

REFINITIV STREETEVENETS

# EDITED TRANSCRIPT

PSX.N - Q4 2024 Phillips 66 Earnings Call

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## OVERVIEW:

Company Summary

## CORPORATE PARTICIPANTS

**Jeff Dietert Dietert** Phillips 66 - Vice President of Investor Relations

**Mark Lashier** Phillips 66 - Chairman of the Board, President, Chief Executive Officer

**Kevin Mitchell** Phillips 66 - Chief Financial Officer, Executive Vice President

**Donald Baldrige** Phillips 66 - Executive Vice President of Midstream & Chemicals

**Brian Mandell** Phillips 66 - Executive Vice President of Marketing & Commercial

**Richard Harbison** Phillips 66 - Senior Vice President - Refining

## CONFERENCE CALL PARTICIPANTS

**Neil Mehta** Goldman Sachs Group, Inc. - Analyst

**Douglas Leggate** Wolfe Research. - Analyst

**Theresa Chen** Barclays Bank - Analyst

**Manav Gupta** UBS Investment Bank - Analyst

**Jean Ann Salisbury** BofA Securities - Analyst

**Roger Read** Wells Fargo Securities - Analyst

**John Royall** JPMorgan Chase & Co - Analyst

**Jason Gabelman** TD Cowen - Analyst

**Matthew Blair** Tudor, Pickering, Holt & Co. Securities - Analyst

**Paul Cheng** Scotiabank Global Banking and Markets - Analyst

**Ryan Todd** Piper Sandler & Co. - Analyst

## PRESENTATION

### Operator

Welcome to the fourth quarter 2024 Phillips 66 earnings conference call. My name is Emily, and I will be your operator for today's call. (Operator Instructions). Please note that this conference is being recorded. I will now turn the call over to Jeffrey Dietert. Jeff, you may begin.

### Jeff Dietert Dietert - Phillips 66 - Vice President of Investor Relations

Welcome to Phillips 66 earnings conference call. Participants on today's call will include Mark Lashier, Chairman and CEO; Kevin Mitchell, CFO; Don Baldrige, Midstream and Chemicals; Rich Harbison, Refining and Brian Mandell, Marketing and Commercial.

Today's presentation can be found on the Investor Relations section on the Phillips 66 website, along with supplemental financial and operating information. Slide 2 contains our Safe Harbor statement. We will be making forward-looking statements during today's call. Actual results may differ materially from today's comments. Factors that could cause actual results to differ, they are included here as well as in our SEC filings. With that, I'll turn the call over to Mark.

**Mark Lashier** - Phillips 66 - Chairman of the Board, President, Chief Executive Officer

Thanks, Jeff. Our results reflect strong operating performance in a challenging margin environment. The strength and stability of our Midstream results provided a resilient platform, demonstrating the advantages of the breadth of our integrated portfolio. In the fourth quarter, we achieved our shareholder distribution target with \$13.6 billion distributed through share repurchases and dividends since July 2022.

In Refining, we set goals to improve performance, lower cost and capture more of the Market. This year was our second consecutive year of above industry average crude utilization. We also set record clean product yields both this quarter and for the full year, while reducing our costs by \$1 per barrel. These results are a testament to the hard work, commitment and dedication to excellence by the people in [Rich's] organization.

We exceeded our \$400 million synergy target on the DCP Midstream acquisition by capturing \$500 million of run rate synergies. In total for DCP transaction has increased Midstream's mid-cycle adjusted EBITDA by \$1.5 billion. We set an ambitious goal of \$1.4 billion in run rate business transformation savings. We positioned the company for success through these cost reductions and exceeded our goal, achieving \$1.5 billion of savings.

As part of the enhanced priorities in 2023, we committed to at least \$3 billion of non-core asset dispositions. We have high graded the portfolio and are currently at \$3.5 billion of announced asset divestitures. Although our net debt to capital ratio ended higher than our target level, we continue to have a strong balance sheet, and we are making debt reduction a key component of our new commitments.

We've completed the strategic priorities that we laid out in 2022, enhanced in 2023 and committed to achieving by the end of 2024. I am proud of the work our employees have done to accomplish these important priorities and deliver on our commitments to shareholders while maintaining industry leading safety performance.

Slide 4 shows the progress of the asset disposition program. In January 2025, we received \$2.1 billion of cash proceeds for the Coop and Gulf Coast Express dispositions. This brings the cash proceeds to \$3.5 billion which we're using to advance our new strategic priorities. We continue to evaluate our assets as part of our ongoing portfolio optimization.

Slide 5 shows the growth of our Midstream business including the recent announcement of the Epic NGL transaction. We've advanced our well head to Market strategy through organic projects and strategic transactions that provided significant synergies and strong returns. This nearly doubles EBITDA between 2021 and the anticipated transaction close later this year.

Similar to the Pinnacle acquisition last year, we saw an opportunity to acquire high quality assets which are complementary to our existing footprint and provide a platform for further growth opportunities at attractive returns. The transaction furthers our vision of being the leading integrated downstream energy provider and upon closing increases Midstream's midcycle adjusted EBITDA to \$4 billion. We'll continue to capitalize on our growth platform to generate strong returns and significant free cash flow in 2025 and beyond.

Slide 6 outlines our new strategic priorities for 2025 through 2027. Supported by our world class operations, we are committed to returning over 50% of operating cash flow to shareholders. We've set challenging yet achievable operational targets for our refining and Midstream businesses. We have developed a culture of continuous improvement in refining and are targeting \$5.50 per barrel adjusted controllable cost excluding turnarounds over the next two years.

