

**TRANSCRIPT**  
**4Q 2019 EARNINGS**  
**CONFERENCE CALL**



**PHILLIPS 66 (NYSE: PSX)**  
**January 31, 2020 at 12 p.m. ET**

## PHILLIPS 66 PARTICIPANTS

**Jeff Dietert**, *Vice President, Investor Relations*

**Greg C. Garland**, *Chairman and Chief Executive Officer*

**Kevin J. Mitchell**, *Executive Vice President, Finance and Chief Financial Officer*

## MEETING PARTICIPANTS

**Phil Gresh**, *JP Morgan*

**Doug Terreson**, *Evercore ISI*

**Neil Mehta**, *Goldman Sachs*

**Roger Read**, *Wells Fargo Securities*

**Paul Cheng**, *Scotiabank*

**Prashant Rao**, *Citigroup*

**Doug Leggate**, *Bank of America Merrill Lynch*

**Manav Gupta**, *Credit Suisse*

**Paul Sankey**, *Mizuho Securities*

**Matthew Blair**, *Tudor, Pickering, Holt and Company*

## TRANSCRIPT

### Operator:

Welcome to the Fourth Quarter 2019 Phillips 66 Earnings Conference Call. My name is Rob, and I will be your Operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. Please note that this conference is being recorded.

I will now turn the call over to Jeff Dietert, Vice President, Investor Relations. Jeff, you may begin.

### Jeff Dietert:

Good morning and welcome to Phillips 66's Fourth Quarter Earnings Conference Call. Participants on today's call will include Greg Garland, Chairman and CEO, and Kevin Mitchell, Executive Vice President and CFO. Today's presentation materials can be found on the Investor Relations section of the Phillips 66 website, along with supplemental financial and operating information.

Slide 2 includes our Safe Harbor statement. We are going to be making forward-looking statements today. Actual results are going to be different. Factors that could cause results to differ are included here, as well as in our SEC filings.

In order to allow everyone the opportunity to ask a question, we ask you limit yourself to one question and a follow-up.

With that, I'll turn the call over to Greg Garland for opening remarks.

### Greg C. Garland:

Thanks, Jeff. Good morning everyone, and thank you for joining us today. Total adjusted earnings for the fourth quarter were \$689 million or \$1.54 per share. We generated \$1.7 billion of operating cash flow. For the year, adjusted earnings were \$3.7 billion or \$8.05 per share. During the fourth quarter, we continued to progress our major growth projects. We achieved a major milestone with the initial startup of the Gray Oak Pipeline. Midstream performed well, delivering another record quarter in the Transportation business. Refining and Chemicals ran at 97% utilization; however, turnaround activity and weak product and petrochemical margins impacted our financial results.

During 2019, we made significant progress on executing our growth strategy in Midstream and Chemicals. Operating excellence remains a top priority for us, and we maintain our industry-leading performance.

We can always do better. We believe that a zero incident, zero accident workplace is achievable, and it's a goal we work hard for daily.

Midstream completed a number of growth projects and delivered strong operating performance, contributing to another year of record adjusted earnings for that segment. For the year, Refining ran at 94% utilization, while CPChem operated at 97% O&P utilization.

In 2019, we delivered a 34% total shareholder return for Phillips 66 shareholders.

Phillips 66 Partners is integral to our Midstream strategy. PSXP delivered strong operating performance, eliminated incentive distribution rights, achieved a 56% total unitholder return in 2019. Phillips 66 Partners continues to be a leading master limited partnership with a strong financial position, attractive growth opportunities and disciplined capital allocation.

## PHILLIPS 66 FOURTH QUARTER 2019 EARNINGS CALL TRANSCRIPT

We announced our AdvantEdge66 business transformation program in late 2019. AdvantEdge66 is leveraging technology to transform the way we run our operations, execute projects and make decisions. Through this program, we expect to deliver \$1.2 billion of enhancements by the end of 2021.

We are committed to strong shareholder distributions. During the year, we returned \$3.2 billion through dividends and share repurchases. In 2019, we increased the quarterly dividend 12.5% and announced a \$3 billion increase to our share repurchase program. Since 2012, we have returned \$26 billion to shareholders and reduced our initial shares outstanding by 33%.

We made significant progress on our key projects. These projects will contribute to future cash generation and create shareholder value.

Phillips 66 Partners commenced initial operations on the Gray Oak Pipeline in November, and we anticipate full service in the second quarter of 2020. The 900,000 barrel per day pipeline will transport crude oil from the Permian and the Eagle Ford to the Texas Gulf Coast, including our Sweeny Refinery. Phillips 66 Partners owns a 42.25% interest in the pipeline. Gray Oak will connect to multiple refineries and export facilities in the Corpus Christi area, including the South Texas Gateway Terminal in which PSXP has 25% ownership. The terminal will have two deepwater marine docks, 8.5 million barrels of storage capacity and up to 800,000 barrels per day of throughput capacity. The terminal is expected to start up in the third quarter of 2020.

The Liberty Pipeline will provide transportation with the growing Rockies and Bakken production areas to Cushing, Oklahoma. We own a 50% interest and will construct and operate Liberty.

The Red Oak Pipeline System will connect Cushing and the Permian Basin to multiple locations along the Gulf Coast, including Corpus Christi, Ingleside, Houston and Beaumont. We own a 50% interest and will operate Red Oak.

The Liberty and Red Oak pipelines are backed by long-term commitments, and we are targeting initial service in the first half of 2021.

