OVERVIEW:
Co. reported 4Q21 adjusted EPS of $2.27.
CORPORATE PARTICIPANTS

Dominic Macklon  ConocoPhillips - Executive VP of Strategy, Sustainability & Technology
Mark Keener  ConocoPhillips - VP of Investor Relations
Nick Olds  ConocoPhillips - Executive VP of Global Operations
Ryan Lance  ConocoPhillips - Chairman & CEO
Tim Leach  ConocoPhillips - Executive VP of Lower 48 & Director
Bill Bullock  ConocoPhillips - Executive VP & CFO

CONFERENCE CALL PARTICIPANTS

Doug Leggate  BofA Securities, Research Division - MD and Head of US Oil & Gas Equity Research
Jeanine Wai  Barclays Bank PLC, Research Division - Research Analyst
Josh Silverstein  Wolfe Research, LLC - MD and Senior Analyst of Oil and Gas Exploration & Production
Neal Dingmann  Truist Securities, Inc., Research Division - MD
Neil Mehta  Goldman Sachs Group, Inc., Research Division - VP and Integrated Oil & Refining Analyst
Paul Cheng  Scotiabank Global Banking and Markets, Research Division - Analyst
Phil Gresh  JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst
Robert Brackett  Sanford C. Bernstein & Co., LLC, Research Division - Senior Research Analyst
Roger Read  Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst
Ryan Todd  Piper Sandler & Co., Research Division - MD & Senior Research Analyst
Scott Hanold  RBC Capital Markets, Research Division - MD of Energy Research & Analyst

PRESENTATION

Operator

Good morning, and welcome to the Q4 2021 ConocoPhillips Earnings Conference Call. My name is Zanera, and I’ll be the operator for today’s call. (Operator Instructions)

I will now turn the call over to Mr. Mark Keener, VP, Investor Relations. Mark, you may begin.

Mark Keener  ConocoPhillips - VP of Investor Relations

Thank you, Zanera. Welcome to all of our listeners today. First, let me introduce the members of our team who are on today’s call. We have Ryan Lance, our Chairman and CEO; Bill Bullock, Executive Vice President and Chief Financial Officer; Dominic Macklon, Executive Vice President of Strategy, Sustainability and Technology; Tim Leach, Executive Vice President of Lower 48; and Nick Olds, Executive Vice President for Global Operations. Ryan and Bill will lead off today’s call with some prepared comments, after which the team will be available to take your questions.

Before I turn the call over to Ryan, a few quick reminders. In conjunction with this morning’s release, we posted supplemental materials that include fourth-quarter and full-year 2021 highlights, earnings and cash flow summaries, preliminary reserve replacement information, price realization analysis and updated 2022 guidance and sensitivities.
During our call, we may make forward-looking statements based on current expectations. Actual results could differ due to the factors described in today’s press release and in our periodic filings with the SEC. And finally, we'll also make reference to some non-GAAP financial measures today. Reconciliations to the nearest corresponding GAAP measure can be found in this morning’s release and on our website.

With that, I’ll turn the call over to Ryan.

**Ryan Lance - ConocoPhillips - Chairman & CEO**

Thank you, Mark. So 2021 was a truly remarkable year for ConocoPhillips. Our operating performance around the globe was outstanding, we generated strong returns on and of capital for our shareholders and closed on two significant, highly-accretive acquisitions in the heart of the Permian Basin. Our exceptional results last year are directly attributable to the talent and dedication of our global workforce.

We produced 1.6 million barrels per day and brought first production online at GMT2 in Alaska, the third Montney well pad and the Malikai Phase 2 and S&P Phase 2 projects in Malaysia. We also completed the Tor II project in Norway and achieved all of this with excellent cost, schedule, safety and environmental performance.

Financially, we achieved a 14% full-year return on capital employed or 16% on a cash adjusted basis, and generated $15.7 billion in CFO, with over $10 billion in free cash flow. And we returned $6 billion to our shareholders, representing 38% of our cash from operations. We also continued our rigorous portfolio optimization work, completing the truly transformative Concho and Shell Permian acquisitions, and further high-grading our asset base around the world.

In the Asia Pacific region, we exercised our preemption right to acquire an additional 10% in APLNG and announced the sale of assets in Indonesia for $1.4 billion. In the Lower 48, we generated $0.3 billion in proceeds from the sale of noncore assets last year, and last week, we signed an agreement to sell an additional property set, outside of our core areas for an additional $440 million. Collectively, these transactions reduced both the average cost of supply and the GHG intensity of our more than 20-billion-barrel resource base and we’re well down the road toward achieving our $4 billion to $5 billion in dispositions by 2023.

In early December, consistent with our 10-year plan and capital allocation priorities, we announced a returns-driven capital budget for 2022 that’s expected to deliver modest growth this year. We also introduced a new variable return of cash, or VROC, tiered to our distribution framework, and provided a full year target of $7 billion in total returns of capital to our shareholders.

Based on current prices on the forward curve, we’ve increased the target to $8 billion, with the incremental $1 billion coming in the form of increased share repurchases and a higher variable return of cash. The $0.30 per share VROC announced for the second quarter represents a 50% increase over our inaugural variable return to shareholders that we paid this quarter.

Now to put the $8 billion in perspective, it equates to an increase of more than 30% from the $6 billion returned last year and a greater than 50% increase in projected cash return to shareholders. Our three-tier distribution framework provides a flexible and durable means to meet our returns commitment through the price cycle and truly is differential to others in this sector as our returns commitment is based on a percentage of CFO, and not free cash flow.

