

FINAL TRANSCRIPT

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CVX - Q4 2008 Chevron Earnings Conference Call

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PRESENTATION

Operator

Good morning. My name is Matt and I will be your conference facilitator today. Welcome to Chevron's fourth quarter 2008 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 would now turn the conference call over to the Chairman and Chief Executive Officer of Chevron Corporation, Mr. Dave O'Reilly. Please go ahead, sir.

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Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Thank you, Matt. And welcome to Chevron's fourth quarter earnings conference call and Webcast. On the call with me today are Pat Yarrington, Vice President and Chief Financial Officer, and Jim Aleveras, General Manager, Investor Relations. Pat took over as CFO from Steve Crowe who retired last month and has extensive experience in all aspects of Chevron's financial operations. Most recently, Pat has been our Vice President and Treasurer and prior to that was Vice President of Government and Public Affairs and before that Vice President of Strategic Planning. You'll have an opportunity to meet her at our meeting in New York on March 10th.

Pat, I'll turn the meeting over to you.

Patricia Yarrington - *Chevron Corporation - VP, CFO*

Thanks, Dave. Let's turn now to Chevron's financial and operating results for the fourth quarter of 2008. We'll refer to the slides that are available on the web. Before we get started, please remember that this presentation contains estimates, projections and other forward-looking statements. We ask that you review the cautionary statement on slide two.

I'll begin with slide three which provides an overview of our financial performance. The Company's fourth quarter earnings were \$4.9 billion, or \$2.44 per diluted share. Our total fourth quarter 2008 earnings were about the same as fourth quarter 2007. Earnings per share, however, were up about 5% due to our share repurchase program. Comparing the fourth quarter 2008 to the same period a year earlier, lower crude oil and natural gas prices reduced upstream results while falling prices improved profits in the downstream segment. To recap the balance of slide three, return on capital employed for the year was nearly 27%.

Underscoring Chevron's financial strength the debt ratio was below 10% at the end of the year and cash balances exceeded debt by \$700 million. Share repurchases were \$8 billion for the year. Our latest share repurchase program was authorized by the Board in September 2007. For up to \$15 billion over a period of up to three years. We have now repurchased \$10.1 billion of the \$15 billion authorized. We do not anticipate repurchasing shares in the first quarter of 2009. Finally, Chevron's 2008 TSR of negative 18% compares favorably to the S&P 500's return of negative 37% and a 37% decline in the AMEX Oil Index.

Turning to slide four, our total capital spend for 2008 was \$22.8 billion compared with our budget of \$22.9 billion. Upstream spending accounted for \$17.5 billion of that total. Our cash C&E which excludes our equity share of affiliate outlays was \$20.5 billion. Our announced capital program for 2009 of \$22.8 billion is unchanged from 2008 expenditures.

However, about 10% of the total 2009 budget relates to large one-time payments for concessions in the Partitioned Neutral Zone and Chuandongbei gas field. Excluding these items, underlying spending in the upstream segment is budgeted to be lower than last year. Of the overall 2009 capital program, 77% is for upstream activities, reflecting the capital intensive phase of some of our long-term growth projects. Another 19% is earmarked for the downstream for a number of investments to upgrade our refining network.

Jim will now take us through the quarterly comparisons. So Jim, over to you.

Jim Aleveras - *Chevron Corporation - GM, IR*

Thanks, Pat. My remarks compare results of the fourth quarter 2008 with the third quarter 2008. As a reminder, our earnings release compared fourth quarter 2008 with the same quarter a year earlier. Turning to slide five.

Fourth quarter net income was about \$3 billion lower than the third quarter. Starting with the left side of the chart, lower crude oil and natural gas prices caused worldwide upstream results to decline by more than \$3 billion. Similar to the prior quarter,

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falling commodity prices benefited the downstream segment in the fourth quarter. The variance in the "Other" bar reflects lower chemical earnings and higher corporate charges.

Slide six summarizes the results of our US upstream operations. Lower crude oil and natural gas prices reduced earnings by \$1.6 billion. Chevron's average US crude oil realization was down about \$61 per barrel between quarters. Similar to the average WTI change of about \$59 per barrel between the periods. Production volumes were down 4%, mainly due to the full quarter impact of September hurricane shut-ins. This volume impact reduced fourth quarter earnings by \$100 million.

As mentioned in the interim update, lower charges related to the hurricanes benefited earnings by about \$350 million in the fourth quarter, compared to the third. The fourth quarter included a gain of about \$600 million from an exchange transaction which included the Company's interest in a producing property in Utah. For comparison, asset sales added about \$350 million to third quarter profits. This difference of \$250 million is shown on the chart. The "Other" bar is comprised of a number of items, the largest of which was related to a change in natural gas inventories.

Turning to slide seven. International upstream earnings for the fourth quarter fell nearly \$2 billion from the third quarter's results. Lower oil and gas prices reduced earnings by \$2.8 billion. Our average realizations for liquids fell about \$56 per barrel between sequential quarters, compared to the \$59 per barrel decline in the average Brent Spot Price. Higher liftings benefited fourth quarter earnings by \$430 million. Liftings were higher in Kazakhstan due the ramp-up of the Tengiz expansion and completion of the third quarter facilities turnaround there.