We are adding three 150,000 barrel per day fractionators at the Sweeny Hub. Fracs 2 and 3 are on track to start up in the fourth quarter of 2020. Frac 4 is expected to be completed in the second quarter of 2021. The fracs are backed by long-term customer commitments. On completion of Frac 4, Sweeny Hub will have 550,000 barrels per day of fractionation capacity.

We're adding 2.2 million barrels of crude oil storage at our Beaumont Terminal to meet increased need for Gulf Coast export infrastructure. Upon completion in the first quarter of 2020, the terminal will have 16.8 million barrels of crude and product storage capacity. In addition, we are constructing a new 200,000 barrel per day dock. This project is expected to be completed in the third quarter of 2020, resulting in a total dock capacity of 800,000 barrels per day at our Beaumont Terminal.

In Chemicals, CPChem is expanding its strategic partnership with Qatar Petroleum to develop petrochemical assets in the U.S. Gulf Coast and in Qatar. Pending final investment decisions, these world-scale projects will add ethylene and high-density polyethylene capacity and advantaged feedstock locations. This further enhances CPChem's leading polyethylene position to supply the world's growing demand for polymers.

In Refining, we are upgrading one of the FCCs at the Sweeny Refinery to increase production of higher-value petrochemical products and higher-octane gasoline. The project is on track to be completed in the second quarter of 2020. The Ponca City Refinery, we're upgrading FCC to increase yields of higher-value products and to process more advantaged feedstocks. This project is expected to be completed in the fourth quarter of 2020.

## PHILLIPS 66 FOURTH QUARTER 2019 EARNINGS CALL TRANSCRIPT

We recently cancelled the renewable diesel project at our Ferndale Refinery. Permitting uncertainties were leading to project delays and increased costs, impacting the viability of this project. Our renewable diesel strategy has not changed. We continue to pursue renewable diesel opportunities that leverage our existing infrastructure, supply network and capabilities.

In Marketing, here in the fourth quarter we entered into a retail marketing joint venture with operations primarily on the U.S. West Coast. The joint venture currently operates 580 retail sites. In addition, the joint venture is expected to close on an acquisition of approximately 100 additional sites in the first half of this year. The joint venture enables increased long-term placement of our refinery production and increases our exposure to retail margins.

Our strategy and commitment to capital discipline remains steadfast. We are focused on operating excellence, project execution, maintaining financial strength, while providing strong returns to our shareholders.

With that, I'll turn the call over to Kevin to review the financials.

### **Kevin J. Mitchell:**

Thank you, Greg. Hello, everyone. Starting with an overview on Slide 4, we summarize our financial results for the year. 2019 adjusted earnings were \$3.7 billion or \$8.05 per share. We generated \$5.6 billion of operating cash flow, excluding working capital. Distributions from equity affiliates totaled \$2.1 billion, including \$831 million from CPChem. At the end of the fourth quarter, the net debt-to-capital ratio was 27%. Our adjusted after-tax return on capital employed for the year was 11%.

Slide 5 shows the change in cash during the year. We started the year with \$3 billion in cash on our balance sheet. Cash from operations was \$5.6 billion, excluding working capital. There was a working capital use of \$830 million, mainly related to an increase in receivables associated with the timing of crude oil sales at year-end. Consolidated debt increased by \$500 million due to issuances at PSXP. During the year, we funded \$3.5 billion of adjusted capital spending and returned \$3.2 billion to shareholders, including \$1.7 billion of share repurchases. Our ending cash balance was \$1.6 billion.

Slide 6 summarizes our fourth-quarter results. Adjusted earnings were \$689 million or \$1.54 per share. Operating cash flow was \$1.7 billion, including a working capital benefit of approximately \$500 million. Capital spending for the quarter was \$1.3 billion. We invested \$880 million in growth projects, including \$260 million of capital associated with the retail marketing joint venture. We returned \$810 million to shareholders through \$398 million of dividends and \$412 million of share repurchases. We ended the year with 441 million shares outstanding.

Moving to Slide 7, this slide highlights the change in pre-tax income by segment from the third quarter to the fourth quarter. During the period, adjusted earnings decreased \$713 million, driven by lower results in all segments. The fourth-quarter adjusted effective tax rate was 24%, driven by adjustments to our tax liabilities to reflect a full-year adjusted effective tax rate of 21%.

Slide 8 shows our Midstream results. Fourth-quarter adjusted pre-tax income was \$405 million, a decrease of \$35 million from the previous quarter. Transportation delivered another record quarter with adjusted pre-tax income of \$250 million, up \$2 million from the previous quarter. The increase was due to higher pipeline and terminal volumes that were mostly offset by increased planned maintenance costs. NGL and Other adjusted pre-tax income decreased \$49 million, driven by lower propane and butane trading results following a strong third quarter, as well as inventory impacts.

At the Sweeny Hub, the export facility averaged a record 13 cargoes per month, and the fractionator ran at 107% utilization.

## PHILLIPS 66 FOURTH QUARTER 2019 EARNINGS CALL TRANSCRIPT

DCP Midstream adjusted pre-tax income of \$35 million was up \$12 million from the previous quarter. The increase reflects the effect of lower depreciation and amortization following the third-quarter impairments, as well as our increased ownership of LP units following the elimination of IDRs.

Turning to Chemicals on Slide 9, fourth-quarter adjusted pre-tax income was \$173 million, down \$96 million from the third quarter. Olefins and polyolefins adjusted pre-tax income was \$154 million. The \$97 million decrease from the previous quarter is due to lower polyethylene margins and seasonally lower volumes, as well as higher turnaround and maintenance costs. Global O&P utilization was 97%. Adjusted pre-tax income for SA&S decreased \$1 million.

