TRANSCRIPT
2Q 2020 EARNINGS CONFERENCE CALL

PHILLIPS 66 (NYSE: PSX)
July 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*

Robert A. Herman, *Executive Vice President, Refining*

Brian Mandell, *Executive Vice President, Marketing and Commercial*

Tim Roberts, *Executive Vice President, Midstream*

MEETING PARTICIPANTS

Phil Gresh, *JP Morgan*

Neil Mehta, *Goldman Sachs*

Doug Terreson, *Evercore ISI*

Roger Read, *Wells Fargo Securities*

Doug Leggate, *BofA Global Research*

Paul Cheng, *Scotia Howard Weil*

Justin Jenkins, *Raymond James*

Manav Gupta, *Credit Suisse*

Theresa Chen, *Barclays*

Prashant Rao, *Citi*

Ryan Todd, *Simmons Energy*

TRANSCRIPT

Operator:

Welcome to the Second Quarter 2020 Phillips 66 Earnings Conference Call. My name is David, 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 the Phillips 66 Second Quarter Earnings Conference Call. Participants on today's call will include Greg Garland, Chairman and CEO; Kevin Mitchell, Executive Vice President and CFO; Bob Herman, EVP, Refining; Brian Mandell, EVP, Marketing and Commercial; and Tim Roberts, EVP, Midstream. Today's presentation material can be found on the Investor Relations section of 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 the presentation and our Q&A session. Actual results may differ materially from today's comments. Factors that could cause actual results to differ are included here, as well as in our SEC filings.

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

Greg C. Garland:

Thanks, Jeff. Good morning, everyone, and thanks for joining us today. In the second quarter, we experienced an unprecedented disruption to our business from COVID-19, resulting in a challenging operating environment. Going into the second quarter, we anticipated demand for our products would be weak, as states were under lockdown, and people were working remotely. Across our businesses, we have seen demand recovery from the trough, although uncertainty remains for the second half of the year.

We continue to focus on the well-being of our employees, their families, communities, maintaining safe and reliable operations, and ensuring the financial and operational strength of our company. Our business is an essential business, and we're committed to safely providing critical energy products and services for our customers.

Phillips 66 has implemented the appropriate steps to protect our workforce consistent with CDC and national, state and local directives. We have safely and successfully operated our facilities in support of our commitment to provide essential services.

During the quarter, we issued $2 billion of senior notes and increased our term loan capacity by $1 billion. We expect to exceed $500 million in cost reductions and reduce consolidated capital spending by $700 million this year. These actions protect the security of the dividend and our strong investment-grade credit rating as we navigate this challenging business environment. We will continue to exercise disciplined capital allocation with a focus on long-term value creation for our shareholders.

In the second quarter, we had an adjusted loss of $324 million or $0.74 per share. We generated $764 million of operating cash flow and returned $393 million to our shareholders through dividends.

During the quarter, we achieved strong safety performance. We continue to strive towards a zero incident, zero accident workplace.

We're executing our strategy and progressing major growth projects. The Gray Oak Pipeline commenced full operations from West Texas and the Eagle Ford to the Texas Gulf Coast, marking the completion of the project. Phillips 66 Partners has a 42.25% interest in Gray Oak Pipeline. Gray Oak connects to multiple refineries and export facilities in the Corpus Christi area, including the South Texas Gateway Terminal. The first dock and 8 tanks totaling 3.4 million barrels of storage capacity have been commissioned. In July, the first crude oil tanker was loaded for export.

Marine operations, including the second dock, are expected to ramp up by the end of this year as additional phases of construction are finished. We expect the project to be completed in the first quarter of 2021, with total storage capacity of 8.6 million barrels and up to 800,000 barrels per day of export capacity. Phillips 66 Partners owns a 25% interest in the terminal.

At the Sweeny Hub, we recently completed the planned tie-in work to integrate fracs 2 and 3 with the Freeport LPG export facility. The fracs will begin commissioning in the third quarter and start operations in the fourth quarter of 2020. The fracs are backed by long-term customer commitments. Upon completion, Sweeny Hub will have 400,000 barrels a day of fractionation capacity. Also at the Sweeny Hub, Phillips 66 Partners recently completed its storage expansion of the Clemens Caverns from 9 million barrels to 16.5 million barrels in support of fracs 2 and 3, and the C2G Pipeline.

In Marketing, the West Coast retail joint venture recently closed on the previously announced acquisition of 95 sites, bringing the total to approximately 680 sites. The joint venture enables increased long-term placement of our refinery production and increases our exposure to retail margins.

In closing, I'd like to thank our employees for their focus on safe, reliable operations, for their demonstrated commitment and capability to be smart and agile, finding new ways of working together with a determined purpose towards value creation, and for living our values of safety, honor and commitment in what has been a very disruptive and challenging environment.

With that, I will turn the call over to Kevin to go through our financial results.

Kevin J. Mitchell:

Thank you, Greg. Hello, everyone. Starting with an overview on Slide 4, we summarize our financial results. We reported a second quarter loss of $141 million. We had special items amounting to $183 million. After excluding these items, we had an adjusted loss of $324 million or $0.74 per share. Operating cash flow was $764 million, which included a $94 million working capital benefit. Adjusted capital spending for the quarter was $901 million, including $684 million for growth projects. We returned $393 million to shareholders through dividends, and we ended the quarter with 437 million shares outstanding.

