Slide 5. Here, you see current quarter earnings compared against the same period last year. First quarter 2017 results were $3.4 billion higher than first quarter 2016 results. Special items, primarily a gain from the sale of our Indonesian geothermal assets, increased earnings by $795 million between periods.

Upstream earnings, excluding special items and foreign exchange, increased $2.3 billion between periods. This reflected improved realizations, lower operating expenses and increased volumes.

Downstream earnings, excluding special items and foreign exchange, increased by approximately $80 million, mostly due to a swing in timing effects and lower operating expenses.

The variance in the other segment was primarily from lower employee expenses and favorable corporate tax items. As we've indicated previously, our guidance for the other segment is $1.6 billion in annual net charges, though quarterly results are likely to be nonratable.

Turning to Slide 6. I'll now compare results for the first quarter of 2017 with the fourth quarter of 2016. First quarter results were approximately $2.3 billion higher than the fourth quarter. Special items, mainly from a gain on the sale geothermal assets in Indonesia, increased earnings between periods by $600 million, while foreign exchange impacts decreased earnings by $267 million between periods.

Upstream results, excluding special items and foreign exchange, increased by $267 million between quarters, primarily reflecting higher realizations.

Downstream earnings, excluding special items and foreign exchange, were higher by $668 million, reflecting the absence of the impacts of the fourth quarter Richmond refinery turnaround and a swing in timing effects.

The variance in the other segment largely reflects lower corporate charges and a swing in corporate tax items between quarters.

Turning to Slide 7. This chart shows first quarter production growth of 82,000 barrels of oil-equivalent per day or more than 3% from full year 2016 levels. Start-ups and ramp-ups, primarily from Gorgon, Angola LNG and Alder as well as growth in our Permian assets support accelerated production through the quarter. Base declines, the impact of production sharing and variable royalty contracts, along with the 2017 impact of asset sales consummated in 2016, reduced production.

Looking forward to the remainder of 2017, we expect to see additional growth from Gorgon Train 3, the first train at Wheatstone and Sonam. Additionally, we expect to see continued ramp-ups from other MCPs such as Mafumeira Sul and Moho Nord as well as growth in our Permian assets. Ultimate production growth for 2017 will be impacted by uncertainties, such as the timing and speed of MCP start-ups and ramp-ups, external events such as the Partitioned Zone restart and base decline rates. Price and spend levels will also impact the amount of cost recovery barrels we receive. All said, we expect to comfortably be within the 4% to 9% growth range we provided earlier in the year, again before asset sales.

Our current estimate for the impact of 2017 asset sales on production continues to be a reduction of 50,000 to 100,000 barrels of oil-equivalent per day. Earlier this week, we announced an agreement to sell our assets in Bangladesh, which produced approximately 114,000 barrels of oil-equivalent per day in 2016. The annualized impact of this and other asset sales will be dependent upon the timing of this close and of other individual transactions.

And now Steve will walk us through some upstream updates.

Stephen W. Green - *Chevron Asia Pacific Exploration and Production Co. - President*

Thanks, Pat. Good morning. Turning to Slide 8. All 3 trains at Gorgon are operational, making LNG and, in aggregate, running over 85% of nameplate capacity, processing gas from both the Jansz and Gorgon fields. The Gorgon Project is currently loading a ship about every 2 days and has shipped 67 cargoes to date with 38 cargoes shipped since the beginning of the year. Cargo 68 is currently loading now.

Recent highlights include: we maintained domestic gas production of about 130 million cubic feet per day through the quarter; the Gorgon offshore field started up mid-February; Trains 1 and 2 operated reliably near capacity with first quarter net LNG production of 105,000 barrels of oil-equivalent per day; Train 3 started up mid-March, a month ahead of schedule and, very much like Train 2, above expectations on ramp-up and approached nameplate capacity within 2 weeks. We recently completed a shutdown of Train 2. The shutdown was planned to address a reliability issue previously identified and resolved on Train 1, and on Train 3 prior to start-up. Once all 3 trains are at nameplate capacity, our share of Gorgon production will be over 200,000 barrels of oil-equivalent per day.

Looking ahead, we'll complete commissioning and start-up of additional equipment, which boosts efficiency of the trains such as the turbo expanders and the end flash gas compressors, systems that can be started now that all 3 trains are operational. Once all systems are in operation, we can begin the optimization and tuning of each train, the first step in further increasing capacity. After this, we'll analyze plant performance and look for debottlenecking opportunities that will increase capacity and capture incremental value going forward.

Turning to Slide 9. At Wheatstone, the physical construction of all systems required to commence Train 1 start-up is complete, and our outlook for first LNG remains mid-2017. Presently, we're focused on commissioning a range of systems as we move toward first gas and have begun running and testing the compressors. We've achieved permanent power at both the onshore and offshore facilities. We're also progressing activities such as mechanical, electrical and instrument tests as well as final integrity inspections. Within Chevron, we're leveraging our experience locally from Gorgon and more broadly, from Angola LNG, which has been operating steadily since the beginning of this year. We're also working closely with our partner, Woodside, which operates several LNG projects. We're preparing for a strong start-up, recognizing it is still the first train of a new facility. We anticipate Train 2 start-up about 6 to 8 months after Train 1.