During the fourth quarter, we received \$143 million in cash distributions from CPChem.

Next, on Slide 10, we will cover Refining. The fourth quarter crude utilization rate was 97%, clean product yield was 84%. Both are consistent with the prior quarter.

This was a heavy turnaround quarter with \$232 million of costs, up from \$120 million in the third quarter. In addition, our share of WRB turnaround expenses amounted to \$41 million this quarter.

Refining fourth-quarter adjusted pre-tax income was \$345 million, down \$494 million from last quarter. The chart provides a regional view of the change from the prior period.

The Atlantic Basin adjusted pre-tax income decreased \$218 million due to lower gasoline cracks, as well as premium coke inventory and margin impacts.

In the Gulf Coast, the \$108 million decrease was driven by lower product margins and the Lake Charles Refinery turnaround. This was partially offset by widening Gulf Coast crude differentials.

In the Central Corridor, the decrease is due a decline in the gasoline market crack that was partially offset by widening WCS crude differentials.

In the West Coast, the decrease was driven by turnaround activity at the San Francisco Refinery.

Slide 11 covers market capture. The 3:2:1 market crack for the fourth quarter was \$12.45 per barrel, compared to \$14.60 per barrel in the third quarter. Our realized margin was \$9.50 per barrel and resulted in an overall market capture of 76%. Market capture in the previous quarter was 77%. Market capture was impacted by the configuration of our refineries. We make less gasoline and more distillate than premised in the 3:2:1 market crack. During the quarter, the distillate crack increased approximately \$1 per barrel, and the gasoline crack declined by almost \$4 per barrel. Losses from secondary products of \$2.35 per barrel increased \$1.28 per barrel from the previous quarter due to premium coke impacts, partially offset by increased butane blending into gasoline. Our feedstock advantage of \$1.02 per barrel was improved by \$0.99 per barrel from the prior quarter, as we benefited from widening WCS and Gulf Coast crude differentials. The Other category mainly includes costs associated with RINs, outgoing freight, product differentials and inventory impacts. The Other category reduced realized margins by \$0.54 per barrel.

Moving to Marketing and Specialties on Slide 12, adjusted fourth-quarter pre-tax income was \$287 million, \$211 million lower than the third quarter. Marketing and Other decreased \$203 million from lower margins, driven by less favorable market conditions and seasonality, as well as higher costs associated with a one-time true-up to a branded marketing agreement. The Marketing results included a \$62 million benefit from 2019 biodiesel blender tax credits. Specialties decreased \$8 million due to lower finished lubricants margins. We reimaged 532 domestic branded sites during the fourth quarter, bringing the total to approximately 4,200 since the start of the program. In our international Marketing business, we reimaged 82 European sites since the start of the program in early 2019.

Refined product exports in the fourth quarter were 157,000 barrels per day compared to 220,000 barrels per day in the third quarter.

## PHILLIPS 66 FOURTH QUARTER 2019 EARNINGS CALL TRANSCRIPT

On Slide 13, the Corporate and Other segment had adjusted pre-tax costs of \$211 million, an increase of \$33 million from the prior quarter. The increase is primarily due to higher environmental, net interest and employee-related expenses.

This concludes my review of the financial and operating results. Next, I'll cover a few outlook items for the first quarter and the full year.

In Chemicals, we expect the first-quarter global O&P utilization rate to be in the mid-90s. In Refining, we expect the first-quarter worldwide crude utilization rate to be about 90% and pre-tax turnaround expenses to be between \$280 million and \$330 million. We anticipate first-quarter Corporate and Other costs to come in between \$200 million and \$220 million pre-tax.

For 2020, we plan full-year turnaround expenses to be between \$630 million and \$680 million pre-tax. We expect Corporate and Other costs to be in the range of \$800 million to \$850 million pre-tax for the year. We anticipate full-year D&A of about \$1.4 billion. And finally, we expect the effective income tax rate to be in the low-20% range.

With that, we'll now open the line for questions.

**Operator:**

Thank you. We will now begin the question-and-answer session. As we open the call for questions, as a courtesy to all participants, please limit yourselves to one question and one follow-up. If you have a question, please press star, then 1 on your touch-tone phone. If you wish to be removed from the queue, please press the pound key. If you are using a speakerphone, you may need to pick up the handset first before pressing the numbers. Once again, if you have a question, please press star, then 1 on your touch-tone phone.

Phil Gresh from JP Morgan.

**Phil Gresh:**

Good morning.

**Greg C. Garland:**

Good morning, Phil.

**Phil Gresh:**

First question, just looking at the quarter here, I mean I think several of your peers, particularly in Refining, put up stronger results relative to expectations and this is obviously a tougher quarter for you guys, so I was hoping it might be possible if you could disaggregate that for us or help us understand what you think the differences there were. Obviously, the turnarounds were called out as a factor, but I'm also looking at secondary products as a pretty big headwind in the Atlantic Basin, so I'm wondering if needle coke was a factor there as well. If you could help us think through some of the moving pieces. Thanks.

**Jeff Dietert:**

As you look at the quarter, the turnaround activity was heavily focused in October, and October was actually one of the better margin environments that we had last year, and so our turnarounds were focused in that period. Margins softened substantially kind of in the back half of November, and in December. The turnaround expense, \$232 million was more than our guidance and up substantially from the \$120 million in the third quarter.