The ramp-up of Agbami in Nigeria was also a significant factor. The \$210 million favorable variance in tax items shown on this slide reflects various issues in several countries. Exploration expense was higher between quarters, reducing earnings by \$140 million. This was a result of several well write-offs along with higher geological and geophysical expenditures. The "Other" bar is primarily an increase in foreign currency gains.

Slide eight summarizes the quarterly change in worldwide oil equivalent production including volumes produced from oil sands in Canada. Production increased by 97,000 barrels per day or 4% between periods. Lower fourth quarter prices benefited volumes by 73,000 barrels per day primarily due to production sharing contracts and variable royalties. External constraints such as mandated curtailment by OPEC-member host governments and lower natural gas demand reduced production by 51,000 barrels per day.

As mentioned earlier, the fourth quarter was impacted by the September hurricanes in the Gulf of Mexico. The volumetric effect was an adverse variance of 27,000 barrels per day. Base business declines of 17,000 barrels per day were more than offset by the ramp-up of production from the Tengiz expansion, Agbami, Blind Faith and the Northwest Shelf LNG Train 5.

Slide nine compares full year 2008 OEG production, including volumes produced from oil sands in Canada, to that of 2007. Price impacts on production sharing contracts and variable royalties reduced production by 72,000 barrels per day. WTI prices averaged \$72 per barrel in 2007, in contrast to \$100 per barrel in 2008. For the year, 2008 external constraints such as mandated curtailments by OPEC member host governments and lower natural gas demand reduced production by 13,000 barrels per day. The full year impact of Gulf of Mexico hurricanes was 35,000 barrels per day. Our base business decline was 78,000 barrels per day, a drop of about 3%. I'll discuss our outlook for the base business decline in a moment.

Finally, our major capital projects, primarily the Tengiz expansion, Agbami, and the further ramp-up of our 2007 Bibiyana field in Bangladesh added 109,000 barrels per day to 2008 production. Blind Faith came on-stream late in 2008 and did not have a large impact on the full year. 2008 production of 2.53 million barrels per day came in 120,000 barrels per day lower than the outlook we provided at the beginning of the year. The original 2008 outlook of 2.65 million barrels per day assumed crude prices for the year would average \$70 per barrel, instead of the \$100 average that actually occurred.

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Price effects along with external constraints and the September hurricanes noted here were the primary reasons for the difference. Our base business performed slightly better than we assumed. Offsetting this, we experienced a six month delay in the start-up of Blind Faith. The rest of our projects started on time but some ramped up more slowly than originally planned.

Slide 10 shows our production outlook for 2009. We had previously provided guidance for 2008 that each dollar change in crude prices would inversely change our production by about 2,000 barrels per day, due to the effect of production sharing and variable royalty agreements. Because certain thresholds have been reached under these agreements our rule of thumb for 2009 is each dollar change in crude prices affects production by roughly 1,200 barrels per day. As before, I would caution you that this rule of thumb is very approximate and actual results will differ. Each of the underlying contracts is different.

On this basis, comparing 2009 at an assumed price of \$50 per barrel, which is just based on last week's future prices and 2008 at \$100 per barrel, price effects would increase production by 60,000 barrels per day as shown on the chart. External constraints, again curtailments by OPEC member host governments and market factors, are assumed to reduce production by 80,000 barrels per day. Base business declines and the impact of lower investment in the base business are expected to reduce production by 180,000 barrels per day. This amount is an implied 7% decline rate in contrast to our previous 4% to 5% base decline guidance.

Due to lower expected oil and gas prices, spending on our base business to mitigate natural field declines will be reduced in 2009. We're still investing to mitigate these declines, but at a lower level, reflecting the lower level of oil on gas prices. The base barrels that we do not produce in 2009 will still be there to produce when market conditions are more attractive. Because of this temporarily higher base decline rate and market-driven investment deferrals, we do not expect to achieve our full 3% compound annual production growth between 2005 and 2010. We'll update you further at our annual security analyst meeting in New York on March 10th.

Finally, 2009 will benefit from the continued ramp-up and full year production from our recent major capital projects. And from the new ones planned to come online later this year including Frade in Brazil, Tahiti in the Gulf of Mexico and Tombua Landana in Angola.

Turning to slide 11, US downstream operations earned just over \$1 billion, essentially flat with the previous quarter. Indicator margins reduced earnings by \$260 million. While marketing margins improved, lower refining margins on the West and Gulf Coast were a larger factor. The change in the Company's realized margins tracked the change in indicator margins.

WTI prices fell more than \$56 per barrel from the end of the third quarter to the end of the fourth quarter. This exceeded the \$39 per barrel drop that occurred during the prior quarter. These sharply falling prices caused the downstream to have large favorable timing effects in both quarters. Timing effects were \$80 million more favorable in the fourth quarter than the third. On an absolute basis, timing effects in the fourth quarter were about \$700 million. The largest factor was provisionally priced foreign crude which was \$370 million in the fourth quarter, about the same as it was in the third quarter.

In the previous conference call, I mentioned that the Company revised the primary long haul crude supply agreement to the West Coast refineries starting in October. However, August and September liftings were still final priced in October and November and prices were about \$35 per barrel lower than at the end of the third quarter. We do not expect material timing effects from provisionally priced crudes in the first quarter for our US operations. The balance of the timing effects was primarily due to inventory effects, derivative gains associated with sale of refined products, a favorable lag in aviation pricing, and other supply related factors. Finally, operating expenses declined largely from lower fuel costs.

