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COP.N - ConocoPhillips to Acquire Concho Resources Inc - Conference Call

EVENT DATE/TIME: OCTOBER 19, 2020 / 12:00PM GMT

OVERVIEW:

On 10/19/20, Co. announced the agreement to acquire Concho Resources in an all-stock transaction.

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PRESENTATION

Ellen DeSanctis - *ConocoPhillips - SVP of Corporate Relations*

Thank you, Sheryl, and good morning, everyone. Thank you for joining today's call to discuss this morning's announced transaction between ConocoPhillips and Concho Resources. Our speakers today will be Ryan Lance, our Chairman and CEO; Tim Leach, Concho's Chairman and CEO. We also have Matt Fox, our EVP and Chief Operating Officer; and Bill Bullock, our EVP and Chief Financial Officer.

We have a presentation deck for the call that describes highlights of today's transaction. The deck is available from our website, and we will post a replay of this call as soon as it's available.

A couple of important administrative reminders. We will use some non-GAAP terms this morning, and reconciliations to the nearest GAAP measures are included in today's release and on our website. And please note that we will make some forward-looking statements based on current expectations this morning, as well as statements about the proposed business combination between ConocoPhillips and Concho. A description of the risks associated with forward-looking statements and other important information about the proposed transaction can be found in the joint press release and on Slides 2 through 4 of the investor presentation we'll use today. All of these are incorporated by reference for purposes of this conference call.

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And now I'll turn the call over to Ryan.

Ryan Lance - *ConocoPhillips - Chairman & CEO*

Thank you, Ellen, and good morning, everyone. We're certainly pleased you could join us at this early hour for what we believe is an exciting and transformational announcement for our industry. I'll begin on Slide 5 with a couple of short but powerful statements that describe the premise for this transaction.

Tim and I both agree that sector consolidation is both necessary and inevitable. However, today's transaction is not just another industry deal. Neither of us needed to do a transaction to fill a gap in our portfolio or fix something. Instead, Tim and I are jointly making a commitment to lead what we believe is a structural change for a vital industry. We both believe our industry needs solutions that address the lack of scale, poor returns and increasingly, the challenges and opportunities of environmental, social and governance matters. We believe today's combination satisfy these industry issues and ushers in a new era of energy leadership to meet the future. We are both excited to be part of creating a compelling company that can deliver superior returns and performance with purpose for all our stakeholders.

Let me quickly cover some of the highlights of this transaction in three parts: the transaction terms, leadership and governance and conditions and timing. The combination creates a truly formidable company with enterprise value of about $60 billion. Under the terms of the all-stock transaction, Concho shareholders will receive 1.46 shares of ConocoPhillips common stock for each share of Concho. Upon closing, ConocoPhillips shareholders will have a 79% equity ownership, and Concho shareholders will have a 21% equity ownership in the combined company. You'll hear me say this a couple of times on the call, but one of the most important aspects of this transaction is that it fits within the clear long-held criteria we've laid out to the market for M&A.

We've said any deal must support our disciplined financial and operational framework. And we've also said that the all-in cost of supply of a transaction must be less than $50 per barrel WTI. Upon closing, Tim will join our Board of Directors and our executive leadership team. Tim will be named the Executive Vice President and President, Lower 48. This transaction significantly enhances our competitive position in Midland, and I look forward to welcoming Tim and his extensive experience to ConocoPhillips.

The transaction is subject to the approval of both ConocoPhillips and Concho stockholders, regulatory clearance and other customary closing conditions. It's expected to close in the first quarter of 2021. And Tim and I have every reason to believe we'll hit the ground running when it does.

As I mentioned a moment ago, this transaction didn't raise -- arise from needing to fix anything for either company. Instead, this deal is about consolidating two high-quality companies to create a leading company with scale and relevance. The deal has strong merits across the critical drivers for business, which are listed on Slide 7. This list explains why we believe this is an exceptional transaction. It all starts with returns. Returns on and returns of capital through cycles. Tim and I believe this deal offers a truly compelling way to invest in the sector. This deal combines two best-in-class portfolios to create a resource base of approximately 23 billion barrels of oil equivalent with a less than $40 per barrel WTI cost of supply and an average cost of supply that's less than $30 per barrel WTI.

Asset quality matters in this business, but so does margin. With this transaction, we expect to achieve $500 million a year in reoccurring cost and capital savings. As you will see later in the call, the transaction is immediately accretive on key financial metrics based on consensus, including ROCE, cash flow and free cash flow. Both Concho and ConocoPhillips bring investment-grade balance sheets to the deal. The combined-entity balance sheet is strong and resilient. And last but not least, Tim and I agree that ESG performance is an imperative. Our companies have a long track record of and commitments to ESG stewardship. We know that a safe company is a successful company. We believe in our value-based cultures and the talent of our workforces, and we

recognize that our combination provides a platform to -- for taking leadership position in ESG. That summarizes the compelling features of this transaction, and it will also serve as our GPS for today's presentation.

Slide 8 should look very familiar to many of you. This is our proven value creation framework on a page. It's a framework I know Tim values. We have to run this business for the realities of price uncertainty, capital intensity and maturity, and we've added one more reality, a strong focus on

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environmental, social and governance matters. You saw in this morning's announcement, we've adopted a Paris-aligned climate risk strategy that includes new emissions intensity reduction targets, among other steps. We're the first U.S.-based oil and gas company to take this step. Our foundational principles, shown in the middle, drive strong performance against these realities. You need a strong balance sheet. You need to expand cash flows, especially free cash flows, you need to return capital to owners and generate improving returns over time. And we have to do our part to reduce emissions while helping to meet the demand for energy globally.

Finally, on the right, our framework specifies how we operationalize our priorities through clear, consistent stakeholder priorities. The combination with Concho is an affirmation of our mutual commitment to this framework for value creation.

Now let me turn it over to Tim.

Tim Leach - *Concho Resources Inc. - Chairman of the Board & CEO*

Good morning, and thank you, Ryan. Concho has come a long way since its founding in 2004. Thanks to the hard work of our team, today, Concho is one of the largest unconventional shale producers, not just in the Permian Basin, but in the U.S. We have a high-quality asset base, a culture of operational excellence, safety and efficiency and a strong balance sheet. We have long succeeded by taking bold actions and evolving as our markets change. We built Concho based on this strategy and more recently our strategic focus on prudent growth, efficient operations, growing free cash flow and returning capital to shareholders. We've raised the bar every step of the way, and we intend to continue to do so going forward.