And as you know, we are guided in everything we do by our Triple Mandate. We must reliably and responsibly deliver oil and gas production to meet energy transition pathway demand. We need to generate competitive returns on and of capital for our shareholders, and achieve our Paris-aligned net-zero ambition by 2050.

Just as I’m very proud of the excellent operational and returns-focused performance we delivered in 2021, I’m equally pleased about the progress we have made in support of the third pillar of our mandate. We increased our medium-term emissions intensity reduction target to 40% to 50% by 2030 and expanded it to include both gross operated and net equity production.
As a reminder, we’re also committed to further reducing our methane emissions and achieving our zero routine flaring ambition by 2025. And as highlighted in our December release, we’ve allocated $0.2 billion of this year’s capital program for projects to reduce the company’s Scope 1 and 2 emissions intensity and investments in several early-stage, low-carbon opportunities that address end-use emissions. We strongly believe that this level of focus on and performance toward fully realizing our triple mandate has ConocoPhillips very well-positioned to not just survive through the energy transition, but to thrive regardless of the pathways it takes.

While we’re on the topic of energy transition, I’d like to touch on the macro environment. Commodity prices today reflect global energy demand returning to pre-pandemic levels, along with supply being impacted by decreased investment in oil and gas over the past couple of years, concerns about inventory levels, and the amount of available spare production capacity in the system. All these factors demonstrate the ongoing importance of our sector to the global economy today and for the foreseeable future.

It’s becoming increasingly clear that the energy transition isn’t going to happen with the flip of a switch. What people and businesses around the globe need is a managed and orderly transition, but that’s not what the world is seeing to this point. Supply and demand balances are fragile at the moment, likely driving continued volatility, and the current commodity price situation in Europe may be providing a cautionary signal.

The simple reality is that most alternative energy sources still have a long way to go toward becoming as scalable, reliable, affordable and accessible as the world needs them to be, which brings me back to our Triple Mandate and the importance of performing well across all three of the pillars, for our shareholders and for the people in the world who need and use our products.

Now with that, let me turn the call over to Bill, and he will cover the fourth quarter and our 2022 outlook.

Bill Bullock - ConocoPhillips - Executive VP & CFO

Thanks, Ryan. Looking at fourth-quarter earnings, we generated $2.27 per share in adjusted earnings. This performance reflects production above the midpoint of guidance and strong price realizations as well as some commercial and inventory timing benefits, partially offset by slightly higher costs and DD&A.

Lower 48 production averaged 818,000 barrels of oil equivalent per day for the quarter, including 483,000 from the Permian, 213,000 from the Eagle Ford and 100,000 from the Bakken. As previously communicated, our Permian and overall Lower 48 production were both increased roughly 40,000 barrels of oil equivalent per day in the quarter due to the conversion from two-2 to three-stream accounting for the acquired Concho assets.

At the end of the year, we had 20 operated drilling rigs and 9 frac crews working in the Lower 48, including those developing the acreage we recently acquired from Shell. As Ryan touched on earlier, operations across the rest of the portfolio also ran extremely well last year, with our GMT2 project in Alaska producing first oil in the fourth quarter as planned.

Turning to cash from operations, we generated $5.5 billion in CFO, excluding working capital, resulting in free cash flow of $3.9 billion in the quarter. For the full-year 2021, we generated $15.7 billion in CFO, $10.4 billion of free cash flow and returned $6 billion to shareholders. In addition to the asset dispositions Ryan covered, we also sold 117 million shares we held in Cenovus in the year, generating $1.1 billion in proceeds that we used to fund repurchases of our own shares. This left us with a little over 90 million Cenovus shares at the end of the year, which we intend to fully monetize by the end of this quarter.

We ended the year with over $5 billion in cash, maintaining our differential balance sheet strength, even after completing the all-cash acquisition of Shell’s Delaware Basin assets. So to recap, it was not only a strong quarter, but one that also bodes very well for 2022 and future years. We continue to optimize the portfolio, our businesses are running very well around the globe, and we have had an overall reserve replacement ratio of nearly 380%, establishing an incredibly powerful platform for the company as we head into this year and beyond.

Our cash flow performance and leverage to prices have substantially improved over the past couple of years, as demonstrated by our fourth-quarter results, and expect it will continue to improve as we begin including the newly-acquired Delaware assets in our consolidated results this quarter. Now demonstrating this point and appreciating that it’s helpful for the market to have an accurate sense of our stronger CFO generating
capacity, at a WTI price of $75 a barrel with a $3 differential to Brent and a Henry Hub price of $3.75, we estimate our 2022 full-year cash from operations would be approximately $21 billion, which reflects us reentering a tax-paying position in the U.S. this year at those price levels. And our free cash flow for the year would be roughly $14 billion.

And of course, we continue to be unhedged across our global diverse production base, so we expect to fully capture the upside of the current price environment. We provided updated sensitivities in today’s supplemental materials to help estimate how much earnings and CFO are projected to change this year with marker price movements.

So to sum it up, all that we’ve shared with you today underscores our readiness to reliably generate very competitive returns for our shareholders as we thoughtfully move forward as a responsible, valuable E&P player in the energy transition. That is our Triple Mandate. It’s what we have ConocoPhillips built for and ready to deliver.

Now with that, let’s go to the operator to start the Q&A.

**QUESTIONS AND ANSWERS**

**(Operator)** *(Operator Instructions)* And our first question comes from Jeanine Wai from Barclays.

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

Our first question, maybe for you, Ryan. It’s still pretty early in the year, but you have the confidence to increase the expected cash return by $1 billion to the $8 billion. You provided an update on your macro view earlier in the call. And is this really the primary driver for increasing the cash return level? And can you provide an update on how inflation is trending for Conoco, given continued strong oil prices as well as we heard some of the general recent industry commentary from service companies?