## PHILLIPS 66 FOURTH QUARTER 2019 EARNINGS CALL TRANSCRIPT

As you look at our premium coke products, there are two primary markets there, the steel industry and EV sales for batteries. Both were weak with weaker GDP and manufacturing activity impacting steel, as well as lower sales volume, or disappointing sales volumes in EVs. Both China and India had declining sales in 2019 relative to 2018.

As you know, we've extended our coke product line to serve the battery market, which has a substantially faster growth profile, and the car manufacturers are investing significantly to increase manufacturing capability, so we expect that growth to return and balance that market.

**Phil Gresh:**

Okay, thanks. Second question, just given the Chemical side of things, obviously, it seems like everybody has been getting a lot of questions here on the fundamental picture, so Greg, would love to get your latest thoughts about how you are viewing this cycle and the pace of potential recovery, and as you look ahead at the investment opportunities that you outlined in your prepared remarks, does the cycle situation right now concern you at all with respect to those possible investments moving forward? Thank you.

**Greg C. Garland:**

Hey Phil. I think first of all, we're constructive Chemicals in the medium and long term. There's no question that margins today are at cyclical troughs, at least they feel like it anyway at this point in time. I think there were a couple of tailwinds. We saw some economic slowdown globally as we came in the back half of '19. Certainly, the tariffs have had some depressing effect on global margins, whether it's \$0.05 or \$0.10 or somewhere in between, but it certainly has had an impact.

There's quite a bit of capacity coming on in '19 and also in '20 and '21, so I suspect there's going to be some headwinds in margins as we move into '20 and '21 just from the new capacity coming on globally.

If I think about how CPChem is positioned, I like their hand and how they're going to play their hand. First of all, assets in the Middle East and on the U.S. Gulf Coast are going to be advantaged from a feedstock location. And today an LPG cracker on the Gulf Coast is probably \$400 to \$500 a ton advantaged over a naphtha cracker in Asia or in Europe. So, I think that's good.

Then, as we look and kind of dissect the product portfolio, CPChem's exposure is really on the high-density polyethylene side, and so that's not going to be quite as impacted as some of the other ethylene derivatives as we look out in 2021.

Now, in terms of the FIDs for the new projects, these are five-year projects to build. We can't call the cycles that closely. We probably don't hit an FID until late 2020 or early 2021 on the first project. So we've got some time, certainly to look at it. I would say today that we would be on track to approve those projects and move forward with those projects just given what we see around the supply and demand balances for high-density polyethylene where CPChem sits in kind of that ranking of assets.

**Jeff Dietert:**

Phil, I would say when we look at the IHS full chain margin it averaged \$0.165 in the fourth quarter. December was down, slightly below \$0.15 per pound. And we've seen that rally back year-to-date to about \$0.165, back flat with the fourth-quarter average.

**Operator:**

Doug Terreson with Evercore ISI, please go ahead. Your line is open.



**Doug Terreson:**

Good morning, everybody.

**Greg C. Garland:**

Hi, Doug.

**Doug Terreson:**

Greg, over the past several years Phillips 66 has consistently posted better results than peers and especially better than the supermajors, especially in the Downstream, and it seems like AdvantEdge66 is going to sustain that performance over the medium term. My question in regard to this outlook, and specifically whether you feel that there are advantages that you have or disadvantages that you don't have that help explain performance and also how the AdvantEdge66 plan is progressing.

Then, second, what role does stronger corporate governance play into it, in your view? Meaning since you're one of only a few energy companies that benchmarks performance against diversified peers, which is obviously a higher bar for return on capital, than other energy companies. The reason that disciplined capital management would be pretty high emphasis. So, I've got two questions. One, insight into competitive advantages, progress on AdvantEdge66, and also, the role that corporate governance plays into capital management at Phillips 66.

**Greg C. Garland:**

Okay. Thanks for the question, Doug. Working backwards maybe, I think strong governance starts with a strong board of directors. We have a strong board of directors. They're fully engaged in strategy discussions. We don't have board of directors meetings at Phillips 66 where we don't talk about the strategy of the company and we don't talk about the capital allocation. So those are two topics we cover every board meeting.

I think that as we think about our methodology and our criteria and the 60/40, you know, 60% reinvested back in our company, 40% returned back to shareholders. And some flexibility around that, given the opportunities that are in front of us to invest and where our shares are trading, but over a long period of time that's where we want to be. I mean, that is all contingent upon having opportunities to invest in that exceed our hurdle rate. If you look at 2017, 2018, 2019, so the last three-year period, our return on capital employed is 13%. Our nearest refining peers are high-single digits. And by the way, that's an after-tax return on capital employed.

We're always interested in returns and if we can't find good return projects, we're simply not going to invest.

Then you think about in 2019 returning \$3.2 billion back to our shareholders through a strong, secure, growing dividend and buying our shares when they trade below intrinsic value. That's just fundamental to our capital allocation strategy, and so you'll see us continue to do that.

To your first question around the portfolio and what differentiates us, I think there's a couple of things. One, we do have a strong diversified portfolio. We've got a good portfolio of Refining assets. We've built a strong Midstream business, \$2.3 billion, \$2.4 billion of EBITDA in our Midstream business now. Really, if you go back to 2012, excluding DCP, we were about \$450 million of EBITDA in our Midstream business. We've built a significantly stronger Midstream business at Phillips 66. We've got a great Marketing and Specialties business. Then you add on top of that the Chemicals business. I like the diversification that we have across the portfolio. It creates investable opportunities for us. It's a portfolio that generates strong returns, and I would say that Phillips 66 is a great operator. We're consistently one of the safest operators in the industry. We're generally at or better than industry average on operating rates, and so we operate really well. This organization has demonstrated its ability to execute well on these capital projects.