We will grow Midstream and Chemicals mid cycle adjusted EBITDA by an additional \$1 billion in total by 2027. In Midstream, we have plans in place to continue to expand our well head to Market strategy with high return opportunities. In Chemicals, the mega projects in the US Gulf Coast and Qatar are expected to start up in late 2026. These milestones are expected to bring our non-refining mid cycle EBITDA to \$10 billion by 2027 which we expect will represent two-thirds of our total company EBITDA.

We also plan to reduce total debt to \$17 billion as early as the end of this year depending on the margin environment and the timing of planned dispositions. We will continue to increase shareholder value through strong operating performance and disciplined capital allocation as we deliver on our new strategic priorities. Now over to Kevin to cover our quarterly results.

**Kevin Mitchell** - Phillips 66 - Chief Financial Officer, Executive Vice President

Thank you, Mark. Reported earnings were \$8 million or \$0.01 per share. The adjusted loss was \$61 million or \$0.15 per share. Both the reported earnings and adjusted loss include the \$230 million pre-tax impact of accelerated depreciation due to our plan to cease operations at the Los Angeles refinery at the end of 2025. This reduced earnings per share by \$0.43. We generated operating cash flow of \$1.2 billion and returned \$1.1 billion to shareholders including \$647 million of share repurchases.

I will now move to slide 8 to cover the segment results. Total company adjusted earnings decreased \$920 million compared with the prior quarter. Midstream results increased mostly due to record fractionation and LPG export volumes in addition to higher margins on LPG exports. In Chemicals, results decreased mainly due to lower polyethylene chain margins and higher costs related to turnarounds and maintenance.

Lower refining results primarily reflect weaker crack spreads and a full quarter of accelerated depreciation for the Los Angeles refinery. Capture of the new Market indicator was 105%. The increase in Market capture was partly the result of record clean product yield for the quarter, which included the benefits of butane blending.

Marketing and specialties results were mostly lower due to seasonally lower margins. In renewable fuels results increased due to higher margins at the Rodeo complex as well as stronger international results.

Slide 9 shows the change in cash flow for the fourth quarter. Cash from operations excluding working capital was \$901 million. There was a working capital benefit of \$297 million mainly reflecting a reduction in inventories.

We returned \$1.1 billion to shareholders through share repurchases and dividends and we funded \$506 million of capital spending. Our ending cash balance was \$1.7 billion. Looking ahead to the first quarter of 2025, in Chemicals, we expect the global O&P utilization rate to be in the mid 90s. In Refining, we have a heavy turnaround quarter and expect the worldwide crude utilization rate to be in the low 80s and turnaround expense to be between \$290 million and \$310 million.

We anticipate corporate and other costs to be between \$310 million and \$330 million. For the full year, we expect turnaround expenses to be between \$500 million and \$550 million. Depreciation and amortization will be approximately \$3.3 billion. This includes \$230 million per quarter of accelerated depreciation at the Los Angeles refinery.

Now we will open the line for questions after which Mark will wrap up the call.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions)

Neil Mehta, Goldman Sachs.

**Neil Mehta** - Goldman Sachs Group, Inc. - Analyst

Thank you. Good morning, Mark and team. I want to kick off on the Midstream transformation. It does feel that the business is evolving to where Midstream is becoming a major focus and a much more important part of the business and want your perspective on what's the extent that is true. What's the best way to get there? To get there organically or to get there through M&A and how fast can this business grow? Any parameters around that would be helpful?

**Mark Lashier** - Phillips 66 - Chairman of the Board, President, Chief Executive Officer

Yeah, good morning, Neil. Thanks for your question. I'll talk about the high-level view and then Don can dive into the details. But you know, several years ago, we rolled up DCP, got control of those assets to align with the wholly owned assets that Phillips 66 had with fractionation capacity. And that allowed us to consolidate into a full well head to Market strategy that we've been talking about.

But we knew that we had opportunities to fill out that strategy and to really leverage that position. And that's what you've been seeing both from an organic perspective and inorganic perspective. And as you look at the inorganic things that we've done the acquisitions, we've done, they've been very focused on getting the right assets for the right value that could be accretive to us immediately based on the inorganic piece.

But allow us to also have a footprint to grow organically and to capture more of the volumes coming out of the Permian. So both the Pinnacle and Epic acquisitions really are prime examples of that. So we believe there are opportunities to do both, but I'll let Don dive into more of the details.

**Donald Baldrige** - Phillips 66 - Executive Vice President of Midstream & Chemicals

Sure. Neil, I think what you see is, we put together a Midstream platform now, an NGL value chain that we believe we can grow organically at a mid-single digits growth rate on an annual basis. That's what you see in the slide deck here growing to \$500 million of EBITDA and being able to do that because we have clear line of sight to organic growth opportunities that we can execute within our \$2 billion annual capital program.

So I think it's really a testament to the strength of the platform that we have. Certainly, from an acquisition standpoint, if there are opportunities that make sense, that are attractive from a strategic standpoint and evaluation, we'll take a hard look at it. But our growth program here is premised on executing return, enhancing organic opportunities within our footprint and not dependent on or require future M&A activity.

**Mark Lashier** - Phillips 66 - Chairman of the Board, President, Chief Executive Officer

Yeah, Neil, as you saw in our strategic parties that we laid out. Everything that we do, whether it's in Refining or in Midstream, we're focused on enhancing the return on capital employed in each of those businesses as we make these capital allocation choices. So we're very returns focused and value focused.

**Neil Mehta** - Goldman Sachs Group, Inc. - Analyst

That's very helpful. And then the follow up is just as Midstream becomes a bigger part of the business, how do you think about the optimal capital structure? You provide new disclosure today about being less than three times net debt to Midstream and Marketing. So why is that the right number? And there's an argument that the business can run a little bit more levered as it has more fee-based earnings.