With the recent market volatility, the global pandemic and the shift in the way the market has come to value E&P companies, we recognize that our markets have once again changed, and once again, we're taking action. From a position of strength and in light of the market trends, our Board and management team conducted a thorough review of a wide range of options and determined that this transaction is the best path forward for Concho and our shareholders. We believe this transaction reflects the strength of our assets and the quality of our people.

So with that, let me provide some more color on where we are, where we are going and how this transaction will create value for our shareholders.

First, despite the challenging market environment, Concho is operating really well. The third quarter of 2020 -- in the third quarter of 2020, we delivered excellent results. Estimated results for the quarter include oil production volumes of approximately 200,000 barrels per day, with capital expenditures of roughly $280 million and cash flow from operations exceeding $600 million. However, we're not only looking to manage through this quarter or even this year, we're focused on the sustainable and consistent long-term growth and success of our company and passing those results on to shareholders, which is why this merger makes so much sense.

We believe that with ConocoPhillips, we are de-risking our business and can apply our assets, capabilities and performance to the business model of the future. After closing, our combined company will be well-capitalized, have enhanced capital flexibility and a leading commitment to sustainability. Together, we will create a stronger business that fits this model.

In the past, I've spoken about the need for scale. Today, scale has never been more important. Through this transaction, we are joining Concho with a larger diversified energy company with even more size and resources to create value in today's markets and beyond. Through this transaction, our shareholders will receive a premium for their shares in the form of ConocoPhillips stock, allowing them to participate in the upside potential of our combined business. The transaction price represents a 15% premium over our last unaffected trading day last Tuesday. The combination will be immediately accretive to key metrics, and shareholders will receive ConocoPhillips shares, a highly liquid heavyweight stock with a superior track record of value creation. In addition, shareholders will benefit from ConocoPhillips' attractive dividend and capital return philosophy. In addition to the value we are creating for shareholders, one of the most important parts of this transaction for us is the benefits to our local communities, and we're very pleased with the enhanced competitive position this will bring to Midland. We remain dedicated to building on our record of citizenship, sustainability and responsibility. We know that these are priority areas for ConocoPhillips as well. Together, we will continue investing in and enhancing the places where we live and work.

Before I turn the call over to Matt, I want to thank our employees for their continued hard work and dedication. They have always been the cornerstone of our success. It's their commitment to working together safely and as a team, that has enabled us to grow and succeed throughout

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Concho's history. I'm excited to be joining ConocoPhillips' Board and management and to be leading the Lower 48 team. I'm also excited about the opportunities ahead for our employees as part of this larger organization. We look forward to working closely with Ryan and his team to complete this transaction and deliver its compelling benefits to our shareholders, employees, business partners and our communities.

With that, let me turn it over to Matt.

Matt Fox - *ConocoPhillips - Executive VP & COO*

Thanks, Tim. And my goal on this morning's call is to lay out the merits of this transaction in more detail. I'll start with a review of the combined portfolio on Slide 9.

You can see the geographical diversification of the companies on the map, color-coded by our reporting segments. On the bottom left chart, you'll see the 2019 pro forma production split on the same basis. About 50% of our production will be in the Lower 48, 15% in Alaska, with the remaining quarter or so from outside the U.S. The pie chart on the top left shows the geographic split of the combined resource. The combined company will have 23 billion barrels of resource with a cost of supply below $40 WTI and an average cost of supply below $30. That's more than a 50% resource increase of 8 billion barrels from our current 15 billion barrels.

Of our total resource base, 57% will be in the Lower 48, Canada will be the second-largest contributor at 19%, and the remainder is split evenly between Alaska and resource outside North America.

Post-closing, we'll provide our usual detailed cost of supply curve to give you further granularity across the portfolio. But the bottom line is, this transaction results in a diverse, low cost of supply, truly best-in-class resource space.

So what does best-in-class mean? To us, it means scale, diversification and low capital intensity. On Slide 10, we compare our production to our E&P competitors. On this basis, the combined company will be the largest E&P company in the world, with production of over 1.5 million barrels equivalent a day. So the scale criterion is met. But being best-in-class is not just about being big. We think diversification matters, too. The chart on the right shows that we will be the most diverse independent, with production coming from four distinct mega trends: conventional, unconventional, LNG and oil sands.

And low capital intensity is important because it drives free cash flow, and capital intensity is driven by base decline. Obviously, we're adding to our unconventional position, and that will modestly increase our underlying base decline rate. So we estimate that across a range of potential capital plans, our average decline rate will still be less than 12% over the next 10 years. That's 2 percentage points higher than last year's plan, but still be well below all our large independent peers.

Zooming into our Lower 48 unconventional position on Slide 11, our combined company will hold over 1.5 million net acres in Delaware, Midland, Eagle Ford and Bakken unconventional plays, with about 17,000 remaining drilling locations with less than $40 a barrel cost of supply.

On the right, is a four-part map of indicative single well cost of supply in these Big 4 unconventional basins based on third-party data. Red is good. The focus areas of ConocoPhillips and Concho's primary acreage are highlighted in the rectangles. You can see we're in the heart of the sweet spots, and not by accident. These portfolios were both crafted with the same concept in mind. Lasting competitive advantage in this business comes from the quality of the rocks.

Moving to Slide 12. Our combined company Lower 48 business will be one of the biggest unconventional producers with 430,000 barrels per day of net oil in 2019. And you can see in the pie graphic that we're pretty balanced among the four plays. Many of you will recognize the graphic on the right side of the page. It's the optimized plateau model that we showed at last year's Analyst meeting. This describes how we think about the pace of development that optimizes value and capital efficiency and

leads to high returns through the cycles.

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The model represents economically rational criteria for how we develop our assets. And we'll apply these criteria across our whole portfolio. And as long as we are not developing anything with an incremental cost of supply above $40 a barrel, we believe we're ensuring high returns for shareholders through the cycles.