## PHILLIPS 66 FOURTH QUARTER 2019 EARNINGS CALL TRANSCRIPT

We went back to our board and looked at all of our investments from 2012 through to the end of 2019. And we were right on the money in terms of what we said we were going to put the assets on the ground for. And importantly, we're right on the money in terms of what we promised to deliver in terms of the earnings from those assets, which is in my 40 years in the business, that's probably as good as it gets, Doug.

**Doug Terreson:**

Yes. Then also, Greg, things like the AdvantEdge66 plan will help you guys sustain this performance over the medium term. Is there anything to report there on that project or plan?

**Greg C. Garland:**

I think consistent with what we said at our Investor Day, we still see that there's \$1.2 billion of opportunity for us. We hope to drive 60%, 70% of that to the bottom line in terms of seeing that in EBITDA. So, you'll see that in terms of margin capture. You'll see that in terms of cost reduction. You'll see that in terms of capital avoidance, but also cost avoidance across the enterprise.

More importantly from that, changing the way of working for our people. At the end of the day, it's going to be a much better place to work. We're going to have better tools to make better decisions. We'll work smarter. We'll be more agile. We'll be more efficient, and I think that will differentiate from our peers.

Now, everyone is going to move this way, Doug. At some point in time, you either go digital or you die in this business. But I think we're out, at least I think, in the lead position here.

**Operator:**

Neil Mehta from Goldman Sachs, please go ahead. Your line is open.

**Neil Mehta:**

Thanks very much, guys. First question is on the crude side. Wanted to get your perspective about how you think about Western Canadian crude discounts, but also some of the barrels that you import from OPEC or from Alaska that are more medium and heavy in nature. Western Canadian differentials are wide right now. We're trying to get a sense of the sustainability of that from your perspective, and with those medium and sours, we're just trying to think about how the upcoming OPEC meeting could influence the outcomes there.

**Jeff Dietert:**

I think that's a good question. With some of the production in Canada returning from curtailment, the special production allowance rail waivers we've seen more production coming into the market in Canada. There's another 150,000 barrels a day or so of new production scheduled to start up in 2020, so there's more supply coming into the market.

That has supported wider differentials in the first quarter. As you know, we have about a 30-day lag on delivery there, so the wide discounts in December will really show up in 1Q. We expect WCS discounts to follow the normal seasonal pattern with wider winter differentials and then they get tighter in the summer as the production companies perform maintenance.

I think as we look with the new IMO environment and the wider high-sulfur fuel oil discount, we are expecting to see not only your historical transportation differentials, but probably some increased penalty for sulfur content.

On the Gulf Coast, we've moved away from a lot of imports from many of the OPEC countries. We've reduced exposure there. As you know, we don't pull anything in from Venezuela, and so I think there is less

## PHILLIPS 66 FOURTH QUARTER 2019 EARNINGS CALL TRANSCRIPT

exposure there from a direct perspective, but indirectly with more OPEC barrels eventually coming into the market, those will be heavy sour barrels which should widen the heavy sour discounts. I think also, as you look into 2020, there's more Canadian heavy barrels coming in the market. Saudi, Kuwait are bringing up production in the neutral zone, which is heavy sour production. We've got some incremental Gulf of Mexico barrels which are medium and sour. And new production in Norway is 28 API and 0.8% sulfur, so lower-quality than a normal North Sea barrel.

**Neil Mehta:**

Thanks. Just sticking with the macro, we've got the bull and the bear on IMO on the call in Jeff versus Greg, but just wanted to get both of your perspectives on how that dynamic is changing, recognizing there's a lot of other variables that are affecting—particularly the distillate side of the equation, but would love a refresh on the views there.

**Jeff Dietert:**

I'll start and Greg can clarify what I miss.

In isolation IMO is a positive factor for complex refiners like ours. Obviously, there are a number of other considerations. High-sulfur fuel oil has widened to about a \$20 discount relative to Brent. The 10-year average is \$12 a barrel, so IMO has caused some wider discounts there. It was \$30 a barrel in December, so it's come in a little bit, but if you look at the 2020 forward curve as of last year, it was trading \$20 to \$25 under Brent, so we're kind of at the low end of that range.

To the industry's credit, the transition to the low-sulfur marine fuel market has gone very smoothly. Very few compatibility issues or FONAR, fuel oil nonavailability reports. I think there will be strong enforcement. Very low-sulfur fuel oil has been rapidly adopted with its high-energy content viscosity and lubricating qualities. Very low-sulfur fuel oil is actually trading wider than ULSD in some markets.

The disappointment has been on the diesel side. And diesel has been weak following manufacturing activity that has been disappointing, recently mild winter weather. As we look at demand, the first quarter is typically the weakest quarter of the year and gasoline diesel demand decline over a million barrels a day from 4Q to 1Q.

Marine fuel, if you look at some of the major ports, Singapore, in the U.S., Houston, L.A., Long Beach, they all have seasonal trends where the first quarter is the lowest demand quarter for marine transportation. So as that demand picks up, we could see some improvement.

Then, finally, with the weakness in gasoline cracks that's pulling low-sulfur VGO out of the FCCs and into the marine fuel market. As we move into the summer weight gasoline season, that's not likely to be the case so that probably cleans up the gasoline market faster than otherwise would have been the case in the spring and provides some incremental diesel demand for the marine fuel market in the summer.