**Kevin Mitchell** - Phillips 66 - Chief Financial Officer, Executive Vice President

Yeah, Neil, it's Kevin. I mean, you're exactly right. Bow as you will recall, we had objectives to reduce leverage over the course of last year, which we were not able to deliver on partly because we lean pretty heavy into cash returns to shareholders. And so, while we have set a target of a getting the debt balance back to \$17 billion in a sub 30% debt to cap level, we also like to think of the balance sheet almost on a sum of the parts basis.

And so the Midstream and M&S segments bring the more stable earnings and cash generation approximately \$6 billion at midcycle and at a three times or maybe even less than three times debt level, we can think of ourselves as having a strong balance sheet in the context of those two segments. Net zero for the refining business. So in effect, the refining cash flows are all upside in the context of how you look at us, look at the company from a balance sheet standpoint.

**Operator**

Doug Leggate, Wolfe Research.

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**Douglas Leggate** - Wolfe Research. - Analyst

Thank you. I appreciate the chance to ask your question guys. Thanks so much. Mark, I don't want to put words in your mouth, I think I heard you say something along the lines of our new disposal targets. I don't think I actually heard of this new disposal target. So I realize you hit a lot of your targets early for 2025. But what is the scope of the scale? And I guess the way I heard it was you know, drop your debt and \$17 billion clearly with additional disposals. And I wanted to ask specifically about where you are with the rest of the retail system in Europe. That's my first question.

My follow up is really a follow up to Neils. We hear this a lot about the embedded value in so specifically around the Midstream and where the Midstream companies are trading. And obviously Epic is a terrific bolt on. But do you ever see a situation where Midstream is somehow separated or as a standalone business? I know it's a bit of a curveball question, but just in terms of the scale, the importance and maybe the failure of the market to recognize the value in your structure versus what you see for the standalone Midstream players.

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**Mark Lashier** - Phillips 66 - Chairman of the Board, President, Chief Executive Officer

And thanks for your questions, Douglas. Mark. On dispositions, we did not put another target out there. I think that we achieved our targets with what we've actually closed and received the cash for to date. We still have things that we're working on out there and one of them is the retail opportunity in Europe, in Austria and Germany and that we're still in active discussions there. We think we can strike a deal around that. But we found it a little bit counterproductive to put firm numbers out there when you're out negotiating these deals.

We will always be looking at our portfolio to determine if we've got assets that have higher value to others. And sometimes we get inbound calls that people want to talk about things, and we will entertain those calls as well. But it's always about value creation, how we can unlock value of what we view as trapped capital in some assets and redeploy those proceeds into our strategic priorities, whether it's returning it to shareholders, augmenting our balance sheet or investing in our businesses.

And so we're going to be doing that ongoing, but you're not going to see firm targets put out there, which it's -- you can think about it as continuous improvement in our portfolio just like we're focused on continuous improvement in our operations.

And then from the embedded value of Midstream, we agree that that we're not seeing the full value of the things that we've done in Midstream, but we're really just getting started. I think that there's since our Epic acquisition, we've gotten a great response from the market. Good questions, understanding people are showing some interest and excitement around that. We've got some great long only in our shares because of what we're doing in Midstream.

So we think that, that story is still evolving and we're going to lean into that story going forward. You know, there's always a question when you have an integrated business like we do, is it better to separate those businesses somehow? We believe we can create more shareholder value by keeping the Midstream business integrated with our refining and our NGO Midstream business out to the petrochemical businesses. And you'll hear more about that as we move on through the year.

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**Kevin Mitchell** - Phillips 66 - Chief Financial Officer, Executive Vice President

Doug, it's Kevin just to add on to Mark's comments. If part of the question was more around, would we create a vehicle that has a public marker on it? Not a complete separation but helps provide some additional evaluation. We went down that path before. That's a major decision to make and over time you look back over history. There are times where we've traded it for some of the parts. There have been times where we haven't, and we feel we're probably in that phase right now. And I don't think that's the immediate response to that.

I think as the way Mark described it really leaning in and providing the appropriate messaging and the investor disclosures around the Midstream business, the integration value that comes from the value, the two primary value chains that we have and focus on that this point in time. That what you suggested is that option is always there. And so we would never say never, but it's not going to be the near term plan.

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**Douglas Leggate** - Wolfe Research. - Analyst

I appreciate it. If I may, I risk a quick follow up at the risk of jets last year. But the example obviously I was thinking about was [Zempi LX] because clearly there's a marker there. But I take your point. My follow up really quick Mark is just remind us what the EBITDA is on the German, Austria business because we can all put multiple on that, I guess.

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**Kevin Mitchell** - Phillips 66 - Chief Financial Officer, Executive Vice President

Yeah, it's about 300 million.

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**Douglas Leggate** - Wolfe Research. - Analyst

Great, thanks so much.

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**Operator**

Theresa Chen, Barclays.

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**Theresa Chen** - Barclays Bank - Analyst

Hi. Thank you for taking my questions. First on the leverage update, can you think about, can you help us think about the path forward to achieve the below 30% net debt to capital? What time frame would you expect to get to that? And are future [SSL] including the German, Austrian assets earmarked for that? How should we think about the path forward there?

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**Kevin Mitchell** - Phillips 66 - Chief Financial Officer, Executive Vice President

Yeah, Teresa. The path forward to the sub 30%. And I think you look at the absolute \$17 billion debt level in the same way because, one, I'm not saying that one will definitely enable the other, but they won't be too far apart in that context. And in fact, there's a kind of neat symmetry between all of those metrics that we put out the \$17 billion, less than 30% and the less than 3x Midstream and M&S EBITDA, all kind of come together reasonably well.

