CONOCOPHILLIPS
Form 10-Q
August 01, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2007

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ____________________ to ____________________

Commission file number: 001-32395

ConocoPhillips

(Exact name of registrant as specified in its charter)

Delaware	**01-0562944**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

600 North Dairy Ashford, Houston, TX 77079

(Address of principal executive offices) (Zip Code)

281-293-1000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

The registrant had 1,627,185,696 shares of common stock, $.01 par value, outstanding at June 30, 2007.

CONOCOPHILLIPS
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

Consolidated Income Statement **ConocoPhillips**

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	**2007**	2006
Revenues and Other Income				
Sales and other operating revenues*	$ **47,370**	47,149	**88,690**	94,055
Equity in earnings of affiliates	**1,506**	1,164	**2,435**	2,124
Other income	**521**	163	**1,139**	224
Total Revenues and Other Income	**49,397**	48,476	**92,264**	96,403
Costs and Expenses				
Purchased crude oil, natural gas and products	**30,820**	29,448	**57,535**	62,903
Production and operating expenses	**2,557**	2,694	**5,049**	4,909
Selling, general and administrative expenses	**604**	610	**1,131**	1,176
Exploration expenses	**259**	134	**521**	246
Depreciation, depletion and amortization	**2,016**	1,965	**4,040**	3,145
Impairment expropriated assets	**4,588**		**4,588**	
Impairments	**98**	50	**97**	50
Taxes other than income taxes*	**4,697**	4,421	**9,071**	8,808
Accretion on discounted liabilities	**81**	73	**160**	133
Interest and debt expense	**319**	360	**626**	475
Foreign currency transaction (gains) losses	**(179)**	18	**(178)**	40
Minority interests	**19**	21	**40**	39
Total Costs and Expenses	**45,879**	39,794	**82,680**	81,924
Income before income taxes	**3,518**	8,682	**9,584**	14,479
Provision for income taxes	**3,217**	3,496	**5,737**	6,002
Net Income	$ **301**	5,186	**3,847**	8,477
Net Income Per Share of Common Stock *(dollars)*				
Basic	$ **.18**	3.13	**2.34**	5.58
Diluted	**.18**	3.09	**2.31**	5.49
Dividends Paid Per Share of Common Stock *(dollars)*	$ **.41**	.36	**.82**	.72

Average Common Shares Outstanding *(in thousands)*				
Basic	**1,635,848**	1,654,758	**1,641,569**	1,519,593
Diluted	**1,657,999**	1,678,445	**1,663,618**	1,542,752
**Includes excise taxes on petroleum products sales:*	***$ 4,069***	*3,922*	***7,910***	*7,912*

See Notes to Consolidated Financial Statements.

1

Consolidated Balance Sheet **ConocoPhillips**

	Millions of Dollars	
	June 30 2007	December 31 2006
Assets		
Cash and cash equivalents	**$ 1,411**	817
Accounts and notes receivable (net of allowance of $42 million in 2007 and $45 million in 2006)	**12,144**	13,456
Accounts and notes receivable related parties	**2,146**	650
Inventories	**5,245**	5,153
Prepaid expenses and other current assets	**3,435**	4,990
Total Current Assets	**24,381**	25,066
Investments and long-term receivables	**28,875**	19,595
Loans and advances related parties	**1,440**	1,118
Net properties, plants and equipment	**85,296**	86,201
Goodwill	**29,597**	31,488
Intangibles	**907**	951
Other assets	**372**	362
Total Assets	**$ 170,868**	164,781
Liabilities		
Accounts payable	**$ 14,357**	14,163
Accounts payable related parties	**1,776**	471
Notes payable and long-term debt due within one year	**1,109**	4,043
Accrued income and other taxes	**4,072**	4,407
Employee benefit obligations	**669**	895
Other accruals	**1,934**	2,452
Total Current Liabilities	**23,917**	26,431
Long-term debt	**21,703**	23,091
Asset retirement obligations and accrued environmental costs	**6,088**	5,619
Joint venture acquisition obligation related party	**6,595**	
Deferred income taxes	**20,582**	20,074
Employee benefit obligations	**3,565**	3,667
Other liabilities and deferred credits	**2,310**	2,051
Total Liabilities	**84,760**	80,933
Minority Interests	**1,180**	1,202
Common Stockholders Equity		