And zooming in further to the Permian on Slide 13, the addition of Concho's 550,000 acres of premier consolidated position, results in a total of more than 700,000 acres of high-quality land across the Delaware and Midland basins. In addition to the competitive cost of supply of this resource at less than 10-kilograms of carbon per BOE, it's also some of the lowest greenhouse-gas-intensity oil produced anywhere in the world, and it will make a significant contribution to our overall climate risk mitigation strategy. This expanded portfolio will allow us to optimize our disciplined investment philosophy across our broader platform, further enhancing returns.

As Ryan and Tim said in their opening, we begin -- we believe the industry is entering a new era, an era where low-cost, high-quality operators will distinguish themselves. And today's combination certainly brings together high-quality operators and portfolios, but it also presents an opportunity to reduce costs, and that's what's described on Slide 14. We anticipate $500 million of recurring annual cost and capital reductions associated with the transaction.

That translates directly to an increase in free cash flow and an NPV of roughly $5 billion. Based on Friday's close and the deal's exchange ratio, that, by itself, represents value addition of over $3.50 a share.

So where were these reductions sourced? That's shown in the waterfall chart on the left. We will see $100 million of direct reductions associated with the merger for elimination of duplicate G&A costs and board positions, officers and corporate costs. With the addition of Concho's 8 billion barrels of resource, we're going to focus our exploration activities only in existing business units that have remaining exploration potential, like Alaska, Norway and Malaysia. This will result in a reduction in the annual CapEx we had planned for exploration from $300 million a year to $150 million. We'll also see an associated reduction in G&A and G&G spending.

The aggregate reduction from exploration will be $250 million a year. This is clearly a strategic shift for the company that we see as merited, with our expanded resource base, and in the new era of resource abundance. These two categories, direct cost and exploration, can be considered as reductions directly associated with the deal. But also, as part of the integration of the two companies, we intend to streamline our broader corporate and regional organization structure to increase the efficiency of our support to the regions. That represents another $150 million of cost structure improvements. These cost reductions will be achieved as we go through 2021 and be fully implemented by the start of 2022. But there are additional opportunities to improve free cash flow that we haven't fully quantified yet, and this is described on Slide 15.

We've identified three areas where we believe we can realize additional free cash flow improvements over time as we integrate our organizations. First, through commercial and marketing activities. ConocoPhillips is already one of the top natural gas marketers in the U.S., and we have a very strong team that adds margin across the board from our operations and trading positions. This expanded Permian position will offer opportunities to spread that expertise across more product volume, and we expect that to show up as improved margin over time.

Second, we recognized Concho has significantly more experience and expertise in drilling and completion activities in the Permian than we have. That means they're further down the learning curve than we are. And we can apply that knowledge to jump to Concho's position on the curve with our existing Permian position. That experience can be passed on to our other unconventional plays, too. And we'll be able to more fully leverage learnings that we've had across the Eagle Ford, Bakken and Montney plays into the Permian.

Facilitating this cross-fertilization will be a critical focus of the transition team, because we expect the capital savings and recovery improvements from sharing expertise and technology could be significant. And third, we expect to see supply chain benefits from our increased scope in the Lower 48 through logistics optimization and other economies of scale. So these represent currently unquantified savings associated with the transaction. And we will be all over this in 2021 and beyond to make sure we're getting all the benefits we can from our greater scope and scale.

The waterfall on Slide 16 is also very familiar to ConocoPhillips shareholders. Since 2016, we've used this to represent the capital allocation priorities Ryan described earlier. The stacked bars on the left represent our annual sources of cash from operations and our starting cash balance. On a

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run-rate basis, when our $350 million of expected cost savings are in place, at pro forma production rates and $40 a barrel WTI, we'd expect to generate about $7 billion in cash from operations.

At $50 a barrel, it would be about $10 billion. Between both companies, we'd also expect to have around $7 billion of cash on the balance sheet at the end of this year. So those are the sources of cash.

The uses of cash are shown as you move to the right. Our first priority is to sustain production and pay the existing dividend. Sustaining capital for ConocoPhillips is $3.8 billion, for Concho it's $1.3 billion. So a total of $5.1 billion. At this capital level, the free cash flow breakeven price is about $34 a barrel. With the expanded share count and ConocoPhillips dividend per share, the dividend will represent a use of cash of around $2.3 billion. The aggregate of these elements of priority one is covered at roughly $41 a barrel.

Our second priority is to increase the dividend. That's a decision the Board makes each quarter, and we'd expect to deliver steady increases over time. Our third priority is to ensure we have an A-rated balance sheet at mid-cycle prices. So that in stressed price conditions, we're confident we'll retain a strong investment-grade rating. The current strength of the balance sheet means no use of cash is required to satisfy this priority. Priority 4 is to supplement our dividend payment with an additional return of capital to ensure we're distributing at least 30% of our cash from operations to shareholders. Our track record over the last four years has been more than 40% returning to shareholders. Only when these four priorities are fulfilled will we invest incremental capital to increase production to expand cash from operations. And any investment in priority 5 will be constrained by our optimized plateau approach, and to a maximum incremental cost of supply of $40 a barrel. We'll decide a range for this capital as we get closer to 2021, but at $50 a barrel, we'd expect both priority 4 and 5 to have some capital allocated to them.

The punchline of this slide is that today's transaction on a pro forma basis enhances our ability to deliver on our priorities for value creation.

Now I'll hand the call over to Bill for comments on the financial merits of the transaction.

Bill Bullock - *ConocoPhillips - Executive VP & CFO*

Thanks, Matt, and good morning. Slide 17 describes several of the financial metrics that, based on consensus, will improve as a result of this transaction. Both our absolute free cash flow and free cash flow yield will improve.

On consensus numbers, absolute free cash flow improves by more than 50% and free cash flow yield by about 20%. Our balance sheet strength is maintained. At consensus, net debt to CFO was 1.3 turns, and this ratio is 1.0 or below for 2022 and 2023. And as you would expect, we've tested the pro forma plans against lower prices to assure ourselves that the plan can perform well against low-price scenarios. Financial returns on capital employed would improve and earnings per share also meaningfully increase. And finally, as Matt just described, this transaction enhances our ability to satisfy our priorities. The over 50% expansion in free cash flow improves the coverage of our compelling dividend and our ability to consistently meet our return of capital commitment to shareholders.

So as we've said throughout the call, this deal truly improves our already strong financial position as a company.

