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Occidental Petroleum Corp. (OXY)

Q3 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Occidental Petroleum Corporation third quarter 2017 earnings conference call. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference over to Richard Jackson, Vice President of Investor Relations. Please go ahead.

Richard A. Jackson

Vice President, Investor Relations, Occidental Petroleum Corp.

Thank you, Kate. Good morning, everyone, and thank you for participating in Occidental Petroleum's third quarter 2017 conference call. On the call with us today are: Vicki Hollub, President and Chief Executive Officer; Cedric Burgher, Senior Vice President and Chief Financial Officer; Jody Elliott, President of Domestic Oil and Gas; Ken Dillon, President of International Oil and Gas Operations; and B.J. Hebert, President of OxyChem. In just a moment, I will turn the call over to Vicki Hollub.

As a reminder, today's conference call contains certain projections and other forward-looking statements within the meaning of the federal securities laws. These statements are subject to risks and uncertainties that may cause actual results to differ materially from those expressed or implied in these statements. Additional information on factors that could cause results to differ is available on the company's most recent Form 10-K.

Our third quarter 2017 earnings press release, the Investor Relations supplemental schedules, and our non-GAAP to GAAP reconciliations and the conference call presentation slides can be downloaded off our website at www.oxy.com.

I will now turn the call over to Vicki Hollub. Vicki, please go ahead.

Vicki A. Hollub

President, Chief Executive Officer & Director, Occidental Petroleum Corp.

Thank you, Richard, and good morning, everyone.

Before I get started on our third quarter results, I'd like to take the time to thank and express my appreciation to our entire OXY family in prevailing through Hurricane Harvey. We had hundreds of family members that were displaced due to the storm or experienced serious damage to their homes and personal possessions. Even in the face of this destruction, we were able to operate all of our assets safely, and we have returned our business to normal operating rates.

The teamwork across our organization was incredible. OXY employees that were in need of assistance received help from all parts of our organization, from the Permian and Chemicals sites throughout the U.S., to our international employees who provided assistance from the Middle East and Colombia. I have never seen such unity among all the parts of our organization and from our retirees. This storm was devastating to our Texas Gulf Coast community, but our organization was prepared for the storm and its aftermath. The financial impact would have been greater without our team's efforts to safely enact our business continuity plans and manage the business during and after the storm. Times like this make me really proud to be a part of this organization.

I will now share some third quarter highlights on slide 5, and then I'll provide an update on our progress toward our cash flow breakeven plan. Let's start with our most recent well results. While I don't want to steal the thunder from Jody, we've had some really exciting well results in southeast New Mexico. We attribute these new basin-leading well results to our value-based development approach. We're confident in our ability to sustain these results as well as in our ability to reach and surpass our breakeven growth target of 80,000 BOE per day in Permian Resources.

I'd also like to highlight the improvements we've made to our Seminole San Andres CO2 unit. Since acquiring the asset in August, we've been able to increase the throughput capacity of the plant by 10%, which has enabled us to increase gross production by 2,300 BOE per day.

We not only got a great asset, we got great people as well. Their integration into our plant and field operations teams has created a strong group that is already ahead of our plan. And I can assure you, the leaders of our field and plant teams don't set easy targets. Those teams are energized and performing at a very high level.

Despite the impact of Harvey, Chemicals had a strong quarter, generating $200 million in segment income. We received our first dividend from the Ingleside Ethylene Cracker JV, and our team continues to capture additional margin along the chlorovinyl chain. We expect this trend to continue due to improving industry fundamentals as well as a tighter supply market in the near term due to Hurricane Harvey.

Turning to slide 6, as I mentioned on last quarter's call, we will include this slide each quarter to update you on our progress toward our goal of cash flow neutrality at $40 WTI and breakeven at $50 WTI. This means we'll cover the dividend and the production sustaining capital within operating cash flow at $40 WTI. And at $50 WTI, we'll be able to generate 5% to 8% production growth.

As you might expect, Harvey negatively impacted our progress for the quarter. Even so, all of our assets and teams showed progress toward their targets. Slide 7 illustrates this progress. We have included the annualized cash flow impact of $200 million for Harvey in the first gray column. This cash flow impact is a one-time event. And as I just mentioned, in the Chemicals business, we received our first dividend payment of $55 million from our Ingleside Cracker JV. This included catch-up for the prior quarter. We expect the ongoing quarterly dividend to average $30 million to $40 million. The remainder of Chemicals' target will be achieved after the 4CPE refrigerant plant comes online in the fourth quarter of this year.

In the Midstream business, we benefited from a wider Midland-to-Gulf Coast spread, averaging $2.61 per barrel during the quarter. This exceeded our expectations. The segment has achieved over $200 million in annualized cash flow improvement. Additional milestones to achieve our Midstream target of $300 million include the Al Hosn expansion and maximizing throughput at our Ingleside crude terminal.

In the Permian Resources business, we grew 1,000 BOE per day sequentially, net of the 4,200 BOE per day that we divested as of August 1. We expect our growth rate to increase substantially in the coming quarters, as we have accelerated our activity. Jody will give additional guidance on the timing of new wells coming online.

Finally, with respect to the improvements beyond our initial plan, the Chemicals and EOR businesses are experiencing operational end market improvements. Chemicals continued to capitalize on a strong pricing environment. Caustic soda prices, their primary profitability driver, have increased by approximately 14% since the first quarter of 2017. This price improvement equates to $120 million in annualized cash flow improvement.

In the EOR business, we'll continue to improve the operations of the Seminole San Andres CO2 unit and expect to achieve the cost reductions of $5 to $10 per BOE that we have previously mentioned. We are pleased with the progress we made, and will continue to communicate incremental progress towards our pathway to breakeven.