Turning to slide 12. International downstream earnings improved by \$230 million to more than \$1 billion. Refining margins were lower in the fourth quarter, while marketing margins were mixed. Overall, our realized margins fell \$205 million between the sequential quarters. Volumes were slightly lower during the fourth quarter, partly reflecting planned maintenance at our Pembroke refinery in the UK. The volume effect was an adverse variance of \$30 million.

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Timing effects added \$525 million to fourth quarter earnings compared to third quarter earnings. The absolute amount of timing effects in the fourth quarter was roughly \$850 million. Nearly half of the increase between sequential quarters was related to derivative gains on long haul crude and refined products such as PNZ crude, Pembroke exports and crude sales to equity affiliate refineries. As I mentioned during the last few quarters, we often use derivatives to lock in a margin above the cost of transportation, which results in gains when prices decrease and vice versa.

The balance of the timing effect between quarters resulted from gains on derivatives used to convert crude pricing at the time of refinery run and a favorable lag in aviation pricing, as well as other supply-related timing factors. The "Other" bar in this chart reflects an adverse change of \$60 million between quarters. Lower operating expense was more than offset by an adverse swing in foreign currency effects.

Slide 13 shows that earnings from chemical operations were \$28 million in the fourth quarter, compared to \$70 million in the third quarter. Results for Olefins decreased due to lower volumes and prices. Aromatics earnings fell primarily because of a one-time impairment charge. The "Other" bar reflects higher additive earnings.

Slide 14 covers all other net charges. Fourth quarter results were net charges of \$365 million, compared to net charges of \$190 million in the third quarter. \$310 million of this swing reflects higher corporate charges across a number of areas. \$70 million of the change stems from a favorable variance in tax items. The "Other" bar on slide 14 includes the net of many unrelated items which were a \$65 million favorable variance between the sequential quarters.

Before turning it over to Dave, I'd just like to briefly recap the fourth quarter. Upstream earnings fell significantly in line with the interim update. Downstream continued to benefit from sizable derivative gains due to declining prices; also noted in the interim update. And last, as projected, chemical earnings were lower and all other charges exceeded the guidance range.

Dave O'Reilly will now summarize our 2008 strategic progress and provide some thoughts about 2009. Dave?

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Well, thank you, Jim. And turning to slide 15.

In 2008, we focused on execution and succeeded across the board. For several years, we've made improvements in our safety performance and were among the Best-in-Class. In our upstream business, we committed to starting up three major Chevron operated projects adding significantly to our long-term production. The Tengiz expansion, Agbami and Blind Faith are all on line and performing well. We also started the first phase of the North Duri steam flood in Indonesia and achieved first production at five partner operated projects.

We've talked about our exploration success for many years in a row and 2008 was another banner year for exploration, which we'll discuss further at the March security analyst meeting. We told the investment community that our reserve replacement ratio would improve and on a preliminary basis we estimate that we replaced 146% of our production in 2008. In our downstream business we pledged to improve refinery reliability. We delivered on that pledge in 2008 and we've had our best utilization rates on record. 2008 represented a 6.5% improvement in refinery utilization, over the base year of 2005. Our downstream portfolio rationalization has continued in 2008 as we exited a number of non-strategic markets.

And finally, we rewarded our shareholders with another double-digit increase in our dividend and repurchased \$8 billion of our shares. We did so while funding our robust capital program and maintained a balance sheet with more cash than debt at the end of the year. So we enter these challenging times with the financial strength and flexibility to succeed in the years ahead.

Turning to slide 16, let's just look at 2009 briefly. In our upstream business we're on track to start up three more Chevron operated projects, further demonstrating our organic growth potential. We are also focused on the work needed to continue to advance

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our strategically important projects in core areas, such as Australia, and the deepwater Gulf of Mexico. In the downstream business we're maintaining our focus on refinery utilization, to capture the most margin that the market will permit. And we're continuing to rationalize our portfolio to focus on our strongest markets and those with the most potential for long-term value creation.

Across the enterprise, we're focused on managing our costs. The same world class processes we use to manage costs when they are rising are now critical to realizing maximum savings on materials and services in a softening market. Combined with capital discipline, our attention to every element of our cost structure will ensure our success during this economic slowdown. Rewarding our shareholders, continuing our disciplined growth and maintaining our financial strength are all objectives we have been pursuing and will continue to pursue in 2009. Meeting our commitments to our investors, our communities and a world that has a long-term need for our products and services has been and will continue to be our priority.

I look forward to discussing the challenges and opportunities of 2009 and the years ahead at our meeting on March 10th in New York City.

That concludes our prepared remarks. We'll now take your questions. So that everyone has an opportunity to participate, please try to limit your follow-up questions to one or two. So Matt, please open the lines for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). Our first question comes from Mark Flannery from Credit Suisse. Your question, please.

Mark Flannery - Credit Suisse - Analyst

Thank you. Yes, my question is on reserve replacements. And I know you have only preliminary numbers and you'll give us more details in March, but can you give us an early feel for how much the net pricing impact was on the end year reserve replacements and whether it was net positive, net negative, roughly how big?