**Greg C. Garland:**

Good job, Jeff.

**Operator:**

Roger Read from Wells Fargo, please go ahead. Your line is open.

**Roger Read:**

Thanks. Good morning. Maybe just to come back to something that was talked about a little in the fall and probably becomes a bigger issue this spring and ties into that whole description of the gasoline market that on Tier 3 is there anything that you've seen where that's affecting the market, or do you have any particular

## PHILLIPS 66 FOURTH QUARTER 2019 EARNINGS CALL TRANSCRIPT

thoughts as we switch from winter grade to summer grade, and if butane comes out whether or not we'll see any impacts from Tier 3.

**Jeff Dietert:**

Yes, I think it's a good point. We are very well positioned for Tier 3. The vast majority of our tiered spending has already occurred, and so we're in good shape there. We produce much higher premium gasoline as a percent of total than the industry average.

We haven't seen octane strengthening yet, but I think like you, we're looking to the shift in our RVP and summer grade and taking cheap butane that is a good blend stock for the winter grade. We are seeing alkylate prices strengthen in anticipation of the summer. As you know, we recently completed our Lake Charles isom unit which will provide high-octane blend stocks as well, so we're looking to the summer to see evidence of the influence of Tier 3.

**Roger Read:**

Okay, great. Thanks. Changing gears completely there, Midstream side of the business, Greg, I was wondering, it seems like things have gotten tougher in the outlook for a lot of other companies in the midstream. Is there anything as you look at it where it might make more sense to be acquisitive rather than build, or do you need to see valuations and project—I shouldn't say project, but specific facilities come on the market would have to discount quite a bit from current levels to fit within your return criteria?

**Greg C. Garland:**

There's nothing today that we'd be interested in, just simply from a return criteria, Roger. I think that the nice thing, we're really well positioned, certainly for '20 and '21. We've got a great portfolio of projects that we're executing. Post '21 we'll see, and if we can find investable opportunities we'll invest; if we don't, we won't. We're not concerned at this point in time in terms of the opportunities that we have before us. We'll continue to watch what goes on in that space, but there's really nothing out there today that we would be interested in doing in the midstream space.

**Operator**

Paul Cheng from Scotiabank, please go ahead. Your line is open.

**Paul Cheng:**

Hey guys, good morning.

**Greg C. Garland:**

Hey, Paul.

**Paul Cheng:**

We have a slowdown in the export to Mexico and that. Greg, wondering that based on your marketing intelligence, is that slowdown driven by the core demand over there, is slowing down? Or what that is—I mean every year that we have the fall in Houston. We have fall but it doesn't seem like year over year that that should be an incremental factor, so trying to understand what is the dynamic we are seeing?

**Jeff Dietert:**

I think, Paul, with regard to Mexico, you remember a few quarters back there were pipelines that were shut down as people were stealing product off the pipelines. I'm not sure we fully recovered all the demand

## PHILLIPS 66 FOURTH QUARTER 2019 EARNINGS CALL TRANSCRIPT

there. I think that may have suppressed some demand in Mexico. We are seeing that as a continued good market for product exports.

I think if you look at our exports in fourth quarter, they were down a little bit and that was really driven by some of our export refineries being in maintenance and in some cases finding higher-priced domestic markets than what was available in the export market. But we expect to continue to see some growth in the Latin American market from an export perspective.

**Paul Cheng:**

Jeff, I think you guys are receiving about 300,000 barrels per day of WCS net to you. I think another 100,000 may be going to the JV partner. With the increase in the WCS production, is there any opportunity for you guys to receive more, or that is something that you guys are working on?

**Jeff Dietert:**

We're constantly assessing the availability of transportation out of Canada and our ability to access more barrels. They're attractively priced, both from a midcontinent and a Gulf Coast perspective, and so we're constantly assessing those opportunities and our commercial people take advantage of the opportunities when they present themselves.

But as far as long-term commitments for rail or something like that, we don't see that at this point.

**Operator:**

Prashant Rao with Citigroup, please go ahead. Your line is open.

**Prashant Rao:**

Thank you, good morning. Thanks for taking the question. My first one is on renewables and biofuels, I was wondering, Greg, if you could talk a bit more about the decision to cancel the Ferndale project. Apart from the permitting and regulatory hurdles, I mean what you said in your prepared remarks, were there any constraints on feedstock sourcing or developing that network and then maybe taking a bigger picture view on the other projects in the portfolio? San Francisco, Humber and the offtake in Marketing in Nevada, could you help us understand how these differ from Ferndale? Not only in terms of the regulatory and permitting, but maybe also in terms of the feedstock resourcing?

**Greg C. Garland:**

First of all, it wasn't a feedstock sourcing concern that we had at Ferndale. It was strictly around the ability to permit the project there, and so we withdrew.

When you think about what we're doing at Humber, what we're doing in San Francisco, these are existing assets that we're either repurposing or utilizing differently, and those are certainly very easy to do, easy to feedstock source. And we'll continue to look for other opportunities in our portfolio.

The deal with Ryze is essentially we're responsible for securing the feedstock and then we have an offtake agreement there, so think of it like a tolling arrangement. And we have no concerns there.

As we thought about how we're going to approach the renewable strategy for us, we wanted to use existing assets where we could do that. We wanted to partner with people that had existing technology and capabilities and then look at grassroots investments, again in a partnership, which is where the Ferndale one really fell. That would have been a circa \$800 million to a \$1 billion investment in cooperation with REG, so we'll see.