Common stock (2,500,000,000 shares authorized at $.01 par value)		
Issued (2007 1,714,314,763 shares; 2006 1,705,502,609 shares)		
Par value	**17**	17
Capital in excess of par	**42,382**	41,926
Grantor trusts (at cost: 2007 43,363,722 shares; 2006 44,358,585 shares)	**(746)**	(766)
Treasury stock (at cost: 2007 43,765,345 shares; 2006 15,061,613 shares)	**(2,969)**	(964)
Accumulated other comprehensive income	**2,599**	1,289
Unearned employee compensation	**(138)**	(148)
Retained earnings	**43,783**	41,292
Total Common Stockholders Equity	**84,928**	82,646
Total	**$ 170,868**	164,781

See Notes to Consolidated Financial Statements.

Consolidated Statement of Cash Flows **ConocoPhillips**

	Millions of Dollars Six Months Ended June 30	
	2007	2006
Cash Flows From Operating Activities		
Net income	**$ 3,847**	8,477
Adjustments to reconcile net income to net cash provided by operating activities		
Non-working capital adjustments		
Depreciation, depletion and amortization	**4,040**	3,145
Impairment expropriated assets	**4,588**	
Impairments	**97**	50
Dry hole costs and leasehold impairments	**281**	85
Accretion on discounted liabilities	**160**	133
Deferred taxes	**180**	(222)
Undistributed equity earnings	**(1,235)**	(754)
Gain on asset dispositions	**(927)**	(56)
Other	**88**	(14)
Working capital adjustments		
Decrease in accounts and notes receivable	**210**	790
Increase in inventories	**(271)**	(2,167)
Decrease (increase) in prepaid expenses and other current assets	**285**	(436)
Increase in accounts payable	**1,097**	564
Decrease (increase) in taxes and other accruals	**(801)**	49
Net Cash Provided by Operating Activities	**11,639**	9,644
Cash Flows From Investing Activities		
Acquisition of Burlington Resources Inc.*		(14,284)
Capital expenditures and investments, including dry hole costs*	**(5,347)**	(7,916)
Proceeds from asset dispositions	**2,215**	73
Long-term advances/loans to affiliates	**(326)**	(376)
Collection of advances/loans to affiliates	**66**	110
Other	**19**	
Net Cash Used in Investing Activities	**(3,373)**	(22,393)
Cash Flows From Financing Activities		
Issuance of debt	**765**	15,874
Repayment of debt	**(5,121)**	(3,306)
Issuance of company common stock	**181**	104
Repurchase of company common stock	**(2,000)**	(425)
Dividends paid on company common stock	**(1,342)**	(1,091)
Other	**(153)**	(47)

Net Cash Provided by (Used in) Financing Activities	**(7,670)**	11,109
Effect of Exchange Rate Changes on Cash and Cash Equivalents	**(2)**	80
Net Change in Cash and Cash Equivalents	**594**	(1,560)
Cash and cash equivalents at beginning of period	**817**	2,214
Cash and Cash Equivalents at End of Period	**$ 1,411**	654

**Net of cash acquired.*

See Notes to Consolidated Financial Statements.

Note 1 Interim Financial Information

The interim-period financial information presented in the financial statements included in this report is unaudited and includes all known accruals and adjustments, in the opinion of management, necessary for a fair presentation of the consolidated financial position of ConocoPhillips and its results of operations and cash flows for such periods. All such adjustments are of a normal and recurring nature. The acquisition of Burlington Resources Inc. was reflected in our balance sheet beginning at March 31, 2006, and was reflected in our results of operations beginning April 1, 2006. To enhance your understanding of these interim financial statements, see the consolidated financial statements and notes included in our 2006 Annual Report on Form 10-K.

Note 2 Changes in Accounting Principles

Effective April 1, 2006, we implemented Emerging Issues Task Force Issue No. 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty. Issue No. 04-13 requires purchases and sales of inventory with the same counterparty and entered into in contemplation of one another to be combined and reported net (i.e., on the same income statement line). Exceptions to this are exchanges of finished goods for raw materials or work-in-progress within the same line of business, which are only reported net if the transaction lacks economic substance. The implementation of Issue No. 04-13 did not have a material impact on net income.