**Ryan Lance** - ConocoPhillips - Chairman & CEO

Yes. Thanks, Jeanine. It is the primary reason we’re increasing our returns of capital to our shareholders from the $7 billion that we announced here just a few weeks ago to $8 billion now. So again, it represents a pretty significant increase year-on-year, but it’s a reflection of kind of our view. And as we step back and take a look, like we will each quarter, thinking about where the forward curve is at, where the market’s at, where our capital is at, where the balance sheet is at. So it’s a recognition of a strengthening commodity price market.

And that’s a reflection of that strengthening since the December time frame when we announced our capital budget for the year. And we’re seeing a bit more inflation as a result of the strengthening commodity price that we see. And I’d say it’s primarily in the Permian Basin as well, but be kind of spreading a bit to the Lower 48. Prior, we were probably in the mid-single-digit kind of inflation across the whole company. I would say now we’re in the mid-level single-digit kind of inflation rates. So we’re seeing the impact of that.

It’s uncertain commodities of spend like tubulars, trucking, labor, chemicals, OTCG, those kinds of things and primarily in the more active parts of the Lower 48 like the Permian today. Around the whole world, though, we see much lower inflation, and that’s the benefit of a global diversified portfolio. But we are seeing a little bit higher pressure at these higher commodity prices than maybe what we would have said even a month and a half or two months ago.
Jeanine Wai - Barclays Bank PLC, Research Division - Research Analyst

Okay. Great. Our second question is on the Shell acquisition. We know it hasn’t really been very long since it closed, but can you provide any color on opportunities related to the integration or any efficiency gains? And I guess we’re thinking, for example, just using Concho as a playbook, you were very successful at capturing lower-hanging cost savings related to the supply chain, related to marketing optimizations and that added up to a big structural number.

But for the Shell deal, you have a higher percentage of non-operated interest, and that could dampen the impact of similar optimization. So are there other unique opportunities with the Shell assets?

Tim Leach - ConocoPhillips - Executive VP of Lower 48 & Director

Jeanine, this is Tim. Yes, let me address those questions. As a reminder, we closed the Shell acquisition on December 1, just 70 days after we made the announcement of the transaction. We’ve had a smooth and safe transition of operatorship and personnel over that time. So that’s been a huge success.

We plan to continue running four rigs on that property, the same activity rate that Shell was running through the remainder of this year, but we’ve moved our personnel, our rigs on. And since we’ve taken up operatorship, we’ve quickly transitioned to our style of well drilling design, casing design, which has generated lower cost. We’ve also switched to our fracking design, which provides better economics using our style of proppant, fluid specs and cluster spacing.

So all those are kind of the blocking and tackling of us putting our style of operations on those properties. But I would tell you that the biggest opportunity in the near term is transitioning from one-mile wells to two-mile wells. And that’s with our partners out there in the field. All those companies that we’re partnered with, we have done deals with in the past, to core up and drill longer laterals. So I think that’s the low-hanging fruit.

We are in conversations with all of them. We’ve made transactions on some of those properties already. And just for frame of reference, the difference between drilling a two-mile lateral on those properties and a one-mile lateral, everything else being held the same, is a 50-basis-point improvement on rate of return on well economics, which generates about a 30% improvement in cost of supply.

The other thing that we’re working on that I’m pretty excited about, the Shell deal in and of itself has allowed us more freedom for overall property management. You may have read in the last couple of weeks that we sold some noncore assets on the New Mexico shelf and on the Central Basin platform. The kind of efficiency we get from those kind of property managements, for example, that one transaction allowed us to sell 25% of our operated wellbores, and it only affected 2% of our production in the Permian. So that kind of efficiency will flow through the entire organization and it’s just one example of how I think we’re making things better.

Operator

Our next question comes from Neil Mehta from Goldman Sachs.

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

Ryan, you were quoted recently talking about the U.S. production profile, I think your point was entry-to-exit this year, you thought we might grow 800,000 barrels a day, I guess that’s of crude. I just -- I’d love your perspective on how you’re seeing the U.S. production profile as you think about yourself and peers.

And it’s tough for us to get the same store same-store sales growth rate for Conoco in the Permian because, of course, you’ve done some acquisitions here. But just as you think about the growth rate in ’22 versus ’21 for your own asset base, how are you thinking about that in the Permian?
Ryan Lance - ConocoPhillips - Chairman & CEO

Yes, I can let Tim talk about specifically the Lower 48 and the asset. But I'd say the macro, yes, I was quoted in a recent discussion with several of my peers that we put the entry-to-exit at about 800,000 barrels a day this year. And I think -- and in light of the last couple of announcements that I've heard, Neil, I would actually be moving that number up now because I think we were even a bit surprised by the strength of some of the numbers that we were hearing.

But I think importantly, we would place -- and that is a crude and condensate number. It doesn't include NGLs. So I'd say we're 800,000 to 900,000 probably barrels a day growth this year from the U.S. and probably a similar kind of number coming out next year. This year dominated by the privates, with some influence by the publics.

But clearly, next year, probably having that swap a bit and the publics kind of regenerating and coming out of a maintenance capital mode in 2021 and reenergizing, just like we are. We plan to add some activity in both -- in all three of the Big 3, the Bakken, the Eagle Ford and the Permian as well. So I can let Tim maybe talk a bit about how he sees that, how that manifests in our portfolio on a normalized basis.