But it's really a combination of -- if you look at our capital allocation model with 50% plus distributed to shareholders. So dividend plus buybacks, our sustaining capital is a \$1 billion. The organic capital program is a \$1 billion. And if you do the math based on a mid cycle set of assumptions, and I know we're not in mid cycle right now, but on mid cycle, you've got about \$10 billion of cash generation and so \$5 billion goes to shareholders. That's the 50%, \$2 billion of capital budget. So that's \$7 billion, at least \$3 billion. That's a lot of flexibility to either do debt reduction, incremental buybacks and/or bolt on acquisitions that make sense, like some of the things you've seen us do.

In addition, we are still working on the Germany, Austria retail business. And so there's a fair amount of flexibility there in terms of how we get there. So we feel pretty comfortable that those targets are all achievable, including our ongoing commitment to returning cash to shareholders.

**Theresa Chen** - Barclays Bank - Analyst

Thank you. And then going back to the topic of additional Midstream growth. When thinking about other M&A opportunities here, totally understanding Don's comments about doing what's right from both a strategic and economic perspective. When we think about the Midstream assets that have been in the market, there are some that seem more obvious acquisition candidates for you, considering potential synergies in both Permian and DJ.

And then coupling that with who the bigger shippers on both Sand Hills and Epic as well as the visible need for incremental Permian processing. Is FTC also a major concern here. Do you think that would preclude some of the more obvious opportunities along your mystery footprint?

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**Mark Lashier** - Phillips 66 - Chairman of the Board, President, Chief Executive Officer

Yes. Theresa, I think that obviously, we always have to take FTC considerations into play, but I don't think that's necessarily what would have us shy away from looking at any particular assets. But we do take into consideration a broad range of assets that are out there, and we focus on what provides us the greatest value creation opportunity.

And we know intimately how easy it is to connect those assets to our system, what it does from a G&P perspective, what it does from a transportation perspective. And quite importantly, what additional opportunities does it open up for us to grow organically? Because we really see the upside in returns in going in and building things at a low build multiple and realizing that full uptick while adding inorganically things at attractive pricing that also are accretive to our returns and our earnings.

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**Donald Baldrige** - Phillips 66 - Executive Vice President of Midstream & Chemicals

Yes, I'll just add, Theresa. I think along the lines of that value creation, just the M&A -- our M&A lens will really be focused on what is opportunities that we see that are scalable that really enhance our platform. And that's really what drives our thought process, not an FTC lens. It's just that's well down the path as we evaluate opportunities.

But again, I think I'd go back to -- we just see a lot of organic opportunities within our footprint. And so we're very focused on executing those and growing our business that way, first and foremost.

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**Mark Lashier** - Phillips 66 - Chairman of the Board, President, Chief Executive Officer

Yes. We recognize our capital constraints. We're not going to grow Midstream just to grow Midstream, just to get bigger. We're going to grow Midstream to create more value for our shareholders, and we're very disciplined around that. We've got capital constraints, and we're going to be very picky about what we do.

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**Operator**

Manav Gupta, UBS.

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**Manav Gupta** - UBS Investment Bank - Analyst

Switching gears a little. We saw relatively weaker ethylene chain margins here, and I know it's a seasonally weaker quarter. I'm just trying to understand, in management's opinion, when can we start moving towards -- closer to the mid-cycle margins as it relates to the [ethane] chain margins and chemicals?

**Mark Lashier** - Phillips 66 - Chairman of the Board, President, Chief Executive Officer

Yes, Manav, that's a great question. I think in the fourth quarter, CPCChem saw a couple of things going on in their chain margin. Of course, ethane pricing strengthened, crude pricing weakened, which they've got a great advantage with their ethane position. But when both of those things happen, I think their impact will show up.

I think in the longer term, the macro is supportive. Demand continues to grow. You're seeing rationalizations in Europe. You're seeing temporary shutdowns in Europe. I think this year, North American producers had record exports that tells you about the strength of our economics here in North America versus other locations in the world. I think for the first time ever, more than half of the polyethylene producer in North America was exported into the world market.

So they're playing to CPCChem strengths in the midterm and long term. You can see that in their operating rates. And we see continued margin improvement. And actually, it's good and healthy that you see slow -- recovery slow climb out. And we see that continuing this year into next year. really on through 2026. And then their new assets will be stepping right into pretty healthy margins by the end of 2026.

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**Manav Gupta** - UBS Investment Bank - Analyst

Perfect. My quick follow-up here is a very big improvement in renewable fuels, congratulations, breaking even. Help us understand quarter-over-quarter, some of the dynamics that went your way, which allowed you to almost raise earnings in renewable, feels, by like \$150 million.

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**Brian Mandell** - Phillips 66 - Executive Vice President of Marketing & Commercial

Manav, this is Brian. We'll start off by saying, yes, we did \$28 million in the quarter. We're happy with that as a start. We ran well in the quarter. We continued to lower our cost profile. As we discussed last earnings call, we processed a higher CI feed in the quarter as we ran off less valuable feedstock prior to the implementation of the BTC credit.

Additionally, because of the higher CI material, we didn't produce renewable jet fuel for the quarter. We did announce in Q4 a deal to sell United Airlines up to 8 million gallons of SAF. And we've secured a couple of more contracts in Q1 to supply SAF to airlines.

But just thinking about looking forward at renewable diesel margins, we anticipate continued weakness, mostly on the regulatory uncertainty that keeps the market on somewhat weak footing. We'll need to have additional clarity on a number of factors affecting renewable margins, including the PTC, the RVO, LCFS rules, tariffs, renewable, or small refinery exemptions, just to name a few.

So we'll continue to manage our flexible system. We buy a lot of feedstock. We buy more feedstock than our system needs. And so we can move those net feedstock around and manage the optionality in the system. But we'll continue to use the LP at the refinery to provide the most favoured renewable feedstock.