Moving to Slide 5. This slide highlights the change in pre-tax income by segment from the first quarter to the second quarter. During the period, adjusted earnings decreased $774 million, driven by lower results across all segments.

Slide 6 shows our Midstream results. Second-quarter adjusted pretax income was $245 million, a decrease of $215 million from the previous quarter. Transportation adjusted pre-tax income was $130 million, down $70 million from the previous quarter. The decrease was due to lower pipeline and terminal volumes driven by lower refinery utilization. In addition, equity affiliate earnings decreased due to lower pipeline throughput volumes, consistent with lower U.S. oil production and reduced product demand.

NGL and Other delivered adjusted pre-tax income of $83 million. The $96 million decrease from the prior quarter was due to lower margins and volumes at the Sweeny Hub, as well as inventory impacts. The Freeport LPG export facility averaged 11 cargoes per month, and the fractionator ran at 92% utilization. Freeport and Frac 1 were down during part of the quarter as planned tie-in work was completed to integrate Fracs 2 and 3.

DCP Midstream adjusted pre-tax income of $32 million was down $49 million from the previous quarter. The decrease reflects lower hedging impacts driven by improved commodity prices.

Turning to Chemicals on Slide 7. Second-quarter adjusted pretax income was $89 million, down $104 million from the first quarter. Olefins and Polyolefins adjusted pre-tax income was $106 million. The $87 million decrease from the previous quarter is due to lower polyethylene and normal alpha olefins margins, driven by lower sales prices and higher feedstock costs. This was partially offset by record polyethylene sales volumes. Global O&P utilization was 103%. Adjusted pre-tax income for SA&S decreased $1 million. During the second quarter, we received $272 million in cash distributions from CPChem.

Turning to Refining on Slide 8. Refining second-quarter adjusted pre-tax loss was $867 million, down from an adjusted pre-tax loss of $401 million last quarter. The decrease was due to lower realized margins and volumes, partially offset by lower turnaround costs. Realized margins for the quarter decreased by 63% to $2.60 per barrel. Lower Gulf Coast realized margins were due to clean product realizations in a rising price environment during the second quarter and inventory impacts. In the Central Corridor, lower realized margins reflect narrowing Canadian crude differentials. Crude utilization was 75% compared with 83% last quarter. Refining runs were reduced due to lower clean product demand. Pre-tax turnaround costs were $38 million, a decrease of $291 million from the previous quarter. Second-quarter clean product yield was 83%.

Slide 9 covers market capture. The 3:2:1 market crack for the second quarter was $7.47 per barrel, compared to $9.82 per barrel in the first quarter. Realized margin was $2.60 per barrel and resulted in an overall market capture of 35%. Market capture in the previous quarter was 72%.

Market capture is impacted by refinery configuration. We make less gasoline and more distillate than premised in the 3:2:1 market crack. During the quarter, the distillate crack decreased $5.56 per barrel, and the gasoline crack declined by $0.73 per barrel. Losses from secondary products of $0.95 per barrel improved $0.37 per barrel from the previous quarter due to lower crude prices. Losses from feedstock were $0.67 per barrel, a decline of $0.46 per barrel from the prior quarter due to narrowing Canadian crude differentials. The other category reduced realized margins by $2.22 per barrel. This was $2.05 per barrel lower than the prior quarter driven by lower clean product realizations.

Moving to Marketing and Specialties on Slide 10. Adjusted second-quarter pre-tax tax income was $293 million, $195 million lower than the first quarter. Marketing and Other decreased $175 million. The decrease primarily reflects lower volumes driven by COVID-19 related demand impacts, as well as lower realized margins due to rising refined product spot prices in the quarter compared with falling first-quarter prices.

Specialties decreased $20 million due to lower finished lubricants volumes. We reimaged 284 domestic branded sites during the second quarter, bringing the total to approximately 4,720 since the start of the program. In our international Marketing business, we reimaged 29 European sites, bringing the total to approximately 120 since the program's inception. Refined product exports in the second quarter were 160,000 barrels per day, in line with the prior quarter.

On Slide 11, the Corporate and Other segment had adjusted pre-tax costs of $224 million, an increase of $27 million from the prior quarter. The increase is primarily due to higher net interest expense and employee-related expenses, partially offset by lower environmental expense.

Slide 12 shows the change in cash for the year. We started the year with $1.6 billion in cash on our balance sheet. Cash from operations was $1.4 billion excluding working capital. There was a working capital use of $425 million. Consolidated debt increased by $2.7 billion. Year-to-date, we issued $3.2 billion of debt, including $1 billion drawn on a term loan facility and $2 billion of senior notes. We paid off approximately $500 million of maturing debt.

Year-to-date, adjusted capital spending is $1.8 billion. Capital spending will be significantly less in the second half of this year. We expect 2020 adjusted capital to be approximately $2.9 billion as we continue

to optimize our capital program. We returned $1.2 billion to shareholders through $789 million of dividends and $443 million of share repurchases completed in the first quarter.