Tim Leach - ConocoPhillips - Executive VP of Lower 48 & Director

Yes. I don't really have a whole lot to add other than to just remind you that underlying decline rate on the Permian is pretty substantial. And so the increase in activity that we've seen from the privates and such will generate more production, and you've seen that show up in the numbers. But I think companies like ours and other large companies kind of think more of a sustainable growth rate because that's really where you get your efficiency, is a disciplined kind of growth that allows you to move down the learning curve and lower your cost of supply.

We talked in our 10-year plan of a growth rate for our Permian in the high single digits, and that as a result of that disciplined growth. So I do think there'll be more consolidation. So for a company like us, you've seen our operated production grow more than 35% in the Permian since we did the Shell deal and other things. So I think there'll be some production moving around based on the consolidation.

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

And actually, that was my follow-up here, which is you've developed a core competence here, seeing either the market around M&A between the Foster Creek transaction and then, of course, Concho and the Shell assets. How do you think of ConocoPhillips in terms of further consolidation and the role it can play, particularly in the Lower 48?

Ryan Lance - ConocoPhillips - Chairman & CEO

Well, I've said before, Neil, that I think further consolidation makes sense. I think you have to get more assets in responsible hands like ConocoPhillips. We spend a lot of time talking about our Triple Mandate and the value proposition that we have and how we just think about the business. And I think getting more assets like that into responsible hands is going to make sense.

Now clearly, with the addition of Concho and Shell, we've got a lot on our plate, and the bar is quite high inside the company. So we're not immune to what's going on. We watch the market. We're on top of everything that's going on. It takes a lot to make us better as a company, and we've got to see that in any assets that we look at, make us a better company, make our 10-year plan a better plan. And if we apply what we think is a better way of drilling and completing these wells, can we add value to the assets that we might be looking at.

So yes, we're always looking and we're -- we've been ruthless high-graders of the portfolio. So as you mentioned, even dating back to the Foster Creek Christina Lake transaction that we did that really just started us down this path. And the $4 billion to $5 billion that we've committed to sell and high grade by the end of 2023 as well. And we're well on the pathway to do that.
So we're always trying to lower the cost of supply in the portfolio, lower the GHG intensity. And we can do that through organic investments, and we can do that potentially through inorganic if they compete.

Operator

our next question comes from Roger Read from Wells Fargo.

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

I guess maybe come back to the commentary about switching from the one-mile to the two-mile laterals, where you even heard talk of an increasing percentage of three-mile laterals. And I was just wondering as you think about that aspect of it, whether or not you’ve tried that yet, whether or not it made sense on your acreage in any sort of idea what that might do in terms of a further impact on decreasing your cost of supply?

Tim Leach - ConocoPhillips - Executive VP of Lower 48 & Director

Yes, Roger, we just -- in the Southern Midland Basin, just completed a drilling project that included several 3-mile and one 3.5-mile lateral that we drilled in record time, and have been very pleased with the results and the production from that. So I think that’s a big opportunity for the future. It’s another challenge for your lease configuration, that’s why it’s good to have big, blocky acreage blocks.

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

No doubt. And that leads into my next question, which as Jeanine said earlier, very early in your Shell Permian acquisition. But I was curious, anything you’ve seen on the true swap side? You mentioned the one thing in New Mexico, but I mean like a real improvement in terms of acreage alignment where you can become more active?

Tim Leach - ConocoPhillips - Executive VP of Lower 48 & Director

Yes. We have one big partner and several other pretty sizable partners that we’ve done business with for a long time on swapping and trading. The good news is that this is a win-win for both parties. Everybody wants to be able to drill longer laterals where they have bigger interest in their own operations.

So we’ve already accomplished some of this. I can’t tell you if I think it’s going to be a lot of small blocking and tackling or a few big trades, but things are moving pretty rapidly in a good direction.

Operator

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

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

Ryan, I want to come back to your comments about the Permian. And I just want to ask you philosophically, are you concerned about the U.S. going back to that level of growth, given the recent history of growth for growth’s sake? And we all know how Saudi responded to that in that global market, which despite the post-COVID recovery, still has a relatively pedestrian long-term growth outlook. And how does that play into your strategy?
Ryan Lance - ConocoPhillips - Chairman & CEO

Yes, Doug, thanks. No, I am. I think that sits very -- not so much at the back of our mind, but right at the front of our mind, I am absolutely concerned about. I think the one change maybe relative to late 2014 and ’15, the last time we were kind of at these levels is just what is the spare capacity sitting in the OPEC+ group. It was quite a different number back at that point in time, and you can -- we can all debate what that number is. And the fact that the inventories are down quite a bit globally and certainly here in the U.S.

So I think there's a little bit of time that we have associated with that. But certainly, if we're getting back to the level of growth in the U.S. that if you're not worried about it, you should be, and be thinking about it.

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

Yes. Well, I hope your peers are listening. My follow-up is, I don't know if you're able to give this yet, maybe a question for Bill. But with all the portfolio changes going on, one of our favorite kind of outputs is the breakeven analysis you guys do, the sustaining capital that goes along with that. Are you able to give us an update on a post-tax basis, given that you're now back to paying full cash taxes?

Dominic Macklon - ConocoPhillips - Executive VP of Strategy, Sustainability & Technology

Yes, Doug, it's Dominic here. I can help with that a little bit. I mean, I'll just take you back to the numbers we showed in our 10-year plan. That all included tax modeling of course of the prices that we had there. So that we were -- that mid-cycle price, we were about $30 WTI breakeven. So the higher prices, obviously, we'd have a little bit higher taxes.