## PHILLIPS 66 FOURTH QUARTER 2019 EARNINGS CALL TRANSCRIPT

I think we certainly have other places that we could build a grassroots facility and you should expect that our strategy really hasn't changed; it just may not be at the Ferndale location.

**Prashant Rao:**

Okay, thank you. That's helpful. Then my second question is on ESG. The discussion seems to be progressing pretty quickly overseas and a focus on decarbonization is really stronger than it was even a year ago. It seems like the discussion here in the States may be following a similar path but perhaps at a delay to what's going on overseas. P66 has been a leader in positive ESG momentum within the U.S. hydrocarbon space, so I just wanted to get your thoughts on looking ahead. If there is a greater focus on decarbonization among investors, what are some of the strategies to balance this and still maintaining P66's strong return on capital and your low cost of capital across the portfolio? Particularly as you think about growth cap ex decisions, both what's to come and in the portfolio maybe overall the longer-term opportunity set.

**Greg C. Garland:**

I think maybe you want to start with I think the U.S. is a world leader in technology and innovation. Our economy is the envy of the rest of the world. We're a world leader in energy production. We're a world leader in emissions reductions, including greenhouse gas emissions. And so I think that there is a path forward that would say we can develop our energy resources responsibly, sustainably. We can have a strong growing economy and we can have a better environment. So they're not mutually exclusive at all in our way of thinking.

As we think about the opportunity set in front of us, we're investing in next generation technologies for a lower-carbon economy. So things like our OPV, organic photovoltaic, our solid oxide fuel cells. You've seen us introduce two lubes; one for heavy duty trucks, one for light duty vehicles that increase the mileage by 4% or 5%. That's a direct reduction of greenhouse gas emissions.

I think that you'll see Phillips 66 and many companies, frankly, approach this problem from many different angles.

Specifically, around low-carbon investments, I think it's a good thing. I think we should encourage our companies to invest in low-carbon technologies, and we should incent them to do that, but as we look out two and three decades we still see that fossil fuels are going to be a majority part of the energy mix just because you're not going to be able to get there from here with the current technologies that we see.

**Operator:**

Doug Leggate from Bank of America Merrill Lynch, please go ahead. Your line is open.

**Doug Leggate:**

Hi. Good morning, everybody. Greg, I wonder if I could take you back to Midstream again. You did a pretty thorough job of walking us through the assets that you have coming online and your working interests and so on. I'm just curious about what is the thinking in terms of the timing, if and when those may be dropped to the MLP. Or do you have different plans for those versus your historical pattern?

**Greg C. Garland:**

Well, maybe we can start from the point that all those Midstream assets are qualifying income, and they could certainly go to the MLP. We've resisted and will continue to resist specific information about timing of drops and when those drops could occur. I think we've spoken publicly about our interest in growing our Midstream business at PSXP. It's an efficient way for us to do that given where PSXP trades and the yields that it generates. And then you think about the uplift in sum of the parts. We're still incented to grow PSXP as fast as we can and so our view is that you grow it efficiently, but it's got to pay its own way, too. Equity

## PHILLIPS 66 FOURTH QUARTER 2019 EARNINGS CALL TRANSCRIPT

markets are closed, in our view, beyond some dribs and drabs around the ATM program. But generally a great balance sheet at PSXP, executing an \$800 million plus capital program this year at PSXP.

So, you know, at some point in the future you should expect these assets should logically end up at PSXP, but the timing, we just don't go through that, Doug.

**Doug Leggate:**

Okay. Just a reminder, can you tell me what the EBITDA is associated with those assets held at the C-Corp level?

**Greg C. Garland:**

We've got \$800 million to \$900 million of EBITDA still at PSX and growing, of course, as we're bringing on these new projects, too.

**Doug Leggate:**

That's the qualifying income, right?

**Greg C. Garland:**

That's right.

**Doug Leggate:**

Okay, thanks. My follow-up is just very quickly on turnarounds. Obviously, your turnaround expense is up a bit this year. Not just for Phillips specifically, but also for the industry. I think Jeff touched on this a little bit, but do you anticipate that we're going to see that contributing to clean up of the overhang we've seen for gasoline in particular right now? And just specific to Phillips, is there anything unusual this year or is this normal of business?

**Jeff Dietert:**

I think that's a good question, Doug. I think there was speculation given the high turnaround activity in 2019 that there was activity that had been moved forward out of '20 into 2019. And a lot of the turnaround activity is on a pretty strict schedule for replacement. And so we are seeing 2020 turnaround activity being relatively high for the industry as well. You look at the Gulf Coast, PADD 3 looks to be a very active turnaround season this spring with a lot of FCC and alkylation units being included in that planned work. We're continuing to see turnaround activity in 2020 as well. I think that's one of the factors that could help clean up the gasoline market.

**Operator:**

Paul Sankey from Mizuho. Please go ahead, your line is open.

**Paul Sankey:**

Hi, everyone. Sorry for the detail question but as regards to the situation in China, I was wondering in reference to your contracts and how it takes time for these things to feed through, when do you think you'll be able to say with some degree of certainty what's actually happening to markets over there? Thanks.



**Jeff Dietert:**

It's a good question, Paul. I think it's still early. I mean we are seeing some impact on diesel demand - diesel cracks, jet cracks. We are starting to see some impact on freight rates. It's really early. It's a little bit speculative to say that, but I think we are getting some indication of impact already. It's really hard to measure, and I think it's going to be difficult to determine the depth and the duration of this event. I think there's still a huge amount of uncertainty out there.

