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Event Transcript

UCL - Q1 2004 Unocal Earnings Conference Call

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OVERVIEW

UCL is pretty much on target operationally and financially for 1Q04, despite the fact that the co. had an unforeseen two-month pipeline shutdown in the Gulf of Mexico, and had a vessel on one of its pipelines that costed the co. about 2,500 barrels a day equivalent in 1Q04. UCL had $760m in cash on the balance sheet at the end of 1Q04.

CORPORATE PARTICIPANTS

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Chuck Williamson
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PRESENTATION

Operator

Welcome to the first-quarter earnings conference call. At this time all participants are in a listen-only mode. After the presentation we will conduct a question and answer session. (OPERATOR INSTRUCTIONS) Today's conference is being recorded; if you have any objections you may disconnect at this time. I'd now like to turn the conference over to today's host, Vice President Investor Relations, Mr. Robert Wright.

Robert Wright - *Unocal - VP IR*

Also joining me today on the call is Mr. Chuck Williamson, our CEO, President and Chairman, and Terry Dallas, our Chief Financial Officer. A replay of this audio broadcast will be available through our Website and over the telephone. Please call Investor Relations, El Segundo or in Sugarland, if you have any questions. There are also some slides available for you to view as a supplement to what is mentioned on the call. You can view the slides on the Unocal Website at www.Unocal.com. As we progress through the call some of the slides will be referenced by number. Some are provided for backup purposes only.

Our presentation today, including those slides, contains forward-looking statements and non-GAAP financial measures. Please refer to slide 2 for a cautionary note regarding the forward-looking statements and the location of the reconciliation and other information regarding the non-GAAP financial measures. Before I get into my portion of the call I want to turn the floor over to Mr. Chuck Williamson, our Chairman, President and CEO.

Chuck Williamson - *Unocal - Chairman, CEO*

Good afternoon everyone, thank you all for joining us. I'm going to take a few moments and update you on our operations and drilling in the first-quarter and then talk about the next few quarters. We're pretty much on target, as you saw from the press release, operationally and financially for the first-quarter despite the fact thought, I'll mention we had an unforeseen two-month pipeline shutdown in the Gulf of Mexico and we had a vessel sink on one of our pipelines that cost us about 2500 barrels a day equivalent in the first-quarter, but we're back online now. We also had a planned to 2.5 week shutdown in our Indonesia West Seno facility in the first-quarter as well, and I'll update you on West Seno in just a moment.

We recorded less production from our PSC's because of higher prices, frankly that's a trade-off we're very happy to make. And Thailand had a really excellent quarter as the GDP is about 6 to 7 percent in Thailand now; gas demand is up nearly 9 percent year-on-year and continues to be a really strong market for us. So Robert will update you on the variances on our annual forecast in just a few moments after I go through the operating issues.

Our expense and capital budgets are pretty much in the expected ranges and we continue to have success with our drill bit in Indonesia. We're currently participating in two important wells for us in the Gulf of Mexico deepwater; I'll update you on schedules for the deepwater in both Indonesia and the Gulf of Mexico in a moment. In the U.S. businesses we're continuing to go ahead and rationalize and clean our portfolio and build our development inventory. We agreed to the sale of some feed minerals land in our -- to Blackstone Energy in the first-quarter for approximately $190 million and expect that transaction to close late in the second-quarter. I just returned from Midland, I'll have to tell you I think there's probably a lot more new opportunities in terms of smaller development inventory than we've had in the past and some small acquisitions. So that business is very healthy and we've got a great new team there in place in the Permian basin side.

Let me to take a moment now and I want to update you on the progress in our major new production projects for 2005 and 2006. As I've said, many of you've heard me before, 2004 is not by any means a production growth year for us but it's an important year for us in terms of progress on these major projects and certainly a strong year for us financially and generating considerable free cash for as that Terry will update you on. Let me begin with Azerbaijan; as you know, we're the second-largest (indiscernible) holder in AIOC. The Phase I project is on track for startup in the first-quarter of 2005, the end of the first-quarter. The first Tertiary platform is nearly completed and the second and third are under construction. So we expect that project to be pretty much on track.

The BTC pipeline, the pipeline from Azerbaijan through Georgia to Turkey, we expect to be finished in Georgia and Azerbaijan by the end of the year and Turkey early next year. BP has got a lot of force working on this right now. First oil production, again, in late '04 or early '05, more likely '05 from our estimate. And then there will be oil shipments, it'll take a while to pack the line, but we expect first oil shipments from Jahan (ph) by the summer or the beginning of the third quarter in 2005. This will be a million barrels a day pipeline so it's an important part of our project. If you look at some information we put out on Azerbaijan before, depending on oil prices between $20 and $30 we can expect 500 to 750 million of after-tax cash flow out of this project from our net interest by 2008. For the next few years this will be a very important part of our production ramp up and everything looks good. We also expect in third-quarter this year to sanction Phase III, which will be another important and the final phase of full field development for the project. That's Azerbaijan.

Gulf of Mexico deepwater, I'll talk briefly about that. The Mad Dog project that we have a 15.6 percent working interest in is proceeding well. The spar has been set, the top sides will be this summer, and we expect first production by about first-quarter 2005, likely the end of that first-quarter or somewhere there about. four of the wells have been drilled in the field, peak rates will be 80,000 barrels a day and 50 million cubic feet a day by 2006. We're currently drilling, BP is but we're also a 15.6 percent working interest holder in a deep test for the young Tertiary in the Mad Dog field, and that's for the deeper section below the existing Miocene field. The K2 project, we also have a 12.5 percent interest in that, has been sanctioned in the first-quarter. Three subsea wells, it'll be tied back, and, again, first production in March 2005. Expected to peak at about 50,000 to 66,000 barrels of equivalent per day. The three wells have been drilled, we're now drilling development side track, so that project is also on schedule.

In terms of exploration in the deepwater Gulf of Mexico, we are currently drilling at a prospect called Tobago in the Perdido (indiscernible), that's a prospect between Great White and our Trident discovery. We expect to complete that well in the next few weeks. I can't tell you more than that right not but you can anticipate a press release when we have final results on the well. We're 40 percent interest holder, Shell at 30, Chevron 16.7 and Exxon 13.3 percent. Following the Tobago prospect we're going to go back to St. Malo -- our St. Malo discovery from last year and drill an appraisal well to test the quality of the sands and lateral continuity on the East flank of the structure. We'll be going there, as I said, right after Tobago with the drill ship and we'll be actually deepening an older well we have there called Dana Point and try to gather more rock information to appraise the discovery.

Following that we'll be going to a prospect of Sardinia which is the Canyon area between the Perdido fold belt and Walker Ridge where St. Malo is, and then we have a couple options after that that I won't talk about right now but to continue our exploration program deepwater. We have a full inventory there. In addition to the development projects we have a full exploration site ahead that looks quite good for us. We also picked two new tracks in the latest deepwater sale including the second highest bid track in Green (ph) Canyon that I'm quite excited about in the last deepwater sale in the Gulf of Mexico along with BHP Anadarko and (inaudible).

I'll jump overseas now and talk about Thailand and Indonesia and Bangladesh. In Thailand part of our growth certainly in 2005 and 2006 will come from the new oil expansion project. That is very much on track; the floating storage unit is now commissioned and in the field, we're drilling the wells right now, the platforms are being fabricated. We will take that up to about 40,000 barrels a day gross by next September and, again, that project remains on schedule. We're currently producing about 22,000 barrels a day gross; our net is about 60 percent working interest after royalty.

Important news in Thailand for us right now in addition to the oil expansion is the third pipeline. That is still on schedule. PTT are building that by March 2006. That will allow us additional gas to be sold. Engineering has been awarded, the pipe is being procured. Thailand is now burning an awful lot of fuel oil, as you can imagine, pretty high prices so there's huge incentive to get this third pipeline online and on schedule. The other news that's really just breaking in Thailand that gives us some confidence for the next couple of years is there's been some debottlenecking done of the existing two pipelines. We expect additional capacity will be available there and we will again be the swing producer, so we're ramping up to produce into that debottlenecked pipeline. So Thailand continues to be a huge part of our business and the growth continues to surprise us in terms of demand as well as the infrastructure.