The table below shows the actual six months ended June 30, 2007, sales and other operating revenues, and purchased crude oil, natural gas and products under Issue No. 04-13, and the respective pro forma amounts had this new guidance been effective for the period included in this report prior to April 1, 2006.

	Millions of Dollars Six Months Ended June 30	
	Actual **2007**	Pro Forma 2006
Sales and other operating revenues	**$ 88,690**	87,398
Purchased crude oil, natural gas and products	**57,535**	56,246

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48). This Interpretation provides guidance on recognition, classification and disclosure concerning uncertain tax liabilities. The evaluation of a tax position requires recognition of a tax benefit if it is more likely than not it will be sustained upon examination. We adopted this Interpretation effective January 1, 2007. The adoption did not have a material impact on our consolidated financial statements.

At January 1, 2007, we had unrecognized tax benefits of $912 million. Included in this balance was $468 million which, if recognized, would affect our effective tax rate.

We recognize accrued interest related to unrecognized tax benefits in interest expense, and penalties in operating expense. Accrued liabilities for interest and penalties as of January 1, 2007, totaled $99 million, net of accrued income taxes.

See Note 21 Income Taxes, for additional information about income taxes.

Note 3 Acquisition of Burlington Resources Inc.

On March 31, 2006, ConocoPhillips completed the $33.9 billion acquisition of Burlington Resources Inc., an independent exploration and production company that held a substantial position in North American natural gas proved reserves, production and exploratory acreage.

The final allocation of the purchase price to specific assets and liabilities was completed in the first quarter of 2007. It was based on the final outside appraisal of the fair value of Burlington Resources long-lived assets and the conclusion of the fair value determination of all other Burlington Resources assets and liabilities.

The following table summarizes the final purchase price allocation of the fair value of the assets acquired and liabilities assumed as of March 31, 2006:

	Millions of Dollars
Cash and cash equivalents	$ 3,238
Accounts and notes receivable	1,432
Inventories	229
Prepaid expenses and other current assets	108
Investments and long-term receivables	268
Properties, plants and equipment	28,176
Goodwill	16,787
Intangibles	107
Other assets	46
Total Assets	$ 50,391
Accounts payable	$ 1,487
Notes payable and long-term debt due within one year	1,009
Accrued income and other taxes	697
Employee benefit obligations current	248
Other accruals	254
Long-term debt	3,330
Asset retirement obligations	730
Accrued environmental costs	174
Deferred income taxes	7,849
Employee benefit obligations	347
Other liabilities and deferred credits	397
Common stockholders equity	33,869
Total Liabilities and Equity	$ 50,391

All of the goodwill was assigned to the Worldwide Exploration and Production reporting unit. Of the $16,787 million of goodwill, $7,953 million relates to net deferred tax liabilities arising from differences between the allocated financial bases and deductible tax bases of the acquired assets. None of the goodwill is deductible for tax purposes.
The following table presents pro forma information for the six months ended June 30, 2006, as if the acquisition had occurred at the beginning of 2006.

	Millions of Dollars
Pro Forma	
Sales and other operating revenues	$ 95,960
Net income	8,920
Net income per share of common stock *(dollars)*	
Basic	5.39
Diluted	5.31

The pro forma information is not intended to reflect the actual results that would have occurred if the companies had been combined during the period presented, nor is it intended to be indicative of the results of operations that may be achieved by ConocoPhillips in the future.