My final slide quantifies the liquidity we have available to fund the gap between cash flow from operations and the capital needed to achieve our goal. I'd like to remind you that our preliminary capital budget for 2018 is in the range of $3.6 billion to $3.9 billion, as presented in slide 8. At the end of the third quarter, we had $1.8 billion of cash as well as PAGP units with a market value of approximately $600 million. Since WTI has averaged closer to $50 during 2017, we added an additional bullet to this slide to highlight a smaller cash flow deficit of less than $2 billion.

We plan to manage our portfolio to contribute an additional $500 million to ensure we bridge the cash gap if prices average $40 through 2018. So to be clear, even with an average oil price of $40 through 2018, we have sufficient cash and liquidity to cover sustaining capital and the dividend while also funding our path to our $50 breakeven at WTI price.

I'll now turn the call over to Cedric Burgher.

Cedric W. Burgher

Chief Financial Officer, Occidental Petroleum Corp.

Thanks, Vicki. Jody will cover our step-change in Permian well results, so I will address financial items and updated guidance. We present our third quarter results on slide 10, and I'd like to start by commenting on our production results.

Total reported and ongoing production was 600,000 BOEs per day, which came in at the low end of our guidance range. Reported production was impacted by Hurricane Harvey, also third-party downtime in Colombia and the Middle East and downtime at a Permian EOR plant.

The Permian Resources production came in within our guidance range at 139,000 BOEs per day despite losing about 1,000 BOEs per day from the impacts of Hurricane Harvey. Permian EOR production was 150,000 BOEs per day, at the high end of our guidance range. Higher Permian EOR volumes sequentially reflect the successful integration of the Seminole San Andres CO2 unit, and we expect to capture additional production volumes with the increased gas plant throughput.

International production came in at 303,000 BOEs per day, which included the highest quarterly production rate at Al Hosn Gas of 76,000 BOEs per day.

Third quarter reported EPS was $0.25 per share and core EPS was $0.18. Quarterly EPS improved sequentially despite the impacts of Hurricane Harvey. Improvements in the Oil & Gas segment were mainly attributed to lower operating costs of $0.61 per BOE and to higher NGL prices by $1.83 per BOE.

Domestic operating costs for the quarter were $13.23 per BOE versus $13.55 in the second quarter, and they continue to trend lower. Permian Resources operating costs have averaged 3% lower year to date versus the 2016 average, and we expect these costs to trend lower with our production ramp-up.

Operating cash flow improved sequentially as well to nearly $1.1 billion. The improvements to operating cash flow were mainly attributed to incorporation of the Seminole San Andres CO2 unit and the Permian EOR as well as receipt of a cash distribution from the ethylene cracker joint venture.

We spent approximately $950 million our capital program during the third quarter and we expect to spend roughly $1.1 billion in the fourth quarter, with total year capital spend expected to be at our $3.6 billion capital budget. Additionally, we expect to come in at the midpoint of our previously stated $1.6 billion to $1.8 billion capital range for the Permian Resources in 2017.

With respect to our effective tax rate, the lower Q3 rate was mostly driven by our international assets. There are two primary reasons here. First, in Qatar, we were able to reduce operating costs by approximately $20 million, and our production sharing contract allowed us to take 100% of that savings to the bottom line without additional tax. Second, we are recovering an additional $11 million related to our former business in Iraq with no associated foreign tax. In addition to those items, there were some smaller domestic items which had some net benefit in the quarter.

OxyChem's third quarter earnings of $200 million were better than expected considering the $60 million impact of Hurricane Harvey. Favorable pricing and plant operations and lower raw material costs prior to the hurricane partially offset the negative impact the storm had on chlorovinyl production and plant maintenance. We have updated several slides on our Chemicals business in the appendix, including additional information on the 4CPE plant, which will come online during the fourth quarter.

Midstream's third quarter core earnings came in within our guidance range excluding the impact of Hurricane Harvey and lower equity income from our investment in the Plains Pipeline. The business experienced exceptional performance during Harvey and achieved the highest monthly loading rate at our oil terminal in September. We included additional information on our Midstream business in the appendix as well, including a slide with our outlook for Midland-to-Gulf Coast spreads.

On slide 11, you can see that we continue to have ample liquidity to fund our breakeven plan with a cash balance of $1.8 billion. While our cash flow from operations is currently at a deficit to our capital expenditures and dividends, we expect this gap to narrow in the coming quarters and to be in balance by the end of 2018 at $50 WTI, while our assets are generating production growth.

Let me reiterate what Vicki said in regards to liquidity. We forecast our cash deficit to be less than $200 million through the completion of our plan, assuming average WTI prices of $50. Furthermore, our business is approximately 50% exposed to the Brent benchmark, which gives us additional support if that spread continues to hold at current levels.

We have provided updated guidance on slide 12. We have maintained the bottom end of our full-year 2017 ongoing production guidance at 597,000 BOEs per day while lowering the top end of our guidance to 599,000 BOEs per day. Our updated full-year guidance reflects actual third quarter production results and accounts for items particularly to the fourth quarter.

In the fourth quarter, we will carry out a Seminole San Andres plant turnaround to further optimize operations, and EOR will be impacted by a planned third-party pipeline maintenance activity. Jody will cover our improved visibility on our fourth quarter ramp-up and exit rate with information on our new wells and drilling progress. Given the improved results in the Greater Sand Dunes development area, we are excited by the trajectory of production heading into 2018.

Permian Resources total year production guidance has been narrowed to 141,000 to 144,000 BOEs per day. We expect fourth quarter production in Permian Resources to be approximately 30% higher than fourth quarter 2016.

My final point on our Oil & Gas segment is that we have lowered our annual domestic OpEx guidance from approximately $14 per BOE to $13.50 per BOE, as these costs are trending lower due to our highly productive wells.