In Bangladesh, touch on this briefly, we've had record production levels frankly in the first-quarter from the one field we do produce from, Jalalabad, but anywhere on a gross basis 150 to 210 million cubic feet a day. So the demand in Bangladesh is very good. We are the swing producer there. The news for us in '05 and '06 and beyond is we have two new projects. One has been assigned, a gas sales agreement, and it comes online in March 2005. It's called Moulavi Bazar, it's a relatively simple project. We've got two wells that have already been drilled, we'll add another two wells and about a 25 km pipeline to tie in the existing infrastructure. That will come online again gross for 70 to 100 million cubic feet a day in March next year, it's on schedule and on track.

The news for us right now is the biggest field we discovered in Bangladesh is called Bibiyana field, and we have submitted a plan to the government now and have not yet signed the gas sales agreement, but we're in negotiation to add significant addition in fourth-quarter 2006 and beyond to meet the increasing demand in Bangladesh. We'll talk more about that as we sign the gas sales agreement but you can anticipate that being concluded sometime this year. That will be a significant new tranche of production for us in 2006 and beyond.

In Indonesia, as you all know, we have lots of things going on there but I'll start with our development plans for the deepwater gas. Right now we think there's likely to be two major hubs. First will be what we call the Gendalo complex which is to the South. In Gendalo we've already drilled about eight wells, we've certified 3.2 Tcf of additional proven and probable resources. It's a great reservoir. And this is the project we are now targeting for early production that being late 2006, early 2007 to accelerate some of our gas -- deepwater gas development in Indonesia.

The second complex, we've talk to you before about Ranggas field which is an oil and gas field. The Gehem field is just a few km south of Ranggas, we had a successful appraisal well on that. We're currently drilling our third appraisal well on Gehem on northern edge up towards Ranggas. So we're now looking at Gehem and Ranggas as kind of another hub like Gendalo to the south, but this wouldn't have any more liquids in it and certainly an oil column to go with it. So we will be drilling another deep Ranggas well shortly right after we finish this Gehem appraisal well. And Gehem we have found to be a very good reservoir but also very liquid rich with 50 to 60 barrels per million cubic feed a day of condensate.

The next wells will be a project we call Sadewa which is something that we discovered a couple years ago. We need a couple good appraisal wells and if we do have those in the next few months then we'll proceed with a development that will come -- be an extended reach program from a shelf, so we can accelerate some gas productions in Ranggas. We have a lot of other wells in Indonesia coming up, I can talk more about those later, but they're exploration wells some of which are in our new PCS's outboard of the discoveries we've had and some will be in basins in and around the Kutei basin and they're scheduled for later in the year. So same message for deepwater gulf as Indonesia. We have big development going on but we also have an active exploration program.

Let me update you on West Seno. I think if there's anything we've struggled with certainly over the less six months it's been our production from West Seno. Our average production for the first-quarter in West Seno was about 12,400 barrels of oil equivalent per day net. That's up from the fourth-quarter when we were about 9,300 BOE per day despite the fact we did have, as I mentioned earlier, a 2.5 week shutdown. We're currently producing over 17,000 BOE per day, about 11,000 of that is oil, the rest is gas, from 11 wells. Two of the wells are shut in with some completion problems. Our initial issues were mostly around the facility and the emulsion issues.

We've stabilized those for the most part, we've been online most of the time since we shut it down, but we're not seeing the productivity per well from the deep section that we expected. We're not sure if it's our completion techniques or if there's more compartmentalization of the reservoir. We have some experimental things we're going to be doing on fracing with the completion techniques, but can't yet tell you how that's going to work. I think we've made huge progress on our drilling cost side, we were at 29 days a well last year, now we're down to 20 days a well. So the message for West Seno going forward is we expect to drill an additional 14 wells by the end of this year and we see an exit rate, because of the productivity issues and the delay, more like 35,000 barrels of oil equivalent per day, about 25,000 of that being oil rather than our 40,000 to 45,000 that we had previously forecast. We currently have predrilled the first two strings about seven wells so we're going to pick up speed here pretty quickly because we just need to go back and take the wells to depth and complete them on West Seno.

The other thing in Indonesia is we just completed a very successful Gula well. This is a large structure. I hate to confuse you with all the G's, but south of Gehem and north of Gendalo. It's a huge anticline, it's about 12 to 25 or 30 kilometers long. This is actually the second well we drilled on Gula, it was an appraisal well but it was 5 kilometers away from our discovery. I will to you we had a successful well with, again, about 400 feet of gas and we've demonstrated I think potentially a very large gas field there. It will be important more for 2010 and beyond than in the short-term, but we were very pleased with the results of that well and still see this as a several Tcf size feature. We currently have some activities in China and Vietnam but they're longer-term. I won't go through those other than to say that we continue to work to bring Vietnam towards the market in 2008 and '10 and beyond and are in active negotiations right now with Petro Vietnam, and we'll have fulfilled all of our commitments at the end of this year in terms of drilling.

So my summary is a long way about. I think we're off to a good start. We certainly have struggled, as I said, with West Seno and it's caused us to revise our production forecast. But the United States Gulf of Mexico, which I know a lot of you have had concerns about, has actually stabilized pretty well at about 55,000 to 56,000 BOE per day. We can see that kind of (indiscernible) through the rest of the year. Canada, Pure and Alaska remain pretty steady. So I think we're feeling much better about North America in terms of predicting the forecast. That's a lot different feel, I'll tell you, than it was two years ago for me when we had much higher production rates in the Gulf of Mexico, but obviously steeper declines and a lot more capital investment.

Such a short version. I want to just make one more comment on this deep shelf program. I think you all realize we had a very aggressive exploration program in the deep shelf Gulf of Mexico last year with, as I've said, a modicum of success -- it wasn't a melt down but it wasn't a burning success either. We've taken a pause on that, we're drilling no deep shelf wells right now. We would like to go back to probably drilling at a slower pace either late in the third-quarter maybe or fourth-quarter this year. But we're not intending to spend a large investment in the deep shelf at this point and we'll have a more measured probably focused program. We've rationalized that with our deepwater Gulf of Mexico portfolio and are really high-grading between what we have in the deepwater and the deep shelf is one unit and so we'll see where that takes us by the end of the year, but don't expect a lot of deep shelf activity until later. With that, I'll stop and turn the floor back over to Terry Dallas, our CFO, who will make some comments on our cash position and what some of our intentions are.

Terry Dallas - *Unocal - EVP, CFO*

Good afternoon. I'm going to just briefly speak to how we think about our cash balances and talk a little bit about where they are and where they might go. With commodity prices the way they have been over the last few months, Unocal, just like most of the oil and gas companies, has accumulated quite a bit of cash. We have $760 million in cash on the balance sheet at the end of this quarter. We will be discussing with the Board various options and alternatives for that cash. We have not come to any conclusions about what we will do with it. The main reason we have held off on that discussion is, for us at least, the most important thing with that cash is to ensure that we have the capabilities to invest into these several very large projects that we are in construction on this year, 2005 and 2006.

We feel relatively comfortable that these commodity prices are going to hold up and so we will be looking at alternatives for the cash. The way we view those alternatives are I think the first use that we always have to consider is our there additional projects that we would increase our capital budgets on or are there acquisitions that somehow make sense. I think up to this point what we have seen is that with the amount of capital spending that we are managing today and expect to manage over the next two years, we are pretty much at capacity and we're going to focus on executing the projects that we already have, that have been lined up. As far as acquisitions go, we look at small adjacent acquisitions mostly in the U.S., mostly in the Permian and in our Pure division. We may find something that makes some sense but it's very difficult with commodity prices and the competition. So we continue to look at those but if we do find something that makes economic sense it's likely to be relatively small.