Note 4 Restructuring

In connection with the acquisition of Burlington Resources, we implemented a restructuring program as part of the effort to capture the synergies of combining the two companies. Under this program, we recorded accruals totaling $230 million in 2006 for employee severance payments, site closings, incremental pension benefit costs associated with workforce reductions, and employee relocations. Approximately 600 positions were identified for elimination during 2006, most of which were in the United States. During 2007, an additional 25 positions were identified for elimination.
Of the total accrual, $224 million was reflected in the Burlington Resources purchase price allocation as an assumed liability, and $6 million related to ConocoPhillips was reflected in selling, general and administrative expenses in 2006. The following table summarizes activity related to the non-pension portion of the accrual in the first six months of 2007:

	Millions of Dollars
Balance at December 31, 2006	$ 120
Benefit payments	**(40)**
Adjustments	**15**
Balance at June 30, 2007*	**$ 95**

**Includes current liabilities of $49 million. All workforce reductions are expected to be completed by March 2008. Some costs for site closings, continuation of* *employee benefits, and employee relocations are expected to extend beyond one year from June 30, 2007.*

Note 5 Variable Interest Entities (VIEs)

In June 2005, ConocoPhillips and OAO LUKOIL (LUKOIL) created the OOO Naryanmarneftegaz (NMNG) joint venture to develop resources in the Timan-Pechora province of Russia. The NMNG joint venture is a VIE, but we are not the primary beneficiary. We use the equity method of accounting for this investment. At June 30, 2007, the book value of our investment in the venture was $1,233 million.

See Note 11 Debt, for information about the liquidation of Phillips 66 Capital II.

Note 6 Inventories

Inventories consisted of the following:

	Millions of Dollars	
	June 30 2007	December 31 2006
Crude oil and petroleum products	**$ 4,470**	4,351
Materials, supplies and other	**775**	802
	$ 5,245	5,153

Inventories valued on the last-in, first-out (LIFO) basis totaled $4,276 million and $4,043 million at June 30, 2007 and December 31, 2006, respectively. The remainder of our inventories is valued under various methods, including first-in, first-out and weighted average. The excess of current replacement cost over LIFO cost of inventories amounted to $5,090 million and $4,178 million at June 30, 2007 and December 31, 2006, respectively.

Note 7 Assets Held for Sale

In 2006, we commenced asset rationalization efforts that led to the classification of certain assets as held for sale under Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Accordingly, at December 31, 2006, we reclassified $3,051 million of non-current assets and $604 million of non-current liabilities into current assets and current liabilities, respectively.

During the first six months of 2007, a portion of these held-for-sale assets were sold, additional assets met the held-for-sale criteria, and other assets no longer met the held-for-sale criteria. As a result, at June 30, 2007, we classified $1,652 million of non-current assets as Prepaid expenses and other current assets on our consolidated balance sheet and we classified $216 million of non-current liabilities as current liabilities, consisting of $166 million in Accrued income and other taxes and $50 million in Other accruals. We expect the disposal of these assets to be substantially completed by mid-2008.

The major classes of non-current assets and non-current liabilities held for sale at June 30, 2007, reclassified to current were:

	Millions of Dollars
Assets	
Investments and long-term receivables	$ 146
Net properties, plants and equipment	1,407
Goodwill	50
Intangibles	2
Other assets	47
Total assets reclassified	$ 1,652
Exploration and Production (E&P)	$ 331
Refining and Marketing (R&M)	1,321
	$ 1,652
Liabilities	
Asset retirement obligations and accrued environmental costs	$ 28
Deferred income taxes	166
Other liabilities and deferred credits	22
Total liabilities reclassified	$ 216
E&P	$ 37
R&M	179
	$ 216

Note 8 Investments, Loans and Long-Term Receivables

Investments in Venezuela

See the Expropriated Assets section of Note 10 Impairments, for information on the complete impairment of our investments in the Hamaca and Petrozuata projects.

EnCana Business Ventures

In October 2006, we announced a business venture with EnCana Corporation (EnCana) to create an integrated North American heavy-oil business. The transaction closed on January 3, 2007. The venture consists of two 50/50 business ventures, a Canadian upstream general partnership, FCCL Oil Sands Partnership (FCCL), and a U.S. downstream limited liability company, WRB Refining LLC (WRB). We use the equity method of accounting for both entities, with the operating results of our investment in FCCL reflecting its use of the full-cost method of accounting for oil and gas exploration and development activities.

FCCL s operating assets consist of the Foster Creek and Christina Lake steam-assisted gravity drainage bitumen projects, both located in the eastern flank of the Athabasca oil sands in northeast Alberta. A subsidiary of EnCana is the operator and managing partner of FCCL. We are obligated to contribute $7.5 billion, plus accrued interest, to FCCL over a 10-year period beginning in 2007. For additional information on this obligation, see Note 17 Joint Venture Acquisition Obligation.