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**Operator**

Jean Ann Salisbury, Bank of America.

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**Jean Ann Salisbury** - BofA Securities - Analyst

I wanted to follow up on Theresa's question about the Epic acquisition. I think most midstream investors I talked to were a little surprised by the moves to add more NGL pipeline capacity without getting more processing to fill those pipelines. Given that you were already kind of under-indexed to processing before the deal compared to peers, I know the pipes are contracted medium term but does this put pressure on you to get more processing either organically or inorganically in the next few years as those contracts start to roll off?

**Donald Baldrige** - Phillips 66 - Executive Vice President of Midstream & Chemicals

Jean Ann, this is Don. As you heard from Mark, the Epic acquisition is very compelling to us and for a variety of reasons. But to kind of unpack and address your question regarding kind of capacity and supply, because it's certainly a question we've had a couple of times, but I'll focus on this one key attribute.

And that is that Epic provides us and brings us needed Permian pipeline capacity. That is already an expansion program that is very capital-efficient, cost-effective. And we see that as being very important to us. And the reason that is, is right now, our supply portfolio runs at about 125% of our Sand Hills capacity. So that means we move a lot of product on third-party pipelines.

And if you kind of look through '25 and out the years, that supply level will continue to grow this year as well as next as we bring on our expansion plant at Pinnacle in July of '25, as we bring on a third-party plant that's dedicated to us. I'd also expect that we'll be in a position to announce expansion of another plant in the Permian later this year.

And so when you think about all of that supply coming on, it really combines very well and fits very well with the Epic capacity. We'll be able to move product off the third-party pipelines. As our G&P volumes grow, we'll be able to fill in the expansion capacity that comes online at the end of '26 with Epic.

So it really gives us room to continue to grow our G&P footprint. So that's what's quite exciting. So for us, Epic is really the right size and the right time from an expansion and capacity standpoint. It fits really well with our existing assets. We're already highly connected in a lot of spots with them. So when you think about integration and synergies, it's a very straightforward approach with really minimal integration costs to achieve.

So very excited to bring this in, allow us to continue to grow our supply, pull supply of third-party lines and put it all in our system, provide really good service to the Gulf Coast for our shippers and our producers.

**Operator**

Roger Read, Wells Fargo.

**Roger Read** - Wells Fargo Securities - Analyst

Maybe shift gears a little bit to Refining, if that's all right. Kind of two main questions. One, just as you look at the overall fundamentals, kind of how do you see the market here? And then the second part of that, digging in a little deeper on crude supply, crude availability. You've got, obviously, a lot of moving parts on the policy side, tariffs, sanctions on countries that have been supplying crude here, that sort of thing. Just kind of a broad question, but how do you see things?

**Brian Mandell** - Phillips 66 - Executive Vice President of Marketing & Commercial

Roger, this is Brian. Maybe I'll start with kind of product demand and supply, and then we'll work on crude and tariffs. On gasoline, we saw 2024 gasoline demand up a bit, mostly on lower Asian demand growth. We saw strong vehicle switching in Europe, where demand was up almost 3%. US demand increased a bit too driven by lower retail prices.

The demand outlook, we think, looks stronger for 2025 with stable GDP outlooks and Chinese vehicle fleet showing a reduction in the growth in EV sales. So our demand forecast for 2025 for gasoline globally is up 0.8% and up 0.2% in the US.

And on the distillate side, 2024 global distillate demand was 0.9% lower than 2023. 4Q '24 US demand was actually up 0.4% versus 4Q prior year. Currently, US distillate inventories are about 8% under 5-year averages, quite a bit. We're forecasting global distillate demand for 2025 at 1% over '24, with gains particularly focused across India, Malaysia and Indonesia. And US distillate demand up about 2%.

On the tariff question, I think, first of all, we don't know if we're going to have tariffs. But assuming that there are tariffs in Canada and Mexico, our view is that both markets will act a little bit differently. So we think tariffs in Canada, first thing that happens is TMX gets filled.

The second thing that happens is, currently, the inventories are low, the inventories will start to fall. But ultimately, the differentials, the WCS differential, will widen to incentivize crude to move into the US because crude actually has to move into the US. There's a lot of value in Canadian crude before there's any production cuts.

I think in PADD IV and parts of PADD II, there aren't as many alternative supplies, the crack (technical difficulty) will also have to do some work.

And then on the Mexico side, Mexican tariffs, there's about 450,000 barrels a day of Mexican crude that comes into the US. We think that crude will be displaced. It will move to Europe, maybe Asia, and other crudes will come in. We would expect to see the heavy crudes firm a bit just on the inefficiency of logistics. But as the year goes on and OPEC puts more barrels back on to the market, we would expect those differentials to widen back out.

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**Roger Read** - Wells Fargo Securities - Analyst

Very comprehensive. I'll turn it back.

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**Operator**

John Royall, JPMorgan.

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**John Royall** - JPMorgan Chase & Co - Analyst

So my first question is maybe you can talk about your outlook for your Refining business at mid-cycle. According to your slides, you've achieved the \$5 billion of EBITDA. But if I remember correctly, you had a number of initiatives that you touched on at Investor Day around capture rates that weren't officially in those targets?

I think you also have some ongoing reliability work and working around the OpEx side. So I'm just trying to think through if there's some possibility that that \$5 billion can really be moving up over the next couple of years. Because it does feel like there's still some opportunity remaining there.

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**Richard Harbison** - Phillips 66 - Senior Vice President - Refining

Thanks for the question. This is Rich, John. organization, I can't tell you how proud I am of the organization and the work that's been going on inside the organization. It's been fantastic. On the reliability front, we've operated quite well as a system. As a matter of fact, eight consecutive quarters over industry average. In fourth quarter, we were sitting at a very nice 94%, and that's a healthy, healthy number for us.