The second use of cash that as we consider it is paying down debt. We made some substantial repurchases of debt last year. I'm very comfortable with our balance sheet today. As we've always said, our intention is to stay a strong BBB, and we really don't have any intentions of strengthening our balance sheet beyond that. So we are pretty comfortable with our debt and capitalization that we have on the balance sheet today.

Last year we made a $30 million contribution to our qualified pension plan. Unocal's qualified pension plan is underfunded by about $380 million. We would expect to make a contribution of that size or somewhat larger this year. We will decide that towards the end of the year as well. I think the next alternative for cash that we consider is increasing our dividend. The way we think about that is our dividend is competitive with our peer (ph) group. We're fairly happy with the level of the recurring dividend, we would consider in the course of the use of this cash special dividend, if that makes sense compared to the alternative. And of course, the last option that we see and that we will be considering is the buyback of equity either our preferred or our common stock. We certainly would intend to not hold large amounts of cash on the balance sheet if commodity prices stay up. I would assure you though that we're not concerned about having some cash balances a little in excess of normal because we do anticipate very high spending over the next three years on projects that just cannot be delayed.

So, I think those are at least the way we think about our cash balance and our capital structure. As I said, these will be discussions that we have with our Board over the next few months and we would anticipate coming to some conclusion in that general time period. With that I will turn the program back over to Robert Wright who has some other points and some concluding remarks.

Robert Wright - *Unocal - VP IR*

The major elements of our financial performance for the first-quarter 2004 versus the fourth-quarter 2003 were furnished to the analyst community via e-mail, by fax, they were posted on our Website and they were furnished on our Form 8-K to the SEC. This information is repeated on the last seven slides of the deck that you have. So unless there are questions I will not discuss those branch factors or special items on this call. You may, of course, call Investor Relations for more information after the call ends. First I wanted to mention some changes we've made to our disclosures beginning in the first-quarter. We've combined two former E&P groups, lower 48 and Alaska, into a group for the United States. We've provided separate production and price information in the quarterly fact book. And in addition we've taken the former Far East group and it's been renamed Asia. Bangladesh and China have been moved from other international into Asia. And the other international group now contains results for Azerbaijan, Netherlands, Congo, Brazil and Australia.

Another change that was made is the former trade segment will now be moved along with the pipeline and gas storage operations to a segment called midstream and marketing. Conformed results from the prior quarters are available in the quarterly fact book. As of today the figures for all quarters of '03 and first-quarter '04 are available. We should have conformed numbers for 2001 and 2002 available in the next week or. The only group results that cannot be determined from prior reports, of course, are the cost of revenues for Asia and other international because the United States and total international didn't change obviously in the past periods.

There's also a disclosure change in the balance sheet. Due to the requirements of FIN 46R, 538 million of debentures have been added to debt replacing the related 522 million trust in variable preferred securities. Prior debt levels have not been restated so the change will appear like any large increase in debt when it in fact is merely a transfer of one component of total capitalization to another. Pretax interest expense will increase by 32.6 million per year for this change, in prior periods payments to the holders of the preferred were reported in corporate and other segment of cost which will decline by the same 32.6 million per year. If you have more questions on this change please refer to note 2 for accounting changes and the second paragraph on page 85 of the 2003 10-K as amended.

Slide 3 shows pro forma debt amounts for 12/31/02 and forms the new accounting rules that resulted in additional amounts reported as debt. As you can see on that slide, Unocal has made steady progress to reduce these obligations. Coupled with our current cash balance of 760 million, our net debt has been reduced by 1.2 billion since the year end 2002. We have reduced our debt to total capitalization ratio by 11 percentage points using the conformed debt numbers.

Now I'll discuss the other quarter results in the latest outlook. Worldwide production volumes in the first-quarter were 409,000 BOE per day which was just below the low-end of our estimate we gave on the fourth-quarter conference call. (indiscernible) the fourth-quarter production was down about 11 per day due mainly to the fourth-quarter asset sale of the Gulf of Mexico properties and pipeline downtime in the Mobile area that Chuck referred to. The first-quarter production in Thailand was 4 percent higher as lower supply from our competitors allowed us more capacity in the pipeline from the Gulf of Thailand. The higher Thai natural gas production was mostly offset elsewhere internationally because of the timing of LNG shipments from Bontang which had a negative impact on Indonesia gas volumes and facility downtime which impacted gas volumes from the Yudonna (ph) fields.

Looking forward, second quarter production is expected to range between 410,000 and 420,000 BOE per day. Production is expected to be flat in North America and most international operation. Increases are expected in Indonesia due to the West Seno ramp up and LNG liftings and (indiscernible) production is expected to return to normal levels in the second-quarter. As mentioned in today's news release, full year production is expected to equal about 425,000 BOE per day which is below are prior expectations. The lower estimates are due to three main factors. Number one, lower Unocal share in production sharing contract areas due to higher expected annual oil prices, a $10 increase in annual oil prices translate roughly into a 10,000 BOE per day reduction in reported net production. Of course the economic impact of the lower production is vastly exceeded by the benefits of higher oil prices as a $10 increase in oil price means well over 300 million in higher after-tax earnings.

Lower United States production levels reflect a longer pause in our Gulf of Mexico exploration drilling due to the reassessment of all the prospects in the deep and conventional shelf areas. The impact of this longer delay was approximately 8,000 BOE for the full year 2004 forecast. Pipeline downtime in Mobile bay, the sale of feed minerals assets will also have minor effects on the annual estimate. And the third element is the ramp up at West Seno is now expected to be slower, as Chuck reviewed with you, which reduces our estimate for 2004 production by about 5,000 BOE per day. Going forward the changes in gas nominations in Thailand could influence our second-quarter and full year production estimates as well.

Today's press release also stated our consolidated outlook for the second-quarter. You can review the major elements of that on slide number 4. Since commodity prices are such an important driver of results, I want to remind listeners that forward-looking price assumptions are subject to significant change on a daily basis and analysts should look to the changes in the latest NYMAX contract prices for oil and natural gas to adjust their earnings estimates accordingly during the remainder of the second-quarter and for the whole year for that matter.

As shown on slide number 5, the outlook for non E&P and corporate segments after-tax results in the second-quarter and full year are as follows -- the midstream and marketing segment expectation is between 13 and 17 million for the second-quarter and between 65 and 75 million for the full year. Geothermals outlook is for earnings of between 12 and 16 million in the second-quarter and between 60 and 70 million for the full year. For total corporate and other the expected range of after-tax costs are between 75 and 89 million for the second-quarter and between 298 and 329 for the full year. The breakdown of the individual corporate and other segments are shown on slide 5.

Unocal's hedging program is dynamic and volumes and prices associated with the hedges can change over time. In the first-quarter the hedging program had the effect of increasing overall revenues by 11.2 million which included a positive impact on gas revenues of 25.1 million or about 41 cents per unit of North American natural gas, partially offset by 13.9 million negative impact on liquids revenues which was about $1 per barrel for worldwide liquids. We've put in place several future derivative positions that have the effect of fixed price sales for natural gas and oil in the future. In the second-quarter we have fixed the price at $5.53 on 225 million units of gas per day. We've also fixed the price at $31.26 on 36,000 barrels of oil liquids per day; see slide 6 for the details.

Hedge positions for the third and fourth-quarter 2004 are shown on slide 7 and 8 respectively. Analysts are encouraged to check the Investor Relations section of the Unocal Website for the worksheet that shows the most recent hedge volumes and prices. We've now reached the Q&A section of the call and I ask for Mohammed to go ahead and start that process.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS) Fred Leuffer, Bear Stearns.

Fred Leuffer - *Bear Stearns - Analyst*

Robert, I'm glad I took that speed writing course.

Robert Wright - *Unocal - VP IR*

We'll have a transcript for the remarks posted a little bit later, Fred. I'm sorry.