Dave O'Reilly - Chevron Corporation - Chairman and CEO

Mark, thank you. We've got -- we've had a great success with our reserves replacement this year in a number of areas. Some of the projects that we started up where we have conservatively booked reserves, we were able to revise upwards because we've now demonstrated through production more confidence in the reservoirs. We've also had some additions from contract extensions such as the PNZ and those will be disclosed in somewhat more detail when we get to our March meeting.

We did benefit, obviously, from price and my recollection is that we're in the -- the organic replacement for one year was above 80% or around 80%. The balance comes from price. So we've gained back in price some of what we lost -- a lot of what we lost over the last few years as the numbers went in the other direction, as price went upwards and reduced those reserves.

So now that I look over the last ten years, it's very gratifying to see that we are at greater than 100% reserve replacement over that long spread of time. So I feel good about where we are and we'll be covering that in more detail obviously in March. And you'll see a lot more disclosure in the 10-K as well. But thank you for the question.

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Mark Flannery - *Credit Suisse - Analyst*

Great. Thank you.

Operator

Our next question is from Robert Kessler from Simmons & Company. Your question, please.

Robert Kessler - *Simmons & Company - Analyst*

Good morning and Pat, welcome to your new role. My question relates to your production guidance for 2009. Looking at the new implied base business decline rate of 7% and comparing that to your recent experience of 3% to 4%, I recognize you said there was a gap associated with lower spending. And if I look at your CapEx plan it looks like excluding the one-time payments it would have been down about \$2.8 billion.

Is that the order of magnitude spending that you estimate would be required to flatten out or mitigate that decline right down to the 4% figure you typically experience? And why given, I would assume you would expect resilience in your portfolio down to \$50 a barrel at least, why would you not go ahead and spend that amount in a deflationary oil field service environment?

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Okay. A lot of questions there. Generally, your observations are on the right track. But let me give you a reason why I think the primary reason why, and maybe even an example of why we think it's unwise to chase after barrels in this environment.

We're clearly pursuing our long-term strategic projects that require continued investment over the long term and I cited a number of examples of those. But let me talk about a very specific example of where we have consciously slowed down and that's in the Piceance. And there are two reasons for it. One is Colorado has instituted some pretty onerous environmental regulations that have made it a lot more difficult to get permits in a timely manner. So we were in the process of reducing our plans there, just from an environmental permitting standpoint. Also, the pricing outlook is looking a little tenuous in that area so we've slowed it down.

In the meantime, we do expect costs to come down in the goods and services and supplies and Oil field Services area. And as those costs come down, we'll obviously have a chance to re-evaluate our portfolio and make decisions to add more investment if we think it's appropriate. But in this environment, we think we're doing the right thing to back off the -- particularly the opportunities that we can come back to later, because in this case they are on fee land. And we're conscious here of the capital discipline that we need to exercise in order to make the right value decision.

So there are a number of those decisions that we've taken. We think they're the right thing to do in this market and we expect, as prices -- as costs come down, that we'll be -- and permitting requirements are met, that we'll be able to re-evaluate our position in the future, but I think in current circumstances, this is the right thing to do.

Robert Kessler - *Simmons & Company - Analyst*

Thank you for the color.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Thank you.

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Operator

Our next question is from Erik Mielke from Merrill Lynch. Your question please.

Erik Mielke - Merrill Lynch - Analyst

Yes, good morning. I would also like to congratulate Pat on the new role and welcome to the quarterly conference circus. I would like to ask a question on the production outlook as well.

Given the experience you've had in 2008, are you being more conservative in your guidance for 2009, particularly with respect to the ramp-up from the major capital projects and on execution? And is there anything on the external factors that you can help us understand that number a little bit better? Is that 60,000 barrels per day based on the current run rate or is that projected further cuts by OPEC?

Dave O'Reilly - Chevron Corporation - Chairman and CEO

Well, I think we are taking I think a realistic view as best we can of what is happening in the marketplace with OPEC and some market impacts. We showed an 80,000 barrels per day negative on what we call external factors. And basically that's roughly the way we see it, about half of that is market effects, half of it is OPEC with the OPEC impacts being primarily in Venezuela and some in Angola, a little bit in Nigeria.

The balance is market effects and gas in Asia. We saw a deterioration in the gas demand situation in Thailand for example, late in the year, and we just think that it's not wise for us to count on those markets bouncing back very quickly. They're still good for the long-term but in the near term, in '09, I think what we've done is given you the most realistic assessment that we can of what we call external factors. It's very hard to predict this with accuracy, but that's our best shot at it as we see it today.

Erik Mielke - Merrill Lynch - Analyst

Okay, thanks. Can I ask a follow-up? Just on foreign exchange there was quite a bit of noise in the quarter from foreign exchange. Are there any sort of handy rules of thumb that you can give us that we can use to maybe try to predict some of the overall exposure for the group?

Jim Aleveras - Chevron Corporation - GM, IR

Erik, I'm afraid that's a very, very difficult challenge for us. Obviously, you see different factors come into play, depending on the timing of our acquisition of goods and services, depending on the net monetary asset and liability positions in different parts of the Company. In general, what we saw overall was the benefit in the fourth quarter of the strengthening dollar. But obviously, it hit different segments in different ways.