As you well know, there was about 300,000 barrels a day of impact from SARS. In fact, you've included it in one of your reports. China's economy is much bigger today, than it was at that time. We're still dealing with a lot of uncertainty as to the impact of the coronavirus.

**Greg C. Garland:**

I think we're also—Paul, I was just going to say in petrochemicals the same thing, right? I think we're concerned, and we'll continue to watch petrochemicals. Right now, pricing is kind of moving up a little bit in Asia. When you look at petrochemical inventories, they're at five-year lows though, and so we'll just have to see and watch this. But I agree with Jeff, it's just almost too early to make a call on this. But it certainly has our attention and we're watching it closely.

**Paul Sankey:**

Understood. I mean obviously this thing really only took off in the past week. I just wondered how long you thought it would be before you could actually say we now know that this has happened, given the time it takes for all this stuff to move around the world.

**Jeff Dietert:**

It's certainly impacting commodity markets. The volumes we'll have to keep an eye on.

**Paul Sankey:**

I was thinking more in terms of real volumes.

If I could switch. You had a tough October in many ways because it was a good environment, and you had downtime. Do you have a sense for what your lost opportunity was? That your opportunity cost was there? And could you just go over again, the outlook for this year in terms of your turnarounds? I know you've addressed it somewhat, but it's interesting to think how skewed this quarter might have been if it hadn't been for the October turnaround. Thanks.

**Jeff Dietert:**

It's a good point. We don't typically comment on LPOs, but I think if you assume most of the downtime occurred in October and adjust. And kind of model October versus November versus December, I think it would get you close.

We have provided guidance on turnaround activity. First quarter, we do have some turnaround activity planned as well and we've got the full year guidance there also, so I might just lean to that guidance.

**Operator:**

Manav Gupta from Credit Suisse, please go ahead. Your line is open.



**Manav Gupta:**

Hi. Jeff, can you clarify where you are with the permitting process of both Red Oak and Liberty? Liberty specifically because there were some news items out there, and I was hoping you could set the record straight over there?

**Jeff Dietert:**

Yes, we're moving forward. We're getting some feedback there. Is that...

I'll go ahead here.

We've ordered the pipe for Liberty and taken delivery of the pipe. The permitting process is moving forward as expected, and so we're very much moving forward as anticipated there. It's a first half 2021 in-service date and all systems are go on both Liberty as well as Red Oak.

**Manav Gupta:**

A quick follow-up on the Marketing and Specialties side. We saw a slight jump in the cap ex between 3Q and 4Q, about \$264 million. I'm assuming this is associated with the JV payment of the West Coast thing. The press release is saying you are going to acquire 100 more stores in 1Q in 2020. So I'm trying to understand will there be a second payment associated with these 100 stores, or all the payment has already been made here?

**Kevin J. Mitchell:**

Manav, it's Kevin. Yes, you're right. The variance in cap ex for that segment is all attributable to the formation of that joint venture, so \$260 million went in, which is almost the full variance quarter over quarter. The additional acquisition that was referred to in the press release does have some additional spend whenever that timing, whenever that acquisition closes. There will be some additional spend on that. It's not of the same magnitude as the initial upfront JV formation though. You'll see that coming through whenever that closes.

**Operator:**

Matthew Blair from Tudor, Pickering, Holt, please go ahead. Your line is open.

**Matthew Blair:**

Hey, good morning, everyone. Given the discounted high-sulfur fuel oil prices in the fourth quarter, were you able to increase your runs of HSFO as a feedstock in your refineries? If so, can you provide any sort of numbers on the incremental volumes or EBITDA uplift? I guess if not, was the constraint economic or more just like equipment related?

**Jeff Dietert:**

It's a good question, Matthew. I would highlight one of the things we talked about at the Investor Day was some refining projects that allow us to upgrade over 30,000 barrels a day of high-sulfur fuel oil to very low sulfur, sub 0.5% blend stock. We accomplished that late last year and think there's actually some upside to those volumes, so we are moving some very low-sulfur product into the market.

We are finding opportunities to take advantage of dislocations associated with IMO. Not only on the high-sulfur fuel oil side, but we've been able to increase the sales of low sulfur production into the market to capture some of the premiums on low sulfur material. We've also been able to bring high-sulfur material in

## PHILLIPS 66 FOURTH QUARTER 2019 EARNINGS CALL TRANSCRIPT

as a feedstock for our processing units. As you know, we have substantial coking and treating capacity to upgrade heavy sour streams.

Look in our supplemental information. We provide both our crude throughput, as well as our total processed volumes, and the difference there would probably give you a good indication on intermediate feedstocks and a lot of those being heavy sour product.

**Matthew Blair:**

Great. Thanks for the color.

Then on the Chem side, Greg, I was hoping you could share some insights on just the Asia PE market. We've seen margins dip negative for a little bit now; haven't really seen shutdowns. Are those coming, in your opinion? I guess, do other regions need to cut back first?

**Greg C. Garland:**

I think our view is that probably Asia and Europe are probably under the most pressure today, and you would expect there could be some cuts there. Also, you're starting to see some price movement in Asia, though, so I think that's a sign that people need to do something about the margin environment they find themselves in.

I would just say tariffs are still kind of an overhang, particularly to China, and so we'll see where all of that plays out.

But yes, I think it's a pretty tough margin environment out there right now.

**Operator:**

Thank you. We have now reached the time limit available for questions. I will now turn the call back over to Jeff.

**Jeff Dietert:**

Thank you very much for your interest in Phillips 66. If you have any follow-up questions, please contact Brent or me. Thank you.

**Operator:**

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