Moving on to other areas of our business, fourth quarter guidance for Chemicals is $190 million, which accounts for the seasonality in the business due to lower construction activity. Midstream is expected to generate more income sequentially, in the range of $60 million to $80 million. The business expects to benefit from wider Midland-to-Gulf Coast marketing spreads as well as wider Gulf Coast-to-Brent spreads, which enhances our export margins.

Lastly, I would like to remind you of our commitment to our returns-focused strategy. Last quarter, we told you that we will be increasing the amount of compensation that is tied to returns or return on capital employed metrics. Our minimum hurdle rates are 15% after tax in the United States and 20% internationally, which we believe will result in leading full-cycle returns for our shareholders.

I'll now turn the call over to Jody.

Jody Elliott
President - Domestic Oil & Gas, Occidental Petroleum Corp.

Thank you, Cedric, and good morning, everyone. And thank you, Vicki, for your restraint during your opening highlights on our well results in the Permian. Thanks to our team's efforts, we have some basin-leading well results to share with you.

Across our domestic business, we're delivering more production with less cost to generate growth and value towards our breakeven plan. As Vicki mentioned, we attribute this success to our differentiated value-based development approach.

Our Permian Resources New Mexico team delivered record-breaking well results across multiple benches in the Greater Sand Dunes area, as shown on slide 14. During the quarter, our team put on a total of seven wells in the Greater Sand Dunes area, with 30-day production rates that averaged approximately 3,750 BOE per day. Three of these wells ranked in the top 15 all-time best wells in the Permian Basin based on 30-day BOE per day.

Our Cedar Canyon 23-24 Fed 32H achieved a peak rate of 6,497 barrels of oil equivalent, which is the highest 24-hour peak rate recorded in the Permian Basin. These record results span the Second Bone Spring, the Third Bone Spring, and the Wolfcamp X-Y, which makes the Greater Sand Dunes area extremely attractive from a full-cycle returns perspective.

Our engineered approach gives us confidence in the repeatability of these results across the 2,000 remaining undeveloped locations in the Greater Sand Dunes area. We've not yet incorporated this improvement into our Permian Resources inventory counts, but we expect the breakevens to improve by $5 to $10 in the Greater Sand Dunes area.

While the focus of slide 14 is our Greater Sand Dunes development area, our Texas Delaware team also delivered OXY record wells in the Wolfcamp B, the Second Bone Spring, and our Greater Barilla Draw area, which are highlighted in our appendix on slide 27.

Our step-change in well performance is a result of ongoing subsurface characterization and customized well designs to maximize the potential of our play-leading asset. In fact, our teams are studying results from surveillance to make additional improvements across the basin.

In addition to these stellar productivity results, we saw improvements on the cost side. OpEx decreased 7% from a year ago to $7.61 per BOE during the quarter. And well costs continue to trend approximately flat, as operating efficiencies offset inflationary pressure from service and materials providers.

On slide 15, we provide visibility on the timing of wells online for our production ramp over the next three quarters. As a reminder, we added four Permian Resources rigs very late in the second quarter. We'll begin to place the majority of these incremental wells online in the fourth quarter, with peak rates reached late in the year and into the first quarter.

We'll also shift more activity to the Greater Sand Dunes, increasing wells online in the second quarter of 2018 to 26 from the seven in the current quarter. We'll shift one to two rigs to the Greater Sand Dunes area at the beginning of 2018 while maintaining a total of 11 operated rigs.

While Permian Resources production in the third quarter grew modestly due to divestitures and third-party impacts from Hurricane Harvey, we expect to see strong growth in the fourth quarter and into 2018 that will generate the cash flow that OXY needs for the breakeven plan. As well results continue to improve and the number of new wells on productions increase, we're extremely confident in our ability to deliver on OXY's cash flow breakeven plan. The plan we have laid out will result in a growth rate above 30% in 2018.

Finally, I'd like to speak to the immediate success we've had in capturing value from our EOR acquisition. We became operator of the Seminole San Andres unit on September 1, and have applied our technical knowhow to achieve operational improvements. By optimizing the CO_2 throughput of the plant, our team increased the field's production by 2,300 gross BOE per day. This was one component of our operating cost improvement plan, and we're confident in further improvements in our plan to achieve $5 to $10 per BOE in OpEx reduction. Our newly integrated team is energized with innovative ideas to continue to improve the asset.

I'll now turn the call back to Vicki.

Vicki A. Hollub

President, Chief Executive Officer & Director, Occidental Petroleum Corp.

Thank you, Jody.

Now I'd like to update you on a change we've made to our leadership team. Rob Peterson, who had served as President of OxyChem since August 2014, was appointed Business Area Director in our Permian EOR business in mid-September of this year. Rob did an exceptional job in Chemicals, but I noticed that he also provided great input during our strategic meetings, so we felt that it would be beneficial for the company and for Rob to have him to spend some time in our EOR business.

Rob was instrumental in OxyChem's success, and we anticipate the same positive impact within EOR and Oil & Gas. Rob holds a Bachelor's Degree in Mechanical Engineering and an MBA in Corporate Finance from the University of Florida.

Rob was replaced by B.J. Hebert, who is on the call with us today. B.J. is now President of OxyChem. B.J. joined OxyChem in 1991 from Vista Chemicals and has 30-plus years of industry experience. He knows the chemicals business exceptionally well and brings a wealth of strategic insight and passion for safety, environmental stewardship, and success. B.J.'s most recent role was Senior Vice President of Basic Chemicals, and he was previously Vice President and General Manager of OxyVinyls. B.J. holds a Bachelor's Degree in Chemical Engineering from McNeese State University and an MBA from Southern Methodist University.