Our ending cash balance was $1.9 billion. We are focused on conserving cash and maintaining strong liquidity in the current environment. At June 30, we had $8.4 billion of liquidity, reflecting $1.9 billion of consolidated cash, $1 billion of undrawn term loan capacity, and available credit facility capacity of $5 billion at Phillips 66 and $0.5 billion at Phillips 66 Partners.

This concludes my review of the financial and operating results. Next, I'll cover a few outlook items. In Chemicals, we expect the third-quarter global O&P utilization rate to be in the mid-90s. In Refining, crude utilization will be adjusted according to market conditions. In July, utilization has been in the low 80% range. We expect third-quarter pre-tax turnaround expenses to be between $50 million and $70 million. We anticipate third-quarter Corporate and Other costs to come in between $220 million and $230 million pre-tax. Finally, we are not providing effective tax rate guidance for 2020 due to the range of potential impacts the COVID-19 pandemic may have on our business.

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 a 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 JPMorgan. Please go ahead. Your line is open.

Phil Gresh:

Good morning. First question I had was digging into the Refining margin performance a little bit deeper. In particular, looking at your slides, there were two areas that seemed like the biggest headwinds in the quarter. One was feedstock in the Atlantic Basin, and the other was this other category on the Gulf Coast. And Kevin, I know you gave a little bit of color there already. But anything additionally you could share about that result and whether some of that was perhaps temporary in nature you talked about inventory impacts. So, yes, any additional color?

Robert A. Herman:

So yes, Phil, good morning. This is Bob. The other in the Gulf Coast really came down to two items in both really timing. About half of it was due to product realizations as we put product into the Colonial Pipeline and other pipelines in a rising price environment, we tend not to capture all the crack.

And that price environment, where it's going the other way, we get a tailwind out of that. In this particular quarter, you had rapidly rising prices during the quarter, and that hit us there.

And the second was a pretty sizable inventory impact in the Gulf Coast. We had two big turnarounds in the first quarter, Sweeny and Alliance, where we built a lot of inventory and then we pulled that inventory down coming into the second quarter. If you add up those two items alone in the Gulf Coast, it amounts to about $3 on the market capture. Both of those really come back to a timing issue for us.

On feedstock cost on the East Coast, again, it was a little bit of a timing issue with when waterborne barrels land, particularly at Bayway in relationship to a very volatile crude market. So we saw effective feedstock costs in the second quarter to be pretty high coming into Bayway. Just really from a timing between 1Q and even month-to-month in the quarter as crude really moved around.

Kevin Mitchell:

But Phil, in aggregate, that feedstock impact on Atlantic Basin was not that different to the Q1 impact. There's typically a negative -- you see a negative on capture on feedstock in the Atlantic Basin.

Phil Gresh:

So would you say that we're past that at this point as we look forward? Or is it something maybe still need to be thinking about?

Robert Herman:

On inventory move -- moves around on us all the time. It's always hard to predict what's going to happen. Typically, when prices are more stable like we've been seeing in the last couple of weeks, we tend to mute those kind of effects.

Phil Gresh:

Okay. And my follow-up question and just a bigger question on Refining fundamentals. How are you guys envisioning the way the second half of the year might play out? Obviously, we do have soft crack spreads now here in July, utilization guidance from most companies is still reasonably low. Inventories still need to be worked down, and we're going to be flipping into the winter gasoline mode as well. A lot of moving pieces, but I'm curious of your perspective how you see this playing out?

Brian Mandell:

Yes. I think it will be a question of demand going forward. We see demand on gasoline right now at about 15% off, much better than the 50% we were seeing in April. On heating oil we talk to our big truck stop customers and they are seeing about 8% demand disruption. And then finally, the product that's been hardest hit is jet. We're seeing about 50%. A number of us here in the room have been flying on commercial flights recently, and you can see the pickup on both on the planes and in the airports. So we were optimistic that demand will get better as the year progresses. It's interesting, if you look at our 1,000 stores in Germany and Austria, where Germany and Austria didn't have a hard second wave of COVID, we're seeing 95% demand on gasoline, 95% demand on distillate. So again we are optimistic that we can get through this second wave of COVID that we can push up our demand in the U.S. And I think refiners will continue to run at demand levels going forward.

Jeff Dietert:

I think I might add that we're coming up on the fall season, and there's some seasonal impacts driving to and from schools is in rough numbers, about 5% of demand, and there's probably a carryover impact on commuting as well. So I think that will have an influence. And we're expecting a strong planting season -- or excuse me, harvest season this fall to support distillate demand.

Operator:

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

Neil Mehta:

Hi, team. Thanks for taking the question. I guess the first question is about the integrated business model and the value of operating in multiple different businesses. And I think over the course of the cycle, we've definitely seen that. It's been a benefit for Philips 66, but Greg, curious on your perspective, especially in light of the fact you have one of your large competitors is monetizing some parts of their business?

Greg Garland:

Well, you think about the integrated model that we have, we still think that it's a value-add model, Neil. I try

not to let single points in time or single-point pandemics really influence our long-term thinking around this. When we think about the ability to capture that value, starting with DCP, gas gathering, gas liquids, integrating through our fracs and our LPG export and being able to take product into our Chemicals business and then through the Refining chain, we like that optionality that gives us in terms of investable opportunities. But certainly, the earning streams that come out of those businesses are strong for us. So we'll continue to think about this integrated business as a value-add business for us. There's no question the pandemic probably impacted all segments of this business. But it's not unique to us, I would say.