Turning to Slide 10. A primary strength of our portfolio is our base business where we generate value and cash flow through a disciplined approach. Capturing incremental value in base business is not new to us. We've been doing it for decades. During my time in Thailand, we continuously reinvented ourselves and increased efficiency. We planned our work to avoid stranding capital by bringing wells online, timed to meet contractual obligations and market opportunities. This pattern continues today. This chart provides an example from our Thailand E&P business, where we drill over 500 wells per year and have net production of 240,000 barrels of oil-equivalent per day. We've seen a substantial reduction in unit development and operating costs through well planning and execution. We've applied these best practices across the company and are seeing benefits in places such as San Joaquin Valley, Indonesia and the Permian.

We're also leveraging our installed capacity and our technological capability to generate value. An example comes from Agbami, where we've drilled and tied back 36 wells since 2005, which have kept the FPSO full. Another example is the 27-mile Lianzi tieback to an existing host in deepwater West Africa where technology unlocked the opportunity to produce from a remote satellite reservoir.

We have integrated operations centers in many of our core assets where we create collaborative environments for cross-functional teams to analyze asset performance data and to make better intervention decisions. These centers are low-cost and consistently generate value. At TCO, it's helped achieve and sustain record production levels, with a focus on reliability and continued optimization of the well portfolio. We also have an integrated operations center in the Permian, which we expect will help us increase reliability and drive efficiency as our activity levels and production grow.

Turning to Slide 11. In the Permian, we continue to meet, if not exceed, expectations. The chart on the left shows our first quarter 2017 production of approximately 150,000 barrels of oil-equivalent per day, up about 35,000 barrels of oil-equivalent per day from the first quarter 2016. In March, we gave you our forecasted Permian compound annual growth rate of 20% to 35%, and we're currently well within that range. We're standing up our 12th rig, and our plan is to continue to add rigs at this pace, achieving 20 operated rigs by the end of 2018. In addition to our operated fleet, we'll see our share of production from 13 gross nonoperated rigs.

We continue to see efficiency gains and improved well performance, and we're incorporating the learnings into our forward plans. We intend to realize value through accelerated development and deliberate portfolio actions from the 150,000 to 200,000 acres we have identified as candidates for swaps, leases or sales. Our objective in the Permian is to be fully competitive on our unit development and production costs and realizations and use our superior royalty position to generate leading financial performance.

With that, I'll turn it back over to Pat.

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Okay. Thanks, Steve. Now turning to Slide 12. We continue to lower our cost structure and reduce our spend. The chart shows a steep reduction in quarterly average C&E since 2014. Year-to-date capital expenditures of $4.4 billion are down 22% compared to the average 2016 quarter and down 56% compared to the average 2014 quarter. We are trending below annual guidance.

We previously communicated that our capital guidance range is $17 billion to $22 billion per year through 2020. If oil prices remain near the $50 per barrel mark, you can expect to see our future spend near the bottom of this range.

Year-to-date operating expense is down almost 11% when compared to the average 2016 quarter and down 26% when compared to the average 2014 quarter. We have made substantial progress on lowering our cost structure, and we are striving to have the remaining quarters of 2017 broadly continue this pattern.

Now on Slide 13. We received approximately $2.1 billion in asset sale proceeds in the quarter, the vast majority of which related to the sale of our geothermal assets in Indonesia. Since the beginning of 2016, we've sold approximately $5 billion in assets and thus have already achieved the lower band of our targeted 2-year range.

Also during the quarter, we signed sales and purchase agreements to sell our marketing and refining assets in British Columbia and Alberta as well as our downstream business in South Africa and Botswana. These in-progress transactions are subject to regulatory reviews prior to closing, hopefully later this year.

Additionally, we announced an agreement to sell our upstream assets in Bangladesh, a business where gas production is sold into the domestic market at a fixed price.

Turning now to Slide 14. I'd like to close by reiterating our messages from our recent Security Analyst Meeting. Our financial priorities are clear and consistent. Our #1 priority is to maintain and grow the dividend as earnings and cash flow permit. To do that, we're focused on 3 areas. First, we are taking actions that should enable us to be cash-balanced in 2017. We intend to continue to grow free cash flow thereafter. The first quarter was a good start.

Second, we are focused on improving returns. This will happen as projects are completed and revenue is realized from growing production volumes. It'll happen as we shift our capital program. 75% of our spend is expected to generate cash within 2 years, and it will be aided by ongoing reductions in operating expenses and improvements in how we manage our major capital projects.

Third, we're focused on unlocking value from our entire portfolio. Our portfolio is anchored by legacy positions and advantaged by assets that are early in life. This gives us the opportunity to realize efficiency, reliability and debottlenecking gains with short-cycle, high-return capital investments.

So that concludes our prepared remarks, and we're now ready to take your questions. (Operator Instructions)

Jonathan, please go ahead and open up the lines for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Jason Gammel from Jefferies.