I'd like to close by reiterating the timeline for achieving our production growth target. We expect to add the 80,000 BOE per day by the end of 2018. We are excited about the trajectory of production growth in the upcoming quarters, which will begin with a large ramp-up of Permian Resources well completions in the fourth quarter, and the step-change in well results materially derisk our timeline for achieving the 80,000 BOE per day. Our teams are focused across our organization to meet and exceed our plan targets in the Oil & Gas, Chemicals, and Midstream businesses.

And finally, we ended the quarter with ample cash on the balance sheet and have liquidity to fully fund our plan while paying a growing dividend.

We'll now open it up for your questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Evan Calio of Morgan Stanley. Please go ahead.

Evan Calio
Analyst, Morgan Stanley & Co. LLC
Q

Hey. Good morning, everyone.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.
A

Good morning.

Evan Calio
Analyst, Morgan Stanley & Co. LLC
Q

My first question is your plan to support the 5% to 8% growth at $50 and funded yield at $40 is well understood. Yet how does the higher oil price factor into the model, meaning, do you use excess cash flow to accelerate the timing to reach your model via Permian Resources growth, or do you return cash to shareholders or further bolster the cash bridge to the model? How does that – if you could talk through those pieces, if you could.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.
A

Yes, specifically the plan is for us in 2018 to lock into our capital plan of $3.6 billion to $3.9 billion. We plan to present the final numbers to our board in December and get approval for the plan for 2018. Then we'll update you on what those specifics are. So we'll be outspending cash flow again. But as we said, we have the liquidity to get there.

Once we achieve the milestone of breakeven at $50, any excess cash that we have beyond that really depends on what the situation is. But our cash flow priorities are always to pay our maintenance capital first, followed by our dividends. And in today's world, with the opportunities we have for organic growth, organic growth is our third priority. Beyond that would be acquisitions and then share repurchases. But we always, when we have excess cash, want to make sure that we assess the situation and the opportunities and make the best decision to deliver value to the shareholders.

Evan Calio
Analyst, Morgan Stanley & Co. LLC

Q

Great, thanks. And second, if I could, the Greater Sand Dunes performance is really the highlight of the quarter. Could you maybe walk us through what specifically is driving the step-change improvement in well performance? And are there any costs associated with improvements? It sounds as though it was targeting and subsurface. Any color there would be helpful.

Jody Elliott
President - Domestic Oil & Gas, Occidental Petroleum Corp.

A

Evan, good morning, this is Jody. You hit the high points there. It's really about improved subsurface characterization, which is leading us to better targeting wells to maximize the value recovery from these assets. So it's a culmination of what we've been talking about for a long time, value-based development, but that again leads to better targeting, better stimulation designs. And what's interesting in these well results is that the sand loading for these wells is below what you'd probably find on average in the industry.

So from a capital efficiency standpoint, I think it argues even more how confident we are about this growth plan and how much cash we can contribute to the breakeven plan that Vicki's outlined.

Evan Calio
Analyst, Morgan Stanley & Co. LLC

Q

Maybe just a follow-up, if I could, how representative do you expect these results are across your 2,000 locations? While it might be early, any thoughts there?

Jody Elliott
President - Domestic Oil & Gas, Occidental Petroleum Corp.

A

We think it's very representative. We continue to do appraisal work in other areas of Greater Sand Dunes. What's also exciting about this is it's across three benches. It's not just one bench. I think the other color is this is done in an area that's more of a brownfield development, where there are legacy wells that we're having to manage, offset wells and shut in wells to avoid implications.

As we move into 2018, we move into more of a greenfield area. We're able to take advantage of the latest generation of our field development plan. And we're really excited about that because it includes the startup of [ph] Aventine (27:25), which will help drive more capital efficiency. Our rig rates, our legacy rig rates roll off in the market. The field development plan at Sand Dunes is – we've got a central tank battery facility with water recycle. Most of the fluids that are being handled there will be on pipe. It's four-well pad and six-well pad development that includes the ability for us to do simultaneous operations of drill, complete, and produce. And so we believe these well results extend across that inventory and that we're set up for even better capital efficiency with the new field development plan.

Evan Calio
Analyst, Morgan Stanley & Co. LLC

Q

I appreciate it, guys. Thank you.

Operator: The next question is from Doug Leggate of Bank of America. Please go ahead.

Doug Leggate
Analyst, Bank of America Merrill Lynch

Q

Thank you. Good morning, everybody. I guess the focus again is on the Greater Sand Dunes well results. I wonder, Vicki, if you could help us understand what's changed as it relates to the timeline of your 80,000 barrel a day target. The wells are clearly substantially better than what you were expecting when you set that target, but you're still talking about a year-end 2018 type of cadence. Are you just being conservative there, or is there a reason why you're sticking with that timeline? And I've got a follow-up, please.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

We may achieve the 80,000 barrels a day earlier than the end of 2018, but there are other drivers like our Al Hosn expansion, our export facility where we are trying to ensure that we're at full capacity there. Those may take place later in the year. So the timeframe is really intended to capture the point at which all of our improvements are fully in place and to ensure sustainability that we have full margins and that those full margins are being realized for the entire quarter.

Doug Leggate
Analyst, Bank of America Merrill Lynch

Q

Just to be clear, on one of the slides Jody spoke to, you now believe this is a repeatable – I guess you had never really given us a type curve, but these results are repeatable across the 2,000 locations?

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

Yes, we definitely believe that. We just sat through over the last couple of days some reviews of how they're doing this technically, and it's very impressive work. There's no reason for us to believe that this is not sustainable. In fact, the fact that we have 3D seismic and can take that seismic, tie it to the performance that we're seeing, and now we are at a point where we can predict what the wells will do and where we need to drill, so this is really a breakthrough for us, and I think we're all really excited about it.