Fred Leuffer - *Bear Stearns - Analyst*

That's all right, I wrote fast. A couple of quick questions here. I guess the higher interest expense in the first-quarter reflected that accounting change. Does that go into effect at year-end?

Robert Wright - *Unocal - VP IR*

No, it went into effect in the first-quarter of '04. So there's 8 million pretax that use to be corporate other that's now in interest. So if you combine those two actually total interest and financing costs are actually down a little bit.

Fred Leuffer - *Bear Stearns - Analyst*

I can see that. I was surprised by the strength in midstream and I guess the -- again, there's different accounting treatment on the convert. That showed in the other category within corporate, is that where that showed?

Robert Wright - *Unocal - VP IR*

Last year those payments were in corporate other, yes. Last time I spoke to you when I gave you the forecast for that it was included in that number. With the accounting change now it's included in interest expense.

Fred Leuffer - *Bear Stearns - Analyst*

That's what I thought. But I was surprised at the strength in midstream; what's going on there?

Robert Wright - *Unocal - VP IR*

Part of it was, as I mentioned in one of the disclosures was 3 million in higher trading profits from the marketing segment and the other 3 million was increased operations kind of spread out all over the pipeline and gas storage segment, I think some of it was higher gas storage income.

Fred Leuffer - *Bear Stearns - Analyst*

Can you give us guidance on exploration expense for the year?

Robert Wright - *Unocal - VP IR*

I don't have that right in front of me, Fred. Let me get back to you off-line. But it's going to be -- I don't think we've changed it from last time we talked. But I'll call you back and give you the number.

Fred Leuffer - *Bear Stearns - Analyst*

It looked a little light in the first-quarter.

Robert Wright - *Unocal - VP IR*

There was some timing for exploration expense. But most of the lower expense is the impact of the restructuring in the Gulf of Mexico. I think you'll notice that exploration expense exclusive of dry holes is lower and we would expect that to continue.

Fred Leuffer - *Bear Stearns - Analyst*

And then just lastly, two of the projects that Chuck mentioned, the third pipeline in Thailand and Viviyana and Bangladesh, what sort of production levels are we looking at there? Viviyana I guess we're talking about '07 and the third pipeline a little bit earlier. But do you have some volume estimates associated with those two?

Chuck Williamson - *Unocal - Chairman, CEO*

Fred, let me do Bangladesh first. The Viviyana field, we're talking about initial -- and this is gross but we're basically 90 percent interest holder -- we're talking about 200 million cubic feet a day and then it ramps up from 2000 --effectively 2007 to 2010 to probably 400 to 500 million cubic feet a day depending on demand. So we're restructuring this so there are tranches, but initially it would probably be 200 million a day. Then in Azerbaijan AIOC somewhere we've put out a production schedule so you can see it year-by-year, Fred. Robert can provide that to you. But full field development depending on our oil price, as I said, our net share of that ranges from -- I don't know -- around 70,000 barrels a day on full field development I think is our midpoint, isn't that right, Robert?

Robert Wright - *Unocal - VP IR*

And, Fred, you asked about Thailand. We can give you the chart so you can see the range.

Fred Leuffer - *Bear Stearns - Analyst*

I think you mentioned a possible third pipeline may be coming on March '06 in Thailand?

Robert Wright - *Unocal - VP IR*

Oh, I'm sorry, Thailand, yes. Let me comment a little bit about that. That pipeline is being built by PTT, it will be essentially a twin of the first two, and it is, as I said, well along in its progress for March 2006. The significance of that first spread is that we have ample resources, and it is all about getting -- and there's ample market -- it is all about getting the gas to the market. so that's important for us that it comes on, and we will enjoy some production increases once that pipeline has come on. The shorter term between now and 2006 the news that, as I said, is breaking is the debottlenecking the existing pipelines is very important for us because the demand is there. And if we can rally ourselves to produce on the order of another 100 million cubic feet a day, then we would be the logical provider of that, and certainly the Thais would love to have that in lieu of important fuel oil.

Fred Leuffer - *Bear Stearns - Analyst*

And lastly, following the appraisal at St. Malo would there be -- would there be a second appraisal well later in the year, or what is the schedule beyond that next well there?

Chuck Williamson - *Unocal - Chairman, CEO*

Let me elaborate on that because the answer is we are not sure. There is some contingency. Right now we're not planning a second well later in the year. But if we have -- if we don't get the information we need from this second, and as I mentioned it is really a deepening of an existing -- the Dana Point (ph) well bore -- a couple of thousand feet below where we are. If we're not successful in acquiring what we need and we're after permeability, pores and rocks, some real hard information for appraisal of the field, then we might come back later and drill a full appraisal well later in the year. If we are successful and get what we need we probably wouldn't have an appraisal well later this year, there may be one more but that's highly contingent until we get the information. So a lot depends on what we get out of this next well bore, Fred, whether we have to come back with a separate well or we wait a little bit and digest what we've got.

Fred Leuffer - *Bear Stearns - Analyst*

Eventually you have to come back though, Chuck, right? Because you can't determine (indiscernible) extent I would imagine from the redrilling of this well.

Chuck Williamson - *Unocal - Chairman, CEO*

Fair enough. We will get some area extent. We'll also ensure that we're not seeing fluid context. But we think the rock -- from what we've seen in the industry, other wells around us -- the rock quality is -- I'll never say it's homogeneous, but it's quite similar. And so we think the important thing is to get good rock information out of this more so than the lateral extent. Now if we're surprised on lateral extent then I won't be saying that, but that's not what we anticipate. I think we're much more interested in getting what we call mini drill stem tests out of this and getting some flow and produceability information on the rate on the well than we are the lateral extent; although certainly that will be useful. The well is -- I can't remember -- it's a few kilometers on the eastern flank down dip of the well we drilled -- the discovery well we drilled last year, so we will learn something about reservoir quality and extent as well.

Fred Leuffer - *Bear Stearns - Analyst*

Thank you very much.

Operator

Steve Enger, Petrie Parkman.

Steve Enger - *Petrie Parkman - Analyst*

Chuck, if I could just follow-up on that. You said the rock quality is quite similar in the St. Malo area. Are you talking about between discoveries? I wasn't quite following that.

Chuck Williamson - *Unocal - Chairman, CEO*

The truth is, Steve, we're doing this on hearsay. Understand we only have the St. Malo data, but we have partners that have participated in other wells. So we don't have the hard information. All I'm going on is what has been relayed to us that the rock quality at St. Malo is similar to maybe Cascade or Chinook or something like that.

Steve Enger - *Petrie Parkman - Analyst*

Are you more concerned about rock quality or fluid quality in terms of produceability?

Chuck Williamson - *Unocal - Chairman, CEO*

As you well know as an engineer, we need both. But frankly, the fluid quality has been pretty good. So we're more interested in, from my standpoint, in the rock quality.

Steve Enger - *Petrie Parkman - Analyst*

Thanks. A couple of clarifications on some of the Indonesian opportunities. The Ranggas Gehem hub, when might that start up?

Chuck Williamson - *Unocal - Chairman, CEO*

The way we're looking at it -- let me elaborate a second. Gendalo would be our first project and we've now said that Ranggas and Gehem will probably follow Gendalo and it's a more complicated development because of the oil involved with it. So, I don't have the exact date. We're in the engineering stage right now, Steve. And we are drilling our third appraisal well on Gehem to make sure that we understand how Gehem relates to Ranggas. So we had a development plan, frankly, pretty far along for Ranggas but now that Gehem has come in like it has we're just regrouping and trying to see what this will look like in total. So all I can tell you, Steve, is I would anticipate that following Gendalo which would be late 2006, early 2007. And I'm not ready to say more than that until we finished our well and got our development plan in place.

Steve Enger - *Petrie Parkman - Analyst*

Yes, because I think Rahggas potentially was in the '06, '07 timeframe like Gendalo is now in, is that right?