Jason Gammel - *Jefferies LLC, Research Division - Equity Analyst*

I'd like to take advantage of Steve being on the call and ask a couple of questions about Australia, if I could. Steve, you referenced in your remarks that Gorgon was currently operating at about 85%. I think each of the trains individually has been able to run at its nameplate capacity. Could you talk about anything that's on the critical path for all 3 trains being able to operate at nameplate capacity simultaneously and, essentially, what needs to be done before you can reach full economic capacity at Gorgon?

Stephen W. Green - *Chevron Asia Pacific Exploration and Production Co. - President*

Sure, Jason. Thanks for the question. We have operated all 3 trains at or near capacity, and we're seeing good performance from all 3 trains. There's nothing that is prohibiting us from operating at nameplate capacity except the fact that we have to work through a methodical start-up and again, bring on the proper blend from gas from Jansz and Gorgon. In my prepared remarks, I referenced there is some additional equipment that we will now commission since all 3 trains are operating that will allow us to, again, boost capacity and continue working toward nameplate capacity. But all 3 trains have operated very reliably. They're operating reliably now. The Train 2 shutdown was a planned event to address a mechanical device. So we're looking forward now to a reliable period of operation that allows us to do some tuning and performance improvement.

Jason Gammel - *Jefferies LLC, Research Division - Equity Analyst*

Okay. Very clear. And then maybe as a follow-up. I did note in the media that there was an unfavorable tax ruling recently in Australia that was related to an interest deduction on some intercompany loans for some prior year tax returns. I think the number was about $250 million that was referenced. Just wanted to check and see if there was any further potential liability on any past tax returns related to this issue and if there's anything, prospectively, that you think will affect your tax position in Australia.

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Yes. Jason, I'm going to start with expressing our huge disappointment in the ruling. I want to make it clear to everybody, though, that the courts affirmed that the financing arrangements that we had in place are legal, and the issue that is being litigated here is the appropriate interest rate for a loan between our corporate group and our Chevron Australia subsidiary. The court ruling deviates substantially from recognized international transfer pricing guidelines. In those guidelines, the courts are to treat related parties to a transaction as if they were standalone separate legal entities. The Australian appellate court really failed to do this. In other words, they were making no distinction between the creditworthiness of a Chevron Corporation as an entity versus Chevron Australia as an entity and, therefore, no distinction on the relative borrowing cost between those entities. There's an awful lot at stake with this ruling, not just for Chevron but for any intercompany lending in Australia and more broadly, around the globe, because it fundamentally changes established transfer pricing guidelines and principles. If the ruling stands, it's certainly going to affect any future investment in Australia. Going forward, specific to the Chevron case, we're currently evaluating the decision. The decision just came out a week ago. It's a fairly lengthy decision, and we're reviewing our options. Those options include going forward with an appeal to the High Court of Australia as well as continuing discussions with the ATO on a possible settlement or any other reasonable resolution to the dispute.

Operator

Our next question comes from the line of Paul Cheng from Barclays.

Paul Cheng - *Barclays PLC, Research Division - MD and Senior Analyst*

Steve, I have two questions. First, you mentioned that Train 2 is down, so when is that supposed to come back? And I presume that you're already -- whatever is the mechanical issue, you're already addressing in Train 3 and at Wheatstone. And also for Gorgon Train 4 and also Wheatstone Train 3, what kind of market condition do you need in order for you to even consider an FID at this moment?

Stephen W. Green - *Chevron Asia Pacific Exploration and Production Co. - President*

Sure. Thanks, Paul. Well, with respect to Train 2, it is online, operating and producing LNG this morning. And as I mentioned, providing a little more color than in my prepared remarks, the issue that we addressed on the recent Train 2 shutdown was a mechanical device that's part of the flow measurement apparatus. We had previously dealt with this issue in Train 1 and we corrected this issue in Train 3 prior to Train 3 even starting up. Certainly, we're transferring all the learnings and experience from Gorgon to the Wheatstone Project, so that prior to start-up, Wheatstone has the opportunity to intervene and address those known issues. As far as expansion trains at Gorgon and Wheatstone, there are a lot of factors that go into that decision. Our first priority is to get these assets up, stable, working as intended and capture the value from the investment we've made. At that point then, that decision, like any major capital project, will be a function of the market and the market's appetite for it and how those individual investments will compete in our portfolio at the time we FID them.

Operator

Our next question comes from the line of Paul Sankey from Wolfe Research.

Paul Sankey - *Wolfe Research, LLC - MD and Senior Oil and Gas Analyst*

Pat, you mentioned TCO's no dividend. Could you just remind us? I think you had said that at $50 Brent, below $50, you have to contribute to the capital expenditure programs there and above it's self-financing. I was just wondering what the sensitivity is on the dividend with respect to the oil price and whether I've got about the right numbers there.

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Yes, Paul, in 2016 we and Exxon made co-loans into the joint venture. There was also a third-party borrowing. And when you consider the amount of funds that came into the enterprise relative to the amount of investment that was going to be required for the capital project, there was sufficient funding projected out for 2017 where there would not be another co-lending requirement needed for 2017. As you look forward in 2018 and if you assume a $50-ish scenario, there will, more likely than not, be co-loans going on in 2018 and 2019. Somewhere in the 2 to 3-ish [billion] range is our requirement for total affiliate spending for this period of time. So what we were saying is that, because it was an advanced funding of capital requirements in 2016, we wouldn't need to co-lend again in 2017. We do anticipate that there will be a dividend receipt in the second half of this year for us [from TCO].