Doug Leggate
Analyst, Bank of America Merrill Lynch

Q

We got to see it up close and personal a few weeks ago in the field, so thanks again for that, guys. My follow-up I guess is on portfolio management, Vicki. Just eyeballing the chart on the $40 breakeven, which obviously is on the bear case, it still implies that you've got a couple-plus billion dollars of asset sales planned. Does that happen regardless of the commodity backdrop? And if so, can you just quantify or qualify what you think comprises the key parts of that monetization plan? And I'll leave it there, thank you.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

So we've always said or have said most recently that at some point we'll monetize the Plains units. We will do that at some point, but we want to pick the appropriate time to do it.

Secondly, whatever environment, it really makes sense for us to continue to optimize our portfolio. And because of this huge position that we have in the Permian Basin, what we want to do first, our highest priority is to swap acreage because we've had a lot of success blocking out the development areas that we have, and we're really happy with our development areas. So the more trading that we can do rather than outright sale is preferred. However, there is some acreage at the tail end of our portfolio that in any environment, we would sell.

Doug Leggate
Analyst, Bank of America Merrill Lynch

Q

Okay, I appreciate the answers, folks. Thank you.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

Okay, thank you.

Operator: Your next question is from Paul Sankey of Wolfe Research. Please go ahead.

Paul Sankey
Analyst, Wolfe Research LLC

Q

Hi, Vicki. Hi, everyone.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

Hi, Paul.

Paul Sankey
Analyst, Wolfe Research LLC

Q

Hey. Vicki, if I could ask simply as a follow-up so early in the call, but could you go back to the idea that Evan had of what happens given the oil price is above $50? I think you really answered that in the context of 2018 CapEx being at a relatively fixed level. Can you go beyond that and talk about – I think the longer-term investment case for OXY may be that you grow the dividend at 5% to 8% a year off the base that you've got now of about 4.6%. that would get into double-digit returns. And conceivably, that would be at $50 assuming you make your plan, which you seem to be making. Can you talk to that and whether or not you see that as the investment case for OXY?

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

I think that's a strong investment case for us. It is, as I mentioned, the maintenance capital is the highest priority, but our second highest priority is the dividend and to continue to grow that. As you know, during this downturn, we haven't been able to return to what we were able to do historically because over the past 15 years, we've more than doubled the S&P growth rate with our dividend growth rate. Going forward, we want to get that back to meaningful growth, and that will be consistent with our production growth.

Paul Sankey
Analyst, Wolfe Research LLC

Q

And then the second follow-up is it sounds as if your disposals and acquisitions are going to be pretty neutral to zero because it will mostly be about swapping and there are no major portfolio moves to be made, again, thinking long term.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

There are no major ones, so just optimization of the tail end.

Paul Sankey
Analyst, Wolfe Research LLC

Q

Yes, okay, I get that. Finally, this is a little bit of a negative. But on a trailing basis, I know the new results are great, but you're still perhaps a little bit behind the rest of the industry in terms of your Permian performance. Do you see that as having been maybe a slow adoption of new technologies, the history of the company in terms of it being growth by M&A, or is there something about your acreage which I know is very extensive? What would you characterize as where you've been and what's allowing you to achieve this rapid improvement in result? Thanks a lot.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

It's certainly not the acreage. We have great acreage. And I think part of it is that our team – over the past few years, we've changed our Resources business significantly. And what we've been able to do is put the right people, the right leadership in place to approach this in the right way. And so now we're more value-based in terms of how we're doing our Resources business.

And we've made a breakthrough really taking all the acreage we have, all the information that we have from all of our offset operated wells, our outside operated, our offset, competitors, we've taken all of that and we've started to apply not only data analytics, but we're applying a more sophisticated subsurface characterization than we had done in the past because, honestly, for shale plays, some people initially in the early stages of shale plays thought they were statistical.

But clearly, developing shale plays, in my view, requires a lot more science than some of our conventional reservoirs. And I think until you get to the point where you realize what you need to do and how you need to do it and what parameters really matter, I think that you can struggle with that. But we're to the point now where we've done the work, the right work, and that analytics had helped with that. But just the massive amount of data that we have, we've been able to achieve a breakthrough in terms of what parameters really matter the most, and that's going into our evaluations now.

And also, the other thing that sets us apart, I believe, from some others is that we are taking our development plans, we're using integrated planning and doing field-by-field development plans so that we maximize the value. We don't go for – although you heard us talk about initial rates and 30-day rates, really that's not the target for us. We're just trying to give you a measure of how good these wells really are. But the target for us is to optimize the value of the full field development. And you don't need to focus on initial rates and 30-day rates to do that. But what you need to do is focus on how do you build your infrastructure out, how do you pace your development to ensure that you're maximizing the value of the reserves.

Paul Sankey
Analyst, Wolfe Research LLC

Q

Great, thank you.

Operator: The next question is from Phil Gresh of JPMorgan. Please go ahead.

Philip M. Gresh
Analyst, JPMorgan Securities LLC

Q

Yes, hi. Good morning. So my first...

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

Good morning.

Philip M. Gresh
Analyst, JPMorgan Securities LLC

Q

Good morning. My first question I guess would be a follow-up to Paul's, maybe asked a slightly different way. On slide 6, where you break out your dividend, your sustaining capital, your growth capital, with all the improvement you've been talking about here in well results, I guess I'm wondering if the underlying required capital from a sustaining basis or from a growth basis to hit the 5% to 8% on a longer-term basis, do you think that has a possibility of changing?

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

I think the more...

Philip M. Gresh
Analyst, JPMorgan Securities LLC

Q

I mean down.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

I think the more we learn about what we have and the more efficient we get, I think there is a possibility that that could come down.

Philip M. Gresh
Analyst, JPMorgan Securities LLC

Q

Right, okay. My second question would be – if I go into your appendix, slide 48, where you're talking about the Chemicals cash flows, you are implying that the CFFO can be nearly $1.5 billion on a normalized basis. And I guess I was a little surprised by that because I traditionally thought that pre-tax income for Chemicals on an annual basis to be maybe $1 billion. You tax-effect that, add back the DD&A, and you get to back to right around $1 billion. So is there something structurally different with the business, or is there some other cash flow effect there with respect to taxes or something else to drive the higher cash flow?