And the underlying part of that is really driven by our reliability program. We actually achieved a 98% mechanical availability on the crude units, which for the year actually drove us to a 95% utilization across the entire year. So the reliability programs have been working really, really well for us. And that's fundamental to being in the market when the market is there, right? So that reliability.

The other part of the program has really been around increasing our market capture, as you indicated. And we've been working on a series of high-return, low-capital projects there. And it's tough to see those in this low-margin environment right now and -- but there are some really good

signposts there that are showing their way through. And one of them is the record clean product yield that was mentioned in the opening comments. 88% fourth quarter '24. That is the highest we've ever achieved as an organization. Now seasonally, that's supported by butane, but that's been going on for years.

There's still some underlying clean product yield that's improving. And that also -- we achieved an 87% clean product yield across the entire year. So a fantastic performance.

And what's most important about that is that the gasoline yield stayed pretty flat, which is consistent with Brian's comments on the marketplace, but we've actually increased our distillate yield through that process. So we're actually seeing yield improvements. These aren't just fractionation changes that are occurring inside the plant. And that's led to a pretty solid market capture here that -- in the fourth quarter of 105.

The last part of that mantra that we've been working on is really that cost reduction, right, that dollar per barrel. And that's -- roughly, we've moved \$650 million out of our operating expense. And that includes our share of WRB, our proportionate share there. But we clearly see that hitting the line.

So with that, the additional market capture, the reliability components, that mid-cycle target that you're talking about is well within range. And we feel that that's very achievable, that \$5 billion. And we're going to continue to strive on that and through that as the market continues to improve.

But don't let me leave you with the opinion that I think we're done with this whole program, right? We're going to continue to drive the efficiencies out of the business. Our reliability journey is never going to be over. And we're going to continue our focus of these small projects with high return on increasing the production of our most valuable products. And we're going to do all that with our industry-leading standards in health, safety and environment.

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**Mark Lashier** - Phillips 66 - Chairman of the Board, President, Chief Executive Officer

Yes. Our engineers and operators out of the plants are just hyper-focused on taking the reliability journey from the crude units on throughout the downstream units in the refineries. Because as you get better with the crude units, that puts the pressure downstream, and they are out there actively pushing and harvesting those opportunities and teeing them up as well.

So we're going to continue to do this each and every day, looking for ways to improve, drive those inefficiencies out, and open up opportunities for more throughput and more reliable throughput.

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**John Royall** - JPMorgan Chase & Co - Analyst

Very thorough. and if I could just follow up on RD margins. You've already given some thoughts on margins. But I was hoping to dig in on your thoughts on the 45 Z in particular. And what are the different scenarios for how that could play out this year? And maybe in the extreme where we have no BTC or PTC for a sustained period of time, what would that look like for the industry? Would you expect the RIN to plug the difference? Or will we end up seeing some kind of capacity coming out?

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**Brian Mandell** - Phillips 66 - Executive Vice President of Marketing & Commercial

John, it's Brian. Yes, I think when you think about RD margins and renewable jet margins, you have to think about all the credits, the cost of the feedstock and the value of the product. And if there's a PTC or BTC or there's none of the above, then the other credits, the value of the feedstock stock and the final product have to move in tandem to drive a margin. And if that doesn't happen, we're going to see plans start to cut.

So even now when margins are low for biodiesel, we've seen biodiesel plants cut back their runs, so that helps expand the margin as they cut back because there's less renewable diesel on the market. So we'll see all those things work in tandem to drive margins for the operations.

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**Operator**

Jason Gabelman, TD Cowen.

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**Jason Gabelman** - TD Cowen - Analyst

I wanted to ask another one on corporate structure. Phillips has been the -- they've shut down more refining assets since COVID relative to peers. And as you think about the right size of the Refining footprint, not only to kind of optimize the system but to support Midstream and get the right multiple within the company, do you see further potential to rationalize some of your refining assets? Or do you feel like after the LA refining shutdown, you're in a pretty competitive position with your Refining asset base?

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**Mark Lashier** - Phillips 66 - Chairman of the Board, President, Chief Executive Officer

Thanks, Jason. Exiting LA does -- will have a material impact on our cost structure, and that's part of the story there. I think we're always evaluating our assets and each location has different pressures, different opportunities. And those -- if those things change, and certainly, that's what we saw in California, that it moved to a set of conditions where it was really not viable to continue, we'll make those decisions. But really, it is an ongoing evaluation of all the assets in our portfolio.

We don't have anything staring us in the face that would indicate we've got other assets that we need to shut down. There may be people that would want to buy some of those assets, and we'd entertain those conversations. We know where we want to focus, we know what we need to do to get better in Refining. We don't necessarily need to get bigger in Refining, but we're going to focus on getting better every day.

And again, we're not going to grow Midstream just to grow Midstream. We're going to grow Midstream because there's opportunities there to grow. And volumes are growing and we've got some really advantaged positions that we can leverage to enhance the ROCE of our Midstream business while we grow the volumes that we process, and open up opportunities for upstream customers to get their materials to a wide array of markets that we can facilitate.

And that's one of the things that Epic does for us. It brings us into Corpus Christi, and we can bring Corpus Christi volumes to the Sweeny hub, all the way to Mont Belvieu. It just really affords our customers, from the upstream perspective, a wide array of opportunities to monetize their hydrocarbons.

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**Jason Gabelman** - TD Cowen - Analyst

And my follow-up is on the marketing business. There was a pretty large decline quarter-over-quarter, larger than what would seasonally be expected. I think you tend to see outside moves in marketing to the downside when crude prices increased rapidly, but we don't really see that in 4Q. So I was wondering if you could elaborate on what drove the marketing weakness in 4Q and if you expect that to continue or not.