Paul Sankey - *Wolfe Research, LLC - MD and Senior Oil and Gas Analyst*

That would be at around these oil prices?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

That's exactly right. Going forward, there will be a lot of planning around the pace of spending on the project, what's happening to oil prices, what's the internal cash generation at TCO, et cetera.

Paul Sankey - *Wolfe Research, LLC - MD and Senior Oil and Gas Analyst*

Great. And then the follow-up is, your volume target for this year at 4% to 9% growth is a pretty big range. When I look at the uncertainties that you've listed, you seem to be saying that Gorgon and Wheatstone are bang-on schedule as far as you're concerned. I'll give you the Partitioned Neutral Zone uncertainty. I understand that one. I would've thought the base decline was fairly predictable by the time we're in April, and I don't really understand why there would be a PSC effect if you're assuming $50 oil. Is it safe to say that we should be looking towards the higher end of that range because the uncertainties, apart from Partitioned Neutral Zone, are essentially being significantly mitigated?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

PZ is a significant component. But what people capture in their mind is that the 4% to 9% range [isn't price dependent], and they forget the pricing premise that was used for it. There are price sensitivities built into that range that influence cost recovery barrels. Also, the investment levels going forward influence the cost recovery barrels. We were trying to be as descriptive as we possibly could be in naming the things that could either work to the upside or work to the downside.

Paul Sankey - *Wolfe Research, LLC - MD and Senior Oil and Gas Analyst*

Yes. I guess my point is that it feels like the downside effects are significantly mitigated.

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Well, if we continue on with first quarter results into second quarter and third quarter, I would agree with you.

Operator

Our next question comes from the line of Neil Mehta from Goldman Sachs.

Neil Mehta - *Goldman Sachs Group Inc., Research Division - VP and Integrated Oil and Refining Analyst*

Pat, first question relates to CapEx. It looks like you're tracking below the guidance. And I wanted to confirm, Pat, the $17 billion to $22 billion, it sounds like you're going to be on the lower end of that range at $50 barrel Brent. And relative to the guidance, what surprised to the downside here as it relates to CapEx?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

I think that we are trending lower than a ratable amount relative to our $19.8 billion target for this year. The affiliate spending was a little bit lower than ratable. And as you go through the year, spending by TCO, in particular, should pick up. Other than that, I would speak to capital efficiency. I think we are getting much greater activity for a given dollar spend than we had been anticipating. So coming in at the lower end or below the $19.8 billion could very well be where we end up for the year.

Neil Mehta - *Goldman Sachs Group Inc., Research Division - VP and Integrated Oil and Refining Analyst*

I appreciate that. And Pat, corporate costs were a little funky this quarter -- favorable after being unfavorable last quarter. Can you talk about some of the drivers that contributed to that benefit?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Yes. All I'll say is that the corporate sector can be quite volatile. It does include certain corporate expenses, for example, related to employees. I mentioned last quarter, if you recall, about pension settlement costs. That's a factor that goes in here. More impactful typically, would be corporate consolidated tax entries, and those are just very hard for us to predict. They're not necessarily ratable, and that's what you see going on in this particular quarter. I would again ask you to go back and think about the full year and use the $1.6 billion net charge for that sector in your predictions. That's the best information that I have, and it will not be ratable. It will be lumpy.

Operator

Our next question comes the line of Doug Leggate from Bank of America.

Doug Leggate - *BofA Merrill Lynch, Research Division - MD and Head of US Oil and Gas Equity Research*

Pat, disposals, you made the point that you already hit the low end of your range. There's some speculation that there could be additional asset sales that you haven't yet put in the public domain. Canada oil sands being the case in point. I'm just wondering if you could frame what the objective is. Is it to achieve the $5 billion to $10 billion? Or is it to high-grade the portfolio? And what I'm really getting at is, if there were other things to sell, would you cap the sales at $10 billion? Or would you keep going as you upgrade the portfolio? And I've got a follow-up, please.

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Right. I don't think it's an either-or circumstance. We do want to come in between the $5 to $10 billion, but we are also very focused on improving and high-grading the portfolio. We put this target out about one and a half years ago, and we're in the second half of that time period in executing it. I think it's still a good target for us this year, but we will continue to look at the portfolio to see if there are assets that aren't closely strategic, where there's value that others see in them that's greater than the value we see or that won't attract capital in our capital allocation process.

Doug Leggate - *BofA Merrill Lynch, Research Division - MD and Head of US Oil and Gas Equity Research*

Can you address Canada, specifically?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Canada, it's a good asset for us. It's a cash generator for us. You're talking about oil sands? I'm talking about oil sands.

Doug Leggate - *BofA Merrill Lynch, Research Division - MD and Head of US Oil and Gas Equity Research*

Yes, I am.

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

We're aware of the transactions that have occurred in this space over the last few weeks. All I will say is that if we were to have a transaction, we would make sure we received good value for it.