WRB s operating assets consist of the Wood River and Borger refineries, located in Roxana, Illinois, and Borger, Texas, respectively. As a result of our contribution of these two assets to WRB, a basis difference of $5.1 billion exists due to the fair value of the contributed assets recorded by WRB exceeding their historic book value. The difference will be amortized and recognized as a benefit evenly over a period of 25 years starting from the closing date. The basis difference at June 30, 2007, is approximately $5.0 billion. We are the operator and managing partner of WRB. EnCana is obligated to contribute $7.5 billion, plus accrued interest, to WRB over a 10-year period beginning in 2007. For the Wood River refinery, operating results are shared 50/50 starting upon formation. For the Borger refinery, we are entitled to 85 percent of the operating results in 2007, 65 percent in 2008, and 50 percent in all years thereafter.

LUKOIL

Our ownership interest in LUKOIL was 20 percent at June 30, 2007, based on 851 million issued shares. For financial reporting under U.S. generally accepted accounting principles, treasury shares held by LUKOIL are not considered outstanding for determining our equity-method ownership interest in LUKOIL. Our ownership interest, based on estimated shares outstanding, was 20.5 percent at June 30, 2007.

At June 30, 2007, the book value of our ordinary share investment in LUKOIL was $10,099 million. Our share of the net assets of LUKOIL was estimated to be $7,523 million. This basis difference of $2,576 million is primarily being amortized on a unit-of-production basis. On June 30, 2007, the closing price of LUKOIL shares on the London Stock Exchange was $76.20 per share, making the total market value of our LUKOIL investment $12,963 million.

Loans to Related Parties

As part of our normal ongoing business operations and consistent with industry practice, we invest and enter into numerous agreements with other parties to pursue business opportunities, which share costs and apportion risks among the parties as governed by the agreements. Included in such activity are loans made to certain affiliated companies. Significant loans to affiliated companies at June 30, 2007, included the following:

- $607 million in loan financing, including accrued interest, to Freeport LNG for the construction of an LNG facility. We expect to provide loan financing of approximately $630 million for the construction of the facility.

- $255 million in loan financing, including accrued interest, to Varandey Terminal Company associated with the costs of a terminal expansion. We expect our total obligation for the terminal expansion to be approximately $525 million at current exchange rates, including interest to be accrued during construction.

- $540 million of project financing, including accrued interest, to Qatargas 3, an integrated project to produce and liquefy natural gas from Qatar s North field. Our maximum exposure to this financing structure is $1.2 billion.

Note 9 Properties, Plants and Equipment
The company s investment in properties, plants and equipment (PP&E), with accumulated depreciation, depletion and amortization (Accum. DD&A), was:

	Millions of Dollars					
	June 30, 2007			December 31, 2006		
	Gross PP&E	Accum. DD&A	Net PP&E	Gross PP&E	Accum. DD&A	Net PP&E
E&P	**$ 95,244**	**26,276**	**68,968**	88,592	21,102	67,490
Midstream	**330**	**163**	**167**	330	157	173
R&M	**18,747**	**4,221**	**14,526**	22,115	5,199	16,916
LUKOIL Investment						
Chemicals						
Emerging Businesses	**1,091**	**119**	**972**	1,006	98	908
Corporate and Other	**1,301**	**638**	**663**	1,229	515	714
	$ 116,713	**31,417**	**85,296**	113,272	27,071	86,201

Suspended Wells
The following table reflects the net changes in suspended exploratory well costs during the first six months of 2007:

	Millions of Dollars Six Months Ended June 30, 2007
Beginning balance at January 1	**$ 537**
Additions pending the determination of proved reserves	**60**
Reclassifications to proved properties	**(15)**
Sales of suspended well investment	**(22)**
Charged to dry hole expense	**(10)**
Ending balance at June 30	**$ 550**

The following table provides an aging of suspended well balances at June 30, 2007, and December 31, 2006:

	Millions of Dollars	
	June 30 2007	December 31