Cedric W. Burgher
Chief Financial Officer, Occidental Petroleum Corp.
A

Phil, this is Cedric. I'm going to take part of that, and then I'm going to ask B.J. to come in for the other part. But there is something that I guess has caught a few people by surprise, and that is some of the nuances with our tax position. The income generated in Chemicals is taxable, of course. But because we are integrated with the other parts of the business, we have domestic losses that are able to offset that. So we have been enjoying a very low, basically no tax position for some time in the Chemicals business.

We anticipate this situation to continue for some time at the current commodity price levels. You've got a number of commodities in play here. You've got the caustic soda prices obviously benefiting the Chemicals business, as well as the oil and gas prices affecting the other parts of the business. So all of that comes into play when you think about looking out and projecting your tax. But at the current levels, we think we've got sufficient tax losses to offset the Chemicals income for the projected time period that we've given you. And then, B.J., do you want to address the other piece?

Burnis Hebert
President, OxyChem, Occidental Petroleum Corp.
A

Sure. Good morning, Phil. This is B.J. Hebert. In talking about Chemicals, it continues to be positive in the market. And from a cash flow standpoint, obviously there are step-changes with both the cracker and the 4CPE plant that's going to come online. But just from a fundamental standpoint, they're very positive, especially for costs. I think Vicki talked about earlier that caustic prices were up 14% since the first quarter to the third quarter. And that was being driven by the fundamentals well before Harvey. And even after Harvey, it's tightened a little bit further.

But when you look forward globally, we think the fundamentals are pretty strong for us when you look at the main driver for caustic – or main consumption for caustic is in the aluminum industry, which is growing 5% to 6% per year. You have capacity coming down in Europe. And so when you look at all that in total, it's pretty strong from a fundamental standpoint. So that's really what's driving the earnings.

Philip M. Gresh
Analyst, JPMorgan Securities LLC
Q

Got it.

Cedric W. Burgher
Chief Financial Officer, Occidental Petroleum Corp.
A

Phil, this is Cedric again. I'm going to mention one other thing just because it's related. I really perhaps didn't give it due in my prepared remarks about our effective tax rate. But what was really cool about that this last quarter was it in large part was reflecting the operational improvements and cost reductions we've made in the international side of our business. And so Ken Dillon's with us, and I'd like to ask him to just add a few comments about those cost reductions and the improvements we've made internationally.

Kenneth Dillon
President, International Oil & Gas, Occidental Petroleum Corp.
A

Morning, Phil. This is really a strong story in Qatar. Field OpEx as at a seven-year low now, and it's been driven down by 68% since 2013. We're the lowest cost operator in country with a best-in-class ATS performance. With our partner QP, we have worked at each element of expense. We've been collaborative in logistics, including shared services, for example, work boats, lift boats, and helicopters.

And on the technical side, we upgraded compressor bundles, dry gas seal systems to state of the art to improve reliability, performance, and cost. We've also rolled out OxyLift leading to improvements in ESP run life. And lastly and not least, our supply chain team have been very successful in negotiating reductions in contracts of up to 27% for next year. Overall, it's a really strong team OXY performance and a really great partnership.

Philip M. Gresh
Analyst, JPMorgan Securities LLC
Q

Thanks for that, and then just one last one, Cedric. On the foreign upstream tax rate, your guidance remains 55%, but you've been coming in well below that. For the year to date, it's in the low 40%s, at least on the foreign upstream side. So is that sustainable, or is there something unique going on there?

Cedric W. Burgher
Chief Financial Officer, Occidental Petroleum Corp.
A

Well, we haven't adjusted the guidance because there were some more or less one-time items. The Iraq lifting I mentioned in the call – my prepared remarks – excuse me, so that obviously wouldn't be something we expect to recur. But of course, we did have that in the first quarter also, so, but really don't see much upside there. But on the operational improvements, we hope and expect that we'll continue to improve there, but we have not baked that into our guidance, so there is some upside there.

Philip M. Gresh
Analyst, JPMorgan Securities LLC
Q

Got it. Thanks for everything.

Cedric W. Burgher
Chief Financial Officer, Occidental Petroleum Corp.
A

Yes.

Operator: The next question is from Guy Baber of Simmons. Please go ahead.

Guy Baber
Analyst, Simmons Piper Jaffray & Co.
Q

Thanks and congratulations on the results.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.
A

Thank you.

Guy Baber
Analyst, Simmons Piper Jaffray & Co.
Q

So I wanted to start on the CapEx side. But with the visibility to delivering the cash flow piece of your breakeven plan improving here, maybe we can talk a little bit about the capital spending side. But you're highlighting the sustaining CapEx of $2.1 billion to $2.3 billion going forward. I wanted to talk about how the capital intensity of your international upstream business is evolving in particular given the changes in your asset base over the last few years, given deflationary pressures and some of the cost reductions that you've highlighted, in Qatar, for example. But just curious if you have an estimate of where your international F&D might be trending and the degree to which that has improved over the last few years.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

We are seeing improvements. We have seen over the past couple years continued improvements in what we're doing in the international operations, and in particular in the Middle East.

What we're seeing there is, as you may have remembered, we acquired 3D seismic over our Blocks 9 and 27, so we have one of the largest onshore 3D surveys in the world. And we're using that survey to successfully drill wells that have virgin pressure in a field that we discovered a long time ago, 30, 35 years ago. So that's really helping us because when you can drill wells in a field that already has infrastructure, that helps you to start to drive down your F&D. We have some other opportunities, and I'm going to throw it over to Ken to provide you more detail on what we're doing there.