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**Brian Mandell** - Phillips 66 - Executive Vice President of Marketing & Commercial

Jason, it's Brian. You're right, marketing margins were off in Q4 with seasonal weakness. But the big thing we saw, we -- in Q3, M&S earnings benefited from about a \$50 million inventory hedging impact from falling prices. And that got reversed out in Q4 when the physical barrels were actually sold, so that created a \$100 million negative sequential impact. There were a couple of other little things. We had a 20-day turnaround in our base oil plant and lower base oil spreads. But overall, the marketing volumes remained strong for the quarter.

So I'd say, looking forward to your question, we expect Q1 to follow our historical trend. In January, we did see about 3% Marketing volume impact from the winter storms and from the California fires, although the addition of new business should close that gap. And we didn't see any operational volume effects from the fires that are caused on our lubricants business.

**Operator**

Matthew Blair, Tudor, Pickering, Holt.

**Matthew Blair** - Tudor, Pickering, Holt & Co. Securities - Analyst

On the new target of \$5.50 a barrel of controllable refinery cost, I think you were at \$6.71 in 2024, which already reflected some pretty good progress. Could you talk about the additional levers that you can pull? And then of the delta of the new target, how much will the closure of the Los Angeles Refinery to contribute to that further improvement?

**Richard Harbison** - Phillips 66 - Senior Vice President - Refining

Matt, this is Rich. Good question. So how do we plan to achieve the \$5.50 per barrel? So first of all, the base is pretty important to talk about. This is \$5.50 ex turnaround cost, too. So our 2024, we ended approximately about \$5.90 a barrel in operating expense, excluding turnarounds. So there's about a \$0.40 delta there in that.

We do see the ceasing of operation at Los Angeles occurring in the fourth quarter. This historically has been one of our higher cost operations. So there'll be a net deduction across the system impact, and that's roughly 50% of the gap.

And the balance of that, we will look at closing using the momentum of the organization that's already been built up through our business transformation opportunities and exercises. We're continually challenging ourselves to reduce the inefficiencies. I've talked a lot about the reliability programs and that continued reliability actually drives down your operating expense as you become more reliable.

And then, of course, there's the denominator on this equation as well and continuing to push the barrel numbers and the clean product yield up on the backside of the number. So we see this as a pretty clear path. Is it a stretch? It's a bit of a stretch, yes. Is it achievable? Absolutely. We will achieve this. And I'm very confident by '26, we'll have that number down there on a routine basis.

**Jeff Dietert Dietert** - Phillips 66 - Vice President of Investor Relations

Matthew, just for you and for others listening in, on Page 17 of our supplemental, it's the second to the last line there, Refining adjusted controllable cost, excluding turnaround expense. So that's where the \$5.50 number is comparable.

**Matthew Blair** - Tudor, Pickering, Holt & Co. Securities - Analyst

Sounds good. And then you mentioned that there was no SAF production in the fourth quarter. As we turn into 2025, the EU is implementing the 2% SAF blending mandate. So could you talk about what you're seeing in that market? Are you seeing calls for increased SAF demand as a result of this EU mandate? Or has that not really materialized yet? And would you expect to increase your SAF production as we progress through 2025?

**Brian Mandell** - Phillips 66 - Executive Vice President of Marketing & Commercial

Yes. We think renewable jet and SAF are going to be important products we made renewable in January. We'll make it again in February. If you look at renewable jet versus RD right now, it's a pretty tight market. But we continue to use our linear program out of refineries to determine what we should make, what makes the most sense in terms of netback or value in the market. So we'll continue to do that going forward.

**Operator**

Paul Cheng, Scotiabank.

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**Paul Cheng** - Scotiabank Global Banking and Markets - Analyst

I think the first question is for Kevin and Mark here. You said a reduction target of \$17 billion. So that's about \$5 billion lower than your current level. Meanwhile, that -- and you're saying that this is a priority. But meanwhile that you're also looking to grow your EBITDA and through perhaps some accretive bolt-on acquisition, like Epic, I think that is probably a good acquisition. But on the other hand, you add to your leverage.

So how -- I mean, how we prioritize between the two? That should the debt reduction take a more priority until that you are at a lower level? Or do you think that, as I think Kevin in his prepared remarks saying, you actually feel already reasonably comfortable. So if there's an inorganic opportunity, you think it's good that you will put it further delay on the debt reduction and go with that acquisition opportunity.

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**Kevin Mitchell** - Phillips 66 - Chief Financial Officer, Executive Vice President

Yes, Paul. So just to be clear, the \$17 billion debt level would be a \$3 billion reduction from where we are. I think you said \$5 billion, it's \$3 billion, which is still not insignificant. But that's how we are looking at this. And the reality is.

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**Paul Cheng** - Scotiabank Global Banking and Markets - Analyst

I'm sorry, but I'm including Epic.

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**Kevin Mitchell** - Phillips 66 - Chief Financial Officer, Executive Vice President

You're including the purchase of Epic. Okay. But you also have to look at we've also been selling assets. And so in January of this year, we've collected just north of \$2 billion on proceeds from asset dispositions. We've talked about the jet retail assets in Germany and Austria that we are in active negotiations on. And so there's more inflow than just thinking about the operating cash flow of the company. So when you look at all these pieces together, we actually think we're going to have a fair amount of flexibility to be able to accomplish everything we want to do.

Now granted, when I say a bolt-on, I naturally think of something that looks more like Pinnacle than Epic, and a \$500 million acquisition or something like that is obviously a lot easier to digest than doing a string of \$2 billion acquisitions. In that instance, we'd have to think differently about capital allocation and balance sheet impacts.