Neil Mehta:

Yes. Very clear. And then the follow-up is just your thoughts on Dakota Access and how it's likely to play out from here. The firms position on any – on the ruling? And then the bigger picture question around Midstream is relative to what was laid out at the November Analyst Day, what's changed and any quantification of what's changed would be helpful, too?

Tim Roberts:

Okay. Neil, this is Tim Roberts. Let me address DAPL first of all. Obviously, we're disappointed with the ruling that initially came out with regard to mandating an environmental impact study. And then subsequently, the further ruling on that, which vacated the permit, which then led to a potential shutdown on August 5 on the pipe. Fortunately, it's been appealed to the D.C. Circuit Court of Appeals. I think you guys are aware of that. We're waiting for that outcome currently. And there's been a stay put in place while they're evaluating the case. We think at this point, the positions that we have are well-founded. And certainly, clearly disappointed by a position that was taken on a pipeline that has run for three years and has run safely and is truly the most economic and safe way to get hydrocarbons to the marketplace. It is a little bit frustrating on that point, and we will let the court play out at this point forward from there.

Our challenge is just the fact of the impact it has on the region. When you look at it, both on the producers, from the state, local governments, communities, people that work in the energy value chain and those that don't, who support businesses in the energy space, they're really getting impacted by this. With the pandemic, we just feel this is going to be tough economically on some very specific regions of the country.

With regard to the Midstream strategy, the long-haul transmission business feels like it's been challenged a little bit, especially with COVID-19, the pandemic, oil shock, all those things that caused us to pause. And you've seen that through our actions by deferring a couple of our projects. We need more clarity. I think our producers need more clarity and shippers need more clarity. We need to get a view on that. But from a midstream standpoint, if it's a good project, we're going to do it. And when you look at the diversity of our business in our midstream space, yes, we've got crude transportation. Yes, we're in clean products as far as terminals and moving product out of the refineries. And then subsequently, we're also deep in the NGL value chain.

We look at all those. We're not a one-trick pony at this point. We have ways to shift our investment through those three different very specific businesses in our Midstream business. So yes, you may see us come off. We're certainly going to be a little more cautious as we look at transmission lines, but that doesn't mean we're not going to do those. We're going to make sure it makes sense. If we've got people who are willing to make long-term commitments that are good, solid counterparties and hits the return thresholds that we need. If those happen, of course, then we're going to be interested in that. But if not, we will find other ways to pivot and build out integration with our company.

Jeff Dietert:

Neil, just to quantify the Midstream, we reported $2.26 billion of EBITDA in 2019, at the Investor Day, we highlighted projects that could take that to $3 billion by 2022. The projects that we have deferred represent about $300 to $400 million of EBITDA that would scale that back. From a DAPL perspective, you can see from our historical disclosure it contributes – or has contributed about $250 million a year to PSXP. We own roughly 75% of PSXP at PSX, so the PSX impact is in the ballpark of about $200 million a year.

Operator:

Doug Terreson from Evercore ISI. Please go ahead. Your line is open.

Doug Terreson:

Good morning, everybody. So financially, the pandemic has obviously reduced financial flexibility and led to higher debt levels at and led a lot of companies, Phillips 66 included. Simultaneously, economic growth is expected to recover. And as it does, my questions are what are the likely implications for capital management, which has been a positive hallmark for you guys over the years? And specifically, how are you thinking about the balance between spending, shareholder distributions, et cetera, given the changes in debt? So, the question is really about how you're thinking about financial priorities over the medium-term?

Greg Garland:

Yeah. Well, so our view is mid-year next year, we'd probably get back to something approaching mid-cycle for our company. As we do that, then we can kind of get back to a normalized framework as we think about the 60-40 allocation. The other thing I would say is, clearly taking on $3 billion of debt, there's going to be some priority to debt repayment over the next two to three years. We've got the 364-day facility. It's $1 billion comes due in the first quarter of next year. And then in 2022, we've got another $2 billion normal course debt that is coming due. So you should think about us trying to pay between $1 billion to $3 billion of debt off in the next two to three years.

As we start approaching mid-cycle conditions and certainly pick back up with share repurchases. The other thing is, our view is investable opportunities in Midstream in 2021 and 2022 are probably going to be less than what we would have anticipated. That's going to free up more capital to put towards debt repayment and shareholder distributions, Doug. So anyway, that's how I'm thinking about it at this moment in time.

Doug Terreson:

Okay. That sounds good. And then my second question is about Refining, and specifically, how you guys are thinking about the closures of refining capacity over the next few years? And the reason that I ask is because, I think during the last cycle, IEA final tally of closures was about 6 million to 7 million barrels per day over the two to three years following the trough in the cycle. And we have seen recent announcements of closures in Asia. We've got IMO-related factors and current refining economics aren't great either. So it seems like we could be in the early stages of going back to that closure track as well. So, I just want to see how you're thinking about how the supply side could be affected by this factor in coming years if you think it will be meaningful.

Robert Herman:

Okay. Doug, it's Bob. Yeah, I think we would agree with you that 2008, 2009 is a good go by. And we would expect rationalization across the globe since it really is a global business. Even before the pandemic, we expected to see significant rationalization in Europe, and some, quite frankly, in the U.S. And we've seen that, right? We've got PES that's down, and I think everybody could agree that's not coming back.