I wish I could provide better guidance than that but because of, again, the mix of components that goes into that, both what we buy, what we sell, as well as the assets and liabilities in our different international businesses, it's very, very difficult to give anything other than guidance that suggests the strengthening or weakening dollar would help or hurt our foreign exchange gains.

Erik Mielke - Merrill Lynch - Analyst

Okay. Fair enough. And finally, was there any significant under/over lift in international upstream in the fourth quarter?

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Jim Aleveras - *Chevron Corporation - GM, IR*

The fourth quarter we had an underlift relative to our production of about 5%. For the year as a whole we were essentially in balance.

Erik Mielke - *Merrill Lynch - Analyst*

Thanks so much.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

You're welcome.

Operator

Your next question is from Michael LaMotte of JPMorgan. Your question, please.

Michael LaMotte - *JPMorgan - Analyst*

Thank you. Good morning. Question for Dave. The ministry of petroleum in Iraq seems pretty committed to moving forward with MSCs and awards in June of '09. I was wondering if you could give us your thoughts on what that might mean for Chevron this year.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Well, I've just actually been in the Middle East this past month and there is -- there's certainly motivation on their part to move to some agreements I think in this year. So there's been a pickup of the pace. It's very hard to predict. Despite the -- I think good intentions by the government there to move prospects forward, there are limitations in the capacity of the ministries that just handle the volume of activity.

So this could be a year in which the -- some opportunities will get firmed up, but I don't know how to predict it, really. I would hate to go on record and say yes, something will happen this year. But we're clearly interested, as many others are. And we're clearly buying the appropriate packages and ready to move forward and make the appropriate proposals as the opportunities arise.

Michael LaMotte - *JPMorgan - Analyst*

Thank you for that. I understand that it's difficult to predict, but just the fact that you're staying close to it really is what I was interested in getting.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

We are staying close to it. I can assure you of that.

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Michael LaMotte - JPMorgan - Analyst

Very good. Thank you.

Operator

Our next question is from Neil McMahon from Sanford Bernstein. Your question, please.

Neil McMahon - Sanford Bernstein - Analyst

Hi. Just a few of them, sort of follows one from the other. Just a question on projects. Can you give us any update on Jack and St. Malo and the current challenges times, just wondering if you're doing the sensible thing and renegotiating any potential engineering contracts that you've awarded on those projects or in terms of FEED and also rig contracts? And also an update on where you are with the Reliance Petroleum option for Jamnagar?

Dave O'Reilly - Chevron Corporation - Chairman and CEO

Okay. Let me start with the Jack and St. Malo and the lower tertiary in the deepwater Gulf of Mexico. This is a very, very important trend and one that we're really focused on. We had a lot of success in the leasing rounds that just happened this year in the Gulf of Mexico and we have a fine portfolio I think of prospects in that trend.

We are continuing to move forward with Jack and St. Malo. And we're just now at the very early end of the front end engineering work. So this is an ideal time, we think, to be moving into the market as the costs of goods and services are coming down. This is a great opportunity for us and we'll certainly talk more about it in depth at the March analyst meeting. But let me assure you, this is one of our top priorities for the long-term, and one that's getting a lot of our attention and we think it's a good time for us to be starting to move into the market on these opportunities.

On Reliance, we are discussing with Reliance the opportunity there at the Jamnagar refinery. These are sensitive commercial discussions and I would prefer not to comment on them at the present time. But this is a year in which the situation there will clearly become clarified as we've been predicting for some time.

Neil McMahon - Sanford Bernstein - Analyst

Just a quick follow-up.

Dave O'Reilly - Chevron Corporation - Chairman and CEO

Yes.

Neil McMahon - Sanford Bernstein - Analyst

On Jack and St. Malo. Given the fact that you're entering this, and it seems in a very logical and sensible manner, are we to presume then we're sort of talking middle of the decade before we see any significant production coming on from those lower tertiary developments?

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Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Well, it will be in the next decade since we're almost there. I would hope that we would have production before the middle of the decade at this point. This year though will be clearly one of a lot of engineering work. And I think we've come very close to selecting the optimum development plan, the conceptual development plan. So I would hope that by the middle of the decade we would have good production there, but I think we'll try to -- we'll try to predict that a little better for you in March when we see you all. Thank you.

Neil McMahon - *Sanford Bernstein - Analyst*

Thanks.

Operator

Our next question is from Arjun Murti from Goldman Sachs. Your question please.

Arjun Murti - *Goldman Sachs - Analyst*

Thank you. Perhaps it's a little bit of a follow-up to the question on the base declines and the decision to spend less there and I appreciate part of it's the environmental Regs but also service costs are still high and as the oil prices come down. You still have otherwise though a very robust capital program and it seems like costs have been inflated in the industry across the board.

Perhaps some of those major development projects you can't stop at this point because you're already in the middle of them. But if there's perhaps cost concerns in going through with the base business, wouldn't that also be true of the growth projects that you're not really slowing those down? Just trying to reconcile those two things.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Well, thanks, Arjun. Let me comment on that. We sanctioned actually very few projects in 2007 and 2008. Many of the projects that came on-stream in 2008 and are coming on in 2009 were sanctioned and most of the expenditures and commitments to spend were made in the 2003, '04, '05 period. So we are -- while, yes, there are some -- there's clearly been some cost escalation, none of these projects were launched and made major commitments to at the peak of costs.