But I think that demonstrates the competitiveness of the portfolio. So Bill, I don't know if you've got anything to add to that?

Bill Bullock - ConocoPhillips - Executive VP & CFO

No. That's well said, Dominic.

Operator

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

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

With proxy season coming up, could you guys talk a little bit about the shareholder proposition on your Scope 3 emissions? And where you all stand on that right now?

Dominic Macklon - ConocoPhillips - Executive VP of Strategy, Sustainability & Technology

Yes. Thanks, Scott. It's Dominic again. So we have engaged very extensively with our shareholders on the resolution, as you would expect. So we've met with around half of our stockholder base, and that represents about 80% actually of our institutional investor base. So we'll have a lot more detail coming in our Proxy Statement.

But at a summary level, I would say we heard a lot of support for being the first U.S.-based oil and gas company to set a Paris-aligned net-zero ambition on our Scope 1 and 2 emissions and for the progress that we're making towards that. And that includes the $200 million capital allocation we announced for this year, which will go to our Scope 1 and 2 emission-reduction effort as well as some low-carbon business opportunities.
Our stockholders, with very few exceptions, did not express an expectation for ConocoPhillips as an E&P upstream-only company to set the Scope 3 target. And that's because there was really a general recognition that this would amount to really a prescribed shift of responsible Paris-aligned production to other less-accountable sources. And also the end-use emissions will only be addressed effectively, if all the many consumers across the value chain, industrial consumers, commercial consumers, retail consumers, that they also address their Scope 1 and 2 emissions.

So -- but we also, we're able to emphasize that we are not ignoring Scope 3. We are continuing to actively advocate for an economy-wide price on carbon. Of course, that's so important to address both the supply side, but so important, the demand side. We're also engaging with our supply chain on their emissions and their reduction plans, and we're making some early-stage investments in low-carbon business opportunities that address end-use emissions. And of course, we've talked a lot about that, and we're pursuing those. That's carbon capture, storage and hydrogen.

So we believe a Paris-aligned E&P company, with a focus on reliable, low GHG intensity and the low cost of supply production has a valuable and really, a crucial role to play in the energy transition. So of course, we are continuing in dialogue with our shareholders, but that's really an update as to how that dialogue has progressed.

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

I appreciate that. That was very, very thorough. As a follow-up, can I ask on Norway? Obviously, you've got the Tor project online, and it seemed like gas volumes are very robust this quarter. Is that just it ramping up to full capacity? Or are you guys pulling some other dials, given the strength in prices for gas over there?

Nick Olds - ConocoPhillips - Executive VP of Global Operations

Yes, Scott, this is Nick. Yes, we -- on Tor II, we did bring all the wells online in May of last year. That asset is producing as expected. And then we did a lot of work with our non-operated folks and just trying to make sure we maximize gas production through the end of 2021, and that's what you're seeing come through the bottom line.

So yes, assets are performing well, Tor II as expected and some additional gas flowing through 2021.

Operator

Our next question comes from Phil Gresh from JPMorgan.

Phil Gresh - JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst

My first question, just a bit of a follow-up on the activity levels planned for 2022. I hope you could elaborate a little bit more on the cadence and some of the moving pieces, particularly in the Big 3. In the press release, you gave some information on rig count and frac crews, but any additional color by basin and how you see things playing out as the year progresses?

Tim Leach - ConocoPhillips - Executive VP of Lower 48 & Director

Phil, this is Tim again. The cadence of activity as we talked about before is kind of back-end weighted in the year. And it's cadence that we think will give us efficiency gains. But right now, we're at 20 drilling rigs and nine frac spreads, and we would add approximately four more drilling rigs in the Lower 48 throughout the balance of the year.

One of those standing up in the Bakken, and I think the rest are in the Eagle Ford and the Permian. So it's kind of a measured pace and we are being very disciplined, and as we said in the last quarter, it's a constrained pace in the Permian. And we have lots of flexibility and capacity. But we think this is -- will give us the greatest efficiency.
And I would add, Phil, what we talk a lot about is setting our scope early in the year with our teams and not wanting to whipsaw that scope. So just wanting to go execute it as efficiently as they possibly can. So on our operated scope, we want that to be -- we want them to know right at the beginning of the year what we expect them to go do and hope to execute that, that as Tim said, have flexibility.

That makes sense. One just quick follow-up for Bill. Very much appreciate the cash flow color for 2022. I did have one follow-up question there. Do you have anything pending in the first quarter for Libya for income tax and royalty payments? One of your peers that operates there mentioned something on their call. And I presume your guidance would be kind of ex any working capital, of course, but just any clarification there.

Yes, sure, Phil. So on Libya, we're now current with our income tax payments in Libya and current through the month of January. I would expect that to continue through the year.

Was there a particular payment in January?

There was. So we became current for the year on January. It's about $900 million was paid in January that was catching up on taxes from last year. That was shown in working capital as you look at our financials for the year. So not a surprise on that.

Got it. And the guidance of $21 billion would be excluding that, right?

Correct, based on CFO.

Yes. Maybe if I could just -- a couple of detailed follow-ups. On the -- regarding the operating expense guidance of $7.3 billion for 2022, you mentioned a number of factors pushing that higher year-on-year. Maybe any rough breakdowns on roughly how much of that is coming from portfolio change versus two-, three-stream switch versus how much is driven by inflation?
Ryan, it's Dominic again here. Thanks for the question. Yes. So just to sort of provide a little bit of context here, I think, remember that last -- Q3 last year, we achieved a $6 billion run rate target we set when we announced our acquisition of Concho and now that was a $1 billion improvement to our cost structure versus the 2019 pro forma adjusted op costs of $7 billion. So we're continuing to benefit from that. That's been a major advantage from the transaction and through the work we've done over the last couple of years.