But in overall terms, I think we've got a lot of flexibility to be able to accomplish what we want here. And I think Brian alluded to this earlier as well, as we get into the second half of this year, we become a lot more bullish on Refining margins and the Refining outlook, which will provide further boost on the operating cash flow side.

And there's not a -- we would love to get to \$17 billion of debt by the end of this year. but that's not a must-have. We still have some degrees of flexibility around that in terms of how we look at it.

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**Mark Lashier** - Phillips 66 - Chairman of the Board, President, Chief Executive Officer

Yes, Paul, the growth in EBITDA is not premised on any bolt-on acquisitions. That \$1 billion increment in Midstream and Chemicals is organic, and about half of it would be from the CPChem growth projects that are outside of our capital budget. And so the other half is in Don's business primarily, growing the midstream business organically. And it's all within the \$2 billion-ish kind of capital budget that we're projecting.

**Paul Cheng** - Scotiabank Global Banking and Markets - Analyst

I fully understand on that. I'm just trying to get some better understanding, if you do deal with, say, \$2 billion or \$3 billion of acquisition opportunity, and you think that it's actually quite accretive, comparing to the objective of deleveraging, I mean how at that point that you will consider or which is going to take the priority?

**Kevin Mitchell** - Phillips 66 - Chief Financial Officer, Executive Vice President

Yes, we'll make that -- if we're faced with that kind of opportunity, we'll make our own assessment on what's -- how we need to think about that from a balance sheet and a funding standpoint. I wouldn't -- we wouldn't be incapable of executing on a transaction like that. We would have the flexibility to be able to execute. We may have to relook at other priorities, but we would deal with that at the time.

**Paul Cheng** - Scotiabank Global Banking and Markets - Analyst

Okay. Kevin, second one is a real short one. We see still a bit of the uncertainty on PTC in the first quarter for your RD business. Do you think you will start recording some of the benefit related to PTC or that you're not going to report any PTC credits until you are 100% certain on everything?

**Kevin Mitchell** - Phillips 66 - Chief Financial Officer, Executive Vice President

Yes. Paul, the only thing I can say with certainty is there's a lot of uncertainty, as you highlighted. The reality is what we have on PTC are notices, not proposed rules. There have also been these sweeping executive orders that have put a pause on many forms of rulemaking. We don't know if what's been published on PTC is subject to these executive orders or not. And so we're still working through all this.

The reality is we'll have two options here. One is we just don't record anything in the first quarter or until there's more clarity. The other is we go with the information that is available, which are these notices and the provisions that are provided in those. And this is something that we'll work through over the course of the first quarter. I wish I could provide more clarity.

**Operator**

Ryan Todd, Piper Sandler.

**Ryan Todd** - Piper Sandler & Co. - Analyst

Maybe a couple of quick ones. I appreciate the comments you gave on Refining capture in the fourth quarter, which is really strong. Any comments on how you would see in the early part of this year the outlook, any moving pieces that might drive capture rate higher or lower on the Refining side?

And then maybe just as part of the business transformation process, curious as to where you think you are in terms of progress on the commercial side of things.

**Richard Harbison** - Phillips 66 - Senior Vice President - Refining

Yes, on the Refining capture rate, of course, we have some turnarounds that we've indicated in there. So that will certainly have an impact in those markets that those turnarounds are occurring. Overall, in the fourth quarter, we saw a benefit from the seasonal butane blending. That will continue through the first quarter as well. So that impact should be there.

And then the balance is really reflected in our regional indicators that are put out there on the IR website. So I'd encourage you to run those, Ryan, if you haven't run those or seen those. But that will really give you a good insight as to how the market viewed us.

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**Kevin Mitchell** - Phillips 66 - Chief Financial Officer, Executive Vice President

The 83% or low 80s utilization is also going to have an impact.

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**Richard Harbison** - Phillips 66 - Senior Vice President - Refining

Right, that's associated with the turnaround. Right. That's correct.

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**Brian Mandell** - Phillips 66 - Executive Vice President of Marketing & Commercial

(technical difficulty) We had a goal to grow the organization. We continue to look at opportunities to grow the organization. We're hiring from the outside. We're building a lot more expertise. And so we continue to look at margin opportunities. We look at cost-cutting opportunities as well. We'll continue to do that, and as we grow our returns in our business and continue to grow the size of our business.

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**Operator**

This concludes the question-and-answer session. I will now turn the call back over to Mark Lashier for closing comments.

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**Mark Lashier** - Phillips 66 - Chairman of the Board, President, Chief Executive Officer

Thanks for all your questions. We've ticked off our strategic priorities from Investor Day 2022. And with our new 2025 to 2027 priorities, we remain steadfast in pursuing operational excellence with a competitive cost structure and enhancing shareholder value. We're growing the Midstream business to \$4 billion of stable mid-cycle EBITDA with the anticipated close of Epic later this year. And we have plans in place to add \$1 billion in total mid-cycle EBITDA in Midstream and Chemicals by 2027.

We're continuing to make investments to enhance clean product yield and reliability in Refining. Our assets are ready to capture the upside as the market returns. The stable cash generation for Midstream covers the company's sustaining capital and dividends. Combined with \$2 billion of expected earnings from our Marketing and Specialties business, we have a strong base before adding contributions from our other segments.

The power of integration provides a unique, compelling investment opportunity. We will reward shareholders now and in the future as we move forward with our vision to be the leading integrated downstream energy provider. Thank you for your interest in Phillips 66. If you have questions after today's call, please call Jeff or Owen.

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**Operator**

Thank you, everyone, for joining us today. This concludes our call, and you may now disconnect your lines.

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