Doug Leggate - *BofA Merrill Lynch, Research Division - MD and Head of US Oil and Gas Equity Research*

And my follow-up, Pat, and hopefully a quick one. At the Analyst Day, you talked about evaluating a case to add an additional 10 rigs after the 20 rigs [in the Permian] at the end of 2018. I'm just wondering, with CapEx trending below target -- I know it's really early days, I get that. But I'm just wondering where you are in that evaluation, whether the pace might accelerate faster than you're currently guiding, and I'll leave it there.

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Doug, I hate to go off guidance we gave just 4 weeks or so ago. [Adding additional rigs] is in our quiver here. We are evaluating that. We're seeing great efficiency in terms of what we get per dollar spent. All of the production and operating cost improvements that we noted before continue to happen. We've been able to get much greater activity, and therefore, much greater volume per dollar spent. We'll continue to look at this [opportunity]. We have the same desire that our shareholders have, which is monetizing that asset as best we can. And this is certainly one option for doing that.

Operator

Our next question comes from the line of Phil Gresh from JPMorgan.

Phil Gresh - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

Just one additional follow-up on Gorgon, and I guess Wheatstone as well. With the production that we saw in the first quarter and where you're running today, and then assumed start-up costs for Wheatstone, I mean, how are you thinking about the real cash flow contribution from these 2 assets in 2017? I know they're meant to be the big contributors in the long term, but with the start-up costs for Wheatstone, and Gorgon finally just hitting its full stride, I mean, how much of that long-term cash flow contribution would you actually expect this year?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

I would say from a Gorgon standpoint, a reasonable number to have in your mind is a couple of billion dollars. Wheatstone is just going to be ramping up, so I wouldn't expect a significant contribution there [in 2017].

Phil Gresh - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

Would you expect it to actually be a negative, like with the start-up?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

I don't think I want to give a number there. There's still capital expenditures that are being incurred. If you look at it including capital expenditures, the answer on that would probably be a net drain on us for 2017.

Phil Gresh - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

Understood. Yes. Okay, got it. My follow-up is just on your supplement, the other production bucket for nat gas has been up significantly. I assume that's Angola. You touched on it a little bit in the prepared remarks, but maybe, Steve, if you could just highlight a little bit more for us where you're at with Angola and kind of what you're expecting for the year.

Stephen W. Green - *Chevron Asia Pacific Exploration and Production Co. - President*

Well, as you know, Angola restarted early part of the year, and it's been running very reliably since that time. And we are consistently loading LNG cargoes, propane cargoes, butane, and we expect that performance to continue. We've gotten the plant where we want it now, and it's operating reliably.

Operator

Our next question comes from the line of Evan Calio from Morgan Stanley.

Evan Calio - *Morgan Stanley, Research Division - MD*

Pat, you mentioned that CapEx runs to the low end for 2017, if oil's near $50. Oil being near $50, I mean, can you discuss when you begin to adjust that spending? And is that adjustment within short-cycle Permian or elsewhere? Just how does that play out in the 2017 capital program?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Well, within upstream, there is fine-tuning as the year progresses about where additional capital spending opportunities are being generated. The Permian is one of the first places to consider for additional capital, but there are other short-cycle investments, for example, in Thailand and in San Joaquin that would also be attractive. That is a routine optimization that goes on within the upstream leadership team. I won't say [they do this] on a monthly basis, but they continue to monitor it as the year progresses.

Evan Calio - *Morgan Stanley, Research Division - MD*

Right. So that works for lowering CapEx as well. I think you kind of phrased it for raising CapEx.

Evan Calio - *Morgan Stanley, Research Division - MD*

My second question, a lot's been covered here within Australia, maybe -- I know you have a lot of moving pieces in the portfolio that are outside of Chevron's control and maybe there's just some update of conditions or outlook in Nigeria, Venezuela and PNZ. Any update in those regions I think would be helpful.

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Okay. I'll take PZ first. I can say that negotiations or discussions are underway. They're still occurring between the parties of the government. I really can't go out on a limb and predict when the resolution might occur. We're going on 2 years now where [the dispute] has been an issue. I will say that the longer this goes on, the more challenging it is to get the equipment back up and running. We continue to reduce operating expenses in PZ and continue to let people leave the payroll, because we need to limit the losses that are occurring there. I don't have any fresh news about when we might expect that restart, unfortunately. In Venezuela, I would just say it's a very tough circumstance for all the people of Venezuela. [The situation] has been minimally impactful to our operations and our facilities. Priority #1 for us is keeping our people safe, and we're operating with that intention in mind. And Nigeria just continues to be a challenging location as well. There has been some disruption to production facilities in the first quarter of the year. We continue to monitor [our people's] safety there as well.

Operator

Our next question comes from the line of Ed Westlake from Credit Suisse.

Ed Westlake - *Credit Suisse AG, Research Division - MD and Co-Head of the Global Equity Oil and Gas Research*

A question for Steve on Australia. I mean, you had an issue, I think, with a flowmeter, and you've sorted that out on the trains. So I just wanted just to confirm that there isn't any design difference between Gorgon and Wheatstone, and therefore, what the risks are in terms of starting up at Wheatstone that it's all been fixed based on the learnings at Gorgon, if I understood you correctly.