As we look this year, so obviously, we've increased, we've said $7.3 billion and that's really -- that's from incorporating our Shell Permian assets, obviously. We've got costs that come with those properties, converting historical Concho production from two- to three-stream. We've got some impact of that and we do have some anticipated inflation.

I would say in terms of general breakdown, I would say about half of the increase is from the Shell Permian and the other -- the Concho production two- to three-stream accounting and the anticipated inflation would represent the rest, about equally split, something like that. So -- but we're very pleased with the progress we've made on our costs, so.

And I would put that a little bit in context, Ryan, too, we were -- just a reminder that kind of pro forma Concho, we were at about the $7-ish billion level and we had 1.5 million barrels a day of production. So we're at that kind of level now at 1.8 million barrels a day of production for 2022. So I just want to put some context around sort of where we've come and where we're at.

That's very helpful. Maybe one follow-up on realizations. I mean realizations continue to trend towards relative highs across much of your mix, and we appreciate the slide that you've included in the deck. Any thoughts on what you may be doing as an organization that's helping to drive that? And looking forward, is that something that we should expect to continue? Or should we expect those to widen back out at some point going forward?

Yes. Sure, Ryan, this is Bill. Looking at our realizations in the supplementary data, total realizations as a percentage of Brent, you'll notice that they increased to 82% versus in fourth quarter versus 77% in the third quarter. And that's really driven by a 45% increase in Henry Hub and about a 120% increase to our gas prices in Europe versus just a 9% increase in Brent. So it's that relative outperformance by those that are driving that percent of overall realizations.

I'd say on our crude realizations, those continue to remain strong. They're all within historical ranges. As you go through there, I would expect those to continue as we go through the year, particularly as we continue to optimize our deliveries there. And then gas realizations is really the one that you saw the big change on.

This shouldn't be a surprise to folks. The change here on Lower 48 really was, as our gas realizations move back to kind of the 90% level versus 115%, that's primarily driven by conversion of the Concho volumes from two- to three-stream that we signaled on the third-quarter call. It's in line with what we were expecting. So I would expect that what you're seeing as realizations here for fourth quarter are pretty good indication of where we expect to be.
Josh Silverstein - Wolfe Research, LLC - MD and Senior Analyst of Oil and Gas Exploration & Production

Just had a question on the asset divestitures, the $4 billion to $5 billion there. As they start coming in, are the proceeds going right to debt reduction? Or could this potentially accelerate the return of capital profile, whether it be via the buyback or dividend? I asked because that — you have about $1.2 billion of short-term debt, but I don’t think there’s a lot of big maturities over the next few years.

Ryan Lance - ConocoPhillips - Chairman & CEO

No, it’s pretty ratable maturities. Over the next few years, I can have — Bill can give you the specifics on that. But no, I think cash is cash, Josh, we look at the cash flow that’s coming in and we looked at the proceeds that we’re getting in as well. And I think if you look at our past history, we’ve been sharing pretty significant percentage of both our cash and our proceeds back with our shareholder on an annual basis. So it’s all fungible cash.

And we watch the balance sheet as well. We have a $5 billion gross debt-reduction target, and we’re on track, and Bill can maybe provide a little bit of color on that with respect to the balance sheet.

Bill Bullock - ConocoPhillips - Executive VP & CFO

Sure, Ryan. Yes, we’re right on track to achieving our $15 billion gross debt target by 2026. And as you noted, we do have some debt maturing this year, about $800 million of debt. We’re expecting to repay that when it matures. And then as we’ve said previously, we’re looking at potential debt refinancing, and that would depend on multiple factors, including cost to retire and cost to issue new debt and how we decide to manage that overall portfolio.

We’re looking at those factors and you could expect to see us act sometime relatively soon to take advantage of that supportive market if all things stay where they’ve been at. And as Ryan pointed out, we don’t mind putting cash on the balance sheet.

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

Got you. Just a question on the asset base and the portfolio mix. You’re increasing your position in APLNG. It’s an asset that you already have a stake in. But how do you think about COP’s position within the global gas market? And is this an area of the portfolio where you may want to get bigger, given what’s happening with Europe and Asia prices?

Ryan Lance - ConocoPhillips - Chairman & CEO

Well, I mean we’re pretty longer-term, we’re bullish on LNG prices, both in Europe and Asia, given the trend the energy transition and what the planet is going to be going through and the role that gas is going to play on that. So yes, that informs some of our decision to preempt on the sale of some of the APLNG assets. It’s why we’re interested in the North Field expansion in Qatar. It’s LNG that services both Europe and Asia, and then looking at what role we play in terms of that here in the U.S. as well.

That’s the beauty of our cost of supply model. It’s kind of indifferent to gas and oil. And if we see a structural advantage to gas developing over the next few years, it will show up in our cost of supply model and will attract additional investment. But that’s the basis — again, the basis and the foundation for how we allocate capital, whether it’s geographically or by product type or by geology.

Operator

Our next question is from Paul Cheng from Scotiabank.
Paul Cheng - Scotiabank Global Banking and Markets, Research Division - Analyst

Ryan, that maybe there is a little bit detail, but in -- from the fourth to the first quarter, it seems that you’re going to add Shell, which the production, say, call it 175 to 200. Alaska production is also going to be higher. So seems like without other offset, the first-quarter production should be higher than your guidance.