Chuck Williamson - *Unocal - Chairman, CEO*

That's right. And I think that what's changed is, first of all we think Gendalo is a better candidate for gas development, but secondly, the Gehem discovery with the liquid content really changes how you develop Ranggas. I'll have to add, the next well we drill after Gehem is a deep well in Ranggas that we talked about I think late last year to test the oil potential deep in Ranggas and we need that before we commit to any development. Because I think there's a good chance we'll find deeper oil there.

Steve Enger - *Petrie Parkman - Analyst*

Good point. And then on Sadewa, if you do have successful appraisals and move ahead, can that come online before '06 as a means to meet the needs forecast from Bontang or is it also '06 plus?

Chuck Williamson - *Unocal - Chairman, CEO*

My guess is -- let me just characterize Sadewa. We had a deep Sadewa test for oil, we didn't find much oil there. The shallow gas is quite easy to develop as long as we have enough reserves there and we can satisfy ourselves. So we'd see that as kind of late -- the same schedule as Gendalo basically -- late 2006, early 2007 as long as we get a couple of good appraisal wells. And we'd take it off of a shelf infrastructure and do some extended reach drilling and produce that gas to meet some of our contract quantity requirements in East (indiscernible).

Steve Enger - *Petrie Parkman - Analyst*

Was there some relationship with Ranggas?

Chuck Williamson - *Unocal - Chairman, CEO*

No, not between Sadewa and Ranggas. That's quite a ways off.

Steve Enger - *Petrie Parkman - Analyst*

Okay, that's what I thought. Okay, thanks a lot.

Operator

Arjun Murti, Goldman Sachs.

Arjun Murti - *Goldman Sachs - Analyst*

Chuck, are there any issues in terms of the proved reserves booking related to West Seno? Clearly a price related revision is I understand, and most people worry too much about, but related to the performance issues and what you highlighted in your prepared remarks?

Chuck Williamson - *Unocal - Chairman, CEO*

Yes, Arjun, here's how I'd characterize it. I think I said this last time we talked. The pay counts we found in West Seno and absolute volumes we've seen in the well bores are very similar to what we expected and, first of all, we've never fully booked all of West Seno anyway. I think if there's going to be any reserve adjustment we need a lot of performance data. It isn't that we haven't penetrated a lot of the reservoirs, we've just been disappointed with the rate especially in this deep section that we expected to get and frankly we got on drill (indiscernible) tests. I think it's early to say there's going to be any adjustment reserves. I will tell you, the reserves aren't higher than we expected, but then again we ever fully booked all of West Seno to start with knowing we needed performance data. So the answer for now is, no. I think we need another year of performance data before we even think about it.

Arjun Murti - *Goldman Sachs - Analyst*

I would guess if it's more of an issue of compartmentalization there's probably a greater reserve risk than if it's just completion method?

Chuck Williamson - *Unocal - Chairman, CEO*

I would agree with that for sure. And again, let us try these recompletions. It's puzzling to us frankly because the drill stem test flowed at very high rates out of these intervals. So I don't think -- I'm safe in saying right now we don't have a big reserve issue there, we do have a rate issue that's real right now.

Arjun Murti - *Goldman Sachs - Analyst*

Chuck, I guess on the positive side you highlighted that you're expecting now North America to stay flat, you've sold a lot of the mature shelf assets. I guess the question is longer-term I know the original goal was to have the deep shelf drilling be successful and allow North America to stay flat, and I'm talking about excluding I guess deepwater which would be additive when it comes on. With a more scaled back deep shelf program beyond 2004, what are your thoughts on North American production?

Chuck Williamson - *Unocal - Chairman, CEO*

I think that, again, we will reinitiate some semblance of a deep shelf program but without any success in the deep shelf -- if you look at our '05, '06, '07 forecast we decline certainly Gulf of Mexico part from about roughly 55, 56 today I think down into the 40s because we're only injecting about $55 million of capital into it right now and you won't hold it at that level with that level of capital. So either we have more exploration success or we let it decline and just don't invest in it.

Arjun Murti - *Goldman Sachs - Analyst*

(multiple speakers) you are now filling in declines where I think maybe in the past you hadn't been.

Chuck Williamson - *Unocal - Chairman, CEO*

Yes, filling in declines is just what you said earlier, Arjun. We have K2 and Mad Dog for next year basically making up for any declines and keeping that fairly flat for the next year or two. But beyond that Gulf of Mexico shelf without new exploration will certainly decline.

Arjun Murti - *Goldman Sachs - Analyst*

For sure. Thank you very much.

Operator

Shannon Nome, J.P. Morgan.

Shannon Nome - *JP Morgan - Analyst*

My question is kind of along the same lines as Arjun's but more near-term in the context of North American production. Even with the -- you mentioned the pipeline shut in right at the beginning of the call. But even adjusting for that it looks to me like the sequential drop in lower 48, particularly in gas volumes, seemed really quite steep. I just wander, is there anything else unusual there or what is it that gives you comfort that you've got North American production stable at this point?

Chuck Williamson - *Unocal - Chairman, CEO*

Shannon, remember, of course we disposed of a lot of those assets in the fourth-quarter and so if you're looking fourth-quarter to first-quarter most of that is the sale of the Gulf of Mexico assets (multiple speakers).

Shannon Nome - *JP Morgan - Analyst*

I was thinking a lot of that was in September of last year. Was there a big impact in the fourth-quarter?

Chuck Williamson - *Unocal - Chairman, CEO*

No, it was -- help me, Robert. I can't remember the timing but it was halfway --.

Robert Wright - *Unocal - VP IR*

Yes, it was about midway through the fourth-quarter. It was announced in September but we actually booked the production up through sometime in October.

Chuck Williamson - *Unocal - Chairman, CEO*

I'm glad you're raising the point because if you look at our forecast for the rest of this year that's in that 425, we have a slight decline in the Gulf of Mexico but frankly it holds pretty steady through most of the year with the amount of capital we're spending on it. Beyond 2005 we're not as confident without some exploration success.

Shannon Nome - *JP Morgan - Analyst*

And then I guess as a follow-on, do you have what your total property sales last year amounted to just on a full year basis?

Chuck Williamson - *Unocal - Chairman, CEO*

Yes, I think Robert -- I'll let Robert give you that number. I can give you one but I'd rather he did it. I think he's got it here.

Robert Wright - *Unocal - VP IR*

While I'm searching for it -- I think it's around 635, it was in the 10-K which included, of course, the proceeds from Tom Brown and (multiple speakers).

Shannon Nome - *JP Morgan - Analyst*

I'm looking actually more for production than proceeds.

Robert Wright - *Unocal - VP IR*

Oh, the production, sorry. The impact was 35,000 BOE a day on a full year basis. If you take the quarter-to-quarter change it was about 50,000 BOE a day because most of those sales -- there were some sales that started in the -- we call it the April sale package. It started in April -- that's why I call it that I guess -- and then, of course, the others came along beyond that. If you look in the quarterly fact book you can carve out the affiliates; those were there last year, they're not there now. And then the others amount to with the affiliates about a total on an annual basis about 35. But on a first-quarter to first-quarter basis it's closer to 50.

Shannon Nome - *JP Morgan - Analyst*

Okay, thanks very much.

Robert Wright - *Unocal - VP IR*

And that includes assets sold in Canada, onshore and the Gulf.

Shannon Nome - *JP Morgan - Analyst*

Right. Got it, thanks.

Operator

Phil Pace, CSFB.

Phil Pace - *CSFB - Analyst*

A couple things. To the 10,000 or 12,000 barrels a day you carved out of the forecast for the higher prices, what have you assumed about pricing for the rest of this year? And Chuck, you mentioned that in the third quarter you had sanctioned Phase III of Azerbaijan, what's that do to reserves on a gross or a net basis and when might those be recognized? And finally, is the La Jolla well either drilled by you or BP still on somebody's schedule and could you review that timing and what difference that might make to St. Malo economics?