Stephen W. Green - *Chevron Asia Pacific Exploration and Production Co. - President*

Well, yes, Ed. Thanks for the question. There are design differences. There are 2 different technologies in the plant between Gorgon and Wheatstone. But of any common equipment and any issues that we have dealt with in the start-up of all 3 trains at Gorgon, we have communicated, and those issues have been addressed at Wheatstone, to the extent they're common to Gorgon. I mentioned our partner, Woodside. Any issues that they have experienced in any of their facilities, we're benefiting from that as well. As well as Angola LNG. So any place we can get learnings or experience and borrow it, we're factoring that in and addressing it as best we can prestart-up [for Wheatstone] to try to remove those variables.

Ed Westlake - *Credit Suisse AG, Research Division - MD and Co-Head of the Global Equity Oil and Gas Research*

And then sticking with Australia, I mean, obviously, Gorgon, you talked about debottlenecking. It'd be interesting to see what sort of debottlenecking uplift you can get from the plant. But also obviously, there's Northwest Shelf and then there's other plants that need filling, maybe how would those investments compete against each other? I mean, obviously appreciate there's commercial terms to be negotiated as well.

Stephen W. Green - *Chevron Asia Pacific Exploration and Production Co. - President*

Right. I'll start with the second part of your question first. We have active work going on now to assess our large portfolio of discovered resource and look for commercial opportunities to accelerate [those resources] and commercialize that as the market materializes. That work is ongoing, whether it be through one of our facilities or third-party facilities. With respect to Gorgon and debottlenecking, as I mentioned in the prepared remarks, we have been looking forward to the day where we are today at Gorgon, where we have all 3 trains up and running. We can begin to now tune and improve performance in the system as a whole. We have some additional equipment that will boost capacity as we bring it online. I mentioned a couple of examples of that in the prepared remarks. But this is really an opportunity to exercise what I consider a real core competency of the company, and that is getting more and more out of assets once they're up and operating. A terrific example of that is our long experience at Tengiz where we have consistently improved performance and efficiency and increased the throughput from that facility. We're looking forward to having a similar experience at Gorgon as we go forward in time. Specific to debottlenecking, we'll analyze those opportunities, and some of those will be relatively short term that we can do while we're in operation. Others are more complex and will require engineering and scheduling into planned outages or turnarounds as we go forward in time.

Operator

Our next question comes from the line of Alastair Syme from Citi.

Alastair Syme - *Citigroup Inc, Research Division - MD and Global Head of Oil and Gas Research*

Pat, can you talk about the cost trend on Slide 12 a little bit? As you look back, how much do you think that has been variable costs, such as energy and chemicals? And are you seeing any signs of that beginning to come back? And I had a follow-up for Steve as well.

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Yes. I would say, in terms of inflationary pressures, the only place around the globe that we are seeing inflationary pressures of any size would be in the Permian, and that's obviously being driven by activity levels. Within the Permian, we're working very hard to restrict inflation through our contracting strategy in terms of fixed price contracts, indexed contracts, staggered contract terms, performance contracts, et cetera. Overall, we think inflation will be manageable for us and will have a relatively small impact in 2017. And then outside the Permian, we just haven't seen inflationary pressures. In general, we're striving to have a continued downward trend on operating expense in the remaining 3 quarters of the year, acknowledging that we will be bringing on additional production, and that will be an element going in the other direction.

Alastair Syme - *Citigroup Inc, Research Division - MD and Global Head of Oil and Gas Research*

And my follow-up for Steve. I know this is going to be a sensitive subject, but can you comment on what you think the Australian government is trying to achieve with its PRRT review? And are there aspects of existing legislation that you would like to get changed?

Stephen W. Green - *Chevron Asia Pacific Exploration and Production Co. - President*

Well, I think as an investor, there's no difference in Australia than where we look anywhere [to make an investment]. We look for stability of fiscal terms and conditions that we invest under to be maintained over the life of those investments. So we have engaged with the government on the PRRT question; and that is a cautionary note for all investors, not just us. The government yesterday in Australia released the initial report, and any changes that are contemplated will be prospective, which is exactly what our position was. You can't go back and change the rules of the game after the investments are made. So I think we have good engagement with the government. It has been a bit of an irony. I was there last week. And the second story on Page 1A is the emerging gas crisis or energy crisis on the East Coast, for which any solution will demand significant capital investment. I think Australia is appropriately trying to find the right balance between their fiscal needs in the government and preserving what has been a very, very successful regime for attracting large capital investments, especially in our sector.

Operator

Our next question comes from the line of Blake Fernandez from Scotia Howard Weil.