So we are in fact I think in a very good position, because the next projects that we sanction in our queue will be going out for requests for proposal in '09 and in 2010. And this we think is a good window for that because costs are clearly softening. There's a little bit of a lag. But on the other hand, we've seen costs come down quite a bit faster than they have in the past, which tells you that I think we could be hitting the sweet spot here for some of these projects. Hard to predict, but clearly that's going to be part of our thinking.

And we believe that these major projects that are good for our long-term will be cost competitive in this environment. Now, obviously, if we're wrong about that, we have the flexibility to go back to investing more in the base business, if those costs justify it. But we think we're making the right balanced decision here and given the slack in the market, its good timing.

Arjun Murti - *Goldman Sachs - Analyst*

Dave, that's actually really helpful comment and I appreciate that. Does that suggest that the '09 budget then -- or let me try it another way. I guess are you confident that you'll be able to sanction these and that the negotiations in this sort of very uncertain

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environment can get done to then be able to sanction them and move forward? Or is the '09 budget is then perhaps overstated, I don't want to use the word overstated, but higher than likely level of spending?

And as you get through these negotiations and sanction the projects it's more the '10 and '11 CapEx that will be more robust? I guess it is a very high level of CapEx. I don't have a an issue with it. I hear you but we are still spending a decent amount in '09.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Well, yes. Look, if -- clearly, if we can't justify and don't feel comfortable with the costs relative to outlook for the business, we would wait, I think is the best way of putting it. We have some flexibility on some of these major projects. But I think the reality that we see in the marketplace right now is we think this is a good time to be going back in the market. And if we're wrong, well, then, obviously these numbers are too high and we'll back off.

But I think we're seeing signs that this market is changing more rapidly than it has in the past. I think the suppliers of goods and services to our industry realize that they're in a different environment as well. They want -- the ones that are in it for the long term clearly want our business. And they'll be modifying their pricing appropriately. So I think some of that's going to occur.

Arjun Murti - *Goldman Sachs - Analyst*

Thank you very much. I appreciate it.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

You're welcome, Arjun.

Operator

Our next question is from Paul Cheng from Barclays Capital. Your question, please.

Paul Cheng - *Barclays Capital - Analyst*

Thank you. Good morning, guys.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Good morning.

Paul Cheng - *Barclays Capital - Analyst*

Dave, when you're talking about the cost reduction that you're expecting, how receptive so far with your negotiations with your vendor, I mean are they receptive, recognize that that change is coming down? And how quickly that you think the lower costs may start to flow through into your results and benefiting you guys? From that aspect, that when you're talking about lower tertiary, wondering if you can talk about Gorgon, George was thinking about potentially sanctioning in the second half 2009 and if the market conditions may have changed that expectation at this point?

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Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Well, let me just kind of -- I think I've commented on the lower tertiary already but let me just talk about Australia and Gorgon for a moment. We are on track we believe to sanctioning that project late in the year. Again, we think this is good timing. We're currently in the market with RFPs. The Australian dollar has weakened significantly. There's a lot of capacity now in the labor force in Australia, as many of the resource industries have deferred activity in mining and other activities.

So there's a lot of interest in this project. And I think this is, again, a good time for us to be out in the market, beginning to assess and call for prices for equipment and for services and construction. So how it will turn out, will remain to be seen. But we're very -- we're bullish on Gorgon and believe that's one we hope we'll be able to tie up and create something long-term for the Company sometime late in the year.

Paul Cheng - *Barclays Capital - Analyst*

Okay. Can I have a follow-up?

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Sure.

Paul Cheng - *Barclays Capital - Analyst*

Dave. In the last three years, rightfully so after your Unocal acquisition, the Company has been focusing on the organic projects and not really looked that much on the M&A market. Wondering if the view has changed given the market conditions has changed and asset price has deflated? And sometimes people would say that you want to be a counter cyclical buyer. Not asking for specifics, just want to see what is the management's view about that subject?

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Well, two answers to that question. First of all, we clearly have a great organic queue of projects here that we're continuing to pursue and invest in. And we believe that certainly compared to our size, we have -- we're among the best in the industry in that area and that we're fueling that in the background with continued success in our exploration program.

Look, we're not blind to what's going on in the world around us and we make assessments of the opportunities. But those are hard to predict and I would prefer not to comment on them. But clearly, we're not blind to looking for other opportunities as well. But our priority in 2009 I think is going to be on advancing these projects and bringing them to market as well as starting up the ones that are in the commissioning phase that Jim referred to in his remarks a few minutes ago.

Paul Cheng - *Barclays Capital - Analyst*

Thank you.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Thank you.

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Operator

Our next question is from Jason Gammel from Macquarie. Your question please.

Jason Gammel - *Macquarie - Analyst*

Thank you. I would like to add my congratulations to Pat as well on your new role. Dave, you've had a lot of specific questions today relative to some of the projects you have captured. I think you just marked your ninth anniversary as CEO. I was just hoping I would just ask a broader question, how would you assess the state of your investment opportunities now relative to where it's been over the course of your tenure?