We've got other temporary closures right now. Whether they come back probably depends a lot on how long COVID-19 hangs in there. Our bigger view would be, we expected several million barrels to rationalize across the globe before this. The pandemic only pushes it forward, and we'll probably get it sooner than later.

I think you'll see a lot of people make their moves early. And they'll -- it may not happen ratably here, because I think people will run, maybe as long as they can with these assets. But they're going to run up against either really expensive turnarounds or some kind of regulatory impact in some parts of the world, and that's going to make a decision for them, I think.

Jeff Dietert:

Doug, I think the other thing I would add is not only rationalization of existing facilities, but delays in new capacity additions with the significant capital spending reductions that have been put in place with the COVID impact on challenges getting labor. As you well know, even in a good environment, these projects tend to get delayed. But in the environment we're in today, they're likely to get delayed even more significantly.

Operator:

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

Roger Read:

If I can get two questions, kind of small questions on Refining and then one on Chemicals. On Refining, what do you think is happening or what do you think needs to happen in exports to kind of bring the market back, I'm thinking pretty specifically the Gulf Coast, here?

And then on the crude supply side with WCS specifically, how you see that coming in because that was obviously a big headwind in Q2. Just curious how you think of that for the second half of the year?

Brian Mandell:

Hey Doug, this is Brian. On exports, if you look at Q1, Q1 exports for gasoline and distillates were about little over 2.2 million barrels a day, which we would say is typical. In Q2, close to 1.6 million which is about 30% off, and in July, we're about 20% off. So, we're starting to come back and we can see that in the marketplace. We can see Mexico is having a lot of refinery problems. In June, they were down about 35% utilization. We think, July, that's probably in the high 20s with more problems. We can see them in the marketplace. They're coming in and out for spot barrels. They were just term barrels before. We've even talked to some folks in the retail business, who have said that some of their volumes have come back to pre-COVID levels. So, we're seeing better demand for Phillips 66. We exported in Q2 160,000 barrels. That was the same amount we exported in Q1. Typically, for us at Phillips 66, it's more opportunistic, and we've had better opportunities domestically over the next couple of quarters.

Robert Herman:

I might add on that, too. I think if you look at the distillate inventory overhang, it's mostly in the Gulf Coast at this point, right? That's where the barrels are sitting and we need to get those back into the export market to help clean up inventory levels in the business. That's the missing piece for PADD 3, I think.

Jeff Dietert:

I think the U.S. statistics, the DOE coming out weekly, that's kind of the most evident. But if you look at Asian and European distillate inventories, they've come off their highs and are improving at a faster pace than what we're seeing in the U.S.

Greg C. Garland:

Brian, you want to take the WCS part of the question?

Brian Mandell:

On WCS, we've seen differentials in Q1 to Q2 differentials came off about $9, and from Q2 to Q3, Q3 is kind of baked in for about two-thirds of it. We'll see another $2 off. But what we're seeing in Canada for -- in August, we're seeing about 200,000 barrels offline for production maintenance and about another 200,000 barrels shut in. That means pipeline takeaway is greater than production. So, that's what's kept the differential rather tight. We think that will change going in the next few months in September, and October, we think that production will be greater than the pipeline capacity takeaway and we'll see the differentials

start to widen closer to rail arbs.

Roger Read:

Okay, great. Thanks. And then on the Chemicals side, I just wanted to understand, margins were obviously weak in the quarter, but it ran at 103%. It sounds like margins are probably better Q3, but guidance is only in the mid-90s. So, I guess the way I'm thinking about it, why run so hard when things were weak, but running less so when things look a little bit better. What kind of underwrote the decisions in Q2 or the market conditions in Q2 that pulls such a high utilization? And should we think about you maybe build inventories that we can see sold later at better pricing?

Greg Garland:

Yes, not really building inventory in the chemical space. If you go back to 2019, that ethane, the high-density full chain margin was 22 cents per pound (cpp). It was 18 cpp in the first quarter, and it got to 10 cpp in the second quarter, but actually dropped to about 7 cpp in May. And today, we're pushing kind of 16 cpp.

And as you look across the U.S., Europe and Asia, we've seen rising prices. So spot prices in the U.S. are up 8 cpp. Contracts up 5 cpp. Europe contracts up 8 cpp. In Asia spots up 5.5 cpp. There's been really good price movement. Part of that reflects a rising crude price environment. Part of that reflects just really strong demand for consumer products.

And if you bifurcate the petrochemicals business into consumer and durables, the consumer part is doing really well. The durables is still challenging, but improving. So, think automotive and others. And on the consumer side, which is mostly where CPChem is -- market facing, there's kind of two trends that are going on. One is hygiene. And so think about the wipes and the bleach and the detergent and the hand sanitizer and all that. And those products across the world continue to sell strongly.

And the other is a term that the chemicals guys are calling nesting; that people aren't moving very far from the nest. They're staying home. They're cooking more. They're using more disposables. They're using more trash bags. They're buying more bottled water that's wrapped with plastic. They're buying -- doing home improvement projects. So polyethylene paint cans and garden sheds. They're trying to find things to do outside of the house. So they are spending more money on kayaks and coolers and camping materials and things like that. It's all really positive for high density demand. So I think we're constructive on the demand side. And I would say, I'd say strong demand, weak to improving margins, and that's what we're running into.