I noted that, I mean, we assume that the Permian legacy production will also be somewhat higher. So I mean, where the offset that in order for the first quarter production guidance to come down to the [1.75 to 1.79]? 

The second question is just -- I mean, it’s not such a big deal, but I think you and Total is going to take over the Shell interest in Libya. You already have the ownership there. But given the really high tax regime over there and also that the political volatility, just want to understand the rationale behind why that kind of M&A will be interested to you?

Ryan Lance - ConocoPhillips - Chairman & CEO

Yes, let me go production-first, and I can have Dominic add a little bit of color to it as well. I think what -- Paul, at a high level, I’m not worried about production at all. We’re going to be just fine. It’s -- as Tim described earlier, it’s a bit of a back-end ramp in our Lower 48, that’s always going to be lumpy on a quarter-by-quarter basis depending on when you get the frac spreads out to complete the wells and when they come online.

What’s probably missing from people, there’s a planned turnaround in Qatar in the first quarter that wasn’t in the fourth quarter. So there’s a few ins and outs with respect to that. So I think that’s maybe around the edges why if you’re looking at just sequential production from the fourth quarter to the first quarter, you might see a little bit of differences.

On your -- to the Libya question, Paul, it’s -- we were approached. It’s not like Hess wanted out of Libya and its partnership after Total bought Marathon’s interest. It remained Total, ConocoPhillips and Hess as the 2P parties in the venture in Libya. We were approached and said, would we want to participate with Total to take -- pick up the Hess interest in there, and it’s a pretty good deal.

Take all your points. It’s relatively low-margin. It’s a contract that is just a gross-margin contract. We recognize that, but the deal was quite attractive on a cost of supply basis for us. And frankly, we’d like to control who the partnership is, not necessarily interested in an outside partner coming in to take some of that. And then clearly, with Total and ConocoPhillips in Libya, there may be some opportunity to have some different kinds of conversations with the Libyans going forward.

Operator

Our next question is from Bob Brackett from Bernstein Research.

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

If I think about that U.S. growth rate of 0.8 million to 0.9 million barrels a day and the lion’s share of that being in the Permian, you can start to see the day where Permian gas takeaway gets exhausted. How do you guys think about your gas takeaway to meet your growth targets? And how do you see the whole basin shaking out?

Ryan Lance - ConocoPhillips - Chairman & CEO

Yes, I can start and anybody else can chime in, Bill. With our commercial team is, we’re all over this, Bob. And yes, we see the potential for some of that, I guess, I think we’re in really good shape based on the position that we have and the infrastructure we have. We can evacuate gas south, we can go west. And we can come into the Katy hub and into the Gulf Coast as well.
So -- but we’re watching it pretty closely because we’ve got to make sure industry-wide, we don’t go back to flaring as an industry and all those kinds of things. So we’ve got to build the gas infrastructure and offtake capacity has to be there to support these macro offtakes in the oil side coming out of the broader Permian Basin. And maybe I can have Bill add a little bit of color from our commercial team.

**Bill Bullock - ConocoPhillips - Executive VP & CFO**

Yes, sure, Ryan. You’re exactly right, Bob, that watching the takeaway capacity out of the Permian Basin is something that’s important to do, particularly as more production is coming on and particularly as associated gas starts ramping up, we’re probably a couple of years away before you start hitting that capacity, but it’s important to keep an eye on.

I think as we look at a couple of things to note. First, we are currently moving several multiples of what our current production is across the Permian Basin. We’ve got a very skilled commercial organization in terms of how we move that volume, so we have flow assurance for ConocoPhillips production.

And then you’ve seen in the market, there’s been a couple of recent proposed pipelines coming out that would put additional takeaway capacity both down to kind of the Corpus Christi area and the Houston area. I think those are going to be important to keep an eye on as we look at where the market goes. But flow assurance is something we definitely keep an eye on for our physical production.

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

Great. A quick follow-up. What’s your appetite or philosophy around revisiting the capital program in sort of mid-year results?

**Ryan Lance - ConocoPhillips - Chairman & CEO**

Well, we watch it every month, every day, Bob. And so we're looking at the inflationary pressures that might be in the system. We're looking at what our partners areballoting us for, what the operated by other activity level. And certainly, they see these kinds of prices and that pressure on the OBO spend is there. So we look at that every year. Obviously, we can impact that through our operated scope, should we choose to go do that. But again, we like the steady program nature on our operated scope.

So I guess the message as we watch it, absolutely, and we’ve got lots of levers in the toolbox to manage to an outcome, should we choose to go do that. But that will be conversations and things that will come on the next couple of quarterly calls as we kind of watch the macro, watch the activity level, watch the inflationary forces that might be out there and what sort of offsets that we’re seeing on the efficiency side because as we integrate the Shell assets into the portfolio that Tim talked about, we still have those opportunities as well.

So there’s a lot -- there’s a number of moving parts, but absolutely, we'll be all over it and update the market as necessary through the remaining quarters.

**Operator**

Our next question comes from John Freeman from Raymond James.


The first question I had was just a follow-up on the inflation topic, just to make sure I understand what’s kind of built in on the guidance. So the couple of hundred million dollars that you’ve got in the budget for inflation, is -- can you give us some idea like pretty much almost all of what you would have from a service cost inflation standpoint, is that locked in? Or are there certain items that as you go through the year, you’re still exposed to I guess, “the spot market for certain items?”
Ryan Lance - ConocoPhillips - Chairman & CEO

No, we're not fully locked in on that side in the service side. So we are exposed like most everybody is to what you describe as spot condition or what's happening in the service side of the industry. And again, it's predominantly in four or five categories of spend. Those are the ones that we watch pretty closely.