Now let's talk about our balance sheet on Slide 18. Both companies came to this deal in a very strong financial position, and our pro forma balance sheet is structured for resilience. Both companies are committed to maintaining an investment-grade credit rating through cycles. On a pro forma basis, we'll have net debt of about $12 billion with a distinctive-level liquidity, consisting of almost $7 billion of cash and short-term investments, plus a roughly $6 billion credit facility. That's total liquidity of about $13 billion. Over the next five years, there's only about $2 billion of maturities coming due. So we're also in very good shape there.

On the right, we're showing net debt to CFO for our stand-alone companies as well as on a pro forma basis. As I said earlier, we both bring strong balance sheets to this transaction and maintain a distinctive position compared to most of the industry. This is a clear advantage for a cyclical business.

And with that, now I'll turn it back to Ryan for some closing comments.

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Ryan Lance - *ConocoPhillips - Chairman & CEO*

Thank you, Bill. As I said at the opening, today's transaction combines two companies with track records of and commitment to ESG excellence. Our announcement this morning to adopt a Paris-aligned climate risk framework is a clear indication of our continued commitment. We've set a target to reduce our Scope 1 and 2 emissions intensity by 35% to 45% by 2030, with an ambition to achieve net zero by 2050.

We're advocating for Scope 3 emissions intensity reduction through our support for a U.S. carbon price, and we've joined the World Bank flaring initiative. Concho's low Scope 1 and 2 emissions and their leadership in water stewardship in the Permian is an excellent complement to our ConocoPhillips activities. We're also aligned in our commitment to social responsibility. We have strong values-based cultures and the most talented workforces in the business, and we give where we live.

On the governance front, we'll continue to have a diverse, skilled Board. We align compensation and performance and take pride, both of us, in our disclosure and engagement practices. Tim and I are excited to elevate our commitment to ESG excellence for the benefit of all our stakeholders.

Now I'll conclude where I began for the summary of the compelling rationale for this transaction. Tim and I are eager to restore relevance and appeal to our sector, and that's what we're offering today. We have a shared view of how to create value in this business. The company will have a global, diverse, low-cost of supply resource base of 23 billion barrels that will be developed for returns, not growth. The deal will facilitate $500 million of sustainable annual savings, representing more than $5 billion of net present value. The company will continue to focus on free cash flow and returns that are tied to shareholder-friendly priorities. The combined balance sheet is strong and resilient, and we're taking ESG leadership to the next level. So we're extremely excited to take this step forward to assuring a new era of energy leadership.

So now operator, we'll turn it over and take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Neil Mehta from Goldman Sachs.

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

And congratulations, Ryan, Matt, Ellen, Tim. I'll ask the first question and turn it over to Brian Singer to ask a second. The first question I had was just really on the assets. And Ryan, how did you get comfortable with the federal lands risk as you were evaluating the value of Concho's assets? And then as you think about recognizing, you haven't provided the cost of supply curve yet and we're going to get that, the Permian versus other assets on that curve, whether it be Alaska or Qatar or something else, where does it fit based on your preliminary analysis?

Ryan Lance - *ConocoPhillips - Chairman & CEO*

Yes. Thanks, Neil. So yes, we spent a lot of time thinking about the federal exposure. And I think both companies have stated publicly that we have enough assets on the nonfederal acreage to support development for a decade and beyond. So I think while we recognize that people are talking about federal exposure, we don't -- we believe all the leases, they're held. So it's just a matter of permitting and going through the regulatory process.

And we think these are resources that are important to get developed. They will get developed over time, and they're going to be needed to supply the energy for the world. So we felt comfortable with the risk. It's not materially increased at all with this addition of Concho because we both had similar plans in place to mitigate against that risk.

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And I would say -- I'll let maybe Matt chime in also on the cost of supply for a second. We'll be in the process of looking at that. And as we said in the prepared remarks, we'll be publishing that as we get through the transaction, close the deal and start thinking about the combined plans. Matt, would you add maybe a bit to that?

Matt Fox - *ConocoPhillips - Executive VP & COO*

Yes. Yes, Neil, the cost of supply of Concho's Permian acreage is in the low to mid-30s. So it's a huge tranche of extra resource that sits well under our criterion of $40 a barrel. It's competitive with our other unconventionals. It's competitive with things like the Willow project in Alaska. So it's certainly going to attract capital.

Brian Singer - *Goldman Sachs Group, Inc., Research Division - MD & Senior Equity Research Analyst*

It's Brian Singer, and appreciate the opportunity on the call here. We have a question for Tim. Tim, you mentioned that you and the Board looked across options in the market, and you highlighted the similarities in how Concho and Conoco look at the values of low leverage, capital and corporate returns and falling emissions intensity. As you looked at the go-it-alone scenario versus the combined scenario, what were the primary factors that drove you away from the go-it-alone scenario?

Tim Leach - *Concho Resources Inc. - Chairman of the Board & CEO*

Yes, that's a great question. I mean, Ryan and I started talking about the company of the future quite a while ago and discovered that we shared a lot of the same views. And Concho is running a great business and kind of hitting on all cylinders right now. But I think size and scale are the driving factors today, and at the size and scale that we are today with the underlying decline rate that approaches 40%, it's hard to distribute cash back to the shareholders as rapidly as we can in this new model. So that was really what drove the decision about -- between the go-it-alone and this combination.

Operator

Our next question comes from Jeanine Wai from Barclays.

Jeanine Wai - *Barclays Bank PLC, Research Division - Research Analyst*

I guess my first question is on the future global exploration program. It sounds like in order to make room for Concho, Conoco is de-emphasizing this effort by about $250 million a year. The presentation indicates refocusing exploration going forward. So I was just wondering if you could provide a little bit more commentary on what that program will look like. And on a related note, has your view on potential larger future development projects, for example, in Qatar or Willow, has that changed at all? I wasn't sure if Willow was included in your remarks?

Matt Fox - *ConocoPhillips - Executive VP & COO*

Yes, I'll take that, Jeanine. Yes, at the moment we have quite an active new ventures exploration program, looking for opportunities that meet our development cost of supply criterion away from our existing business units. What we intend to do now is to really focus only on those business units that have remaining exploration potential. Because the addition of this resource from Concho means that we just really don't need to spend that money to add additional resource at this time. So that's the underlying rationale associated with it, to do exploration across places like Alaska and Norway and Malaysia, we only need something like $150 million a year on average to do that. So that's where the source of reductions are. And of course, that also comes with some G&A and G&G reduction.