Blake Fernandez - *Scotia Howard Weil, Research Division - Analyst*

I had two questions for you on the Permian. I know you already addressed the operated rig count, but my question was on the nonoperated rig count. I think you said the base case contemplated 13 nonoperated rigs. And just based on the level of activity increases we're seeing in the industry, it just seems like there's probably upward pressure there. So can you confirm whether you're getting pressure from peers to maybe increase activity on that and whether that probably leads to some upside on your base case? And then, I guess, tying in with the Permian question, the second is on the oil price realizations in the U.S. It seems like there was a pretty healthy increase in U.S. oil relative to the benchmarks. I didn't know if there was something one-off or if this is just a function of Permian ramping up in that representing better realizations relative to the rest of the portfolio.

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Okay. Blake, on the NOJV issue, I don't have any significant information that would suggest that the NOJV plan is any different than we had outlined. Currently, we've got 13 gross NOJV rigs, and that's 5 net. In our plan as we look forward, there was some ramping up [of rigs], but I don't have any new information relative to that. With regard to the realizations, there's nothing unusual there in terms of one-off on realizations. It really is just a function of WTI prices, San Joaquin Valley prices, Mars prices, et cetera, and how those moved relative to one another.

Operator

Our next question comes from the line of Anish Kapadia from TPH.

Anish Kapadia - *Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD, Integrateds and Upstream Research*

First question was related to Steve to think about the Southeast Asia business from a more strategic standpoint. You've divested the Bangladesh assets. There's been quite a few stories in the press that you've been looking at least divesting of maybe some of your other Southeast Asian assets. And then on the other side, you have got some predevelopment, pre-FID decisions to make on things like Ubon and the developments in Indonesia. So I just wanted to kind of get an idea of how you view Southeast Asia within the context of the portfolio and the strategic decisions that you're thinking about for that portfolio.

Stephen W. Green - *Chevron Asia Pacific Exploration and Production Co. - President*

Thanks for the question. Southeast Asia has long been and remains a core part of our upstream portfolio. We have a great business in Thailand, have had for 40-plus years. That business continues to perform very well. And in terms of incremental investments in Thailand beyond the base business, those are evaluated just like they are anywhere else in the company -- the market, the terms and conditions, the resource, the cost of finding and development on unit basis, all those things factor into our decision -- whether it's Thailand or Indonesia as well. Our process for some time has been to go through the portfolio systematically and look at incremental investments on how they compete within the portfolio relative to our other opportunities. Notwithstanding the asset divestments that have been announced, Southeast Asia is still a very, very core part of our upstream portfolio and is performing well.

Anish Kapadia - *Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD, Integrateds and Upstream Research*

And then a follow-up for Pat around cash flow. So you mentioned some impacts in Q1 that may turn around in the second half of the year, I think in terms of the working capital, in particular. I'm guessing also, you've got the impacts of projects ramping up in the second half of the year. So I'm just thinking, in a flat oil price environment, should we expect a significantly higher cash flow in the second half of 2017 to the first half of 2017? And also, just related to that, are there any kind of significant pension contribution impacts through the course of this year?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

If you look back over time, our first quarter tends to be typically our lowest cash generation quarter, and part of it is driven by the working capital. I did indicate that we anticipate a portion of that working capital likely reversing between the end of this quarter and the end of the year, so I don't think we will get the same kind of penalty there per quarter. I mentioned the dividends, a potential [dividend] from TCO in the second half of the year, so that would be a positive in the remaining quarters of the year. If you go back to what I said in March, one of the questions I had was about the summation of all of these "headwinds," and I gave an indication then of them being a little bit over $4 billion for the year. I still think that is good guidance to think about when you consider the deferred tax impact, the working capital impact and the difference between affiliate dividend and affiliate earnings during the period. So all said I think the second part of the year will have stronger cash generation, not only from these reasons I'm talking about, but also from production increases and the high cash margin barrels that we're bringing on.

Anish Kapadia - *Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD, Integrateds and Upstream Research*

Okay. And just to clarify that $4 billion, does that include the cash contributions to pensions?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

It would.

Operator

Our next question comes from the line of Doug Terreson from Evercore ISI.

Doug Terreson - *Evercore ISI, Research Division - Senior MD, Head of Energy Research and Fundamental Research Analyst*

To me, a positive aspect of the capital allocation and the corporate governance changes that are underway at the company is the increased emphasis on cash returns at the business unit level and specifically on project execution, at least in my opinion. And while John talked about this some at the Analyst Meeting, I wanted to see if you could provide a progress report on this process in the upstream business, the time frames over which the teams are going to be judged and, really, any other factors that you deem relevant to positive execution and performance in this area.

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

It's a good question. The place where we're seeing it in action is in TCO. This is the most significant longer duration capital project that we have underway at this point in time. We've talked about the fact that we were increasing the overall engineering that was done before we began to cut steel. We've now started fabrication in Korea and the Kazakhstani yards. We've done more on the project in terms of design assurance, optimizing contracting strategy, and taking advantage of the lower cost environment. All of the elements that Jay and John have mentioned before in terms of strong major capital project execution will be visible in TCO and how well it is progressing. And right now, we're on track with elements of fabrication and construction of the port, and we're underway with constructing the housing village, and the drilling is going very well.

Doug Terreson - *Evercore ISI, Research Division - Senior MD, Head of Energy Research and Fundamental Research Analyst*

Okay, great. It'll be a good test case. And then also, Pat, there's a $2 billion sales proceeds figure floating around in the press for Bangladesh. And so my question, is that your number? Is it somebody else's number? Or is that a no comment at this point?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

That's a no comment at this point, so thank you very much for giving me that third option.