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Well, thanks, Jason. I think the depth and quality of our queue of opportunities is stronger than any time it's been in that nine years. There are -- and I say that not just based on the projects that we've been talking about very specifically and that we've had a number of questions on this morning, but also the success we're continuing to have with our exploration program that tells me that that's going to lead to future developments in the next decade that will be value-creating for the Company for the long term. So I see us in a very, very strong position and I feel very good about the opportunities that we have in the years ahead.

Jason Gammel - *Macquarie - Analyst*

That's appreciated. Maybe as a follow-up, I could ask another open-ended one. What do you see as the two or three biggest challenges facing the Company over the next two to three years?

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Well, clearly, managing through this uncertain period, which is something we've done before a number of times as a Company and as an industry. We are clearly in a more challenging environment with lower demand. It's been about 20 -- I think we have to go back to the early '80s to see two years of back to back oil demand decline in the -- I think that's right. We have to go back to the early '80s. So we had a modest decline globally last year. It's projected there will be another one this year.

So managing our costs and staying focused on the long-term I think is clearly our objective here and we're in a good position to do it because of our strong balance sheet. And because we de-levered during the good times, so that we have that flexibility during the tougher times. The second item I think is the whole issue of carbon management over the next five years or so, as the world tries to struggle with how to value carbon and how that affects the business.

So I see those as two challenges over the next couple years. One we've been through before a number of times and we're kind of -- we're used to it, the cyclical activity. But I think we're moving into an area where we'll be dealing with this new issue and I don't mean new in the European sense where we're already managing it quite well, but I mean in a global sense. As more and more people or countries sign up for carbon management and the impacts on the business will clearly be there and how we manage in that environment I think is going to be -- the people that manage successfully in that environment will do better than those that don't.

Jason Gammel - *Macquarie - Analyst*

I appreciate that context. Thanks, Dave.

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Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

You're welcome, thank you, Jason.

Operator

Our next question is from Paul Sankey from Deutsche Bank. Your question, please.

Paul Sankey - *Deutsche Bank - Analyst*

Hello, everyone. I just would like to carry on a little bit on the CapEx question, if I could, further really to what Argun was asking. I understood that you had quite a significant FX benefit from a stronger dollar, perhaps as much as a 10% to 20% implied benefit given that a lot of your spending obviously is abroad. Which again would have led me to think that perhaps your CapEx number would come down. You've also as we've covered said you stepped back in US, somewhat in US spending. Could you just help me rationalize that particular part of the balance? Thanks.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

I don't think we saw a significant benefit in CapEx on the strengthening dollar in '08. A lot of that dollar strengthening occurred very, very late in the year. And it's very -- so basically these numbers reflect -- the '08 numbers certainly reflect an average year. As Jim said, it's very hard to predict this. We're in uncharted waters. The dollar has been a safe haven at the moment and some other currencies have declined. But if clearly some of these numbers could change if there were more dramatic changes in the relative valuations of currencies. But I just don't think I feel comfortable about trying to predict 2009, but I do feel comfortable telling you that 2008 did not see significant benefit.

Paul Sankey - *Deutsche Bank - Analyst*

No, Dave, I was really thinking about 2009 relative to 2008 and that all things equal, would the move that we had in foreign currencies, we would have thought your CapEx would step down, especially when you then add on a somewhat lower level of spending in the US.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Well, there's perhaps a little bit of a step down in a few areas but remember that when you look at the budget here, about 10% of that budget is for one-time payments for concession extensions. So the budget has come down by about 10% and part of that is built into that 10%. Our current assessment of that. But that's again -- it's a prediction and nobody really, truly knows how the relative exchange rates are going to turn out. It's a fool's game to try to over guess it.

Paul Sankey - *Deutsche Bank - Analyst*

Great, thanks. And then if I could just briefly on the buyback, I believe you said you would not be buying back shares in Q1. Could you talk a little bit about that decision relative to obviously what we said about CapEx, what we said perhaps about M&A as well? Thanks.

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Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Well, I'm going to turn it over to Pat to talk about our financial priorities. She's been sitting here patiently. And you've all been congratulating her. She needs to chime in here on this subject as the keeper of the balance sheet. So Pat?

Patricia Yarrington - *Chevron Corporation - VP, CFO*

Okay. Well, thanks, Dave. I was feeling like I was turning into a potted plant here for a moment. But thanks for the question. Our financial priorities really are from a cash standpoint sustaining and growing the dividend. Then, funding the capital program that we have where we've got projects that earn good returns over a viable, vast range of commodity prices. And then maintaining our financial strength and flexibility. So we've always seen the share repurchase program as sort of the discretionary part of that and we're just indicating certainly for the first quarter of 2009 that we're not going to have a continuation of that repurchase program.

Paul Sankey - *Deutsche Bank - Analyst*

I guess you would expect debt to rise even slower in Q1?

Patricia Yarrington - *Chevron Corporation - VP, CFO*

I think that that's a reasonable expectation. We did as Dave said, we de-levered when the times were right, giving us that flexibility now when revenue stream has come down and our cost structure obviously is adjusting but perhaps not quite as rapidly. So I think you could expect to see modest increase in the debt balance in first quarter. We're very well-positioned, though even at low sustained prices to have a very strong balance sheet.