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So that's the reason for the $250 million. In terms of the other projects, no, this doesn't change our view of projects like Willow or NFE. We are a company with adequate scale to include some longer-cycle projects in our development portfolio as long as they're low-enough cost of supply to compete for capital. And those two and the others that we pursue meet that criterion.

So no, it doesn't change our view of developing other projects.

Ryan Lance - *ConocoPhillips - Chairman & CEO*

And I would add, Jeanine, that those projects are important as well because ultimately, they lower the capital intensity in the portfolio. So having a mix of those are important.

Operator

Our next question comes from Alastair Syme from Citi.

Alastair Syme - *Citigroup Inc. Exchange Research - Research Analyst*

Congratulations on the deal. Look I wanted to come back on the NPV creaming curve on Slide 12 and then relate that back to the pro forma sustaining capital number of $5.1 billion. Can you just sort of give us an indication in terms of rig activity level (inaudible) what you're implying you would have to do as you go into 2021?

Matt Fox - *ConocoPhillips - Executive VP & COO*

Yes. So we'll give more color on that when we roll out the budget, but we've been pretty clear in the past about Conoco's sustaining capital level. And Concho has given some indications recently of theirs, exactly how we allocate rigs across the plays. And the number of rigs, of course, is influenced by the equity across the plays as well. We'll decide that later.

But there's a lot of flexibility to -- if we find ourselves in a prolonged period of $40 a barrel, and we want to simply run at sustaining capital levels, that's something that we have the capacity to do. I mean both companies right now are more or less at sustaining capital levels in the second half of the year.

Alastair Syme - *Citigroup Inc. Exchange Research - Research Analyst*

Is there an intuition here that the combined company can run at a higher activity rate than the pro forma? Do you have better access capital to do that?

Matt Fox - *ConocoPhillips - Executive VP & COO*

Well, we have the capital that we need either do that directly from the cash from operations or from the cash that's on the balance sheet to both run at sustaining capital and distribute the dividend to the broader shareholder base even if prices are $40 a barrel for a sustained period.

Operator

Our next question comes from Roger Read from Wells Fargo.

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Roger Read - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Congratulations on the transaction here. Two questions. One specific to the acquisition and one specific to the ESG side. On the acquisition side, a lot of times we see these transactions, there's a talk about asset sales and so forth. And I was just sort of looking at the footprint here and wondering if there's some coring-up opportunities, asset swaps, direct sales, other things you're looking at in the Permian. And then the second question on the ESG front. If we think about an improvement overall in the operations, but I noticed kind of Scope 3 is left out. Do you see a change longer-term to how you think about the oil sands within the overall framework as an ESG approach?

Ryan Lance - *ConocoPhillips - Chairman & CEO*

Yes. Let me hit the first part and maybe Matt can chime in on the second. I can add some color to that, too. We haven't gotten to the point where we've talked about the portfolio. I think if you look at our company, we've been reasonably prudent in how we think about the portfolio if assets don't compete for capital under our cost of supply or criteria for capital allocation. We've not been shy about moving them out of the portfolio. We like all the assets that we've seen today, if there's a little bit of pruning we can do around the edges, we'll take a look at that, and we'll let the market know what we're thinking as we get into the middle of that.

But I think you should look at our past history over the course of the last eight years, we've certainly moved things out of the portfolio that we don't believe compete for capital. And again, we've got a pretty rigid set of criteria around that. And I can let Matt add some color to the ESG, the Scope 3 emissions. To your comment, Roger, we recognize that's a pretty tall order for the -- and we don't burn our Scope 3. Those are consumers that do that. So we've joined the Climate Leadership Council, and we advocate for a price on carbon, both globally and here in the U.S. to address that specifically on the Scope 3 emissions. So that's how we deal with that in terms of our Paris-aligned ESG and climate risk strategy.

Matt Fox - *ConocoPhillips - Executive VP & COO*

Yes. And Roger, in the press release, there's a link to some more details on our climate risk strategy on our website that will give you more background on both the Scope 1, 2 and on the Scope 3 emissions and what the -- how we're thinking about that.

The -- in terms of the oil sands, we are confident with the application of technologies that we're working on that we will bring the emissions intensity of the oil sands down over time, improving the steam-oil ratio by deploying our flow control devices, by deploying noncondensable gas injection to supplement the steam by using solvents. We and others up there in Alberta are singularly focused on doing that.

We are also the leader with -- as part of the CASIA group in Alberta that award an X Prize, they'll award $20 million to a winner of a competition that's been run to look at innovative ways for carbon capture and use and storage from combustion, things like steam generators.

So that's another potential avenue to reduce the Scope 1 and 2 intensity of oil sands. So the short answer is, no, it doesn't really change our view, and we can achieve these targets and that we are setting out for 2030 with the oil sands still in the portfolio.

Operator

Our next question comes from Ryan Todd from Simmons Energy.

Ryan Todd - *Simmons & Company International, Research Division - MD, Head of Exploration & Production Research and Senior Research Analyst*

Congratulations, guys. Maybe one -- a high-level one for you, Ryan, and I then have a more specific one on some aspects of the deal. But at a high level, as we think about the 10-year plan that you laid out and what feels like a lifetime ago at this point, this deal is clearly consistent with that plan. But maybe -- I just appreciate your thoughts if the events of the last year changed at all how you view the industry and your business going forward? And if so, how does this deal allow you to compete better in what feels like a fairly rapidly changing world going forward?

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Ryan Lance - *ConocoPhillips - Chairman & CEO*

Yes. Thanks, Ryan. No, this -- what we announced today doesn't really change that. When we laid out the plan back in November, it's as much a philosophy for how to run a business. And I think Tim talked about it earlier as well, we've been talking for quite some time and share a consistent vision about what it takes to succeed in this E&P business and bring investors back into the sector. And that's -- you have to have a portfolio of low-cost of supply assets that last for a long time. And this combination with Concho just supercharges that for our company.

And it's about low-cost of supply, it's about a really strong balance sheet. It's about having a rational way to allocate capital that focuses on returns and doesn't just chase growth. It's about distributions back to the shareholders and in delivering 30% of your cash back to the shareholders. And then finally, we've been talking about it. You need to have a sustainable business for the long term to deal with the energy transition that faces the world.