Operator:

Doug Leggate from Bank of America. Please go ahead. Your line is open.

Doug Leggate:

So Kevin, I wonder if you could talk about your tolerance for debt on the balance sheet. Obviously, you're navigating the trough of the cycle, but where does the balance sheet stack up in terms of relative priorities for use of cash? And what do you see as the necessary headroom with the visibility of what was walked through this morning so far?

Kevin Mitchell:

So as – as I walked through the components of liquidity that we have available to us. We're still in a good shape in terms of if we need additional cash. We have availability through the different sources that I commented on earlier. But as you look beyond that, and as we start to come out the other side of this from a prioritization standpoint. What you're going to see is that paydown of debt will be in the near-term, a priority from a capital allocation standpoint. And typically, we don't talk about having to pay down debt as part of the capital allocation construct. And it works out okay for us because we've got the $1 billion term-

loan that matures in the first quarter of next year. We also have a $0.5 billion floating rate note maturity also in the first quarter of next year. And then as you go into 2022, there is $2 billion of notes coming due. And there's another $0.5 billion coming due in 2023. So we have plenty of opportunity to deal with this over the coming next couple of years or so. I think if we're able to take care of the 2021 maturities, that $1.5 billion, I think we'll feel pretty comfortable with where the balance sheet is at that point. That will still have us at slightly higher debt than we had when we went into this. But in the overall scheme of things, I think we'll feel pretty comfortable with where that puts us.

Doug Leggate:

I appreciate the answer. Thanks, Kevin. And Greg, I'm afraid I'm going to take a bit of a different tact, given we're three months ahead of the election, I guess, two months ahead of the election. The topic of carbon tax, we've heard the majors articulate some support for the Baker Shields Plan amongst others, but it's appeared on the democratic platform as a possibility or something that they might want to push in a new legislative setting. So I'm just wondering what PSX official position is on a carbon tax? And I'll leave it there. Thanks.

Greg Garland:

Yes. We haven't had an official position on a carbon tax, Doug, partly because we need to see what the policy really is and what's it look like. I would say that, our views is that it really -- it needs to be done at Congress. They need to legislate a climate program. We prefer that, obviously, to having a patchwork of state and local regulations which is a lot less efficient. There's a few key things that we would be looking for in any program. First of all, transparency is really important for people. And I'm talking about consumers to be able to understand the impact and the cost associated with the new climate program. I think it needs to be economy wide, and it's got to be applicable to all sources of emissions. And also, it's got to recognize that oil and gas is going to have a big role for many years to come. It really is market based, it's predictable and an internationally competitive. And so giving all those boundary conditions, certainly we would support something around a carbon tax if that's the preferred method that comes out of Congress.

Operator:

Paul Cheng from Scotia Howard Weil. Please go ahead. Your line is open.

Paul Cheng:

Thank you. Good morning guys. A couple of questions. Greg, in the past, you have talked about renewable diesel business and have some reservation because of the government lending and all that. Just curious that with the pandemic and everything going on, and they perhaps also have a democratic administration, has your view on that business changed? And if yes, how big is that business that you may be willing to or that you will be targeting or that you may like in the long haul?

Robert Herman:

Okay. So currently, we are in the renewables business over at our Humber Refinery for the last year or so. We've been processing used cooking oil, co-processing it in our cracker there and make about 1,000 barrels a day of renewable diesel. We've actually got a project in-flight right now to raise that to about 4,000 barrels a day. It's around the logistics to get it into the plant. We don't have any problem running it. And on the commercial front, we've committed to backing two renewable plants that are being built by a third-party in Nevada. So we'll supply them feedstock and take 100% of the product off of those two plants. So between those two, that's about 15,000 barrels a day of renewable diesel that we'll have at our disposal to meet the needs -- our own needs in California.

In addition, we've got a project in progress at our San Francisco Refinery that will convert a hydrotreater to run renewable feedstocks, make about another 9,000 barrels a day or so of renewable diesel. Beyond that, we continue to do the engineering to understand where does it make sense to build more renewable capacity across our system. As you know, we had a big project at our Ferndale Refinery up in Washington State to make 18,000 barrels a day of renewable diesel. We could not get permit certainty in that

environment up there, so we canceled that project.

But that hasn't stopped us from continuing to evaluate options on the West Coast, the Gulf Coast and at our other plants test and where does it make sense to do more renewables.

Our fundamental belief is the renewable need is there, and it's going to be there long-term. So we'll – we need to find a way to help meet the demand of the market for renewable diesel in particular.

Greg Garland:

I think our approach at this point in time has been to partner, certainly, and to use existing assets where we can in a capital light mode, Paul.

I still worry about the credit and how that credit price gets set. But as you watch what's happening, particularly on the West Coast, low carbon fuel standard, moving up the entire West Coast, maybe to the East Coast of the U.S. and I think there's going to be a place in the portfolio for renewables.