Kenneth Dillon
President, International Oil & Gas, Occidental Petroleum Corp.

A

Good morning. As you know, we've changed very much over the last few years. Instead of the large megaprojects or efforts this year, we're very much focused in areas similar to Permian. We have large drilling program throughout the Middle East and Colombia. And we've rolled out OXY Drilling Dynamics across the whole region now.

What we're seeing is, for example, in Oman North, we've seen a 12% improvement in foot per day and an 11% reduction in cost per foot, which essentially drives lower F&D costs throughout the region. We just rolled out the same system in Qatar, and we've almost immediately seen a 6% improvement in dollars per foot and a 7% improvement in feet per day.

In terms of using the 3D seismic that we have across Oman, what we're seeing is similar results to Permian, where our IPs are coming in higher than plan, 20% across the whole of international. Basically, we're drilling fewer wells, more productive wells for less capital.

Guy Baber
Analyst, Simmons Piper Jaffray & Co.

Q

That's very helpful. And then my follow-up is on the U.S. The 4Q production growth in Permian Resources' trajectory into 2018 is obviously impressive. So with the meaningful increase in the number of Resource wells you're bringing online, especially in New Mexico, given some of the tightness in the labor market we're hearing about, logistical issues, tightness with services we've seen from others, can you just discuss the confidence and the timing of your planned ramp that you've laid out and how you're mitigating some of those risks regarding the timing of the delivery there, given what we've heard from some other operators?

And then maybe a specific comment on 4Q, the guidance range is wide there. Can you maybe just talk about what would take you to the lower end or the higher end of that guidance, what the sensitivities are there?

Jody Elliott
President - Domestic Oil & Gas, Occidental Petroleum Corp.

A

Hey, Guy, this is Jody. Appreciate the question. It is strong guidance in the fourth quarter, and there's two catalysts there. Obviously, one is the step-change in well results. There's been a significant improvement there.

We're taking advantage of those development plans, utilizing 3D seismic, as Vicki outlined, with respect to how we land the wells and how we stimulate them. The second part of this is the cadence of the wells online. So as I said in my opening comments there, we added rigs late in the second quarter. We'll start seeing those wells come in as we enter 4Q and go into the first quarter. And as you can see on the chart there that the well counts are also going up significantly.

So there are a couple of aspects there that drive why the range is wide. One is you're putting on 3,500 barrel a day wells. Those wells take some time to reach peak production. And so when you have that many wells with that kind of spread in production rate, depending on how – whether a well comes on the 1st of December or the 15th of December can make a big difference in what that quarterly production rate is. To me, it's about the trajectory fourth quarter, first quarter, second quarter that we have a lot of confidence in.

The other aspect is pad drilling. Year to date, we're probably 80% pad drilling, but we anticipate going up to about 95% as we end the year and go into 2018, as I spoke about the field development plans. So good well results, pad drilling, ramp up of number of wells online, those are all really positive, but it makes guidance in a single quarter a little more difficult.

You've got a second part of your question or one of the parts of your question there was around risk mitigation. So pad drilling, the way we do modular-based development, the well designs are very similar from Module 1 to Module 2, and so it's very repeatable. You have crews that get into a learning curve. Remember, we haven't ramped significantly. We're at 11 operated rigs. We believe that's well within our headlights and our capability. We have frac cores that continue to do – work with us in repeatable activities.

One of the risk mitigation techniques we employ is utilizing spudder rigs and batch rigs, where you spud a rig to set surface casing, in many cases, where it makes sense. In other cases, we use batch rigs to set intermediate pipe. So if you set all your intermediate casing strings before you do your laterals, it derisks, if you want to call it, a train wreck or a problem in one of those wells. You derisk that because you've taken it out of the critical path timeline. So that's one example. There are a number of things we're doing on the supply side and cost side. Our logistics hub in New Mexico comes online, and that derisks supply. So I appreciate the question, Guy.

Guy Babber
Analyst, Simmons Piper Jaffray & Co.

Q

Super helpful, thank you.

Operator: The next question is from Brian Singer of Goldman Sachs. Please go ahead.

Brian Singer
Analyst, Goldman Sachs & Co. LLC

Q

Thank you, good morning.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

Good morning.

Brian Singer
Analyst, Goldman Sachs & Co. LLC

Q

When we looked at slide 15, it's definitely noteworthy the increase in lateral length that you've achieved and are expected to achieve, getting to 8,500 feet on average in the first half of 2018 in the Permian. And I wondered if you could talk about the longevity of your inventory of 8,500-plus foot lateral length wells. And going to the earlier commentary on a swap here, a swap there, at what point you would look for more meaningful opportunity or need to swap to add to your Permian position to bolster that continuity.

Jody Elliott
President - Domestic Oil & Gas, Occidental Petroleum Corp.

A

Brian, we've had – last year, I think in the past, we said we did about 10,000 acres of trade swaps in 2016. In the slides, you'll see we've done already 13,000 acres this year to continue to core up. There's energy in the industry to do that. People recognize the value of scale and being able to drill long laterals. So we have a good inventory of wells that are in the long lateral category.

Again, I go back to the value-based development. It's part of that process. There's a subsurface process. There's a commercial process. There's an execution planning process. But there's also a land process that goes with that. You can go chase production. But if you're not set up to do the longer laterals and spend the time to work your land position hard, then it's going to be the potential risk to over-capitalize and not deliver the rates of returns which will lead to the return on capital employed that we're were driving for. So it's all wrapped up into that process. But we've had a lot of good land trades this year, and that gives us confidence about continuing to be able to drill long laterals.

Brian Singer
Analyst, Goldman Sachs & Co. LLC

Q

I guess to sum up this topic then, if we were to think about what's needed for your multiyear growth plans, assuming $50 oil and assume you go at a similar pace of normal course land swaps, would you have the inventory of 8,500-plus foot lateral length wells to support that ramp where we'd see these bars continue to go flat or go up and to the right?