Operator

Our next question comes from the line of Ryan Todd from Deutsche Bank.

Ryan Todd - *Deutsche Bank AG, Research Division - Director*

Maybe a follow-up to the earlier cash flow questions. You generated, I think, roughly $900 million of free cash flow in the quarter beyond the dividend, and you used it to pay down some debt. I mean, I realize there was an asset sale tailwind in the quarter. But as you start to generate modest amounts of discretionary cash flow beyond CapEx and the dividend, how should we think about the use of the discretionary cash flow? How would you prioritize debt paydown versus buybacks versus incremental capital spend?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

I'm going to go back and reiterate what our priorities have long been. The first priority is going to be given to growing the dividend when we feel cash flow and earnings can support it for the long term. And by that, I mean in perpetuity. Secondly, we look at future additional investment opportunities that we've got because we do need to continue to grow future revenue streams. And then we look at the balance sheet. It is important for us to continue to have a strong balance sheet. And what you saw in this quarter is really a flex in our commercial paper program, and that's part of why we have a commercial paper program is to take flex like this. We're at a 24% debt ratio, which is an okay place to be, I would say. But over time, I'd like to see us move a little bit lower in the debt profile when cash flow permits us to do that. Maintaining a AA is important to us. We did just meet with the rating agencies. We did just get affirmed by Moody's as a AA stable. We haven't heard from S&P yet, but it's an important element for us.

Ryan Todd - *Deutsche Bank AG, Research Division - Director*

Okay. And then maybe -- you have a slide there on the deck, I think it's Slide 10, showing the efficiency gains across the base portfolio as well. And obviously, I mean, for investors, the efficiency gains in the U.S. onshore have been a huge area of focus and generally is quite transparent. Can you talk a little bit more about the efficiency gains that you're seeing across the broader global portfolio? Do you think the market underestimates gains outside the U.S.? And is the kind of 30 to 35-plus percentage type of gains that you showed here on a couple of anecdotal things, is that representative of the type of gains you've seen across the broader portfolio?

Stephen W. Green - *Chevron Asia Pacific Exploration and Production Co. - President*

Yes. Well, the chart that you referenced, of course, is specific to our Thailand operations. But as I mentioned in the prepared remarks, we are transferring both people and learnings from those operations into the Permian, into AMBU, into other places where we have this factory well approach, and we are seeing those kind of gains in efficiency and driving down our unit cost. Another example that's probably a little less visible perhaps, comes from Indonesia. Last year in Indonesia, in our Duri operations, which is a heavy oil steamflood, we were able to drive down the cost of our steam, which is our largest line item of OpEx, by over 40%, without degrading production. So again, as I said, in a response to a question about Gorgon, this is in the sweet spot of Chevron's core capability -- transferring learnings and ways to get efficiency and operate assets in the portfolio and get more and more out of those assets as we go forward.

Operator

Our last question comes from the line of Theepan Jothilingam from Exane BNP.

Theepan Jothilingam - *Exane BNP Paribas, Research Division - Research Analyst*

Just coming back to the financials. Could you perhaps just talk a little bit about cash taxes? I know you've sort of quantified the deferred tax impact this quarter, but just going forward at Chevron, let's say, at $50, how should we think of sort of the cash tax rate? And then my follow-up question was just on PZ. Again, broadly speaking, what type of sort of run rate should we be thinking about on OpEx? And how we actually capture that back if and when PZ volumes are back on stream?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Yes. I'll take PZ first. I don't want to get into describing what our ongoing operating costs are there when we've got an asset that is not operating. I will just say that, when it does come back online, these cumulative losses will be taken into account for the eventual tax recovery that's available to us. In terms of cash tax -- this is a hard area for us to forecast at this particular time because of the issue that I've explained before regarding tax loss carryforwards and the fact that we've got different jurisdictions with different circumstances from a current tax position standpoint. In general, we do still have some jurisdictions at current prices that are generating tax losses, and that means that these tax losses will be carried forward into future periods. And when oil prices rise from $50 to $60 to $70, if you assume that hypothesis, we do need higher prices to recover some of those previously deferred tax benefits -- the tax losses that have been carried forward will become a cash benefit in future periods. That's the best guidance that I can give you at this point in time. At low prices we do still have cash taxes in some locations, but not in all locations.

Theepan Jothilingam - *Exane BNP Paribas, Research Division - Research Analyst*

Is there any way to sort of quantify that number in terms of an aggregate number that if prices were to recover, Chevron could use in terms of tax allowances?

Patricia E. Yarrington - *Chevron Corporation - CFO and VP*

Well, I don't have it handy here. It's something I can consider for future disclosures.

Okay. I think that concludes our call for this morning. I want to thank everybody for your time today, and we certainly appreciate your interest in Chevron and your participation on the call. Thanks very much.

Operator

Ladies and gentlemen, this concludes Chevron's First Quarter 2017 Earnings Conference Call. You may now disconnect. Good day.