Paul Cheng:

Greg, do you have an idea, say, some kind of ceiling? How big is that business that you could – you will be willing to assess in the long run as a percentage, let's say, for your overall asset or your cash flow? Or do you think that this business, I mean, it's really just a niche, and you don't want to be too big?

Greg Garland:

Well, our current view is that we would probably either build or partner to cover about what we view is 80% of our requirements, and we'd probably remain exposed for credits for the -- for about 20%. And we haven't changed that strategy yet, Paul, but that's our current views in this market.

Operator:

Justin Jenkins from Raymond James. Please go ahead. Your line is open.

Justin Jenkins:

Thanks. Good morning, everyone. I want to follow up on Neil's question about Dakota Access earlier. I'm curious, does PSXP have to stand on its own financially in the unlikely event that DAPL is shut down? Or would PSX be willing to entertain some more supportive options than might otherwise be the case to help the MLP?

Kevin Mitchell:

Hi, Justin, it's Kevin. Yeah, so it's hard to speculate around activities that may -- or decisions that may or may not happen and how that will play out. But fundamentally, when you look at the MLP, it's got two levers at its disposal in terms of helping its financial position.

One is the distribution and two is the level of capital spending. And as you know, the capital spending is pretty high this year, but a lot of those projects are coming to an end over the course of this year. And so there'll be more flexibility as you look into future years in terms of where cap-ex needs to sit at the MLP.

But what I'd also say is, as you step back and look at PSXP, it is in a very strong position. The MLP last year generated almost $1.3 billion of EBITDA. It's got a strong balance sheet. It has a strong credit rating, and that's a function of – if you look at all the transactions that have taken place between PSX and PSXP over the last several years, they've all been done on a very fair basis that both works for the MLP and for the sponsor. And at the same time, you lay on a conservative financial strategy and policy around how we've managed the balance sheet at PSXP and it's actually in a really good position. It's really hard to

speculate around what other – what sort of sponsor support might be provided on an event that we don't know may happen around all of that.

I think I'll probably just leave it there. One other comment though is also bear in mind, DAPL is one asset. So PSXP has got a great portfolio. It's predominantly fee-based driven assets and while DAPL is very – it's a significant asset. It's a good asset, it is just one asset within the broader portfolio. And we're pretty confident that PSXP will be able to work its way through this whole situation.

Justin Jenkins:

Understood. I appreciate the answer, Kevin. I think second question is just a quick one for you as well on the cash flow statement. JV distributions were pretty high. You mentioned the CPChem distribution is a good chunk of that. Is that onetime in nature?

Kevin Mitchell:

Yes. I think it's fair to look at – you probably want to look at CPChem on a year-to-date basis. The distributions were low in Q1, and they were high in Q2. And so it's probably more appropriate to think of it like that because it was an under – in Q1 they undistributed from an earnings standpoint. And that's the big driver of that undistributed equity earnings benefit that shows up on the cash flow statement.

Operator:

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

Manav Gupta:

Hey, guys. A quick question. You have a very light footprint on retail and wholesale operations. I am trying to understand a little bit of follow-up to Roger's question. Domestically, which are the regions where you are seeing the strongest demand recovery? And domestically, which are the regions where either gasoline is lagging versus the average? And are there regions you actually think where the demand may never recover led to the pre-pandemic levels?

Brian Mandell:

Well, we took a look at that earlier this morning, in fact, we're seeing that 15% demand destruction in gasoline that's the same in each of our pads that we're operating in, and we didn't see any difference in the PADDs that we're operating. And I would say that it's hard to say at this 10 seconds, whether we'll see continued demand destruction.

I know on the West Coast, there have been companies that announced not back to work for a while. Schools, we don't know when they're going to get back to work. My guess would be that in the future, people will get back to work. There's something about being at the office and exchange of ideas at the office that makes that more positive way to work. So I think this is somewhat short-term; by the middle of next year, I think people will be back to work and it would be normal, just like it has been.

Manav Gupta:

And a quick follow-up question again on the Canadian side. You are one of the biggest buyers of Canadian crude. In terms of volumes versus May or April, or May, what kind of increase in volumes from Canada are you seeing at this point of time versus just two or three months ago?

Brian Mandell:

So we've been importing from Canada roughly the same amount, a little over 500,000 barrels a day. We're limited on pipeline logistics, and that's kind of the limits for Canada crude exported out of the West Coast.

Operator:

Theresa Chen from Barclays. Please go ahead. Your line is open.

Theresa Chen:

Hi. Thank you for taking my question. So first on the DAPL front. I understand that to PSX, in the event of a shutdown would be roughly $200 million per year of EBITDA. Can you talk about potential offsets in your system as differentials do blow out? You can import crude by rail at Bayway and Ferndale?

Brian Mandell:

Yes. So currently, we move by rail to Bayway and Ferndale, about 70,000 barrels a day. We think we can get another 75%, maybe up to 120,000 barrels a day of additional crude to both refineries from the Bakken. And we're taking a look at differentials as they get wider, we'll be in a position to move those extra barrels.

Theresa Chen:

Got it. And final, a follow-up to Manav's question on structural demand. So when you talk about the markets where things have progressed more steadily and recovering to close to normal, 95% of demand in Germany and Austria, for example. So are you seeing like plateauing at 95%? Is it continuing to recover? Can you chalk that 5% up to structural losses? How should we think about that?