Paul Sankey - *Deutsche Bank - Analyst*

Okay. Pat, well I didn't congratulate you so I will. Congratulations. And thanks.

Patricia Yarrington - *Chevron Corporation - VP, CFO*

Thank you.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Thanks for the questions, Paul.

Operator

Our next question is from Mike Matus from Merrill Lynch. Your question, please.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Hello, Mike.

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Michael Matus - Merrill Lynch - Analyst

I'm sorry. It's been answered. Thank you.

Dave O'Reilly - Chevron Corporation - Chairman and CEO

Okay. You're welcome.

Operator

Our next question is from Mark Gilman from Benchmark. Your question, please.

Mark Gilman - The Benchmark Company - Analyst

Folks, good morning. Had a couple things, if I could please. Was there any change in the fiscal terms that was agreed upon associated with the extension of the concession to PNZ, Dave?

Dave O'Reilly - Chevron Corporation - Chairman and CEO

The fundamental terms are the same, Mark.

Mark Gilman - The Benchmark Company - Analyst

Okay. And the production outlook for 2009, and the price effect therein, are there any thresholds that are included in that under the \$50 a barrel assumption?

Dave O'Reilly - Chevron Corporation - Chairman and CEO

Well, the \$50 barrel we picked from the strip price. We did hit some thresholds when the prices were high back in -- you're talking about production sharing thresholds?

Mark Gilman - The Benchmark Company - Analyst

Yes. Costs were cumulative -- capital cost recovery or rate of return or cumulative production, any of the things that went into Jim's comments regarding the change in the sensitivity.

Dave O'Reilly - Chevron Corporation - Chairman and CEO

Yes, Jim, why don't you deal with that one for me, please.

Jim Aleveras - Chevron Corporation - GM, IR

Mark, the changes that we saw in 2008 and we did hit some thresholds in 2008, were why we had the higher number, the higher volume impact per dollar per barrel of change in price in crude. Looking ahead to 2009, since we've already crossed those thresholds, we see a lower volume impact per dollar change in crude prices.

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Mark Gilman - *The Benchmark Company - Analyst*

Yes, Jim, but what I'm asking is are any threshold impacts built into the 60,000 a day price effect as part of your 2009 forecast?

Jim Aleveras - *Chevron Corporation - GM, IR*

Not many. Most of them are behind us, which is why the number has come down.

Mark Gilman - *The Benchmark Company - Analyst*

Okay. Dave, can I infer from your Jack, St. Malo comment that the appraisal wells that had been drilling were successful?

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Well, I think we're going to report on the appraisal I think in March. But I think you can infer that we're on the right track and we'll give you a lot more detail in March.

Mark Gilman - *The Benchmark Company - Analyst*

Okay. Just one final clarification. Dave, regarding the 80% organic reserve replacement in '08, does that include the reserves associated with the concession extension at PNZ.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Yes, and you'll see more detail in the K.

Mark Gilman - *The Benchmark Company - Analyst*

Thank you.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

You're welcome.

Operator

Next question is from Erik Mielke from Merrill Lynch. Your question.

Erik Mielke - *Merrill Lynch - Analyst*

I'm sorry for asking another question. I just thought I would ask for an update on Chuandongbei, given you've been running through the other key projects. In your CapEx statement you said you have an initial payment, so but the bonus payment and then also some initial development. If you can give us some guidance on where you expect to take that in 2009?

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Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Well, yes. Thanks, Erik, we are progressing with the construction work in Chuandongbei. So, it's actively moving forward. And yes, that is included, the appropriate capital is included in our program. We view that as another long-term project that will benefit the Company for many years to come. Decades to come. So yes, that one's on track compared to what we've told you basically last year and again we'll be updating in the March meeting. But thank you for the question.

Erik Mielke - *Merrill Lynch - Analyst*

Was it part of your reserve bookings for '08?

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

You'll see the details in the 10-K. I can't answer that right now. But you'll see the details in the 10-K.

Erik Mielke - *Merrill Lynch - Analyst*

Thank you.

Operator

Our final question is from Mark Gilman from Benchmark. Your question, please.

Mark Gilman - *The Benchmark Company - Analyst*

Guys, the exploration spend component in 2009 capital budget versus 2008, give me an idea what it is.

Jim Aleveras - *Chevron Corporation - GM, IR*

It's about flat between 2009 and 2008.

Mark Gilman - *The Benchmark Company - Analyst*

Level, Jim?

Jim Aleveras - *Chevron Corporation - GM, IR*

Pretty much so, yes, Mark.

Mark Gilman - *The Benchmark Company - Analyst*

I mean, the dollar amount.

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Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

A little bit more appraisal I think in -- balanced between appraisal versus pure exploration. But we're going to go through a very detailed review of our exploration program and our plans for '09 very specifically in our -- in the analyst meeting.

Mark Gilman - *The Benchmark Company - Analyst*

Okay. Thanks, folks.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

You're very welcome. I think it's time to wind it up, Matt. Unless there are other questions?

Operator

At this time I show no further questions.

Dave O'Reilly - *Chevron Corporation - Chairman and CEO*

Good. Well, thank you very much for listening. We appreciate everyone's participation in the call. We want to thank you for your questions this morning and look forward to seeing you all or many of you in March in New York. So, Matt, thank you.

Operator

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

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