Interestingly, OTCG started at $1,000 a ton, went to $2,000, has now come back down to $1,300, so for rolled steel. And we get updates frequently from our supply chain organization, chemicals because they -- a lot of them originate out of Europe, are up right now with the supply chain constraints that are in that.

So -- and then local kind of impacts with trucking and labor, sand and some of those things, we watch them pretty closely. But they're probably inflating a bit more, as I said earlier, than what we would have thought just eight weeks ago, when we put out our capital guidance for the year. We've included some inflation, to your point, and we're watching that because we're also generating efficiencies as a company, and we'll update that as the year progresses.


And so Ryan, is there -- I know at least there's a few of your peers that will put out slides that say, well, x percent of our service items are sort of locked in for a given year. I mean is there any ballpark kind of round number you could use in terms of what's locked in versus what's still exposed?

Ryan Lance - ConocoPhillips - Chairman & CEO

No, I don't. We'd have to get back with you on that, John. You cut out on the first part of your question, sorry, but you could have a follow-up.


Yes, sure. And then just the last question for me, just thinking about maybe a longer-term perspective. When we look at the three tiers where you all have been sort of returning returns to shareholders, if you kind of exclude the Cenovus share sales and you just sort of look at kind of your base cash flow, you've kind of had that ordinary dividend and the buybacks have sort of been relatively kind of equal and then anything you get incremental has gone to the VROC.

Do you think of like Tier 1 and Tier 2 is that's kind of the framework that you like when you sort of think about, I don't know, your 10-year plan or something, where those are relatively kind of equal? Or do you see those kind of shifting over time?

Ryan Lance - ConocoPhillips - Chairman & CEO

Well, we don't necessarily think of it as equal look at that. We actually think about what's an affordable ordinary dividend through the bottom end of the cycle. We want to make sure that we can -- it's affordable, it's reliable, it's transparent, it's growable and it's competitive with the S&P 500.

So we look at the ordinary dividend and we think about it at the bottom end of the cycle. But we also have our view of the mid-cycle price and some combination of dividend and repurchasing our shares at what we believe is a mid-cycle price is what we'd like to be able to do for our shareholders and more importantly, make sure that it represents at least 30% of our cash going back to the shareholder. And in our mid-cycle price, the combination of those two things does that in the kind of proportions that you described.

But -- and then on top of that, we recognize the torque that we have to the upside with these higher commodity prices, and we're doing this -- we're swapping into the Cenovus shares. And the strength of the Cenovus share price has allowed us to swap into more ConocoPhillips shares,
which will be complete in the first quarter of this year. So all that kind of weighs in. And what’s left to hit our 30% target and above is coming through that third tier that we introduced last year called the VROC, which is a cash variable return back to the shareholders.

So that’s how we’re using it. We think the three-tiered system is durable, it’s reliable and it recognizes the reality of the volatility that we’re seeing in this business. And so that’s why we put a three-tiered system together. We like ratably buying our shares through the cycles, and we think they’re still a good deal. And we like an ordinary dividend that’s predictable and reliable.

And we like -- we want to recognize that we've got a lot of torque to the upside and shareholders deserve a significant amount of that cash over 30% at least or more in these upcycles like we're experiencing today.

Operator

Our last question comes from Neal Dingmann from Truist Securities.

Neal Dingmann - Truist Securities, Inc., Research Division - MD

Just one last -- I guess, two quick ones, if I could. Just, again, it’s notable the amount of cash you all are kicking off, obviously. And my question is given the returns and the cash you’re kicking off, why not -- and I know you guys have been opposed to this, but why not maybe lock in some of this with at least collars or something along that nature?

Ryan Lance - ConocoPhillips - Chairman & CEO

Yes, we’re unhedged, Neal. We think shareholders buy our shares because of the upside that it represents in the commodity price and the torque that we have to the upside in the way we set up the company. So no, we’re -- we prefer to remain unhedged, and frankly, hedging would do little help.

So we have a very strong balance sheet, which helps us on the downside and shareholders ought to expect full exposure to the upside that we’re experiencing to date.

Neal Dingmann - Truist Securities, Inc., Research Division - MD

No, great point. Okay. And then just lastly on divestitures. Tim mentioned, I know you’ve done a couple of small ones. My sort of two questions around that. Is there anything sort of -- that you’d sort of considered noncore that might be in that sort of near-term divestiture category? And then secondly, why even do -- and given how strong your balance sheet is now, is there -- does it -- the requirement to put it in the non-sort of core, does that make it more difficult and less likely to sell, given how strong the balance sheet is?

Ryan Lance - ConocoPhillips - Chairman & CEO

No, not really. We just want to take advantage of the strong markets we’re seeing today, and we recognize that we’ve made two pretty transformational transactions over the course of the last year, and it’s raised the bar in our whole company on cost of supply. So there’s things that we’re probably not going to invest in that we recognize others will invest in.

So we -- that’s been part of our mantra and our drumbeat for the last 10 years in this company. So we’re constantly trying to high-grade the portfolio. And we see -- again, we see some more opportunities to do that across the Lower 48, primarily the Permian as we think about what’s going to be competitive in the current portfolio.
Operator
Thank you. I’m not showing any further questions at this time. I would like to turn the call back over to Mark.

Mark Keener - ConocoPhillips - VP of Investor Relations
Thank you, Zanera. And thanks to all who dialed in for today’s call. And Zanera, I'll pass it back to you for your wrap-up. Thank you.

Operator
Thank you. And thank you, ladies and gentlemen. This concludes today’s conference. Thank you for participating. You may now disconnect.