So it's all these things wrapped together. And that was the basis for the long-term plan that we laid out to the marketplace. And we intend to demonstrate that we have the resources to satisfy that kind of a plan and that kind of a value proposition. And this transaction we announced today just really greatly enhances that plan because we're augmenting bringing Concho's incredible operating machine, their low-cost of supply resources and their huge position in both the Delaware and the Midland basins. And it's a perfect complement to what we described back to the market back in November with our 10-year plan.

Ryan Todd - *Simmons & Company International, Research Division - MD, Head of Exploration & Production Research and Senior Research Analyst*

Maybe a follow-up on the waterfall chart that you have there in the presentation, which you've done a good job over the years at clarifying. But is there a right way to think, I guess, on a couple of things in there -- is the right way to think about targeted levels on the balance sheet either in terms of total debt or leverage metrics, in terms of the maintenance there? And then on dividend growth versus buybacks within that, maybe any comments on how we should think about dividend growth, whether it's competitive with the S&P 500? Or just how you balance dividend growth, buyback and leverage on there, would be great.

Ryan Lance - *ConocoPhillips - Chairman & CEO*

Yes. So we're trying to manage leverage. We've got what we believe is a very strong balance sheet. You see from the chart, we don't feel the need to allocate any of our existing cash to the balance sheet. We feel very comfortable with where it stands, both from a gross-debt perspective and the net-debt. And if we add a little bit more cash to the balance sheet for a little bit lower net-debt resilience, we'll look at that as this market recovers.

But at this 10 seconds, we feel like the balance sheet is in pretty good shape. On the dividend, we just believe long-term, consistent, steady growth is required in the base dividend. And it ought to grow consistent with the cash flows and the earnings growth that comes with the company. And we believe it needs to be there, it's an important and compelling part of our value proposition, and we would expect that over time, it would grow consistent with the growth and development of the company.

And then as we get excess cash, we'll figure out how to return that back to the shareholders because we recognize that the dividend in and of itself doesn't represent 30% of the cash at elevated prices. Today, it's representing sufficient return back to the shareholders. So we haven't needed to augment that with additional returns. But no, the dividend is important part of our value proposition and you ought to see clear consistent predictable increases over time, and that's important in the base dividend.

Operator

Your next question comes from Doug Leggate from Bank of America.

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

Let me add my congratulations to you all. Tim, I wonder if I could just dig a little bit into the background of this. I'm guessing there will be an S-4 and some color. But to the extent you can, just your rationale as to why sell now? Obviously, if you look at your absolute share performance over the last several years, one could argue you're selling at the bottom of the cycle. So I'm just curious as to what led you to this point now and what this says about the stand-alone E&P growth model? I've got a follow-up for Matt, please.

Tim Leach - *Concho Resources Inc. - Chairman of the Board & CEO*

Sure. Well, you're right. All the details will appear in the filings, but I would tell you that as I said in part of our comments that evaluating the go-forward size and scale really become more and more important. So I guess "why now" is that we have common vision on this and creating a company that can attract capital and be a leader in that regard is the compelling reason that we wanted to move now.

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

Matt, wonder, maybe I could add a follow-up. Tim, thanks for that. This is a comment from me for what it's worth. We see very similar beta with both stocks. So I don't think you're giving up a whole heck of a lot of anything frankly at this level. It's like a great deal all around. But Matt, maybe I could just check in with you on the housekeeping issues. The $41 breakeven, can you just confirm, does that assume the synergies are realized? And what's the pacing that you anticipate the synergies to be realized? And I'll leave it there.

Matt Fox - *ConocoPhillips - Executive VP & COO*

Yes, Doug, that's a pro forma that includes the synergies. And we'll -- we expect to have those synergies fully incorporated into run-rate by the end of 2021, but we wanted to show on a pro forma basis. So some of those synergies will show up as we go through this year, obviously, but will be at the full run-rate by the end of this year.

Operator

Our next question comes from Bob Brackett from Bernstein Research.

Bob Brackett - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Research Analyst*

Congratulations. I had a couple of questions. One was just around the termination fee or a company competing proposal, could you explain the pathway to closing this deal? And what would happen if there were a counterbid?

Ryan Lance - *ConocoPhillips - Chairman & CEO*

Well, Bob, we've got customary fees associated with the deal. We expect to close it, as we said in the -- sometime in the first quarter, we'll be on a pathway to doing that, and it's got customary normal kinds of fees on both sides if something else were to happen. We do not expect that to be the case. We think that this is a compelling opportunity for both ConocoPhillips and the Concho shareholders.

So we're focused on getting it done and delivering on the combined value and getting the synergies and demonstrating to both our shareholders why this is a compelling opportunity.

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Bob Brackett - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Research Analyst*

Great. And somewhat related question would be, there's still perhaps $7 billion of cash on the balance sheet. Is that the right level of cash? Or how do you think about that cash balance sheet? And maybe given the de-emphasis of new ventures, what's the going-forward appetite for future acquisitions, and maybe we're putting the cart ahead of the horse there?

Bill Bullock - *ConocoPhillips - Executive VP & CFO*

So Bob, I'll talk about cash on the balance sheet and how we think about that. Our basic frame for thinking about cash hasn't really changed, about $1 billion for operating cash, about $2 billion to $3 billion to be able to maintain -- reserve cash as we go through the cycles. And anything above that would be strategic cash. So even with the consolidation, that basic level has not changed.

Ryan Lance - *ConocoPhillips - Chairman & CEO*

Yes. And I'd say going forward, we're focused on integrating these two companies and delivering the synergies that we have in front of us, but expect we'll be a pretty competitive company going forward.

Operator

Our next question call -- comes from Paul Cheng from Scotiabank.

Paul Cheng - *Scotiabank Global Banking and Markets, Research Division - Analyst*

I have two questions. One for Tim and one for Ryan. For Tim, I know the next four years coming, but can you maybe share that during the evaluation process is Conoco the only company that you guys have been in contact or that is a pretty exhaustive process that you have contact multiple partners and found Conoco to be the best partner? And also whether you have an opportunity to discuss in a confidential way with some of your major shareholders that to get a commitment, they may vote in favor of the deal? For Ryan, if we're looking...