Chuck Williamson - *Unocal - Chairman, CEO*

Sure. I'll let Robert start.

Robert Wright - *Unocal - VP IR*

On the forecast for oil that resulted in the PSE change, we went from $24 forecast to $34.

Phil Pace - *CSFB - Analyst*

Okay.

Robert Wright - *Unocal - VP IR*

And as far as the Phase III -- you want the rest of the reserve on the AIOC?

Chuck Williamson - *Unocal - Chairman, CEO*

AIOC paid three sanctions so it will result in us booking additional reserves because we haven't booked that. I don't have the number here. I'm sorry. I can guess it but I don't know what it is off the top of my head.

Terry Dallas - *Unocal - EVP, CFO*

And we probably would just wait until the end of the year because it's going to be price dependent as well. And so we probably wouldn't say anything about how large it would be until the end of the year.

Chuck Williamson - *Unocal - Chairman, CEO*

I'm glad you raised the third one, Phil, on La Jolla. La Jolla is the prospect just southeast of St. Malo discovery. There's a small (indiscernible) that separates them. But we have one block on -- BP owned a lot of the other acreage on it. BP referred to the same prospect as Das Bump (ph). Here's what we now know; we've had a lot of discussions with BP after the BP drills the Mad Dog Deep, the lower tertiary test below the Miocene, they intend to go to Das Bump on their acreage and drill an exploration well on what effectively we call La Jolla Prospect, Phil. Right now we don't have any equity interest in that well and we think they'll probably drill it on their side and more than likely with their partnership. But that's all we know right now, but it is scheduled after the Mad Dog deep well.

Phil Pace - *CSFB - Analyst*

What is your interest in the structure I guess if you think about it in its entirety?

Chuck Williamson - *Unocal - Chairman, CEO*

As you can guess I'm not going to tell you what that might be. We've had maps that show St. Malo and La Jolla on their. You can look at it. But I will say this, we think we have the crust block. It depends on how low the oil contact might go because it's a fairly flat low release structure. So if it's a really big giant thing and BP has a lot of area, but we have a lot of the crust. But it's a smaller thing, we have a much bigger piece of the structure. That's all I'll tell you. As you can imagine, we don't want to talk about that.

Phil Pace - *CSFB - Analyst*

Thanks.

Operator

Mark Gillman, Benchmark Co.

Mark Gillman - *Benchmark Co. - Analyst*

Not to beat the West Seno thing to death, but Chuck, just kind of wondering, are you going to remap this to try to determine whether it's completion oriented issues or compartmentalization?

Chuck Williamson - *Unocal - Chairman, CEO*

Mark, we have a wholesale effort. We have very good 3-D over it and we're remapping it, as you can imagine, right now as we drill every development well. There's a combination of small faults and reservoirs, just continuity, so I'm not sure we'll ever resolve that from the map. I think what's more important for us right now, Mark, is that we want to go in and try some crack packs on completions on these things. And we have some evidence that there be some damage in a well bore but we're not sure, frankly. In our forecast, I'll tell you, we're not depending on a lot of completion success. We're still thinking 1,000 barrels a day, just what I said on the wells. If we get some better completions, great. And if it's compartmentalization in the deeper section then it simply takes more sidetracks and well bores. And we've got to decide whether it's worth those additional wells or not, Mark.

But I think in the first phase of development that's not what we're after. We're going to keep plugging along right where our plan is and we're going to drill a couple more horizontal wells. We had one horizontal well in there early this year. It was a good well, over 4,000 barrels a day. We now have changed some of the future wells and we'll drill a couple horizontal wells and see if we can get the rate back up, but I don't know the answer, Mark. I don't think you'll ever resolve it just with the seismic and the well bores we have. I think you have to try completion techniques and, fair enough, we may end up drilling a few more sidetracks if that's what it takes.

Mark Gillman - *Benchmark Co. - Analyst*

Okay. Could -- Chuck, possibly update us a little bit on any discussion that are underway regarding Trident Development with or without Great White?

Chuck Williamson - *Unocal - Chairman, CEO*

Yes, I can't tell you a lot, Mark, other than to say there are a lot of discussions underway. And if you talk to Shell and Chevron, BP and the partners in Great White and, as you know, Chevron's drilled a couple wells around there, Shell has drilled a well around -- not in Great White but around (indiscernible) Prospect name. There's a whole bunch of discussion going on, that's all I can tell you. We've some very preliminary agreements with them in terms of what the infrastructure might look like out there. Here's the way I'd leave it is that I think the industry, not just us, the industry has yet to make the decision that that Perdido full (ph) belt is fully commercial. There's a couple key wells, Tobago being one of them, that are being drilled right now. But I think we are anticipating it being commercial and all I can tell you, Mark, is we're fairly far along in talking about shared infrastructure. And I think, Terry, do you want to add anything to that?

Terry Dallas - *Unocal - EVP, CFO*

No, I think that captures it. Those are the discussions that are going on and they really haven't gotten much further than that.

Chuck Williamson - *Unocal - Chairman, CEO*

I think, Mark, a lot of people have been waiting. Chevron drilled Tiger, Shell's drilling Hammerhead, we're drilling Tobago; all those things bear on what this eventual infrastructure is going to look like out there.

Mark Gillman - *Benchmark Co. - Analyst*

Chuck, not to beat a dead horse or familiar theme, whatever you want to call it. Total is again suggesting that they are going to be taking actions to remedy any shortfall they've been experiencing with respect to East Cal production. Do their actions or indications of their actions or intent impact at all in terms of the now multiphase development plan that you're talking about for the deepwater gas there?

Chuck Williamson - *Unocal - Chairman, CEO*

I'm going to let Terry comment, Mark, and then I may have to -- go ahead.

Terry Dallas - *Unocal - EVP, CFO*

Mark, I think the way we would look at what's going on out there, there's kind of two phases in this next development in Bontang. The easy phase is what happens after the current contracts expire in 2010. As you may know, the Japanese have signed letters of intent for about half the volumes that they are taking out of that plant right now. So there will be all sorts of other volumes that will be contracted during this next few years because all the contracts become subject to renewal in Australia, some of them in Malaysia, some of them in Bontang -- they all come at about the same time. So there will be a lot of dynamic action that occurs about where is the gas sold. And then the real issue is what gas then around Bontang will supply those contracts?

Right now Ranggas, Gehem, they'll be producing oil and they'll be mostly producing gas into that second phase of contracts. So that's what the plan is on those big projects. And as far as the other developments that we have, which is the Gendalo early development, Merah Besar, West Seno 2, some of the shelf areas -- this will go for our own contractual supply that's needed into that and then we will be prepared to deliver into any shortfalls that occur. Total has -- we've heard the same statements and that is their absolute position that they are remedying the shortfall and that they will increase their capacity. We don't have any reason to believe that won't happen, but they're producing huge volumes of gas today and they're going to incrementally develop certain fields. And I think the whole assumption about whether they're going to be successful and how this plant is going to produce will really depend on the decline of the old production not so much the incremental, the new development that they go through.

I think both Total and Unocal and Bico, I think what we mostly want to do is make sure that we have enough gas developed to ensure that the customers get the gas that they're contracted and that Bontang stays a viable candidate. And I hope actually there will be some excess gas there just to ensure that happens. But we're not -- Total absolutely has the position that they're going to develop what they need to provide the gas. We are going to develop in excess of what we need as well, and then I think we will ensure that the plant has the capacity necessary to supply the customers.

Mark Gillman - *Benchmark Co. - Analyst*

So Terry, if I can summarize. The balance of Gendalo is really going to offset declines in your Indonesian shelf gas production?

Terry Dallas - *Unocal - EVP, CFO*

And remember, Mark, Gendalo early development is a very small piece of Gendalo. It is a first subsea development of a very large field. So it's an early production scheme on a very large field that has a lot of room to expand capacity as we need it. So yes, it will take care of our shelf capacity so we have an assured market for a piece of it, but there is gas well in excess of what is required for our shelf capacity. So we do have a market for a certain percentage of that field regardless of what happens.