Brian Mandell:

I think that's still effect of COVID. You can – I mean COVID not gone in Germany and Austria, just like it isn't gone here in the U.S., so we would expect that to get back to 100% at the point where we have some type of therapeutic or some kind of cure for COVID. But at its current rate, that isn't structural. People, people want to get out, they want to drive. So we think it's just a lingering effects of COVID-19.

Operator:

Prashant Rao from Citi. Please go ahead. Your line is open.

Prashant Rao:

Hi. Thanks for taking the question. Mines sort of a two-parter, so I'll just leave it at the one with the two parts to it, and they're both on Midstream. I kind of wanted to get a sense of, it feels like there's a lot of moving parts here, but you've got Gray Oak in full operations. The tie-in work is done on Sweeny. Throughput volumes look like they should at least pace. Product demand and crude demands are coming back up. So it feels really like 2Q should be sort of a bottom for the year from where we stand right now. I wanted to get your sense on if that's sort of a fair assumption.

And then from there, the second part then, if I think about sort of the trajectory, the snap back towards getting back to earnings levels where we were back half of last year, at least 1Q of this year, how much of that is volume driven? And what's the – how much of that is more margin driven? I know the two are interrelated, but if you could help us to sort of think about per BOE margin as the volumes come back, how that should trend and ultimately get you north of $400 million on earnings per quarter? Does that – is that something that seems in scope for the back half of this year? So those two parts would be helpful to get some color on both. Thank you very much.

Tim Roberts:

The first part, on that, with regard to our systems and so forth. When you look at Gray Oak and all the activity that we've got going on, I can say that you're right, second quarter really does feel like it was the bottom of the trough. Obviously, it's a little tough to go out with the second wave of the pandemic. But certainly, we're going to work our way through that. But we've seen things progressively move up through the quarter. We've got a lot of activity going on. We have seen, for example, on Gray Oak I'm pleased to tell you, that we're up and running. We have seen volumes have picked up and we're near MVC levels currently, which is good, which is not where we were in the middle of the quarter for the second quarter.

So that's directionally going in the right direction. And we see overall volumes through our NGL system. All of them are – month-to-month are improving. So directionally, we feel pretty good that it's moving in the right direction. It's the length of time it takes to recover. We still think middle of next year is when you should see things start to normalize to a point where we are back in mid-cycle.

Greg Garland:

I think maybe the other thing I would add to that is as you think about Gray Oak, fracs 2 and 3, those are pretty much fixed fee, so there's not a lot of commodity exposure there. Where we still have commodity exposure is really around the LPG export. And of course, in the second quarter, we had some downtime for the tie-ins. We ran the frac a little lighter and didn't get as many export barrels out. And also, the fees went down across the dock in the second quarter. We do think that we'll see some improvement in terms of the -- get more volume across the dock and also some opportunity to increase dock fees. So that's where the big exposure is. And that's more in the $200 million range probably. If you think about it in the total scope, the opportunity set for us.

Jeff Dietert:

Yes. And I think, Prashant, as you know, these projects are underwritten by long-term shipper commitments that support the investment and the return on these projects.

Operator:

Ryan Todd from Simmons Energy. Please go ahead. Your line is open.

Ryan Todd:

Good morning, maybe a couple of quick follow-ups on Refining. Despite the idling of MPC's Martinez refinery, West Coast utilization rates look kind of struggling from the trough of the downturn relative to other regions. Can you talk about maybe how regional demand fundamentals are driving a different recovery path that you see for utilization rates in the Gulf Coast versus the West Coast or East Coast?

Robert Herman:

Yes. I think, actually, if you look at our system across the -- our different PADDs, we don't see that much difference in utilization. I think PADD to PADD to PADD right now. In California, in particular, if the conventional wisdom before the pandemic was, we were a refinery long in California sometimes for market balance. Today, we're something above that. So even with Martinez down, the demands of the market don't require the refining system out there really to be running harder than we currently are. We said we're in the low 80s across our system, and that's pretty consistent for California also.

Ryan Todd:

Okay. Thanks. And then maybe on the Marketing side, retail results have been a relative bright spot, and they were again this quarter. And I wanted to ask how the outlook is looking in the third quarter as commodity prices have started to normalize? And maybe you can speak to further opportunities to inorganically build on your West Coast retail JV from here?

Brian Mandell:

I would say we completed most of the West Coast retail joint venture late last year, which was unfortunate time for us. We finished the rest earlier this month. So we've taken a backcast on the margins and the value driven by the West Coast joint venture. And it's been about what we said it would be. We're in about the 50 million to 60 million barrels; $50 million to $60 million a year in terms of EBITDA for that joint venture. So we're happy about where it is. Of course, it's hard to tell during the COVID period, but we think it's on track. And we'll continue to take a look at opportunities to grow that joint venture and opportunities to integrate into our business. We think integration is very important, as Greg mentioned earlier, and we're looking for opportunities to integrate, particularly on the West Coast and even more particularly in the Middle America where we have a large Refining business.

Operator:

We have now reached the end of today's call. I will now turn the call back over to Jeff.

Jeff Dietert:

Thank you, David. Thank all of you for your interest in Phillips 66. If you have additional questions after today's call, please contact Brent or myself. Thank you.

Operator:

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