Ryan Lance - *ConocoPhillips - Chairman & CEO*

Why don't we let Tim do this one, Paul, and then you can come back to me.

Tim Leach - *Concho Resources Inc. - Chairman of the Board & CEO*

Yes. (inaudible) question is. No. As I said, the Board and the management team have been evaluating all options for a long time. So we've measured lots of different things that we could do and we think that we're clearly convinced that this combination gives our shareholders the best chance with this 100% stock transaction to participate in the upside. And we're very excited about the opportunities that it has for ways that our shareholders can win.

And -- but we've been doing this a long time, so we're constantly out there ramming around and know what's going on with other companies and other opportunities.

Paul Cheng - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Okay. And that -- Tim have you talked to any of your major shareholders in a confidential way and get some form of commitment they may vote in favor of the deal?

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Tim Leach - *Concho Resources Inc. - Chairman of the Board & CEO*

No, we've only communicated in the ways that are appropriate at this point in time.

Paul Cheng - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Okay. Ryan, for your 10-year plan, at some point, I think the market will get normalized. When we're looking at the addition of the very attractive new asset base from Concho, is there in any shape or form that change your development plan in Alaska and Montney?

Ryan Lance - *ConocoPhillips - Chairman & CEO*

No, not at this 10 seconds, Paul. I mean, as Matt described in his remarks, we'll be working on getting this closed, and then I know Concho will be working on their 2021 budget. We'll be doing the same thing. That will -- those announcements, I'm sure will come later in the year. But no longer term, we've got a lot of flexibility and we'll be updating our plans for 2021 later this year.

But we're moving forward with the plans that we outlined in Montney and Alaska, the things that we outlined back in November.

Operator

Our next question comes from Scott Hanold from RBC Capital Markets.

Scott Hanold - *RBC Capital Markets, Research Division - MD of Energy Research & Analyst*

I have two questions, hopefully, pretty quick. And just, Ryan, Matt, if I'm -- just to make sure I'm interpreting your view of 2020 and beyond correctly, is the plan basically effectively maintenance capital spending until oil -- obviously, you've got your priorities, but until oil really hits $50 or above? So would you envision not effectively growing above maintenance capital unless oil is starting to near $50 at this point?

Matt Fox - *ConocoPhillips - Executive VP & COO*

Scott, this is Matt. Not necessarily. I mean, we have the -- and possibly, but not necessarily, we still have to make that decision. What we wanted to highlight on the waterfall chart was the capital that would be required to simply maintain production, and we'll certainly do that, and that's part of priority 1. Whether or not we allocate some additional capital to priority 5, we haven't decided yet, frankly. And we'll make that call as we get closer to the start of the year.

Scott Hanold - *RBC Capital Markets, Research Division - MD of Energy Research & Analyst*

Okay. I appreciate that. And then on the ESG targets, I mean, I think it's very commendable that you guys put this up front and center as part of the plan. And I took a quick view of your website that you all have out there. It does have a target of net-zero ambition by 2045 to 2055, certainly a very commendable effort for a fossil fuel producer. But can you give us a sense on, like, what types of initiatives can get you there?

I mean specifically if you look at carbon sequestration, what kind of things do you think are really important for you guys to get to that net-zero ambition?

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Matt Fox - *ConocoPhillips - Executive VP & COO*

And -- yes, Scott, we have a very clear line of sight to the targets that we've laid out in the next 10 years. We have a 10-year plan that will achieve those targets. In addition to that, we have a very rigorous marginal abatement cost curve process in the company, with more than 100 different projects and in that process just now looking for ways to make additional reductions to intensity in the Scope 1 and Scope 2 emissions. And that could include carbon capture and sequestration.

It could include using renewable energy sources for Scope 2 emissions and perhaps even Scope 1 emissions. So that we have a lot of different ideas. It could include using offsets. And many people who are thinking about net-zero by 2050 are thinking offsets might be part of the solution. But that final part of the emissions reduction is something -- right now, it's aspirational, but it's not aspirational just with the fingers crossed. We've got a lot of work going on to identify ways and pilot test options that will allow us to get there. And just for the avoidance of doubt, that ambition applies to Scope 1 and Scope 2 emissions also.

Ryan Lance - *ConocoPhillips - Chairman & CEO*

And I would say, Scott, that technology is going to advance over the coming years. So we're going to be following all of those advancements, and we certainly expect emissions technology to advance at the same time, such as the world doesn't demand and have to rely entirely on offsets sort of things like that to achieve that ambition.

Matt Fox - *ConocoPhillips - Executive VP & COO*

And then one more thing that I'd add, you also may have seen, Scott, if you look at our website, that we have -- we intend to have a very significant percentage of our Lower 48 large processing sites, with permanent methane monitoring in place by the end of this year. About 2/3rds of our production will be monitored at the larger sites for methane emissions. And we think that the -- we think we're probably the first company to actually deploy this on such a large scale across the whole industry. And we will intend to do that further. And that will allow us to identify when there are methane emissions are above -- that are unexpected and allow us to very quickly go out and address those.

So the -- that's another big part of the climate risk strategy that's come about through technology that we've developed with a third party. That we've now managed to get the cost of that technology low enough that we can very quickly deploy it across our largest sites in the Lower 48 and ultimately at sites beyond the Lower 48. So that's a big part of it, too.

Operator

Our next question comes from Josh Silverstein from Wolfe Research.

Josh Silverstein - *Wolfe Research, LLC - MD and Senior Analyst of Oil and Gas Exploration & Production*

With the Concho acquisition, you're much more balanced now in terms of the profile between unconventional and conventional and production base and the resource base, I think, was already kind of 50-50 around there beforehand. I imagine much of the growth coming forward is probably going to be from the unconventional base. But how do you see this kind of playing out over time in terms of mix and is there maybe a limit to what you would want from an unconventional production base for the corporate (inaudible)?

Ryan Lance - *ConocoPhillips - Chairman & CEO*

Well, I think, Josh, I'll let Matt chime in as well. We described sort of what happens to our capital intensity or decline rate. There's a little bit of increase as we transition to a bit more unconventional, but it stays very manageable because the global diverse nature of the portfolio and the capital intensity of our large legacy businesses in Alaska and Norway, in Canada and what we're doing in Asia and in the Middle East.