Jody Elliott
President - Domestic Oil & Gas, Occidental Petroleum Corp.

A

Yes, we're confident that these core land positions have long lateral inventory deep. But remember, that's just one piece of the value-based development approach. We continue to lower costs. We continue to drive well efficiency. There are places – again, you can see what our lateral length has done over time, not just in the inventory but in the actual results. Now we updated our inventory last quarter. Our average inventory – and this is in the less than $50 category – went from 8,400 to 8,600 feet. So all these steps we take continue to drive better returns at the end of the day.

Brian Singer
Analyst, Goldman Sachs & Co. LLC

Q

That's great. And then shifting internationally, you talked about some of the well productivity improvements that you're seeing in Oman. And I wondered to what degree that international is competing more for capital, or whether these productivity improvements or efficiency improvements just mean you would essentially repatriate or have more capital available for debt paydown or to shift to the U.S.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

We're definitely not opportunity-limited with what we're seeing in international, and so it really would depend on what adds the most value. As we get to the point where we have cash above and beyond our 5% to 8% growth that we've set as a target, we'll look at the opportunities and see what we can do. But I'm really excited about what we're seeing internationally.

Brian Singer
Analyst, Goldman Sachs & Co. LLC

Q

Great, thank you.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

Thank you.

Operator: Our last question comes from Doug Terreson of Evercore ISI. Please go ahead.

Doug Terreson
Analyst, Evercore Group LLC

Q

Hi, everybody. I had a capital management question as well. And specifically, during the past year or so, several of your competitors, they changed their direction. In some cases, they suspended production guidance just to demonstrate the emphasis on returns and value creation. And then they pledged to distribute increased cash flow to shareholders over the next five years, and they were obviously rewarded in the stock market.

So while there was plenty of commentary on growth today, the obvious question is why not more parameters or frames for returns on capital, meaning Cedric was pretty clear about to the commitment to returns, and I think Vicki was too. But is there a reason that pathways and signposts for free cash flow and return on capital are not provided for extended periods?

And I ask because it clearly looks like your economics are improving, so it appears as if returns are probably improving and normalize too. Or do you guys think that the returns for it will take care of itself as production increases? So I guess the question is – I just want to get you guys to comment on how you think about the importance of returns and the balance between growth and returns. So if you could do that, that would be appreciated.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

Okay, I don't want to say this in a negative way, but our history points to the fact that return on capital employed has been a very important metric to us for the last 20 years. And we have a track record that shows that we make investment decisions on that basis.

The only reason we're struggling a little bit right now is that we certainly need to get to the point where we replace the cash flow that we lost from those lower-return and lower-margin assets that we exited. That was really the main reason for that whole strategic plan, was to get us back to a situation where every dollar we invest delivers the highest possible rate of return on capital employed. So we're really committed to that. We're going to execute this plan to get to our cash flow breakeven at $50. And beyond that, our return on capital employed will continue to go up.

Doug Terreson
Analyst, Evercore Group LLC

Q

I didn't think that comment was negative.

Cedric W. Burgher
Chief Financial Officer, Occidental Petroleum Corp.

A

Good. Doug, this is Cedric. I would just add a couple of things. One, it sounded like from the question, I want to make sure I heard, was a little bit reflective of what does our guidance reflect and so on. And while we don't guide ROCE, because one thing that's wonderful about ROCE, and I'm sure you're a big advocate of it, Doug, but it captures pretty much everything. And it's fully audited, it's full-cycle, it's harder for the IR guys to game it and so on. So it really is a great metric and it's one we've been committed to for a long time. And of course, we would never do that here.

But it's a great metric. We've been committed to it in various pieces for a long, long time, organizationally as well as personally. But to give guidance reflective of that really is difficult to do. And if you look at last year, we were in the top quartile of our peer group for ROCE. It was a tough year for everybody in the business just because of the downturn and historic costs on the books. As we work forward, every dollar being reinvested, as Vicki said, is going to very high-return reinvestment returns where it won't get invested. And so that's our commitment to you and to our shareholders, and we're finding a lot of success and progress in doing that. And so we believe that recipe will continue to give us industry or peer-leading ROCE metrics.

So I know it's a competitive environment, but we were top quartile last year, and we intend to be that way over time year in and year out. And that's our goal, and then we are increasingly tying compensation to it. That's something we put out last quarter in one of our slides. And so I'm not sure – but guidance is something that we aren't probably going to do in terms of guiding ROCE. We'll give you components that may be can help you get there.

Doug Terreson
Analyst, Evercore Group LLC

Q

Okay.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

Also I want to – and, Doug, I was going to add one more thing as well. As you know, we've also done share buybacks a lot in the past and we've done quite a bit of that, and that's not something that we have gone away from being willing to do. It is on our list. But right now, with the opportunities that we have for organic development, it's not the highest priority or not the middle priority, but we would consider that in the future. That will be a part of our value proposition. So just to make sure you understand we're open to doing what we need to do to add value, but I appreciate the question.

Doug Terreson
Analyst, Evercore Group LLC

Q

Yes, thanks for covering it because it's obviously topical.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

A

Right, thank you.

Doug Terreson
Analyst, Evercore Group LLC

Q

You're welcome.

Vicki A. Hollub
President, Chief Executive Officer & Director, Occidental Petroleum Corp.

So to close, I'd just like to say that we're very excited about where we are and our direction, but we realize that more needs to be done. We have the highest quality assets across our businesses that we've ever had, and our teams are continuing to find ways to make them even better. This gives our entire management team confidence in our ability to sustain our value proposition of dividend and moderate production growth, and we're looking forward to where we're headed.

So thank you all for joining our call today and I hope you have a good day, and go Astros.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.