Mark Gillman - *Benchmark Co. - Analyst*

Okay, guys. Thanks a lot.

Operator

(OPERATOR INSTRUCTIONS) Don Texter (ph), Dorset Asset Management.

Don Texter - *Dorset Asset Managment - Analyst*

The question I have is first on Gula, you mentioned it was a very successful appraisal well and I think the original reserve estimates were anywhere from 1 to 7 Tcf, is there any way you can narrow that down?

Chuck Williamson - *Unocal - Chairman, CEO*

Don, I think -- we just finished the well so I can't -- I'll just say for now that's probably in the right range, that's all I can tell you. The thing about Gula, we haven't done a good job of describing it, this is a huge anticline. We just drilled wells that are five kilometers apart. This is probably a 15 to 25 km anticline. They don't have fluid contact so we really don't know how big it is other than it's probably big. I think 1 to 7 is probably still in the right range for now.

Don Texter - *Dorset Asset Managment - Analyst*

Okay. And as you go forward to 2010, do you think there's been any change in terms of certifying the gas in terms of what marketshare you may anticipate getting of those rollover volumes given the excess at Gendalo and Sadewa and Ranggas and Gehem and Gula. Do you still -- I think you were what, 30 to 50 percent of the rollover contracts? You thought that was (multiple speakers)?

Chuck Williamson - *Unocal - Chairman, CEO*

We had a projection on that order and I think we're still in the right range, Don. The question for us on certification for post 2010, like Terry said, is it's capital efficiency. We could go drill a lot more Gula wells right now -- probably certify a lot of gas, but we're not going to do that right now. What we want to do for the purpose in drilling that was to show our customers that there's a lot of gas to be had in East Cal, and Gendalo will show some early delivery, we've got Ranggas, but Gula is a big feature and there's others out there. So I don't think our market share expectations have changed at all, Don. I think how fast we certify is more about just capital efficiency.

Don Texter - *Dorset Asset Managment - Analyst*

Okay, thanks.

Operator

Michael Prince (ph), Bluestar (ph) Industries.

Michael Prince - *Bluestar Industries - Analyst*

Great quarter. We've come a long way in one year especially with the stock there. Chuck, did I hear you correctly when you had mentioned earlier that you feel that these commodity prices will hold up for the rest of the year?

Chuck Williamson - *Unocal - Chairman, CEO*

I didn't say that. I'm hoping that, that's for sure.

Michael Prince - *Bluestar Industries - Analyst*

I thought you said you were (multiple speakers).

Chuck Williamson - *Unocal - Chairman, CEO*

I think that if you look that maybe Robert was referring to that when he talked about the hedge program. I don't remember his comments. But I don't think we're that smart. I can only tell you is that what we said is if these prices hold up through the end of the year then those are the kind of guidance we're giving for financial results. And Terry was making the point, we're going to generate a huge amount of free cash flow if the prices hold up, but I don't know that we can predict that.

Terry Dallas - *Unocal - EVP, CFO*

And if you look at it, we candidly say we don't know and we obviously, if we had thought they were going to hold up the way they are we wouldn't have hedged out at the prices. We've got some good hedged -- a nice high oil hedge in place, but it's nowhere near $38. So we just don't know. It's fundamentally -- there are some fundamentals but there's just so much politics wrapped up in oil price now, too, that it's just who knows.

Michael Prince - *Bluestar Industries - Analyst*

And Terry, I'm for increasing the dividend for us long time devoted stockholders. And again, gentlemen, you had a great quarter. Congratulations.

Operator

Steve Enger, Petrie Parkman.

Steve Enger - *Petrie Parkman - Analyst*

Just to clarify, Chuck, you mentioned potential Thai pipeline debottlenecking that might mean 100 million a day, I assume that was gross?

Chuck Williamson - *Unocal - Chairman, CEO*

Yes, Steve, it is gross and that let me be real cautious because this is news that over the last few days we're just starting to digest. All I will say -- and if you talk to PTT they can probably give you a lot more information than we can -- is that they had the pipeline pegged (ph), they've had a lot of consulting work done on -- operating pressure of the pipeline, a whole bunch of work over the last few months that have led them to believe we can probably put more gas through to put two existing pipelines. I say 100 is the gross number, we don't know yet quite frankly. But it's on that order, at least that's what we've been led to believe. So give us a few weeks and we'll get a better bead on it, or you might talk to PTT, they may have a better answer for you.

Steve Enger - *Petrie Parkman - Analyst*

Okay. And then you'd mentioned just being down in Midland and seeing a lot more opportunities down there, can you give us a little color on some of the development or kinds of developments that look intriguing to you?

Chuck Williamson - *Unocal - Chairman, CEO*

Yes, we've been kind of coy about it because first of all they've been picking up a lot of acreage and, as you well know, Steve, these aren't big -- no single well is going to be a huge well. But there's two main plays they have, one is the deep Devonian gas and they have a pretty aggressive program, I think 20 some wells this year. It's a conventional play but we have three or four positions that are in pretty good place.

The second play is one I won't be explicit about other than to say we've been picking up a lot of acreage. We are talking about escalating the rig program by two or threefold, and when we're ready to talk more about it I will. But I don't want you to think these are thousands of barrels a day wells. They're not, they're small things. But if you add enough of them together you can get a pretty good inventory. So what impressed me there, Steve, is for the first time since we've had that business they can see years of pretty good metric looking small inventory of developments that are not real high-risk. Frankly they're manufacturing looking operations. And that's pretty exciting for us because it gives us more confidence in the forecast for that 55 -- 6,000 barrels a day we produce there. But being able to renew it and replenish it at a very good metric and keeping our F&D below $8.

So that's the part I -- I'm just not going to say more than that other than that they're in a -- you know, I like our position there now because so many people have left frankly. We're one of the big players left and there's a lot of opportunity. We're going to see some small acquisitions. We're going to see some acceleration of our rig schedule and more capital going into that business. As the Gulf of Mexico shelf probably declines we'll siphon some of that money and put it over there.

Steve Enger - *Petrie Parkman - Analyst*

But you think in the end you could see some net production growth then out of the assets in the Permian?

Chuck Williamson - *Unocal - Chairman, CEO*

Yes, right now we're not forecasting any, Steve. I think that's possible but if you look at our -- when I say we're trying to hold North America 175 plus or minus, it doesn't include growth in Pure, it holds Pure pretty much where it is. I do think there's some upside to that and it'll take more capital and that's the decision we'll be making.

Steve Enger - *Petrie Parkman - Analyst*

Great, thanks.

Operator

Mark Gillman, Benchmark Co.

Mark Gillman - *Benchmark Co. - Analyst*

Chuck, could you possibly clarify whether or not you've got a firm contract with respect to the incremental Thai gas deliveries associated with the third pipeline? I'm confused whether you've got a letter of intent, a firm purchase and sale agreement or exactly what the status is by -- from recent reading in the trade rags?

Chuck Williamson - *Unocal - Chairman, CEO*

Yes, it is confusing, Mark. And I'll tell you, the short answer is for the additional gas in the third pipeline -- this is the third pipeline -- we don't have a signed agreement other than heads (ph) of agreement which have agreed to the volumes and schedule but not to the price. So we don't have a gas sales agreement yet. That doesn't mean we can't sell gas to them, that just means we don't have a take-or-pay on that third pipeline with the exception of our interest in the RTIP project that PTT operates. We have 16 percent and we do have a gas sales agreement for that. But that's not the big prize for us.

That's exactly what's happening this year. We are in I will say deep discussions and negotiations about the pricing for 2008, '10 and beyond for that -- mostly for the third pipeline but also for the first two pipelines for the next 20 years and they've agreed that we will extend our contract. That hasn't been legally signed but verbally we've agreed we'll extend our contracts -- our concessions there I should say. And what we're talking about now is what the pricing will be for that additional gas. But I'm confident we will get there. As most of our negotiations, Mark, as you know, the last four contracts take one to two years to finalize. We're about almost a year into it now. We're moving along but we're not there yet. So we have a heads of agreement, or MOU, whatever it's called.