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So while that mix starts to grow a little bit, as you described, where we don't see the progression to the kinds of decline rates that pure-play and conventional players have. So that whole mix is important to us. So we keep a close eye on that as it grows over time, which is why, as Matt described, doing some of these big projects like Willow and being interested in a project like the North Field expansion in Qatar is pretty important to the company to help balance that out and maintain the kind of profile and decline rate and capital intensity in the company going forward.

Matt Fox - *ConocoPhillips - Executive VP & COO*

And then obviously, Josh, we're not bringing these assets into the portfolio to starve them of capital. So there will be additional capital going in aggregate to the unconventionals. But then neither did we bring them into the portfolio because we want to rush for growth, that would be completely counter to our underlying philosophy. So we will have a measured sort of growth rate in the unconventionals. We'll continue to invest, as Ryan says, in our conventional business, and we'll keep this nice balance that we have in the company of higher decline, lower declines, short cycle, longer cycle, and that's what we believe is the right sort of mix to be a sustainable company through the next few decades, frankly, through the energy transition.

Operator

Our next question comes from Jeoffrey Lambujon from TPH.

Jeoffrey Lambujon - *Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - Director of Exploration and Production Research*

Congratulations on the transaction. I just have one question on capital allocation and the financial priorities. As we think about the fifth priority, specifically, in terms of capital going towards expanding cash flow, can you just speak to the major parameters you consider around that in addition to cost of supply? I appreciate the comments around capital allocation across the priorities at $50 oil. But just trying to get a sense for what levels of production are reasonable to consider under different commodity price scenarios? And also more color on what the philosophy is around the measurable growth that you mentioned earlier.

Matt Fox - *ConocoPhillips - Executive VP & COO*

Yes, Jeff, we -- in addition to the cost of supply criterion, which is really the primary criterion, frankly, we also look at the flexibility of the capital investment. We look at the greenhouse gas intensity of the investment. We look at our organizational capacity. We look at operational efficiencies and synergies associated with the -- so we look at it broadly across the spectrum.

We're not ready yet to talk about an actual growth rate. I'm not sure if that's what you were getting at during the second part of your question. And that will come over time as we pull our budgets together for 2021 and we look at our longer-range plan beyond that. So it's a bit premature for us to talk about that at the moment.

Ryan Lance - *ConocoPhillips - Chairman & CEO*

Yes. And we need -- Jeoffrey, we need to see what happens to this commodity price. I mean, we don't -- we need to see what recovery and what trajectory the commodity price is going to be on. We won't get on ahead of that either.

Operator

Your next question comes from Leo Mariani from KeyBanc.

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Leo Mariani - *KeyBanc Capital Markets Inc., Research Division - Analyst*

Just wanted to dig in a little bit to the commentary that Concho is a more experienced Permian player as they've been there, I guess, for a handful of decades in prior incarnations. Certainly, it sounds like there's a belief that Conoco can see enhancements to their Permian business. I was wondering if maybe we could take a look at some metrics, such as like well costs on a dollars-per-foot basis in terms of what Concho is maybe doing versus kind of what Conoco is doing? I'm just trying to come up with a way to maybe quantify some of those potential improvements?

Matt Fox - *ConocoPhillips - Executive VP & COO*

Yes. I mean, Concho are a very efficient operator in the Permian. They've been running more rigs than we have. They have more experience in the testing different drilling and completions technologies. We are still in the very early stages. So we do believe that the combination will result in some serious capital synergies when we bring the two together. We haven't quantified that as part of our expectations yet. But the expectations are there that we'll be able to do that.

And (inaudible) just now, Concho's drill and complete cost per well are lower than ours. We have some differences in the benches that we're drilling. We've got some differences in our completion design. But when we put these two teams together, as I said in my opening remarks, that will be a key focus of the transition team is to -- as quickly as possible, make sure that we're -- using best practices from both sides of the house, so that we can get those currently unquantified capital synergies off them and get that to the bottom line as soon as we can.

And it wouldn't just be capital, it will also be recovery -- expected ultimate recovery improvements and getting that balance right between capital and recovery and looking at that done across the supply basis all in.

Ellen DeSanctis - *ConocoPhillips - SVP of Corporate Relations*

Sheryl, Let me push in here. We'll take one more question. We're running past -- a little past our stop time. So one more question, and we'll call it good.

Operator

Okay. Our final question comes from Welles Fitzpatrick from Truist.

Welles Fitzpatrick - *Truist Securities, Inc., Research Division - Analyst*

I just had two related questions. One, obviously, you talked to a great base decline rate going from 10% to 12%. Can you maybe give us your thoughts on what the base plus instantaneous might look like? And then the follow-up is how should we think of that $5.1 billion sustaining capital going forward? Is that unique to '21 maybe because the DUCs are pushing it down a little bit or maybe because the synergies are going to help out going forward. Could you just talk to what that might look like beyond '21?

Matt Fox - *ConocoPhillips - Executive VP & COO*

Yes, the instantaneous decline rate goes up a bit. I don't have it in front of me just now, but I think it goes from about 20% to about 24% from recollection, creates the base decline rate when you take out that first year effect it goes from 10% to 12%.

I have to say that it doesn't go from 10% to 12% instantaneously. That's the average over the 10 years, it's less than that initially. In terms of the $5.1 billion sustaining capital, now that's a sustaining capital that if we simply wanted to sustain production for a decade, we could do that for $5.1 billion.

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In fact, I just found the -- I've just found the number, it goes from 20% to 22%, the instantaneous decline rate initially. So it's not a significant increase. And the underlying base decline doesn't actually increase significantly in the first few years either. So it's the average that goes from 10% to 12%.

So the -- so I think that the -- that decline rate -- some modest increase. But of course, that's what we'd expect when we wanted to quantify that for the analyst community out there. But the sustaining capital of $5.1 billion, we could do that for a decade, if we thought that was the best strategy.

Ellen DeSanctis - *ConocoPhillips - SVP of Corporate Relations*

Sheryl, let me go ahead then and jump in here. We'll go ahead and wrap up the call. Appreciate everybody's time and attention this morning. Also appreciate your support and certainly look forward to ongoing conversations with everybody. Again, thank you, and have a great day. Stay safe.

Operator

Thank you, ladies and gentlemen. This now concludes today's conference. Thank you for your participation. You may now disconnect.

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