Mark Gillman - *Benchmark Co. - Analyst*

Okay, well just one other one if I could. The unit costs in North America just continue to be virtually off the charts despite all of the cost reduction effort of last year. Certainly I recognize the impact of declining deliverability, but are there any other measures that you can take or considering taking to try to bring those unit costs under control?

Robert Wright - *Unocal - VP IR*

Let me give you a little bit of background about some of the cost drivers, Mark. What we found in Canada is that we're suffering a little bit from the foreign exchange difference and some of the efforts we're making there are being offset by the change in the exchange rate for the Canadian dollar. And on the onshore U.S. at least operating costs are higher because of the severance taxes that go in there. But that's just one of the side benefits that goes along with -- or side disadvantages that goes along with the higher oil price benefits and gas price benefits as well.

As far as the ongoing -- we do expect in our AOP to have lower costs in North America. A lot of special wear (ph) repairs were -- I guess bunched in the first half of the year. So we still have expectations that we'll see some improvement in operating costs and exploration expense should be lower because of the layoffs we did in association last year in the Gulf region. And other expenses -- that's going to be tougher because that's the one that you've to reduce those by the same rate you reduced production.

Chuck Williamson - *Unocal - Chairman, CEO*

Mark, let me add to that. You actually have the metrics. What we tell everybody down there is we want an F&D of less than $8, you've heard us say it. We didn't have that last year in the Gulf of Mexico, we did in Canada, Pure and Alaska. We still pound them on that metric because for the capital we put in there we want to get some return. On the operating cost side, just to add to what Robert said, until we can grow production, which isn't likely quite frankly without something changing, then to me the best way to go after some of the cost is, I hate to say this, is the exploration expense.

Remember we have a big deepwater program, we had a big deep shelf exploration program down there at we are going to have to reconfigure, that all I can tell you because that's still a big cost element in North America for us but we still have a $0.5 million a day drilling rig that we have to keep gainfully employed. So longer-term I see some possibility there for a lot less exploration expense which is kind of what Robert said, in North America if we're not going to have more of a program there. I think it's very hard to escape cost pressures, frankly, in Pure in Canada -- that's what the industry is -- that's what's happening. And I'm really, given all the agony we went through last year in the Gulf of Mexico, we're not in a bad place. It will improve in the Gulf, as Robert said, the next couples quarters but it still isn't going to be where you want it to be, I can tell you, but that's an industry symptom.

Mark Gillman - *Benchmark Co. - Analyst*

So I assume that the kind of DD&A rates we're seeing in North America in the first-quarter are at the very least sustainable as we work our way through the year. I mean, if you put U.S. and Canada together you're going to be running over eight.

Terry Dallas - *Unocal - EVP, CFO*

Yes, and we would -- our goal is eight or less in F&D, but you have to understand that some of the money that we spend, all it does is promote -- proven undeveloped to proven developed, it doesn't end up in the metric. So we should see a sustained DD&A or slightly better but it's not going to reach eight as long as you're promoting PUDs. But our incremental exploration and our incremental exploitation for new reserves, we're holding people to this $8 F&D. And they are delivering and the Gulf knows they're going to be held to the same metric.

Mark Gillman - *Benchmark Co. - Analyst*

Okay. Thanks, Terry.

Operator

Tom Driscoll, Lehman Brothers.

Tom Driscoll - *Lehman Bros. - Analyst*

Chuck, can you come back and talk a little bit more about the Gulf of Mexico drilling program, perhaps the deep shelf in particular? You guys had earlier talked about a pause in that program. What would it take for you guys to get back there aggressively? And I assume the 8,000 barrels a day decrease in '04 guidance is a result of pulling out some kind of modeled exploration success? And if you don't get back to it what kind of vulnerability is there into the '05 number?

Chuck Williamson - *Unocal - Chairman, CEO*

Tom, you're right in terms of what would it take to get us back to that program, I think right now it's a combination of things. I think we were -- when we go back to the program I anticipate it will not be a two, three, four rig program, it'll probably be a one rig program, a step at a time because the industry hasn't done that well in the deep shelf and we haven't. So I think there's some learning we've got to reincorporate as we go along the way. We have some inventory that we could start drilling on right now, but I think we are trying to digest what we did last year, frankly, and we need six months to do it. So I anticipate it's coming back and I think the question for us is are you going to go after 200 Bcf targets, are you going to be satisfied with lower risk 20 to 40 Bcf targets because they're two very different program. We had a combination of both last year. I don't know the answer yet.

But I think it just takes some time far us and watching the industry before we go back to -- some of those wells were just too expensive. (multiple speakers) We did have 8,000 barrels a day modeled, there's exploration success, the deep shelf now is producing probably 2,000 barrels a day for us or something like that or 1,500. They decline quickly when you find them, too, but they're great money makers. So how does that affect '05 production? Frankly, in the greater scheme of our new projects it's fairly small. We did have it forecast in '05 when we showed you a forecast in November I think it was. So that won't be there. We're just assuming that's not there.

Tom Driscoll - *Lehman Bros. - Analyst*

Thank you, Chuck.

Operator

Paul Liedman (ph), Big Cat (ph) Energy.

Paul Liedman - *Big Cat Energy - Analyst*

We never really get a focus on Canada. I'd be curious if you could give us a little bit of an update on what you're doing up in the Northwest Territories on I guess what's called Summit Creek or Wilma?

Chuck Williamson - *Unocal - Chairman, CEO*

All I can tell you is you know we drilled a prospect in the Northwest Territories, we call it Wilma. We have TD'd the well, I think it's been disclosed, we have some smaller partners in there. It is a tight hole, it's virgin territory, it's an important opening well and that's really all we can tell you right now.

Paul Liedman - *Big Cat Energy - Analyst*

Is there something we should stay tuned for? Do you see it as being highly perspective? From a portfolio standpoint where does it fit in?

Robert Wright - *Unocal - VP IR*

Yes, we call it big exploration. It's one of the few areas in Canada where you can take a shot at some big reserves but it's a much higher risk, and that's where it fits in our portfolio. And we've encouraged the Canadian business unit to go after this. All I can tell you in terms and staying tuned is obviously it's break up now, this is a winter well, so we don't anticipate a lot of news on that until we can get back probably late in the summer and early into the winter before we actually do anything. And we will -- once the partners have agreed I suppose we would be more willing to talk about what our plans for the evaluation of that are, but right now I can't.

Paul Liedman - *Big Cat Energy - Analyst*

Do pending land sales enter into some of your thinking?

Robert Wright - *Unocal - VP IR*

There is some open land, although most of the stuff we have already tied up, but there is a lease sale to the south -- one reason I'll be very quiet about it.

Paul Liedman - *Big Cat Energy - Analyst*

One other question if I might. I may have had to step off. What was your comment on the Mad Dog deep's status?

Chuck Williamson - *Unocal - Chairman, CEO*

I didn't say anything other than that BP is drilling that, we're a participant in the well. They've had a lot of mechanical issues, I will tell you that. The well's gone -- we thought the well would be near TD and it's not. They are still on the well and having mechanical issues, so it'll probably be -- well, I don't know. It may be a couple months before we reach TD.

Paul Liedman - *Big Cat Energy - Analyst*

Okay, thanks a lot.

Operator

At this time I show no further questions and would like to turn the meeting back over to Mr. Wright.

Robert Wright - *Unocal - VP IR*

Thank you everybody else for participating in the call. It's been running about an hour and 15 minutes now so I'm sure ready to get on to other things. If there are any questions that you'd like to have answered that weren't call the Investor Relations team, Lee Ahlstrom, Nancy Murachanian or myself. With that, thank you very much and goodbye. This concludes the call.

Operator

Thank you for participating in today's conference call and have a good day.