TRANSCRIPT
4Q 2020 EARNINGS CONFERENCE CALL

PHILLIPS 66 (NYSE: PSX)
January 29, 2021, 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*

Tim Roberts, *Executive Vice President, Midstream*

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

MEETING PARTICIPANTS

Doug Terreson, *Evercore ISI*

Neil Mehta, *Goldman Sachs*

Phil Gresh, *JP Morgan*

Roger Read, *Wells Fargo Securities*

Doug Leggate, *BofA Global Research*

Paul Cheng, *Scotia Howard Weil*

Jason Gabelman, *Cowen & Co*

Manav Gupta, *Credit Suisse*

TRANSCRIPT

Operator:

Welcome to the Fourth 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 the 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 Fourth 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:

Okay. Thanks, Jeff. Good morning, everyone, and thank you for joining us today. At the start of this last year, we could not have envisioned the unprecedented challenges that we faced in 2020. We're proud of and grateful to the many people who worked diligently and tirelessly to develop the COVID-19 vaccines. We're optimistic about the positive impact the vaccines will have on economic recovery in the months ahead.

In the fourth quarter, we had an adjusted loss of $507 million, or $1.16 per share. Market conditions remain challenged. Our Refining business continues to be affected by demand destruction associated with the pandemic.

For the year, we had an adjusted loss of $382 million, or $0.89 per share. We operated well and completed major growth projects in our Midstream segment, including the Gray Oak Pipeline, our largest pipeline project to date, and the Sweeny Hub Phase 2 expansion.

We took early decisive steps to reduce costs and capital spending, secure additional liquidity and suspend our share repurchases. We exceeded $500 million in cost reductions and cut capital spending by more than $700 million. These actions, combined with cash flow generation from our diversified portfolio, provided us with financial flexibility to maintain our strong investment-grade credit ratings, sustain the dividend and to navigate the crisis. Our focus continues to be on the well-being of our company, our employees and our communities.

In 2020, we contributed $32 million to charitable organizations, including $6 million for COVID-19 and disaster relief. Even with the distractions and the challenges of the pandemic, our people remain focused on safe, reliable operations and execution of our strategy.

2020 was the safest year in the history of our company. Our total recordable injury rate of 0.11 was 30% better than our industry-leading rate in 2019. Our process safety improved by 60%, and our environmental performance was our best ever.

In 2020, we generated $2.1 billion of operating cash flow and returned $2 billion to shareholders. Since we formed the company, we've returned approximately $28 billion to shareholders through dividends, share repurchases and exchanges. We remain committed to a secure, competitive and growing dividend.

Entering 2021, there's still uncertainty in the market. We'll continue to maintain a strong balance sheet and disciplined capital allocation. In December, we announced our 2021 capital budget of $1.7 billion, including Phillips 66 Partners. This is a reduction compared to recent years. We have the capital for debt repayment.

In 2020, we added approximately $4 billion of debt. We plan to reduce debt to pre-COVID-19 levels as cash generation improves. Our 2021 capital budget includes $1.1 billion of sustaining capital for reliability, safety and environmental projects. In addition, $600 million of growth capital is directed toward in-flight projects and investments in renewable fuels.

During the quarter, we advanced our growth program. At the Sweeny Hub, Frac 2 commenced operations in September, and Frac 3 started operations in October. We plan to resume construction of our fourth fractionator in the second half of 2021. Upon completion, the Sweeny Hub will have 550,000 barrels a day of fractionation capacity supported by long-term customer commitments.

At the South Texas Gateway Terminal, the second dock commenced crude oil export operations in the fourth quarter. On expected completion in the first quarter of 2021, the terminal will have 8.6 million barrels of storage capacity and up to 800,000 barrels per day of dock throughput capacity.

Phillips 66 Partners owns a 25% interest in the terminal. Phillips 66 Partners continued the construction of the C2G Pipeline, connecting its Clemens Storage Caverns to petrochemical facilities in the Corpus Christi area. The project is backed by long-term commitments and expected to be completed in mid-2021.

At the Beaumont Terminal, we completed the fourth dock, bringing total dock capacity to 800,000 barrels per day.
The terminal has a total crude and product storage capacity of 16.8 million barrels. Since acquiring the terminal in 2014, we've doubled the dock's capacity and more than doubled its storage capacity. In Chemicals, Chevron Phillips Chemical Company LLC (CPChem) is advancing optimization and debottlenecking opportunities. This includes recently approved projects at Cedar Bayou facility that will increase the production of ethylene and polyethylene. In addition, CPChem is developing an expansion of its normal alpha olefins production.

During the quarter, CPChem announced its first production of polyethylene from recycled plastics at its Cedar Bayou facility and received ISCC PLUS certification. CPChem remains committed to finding sustainable solutions, including the elimination of plastic waste in the environment. We're advancing our Rodeo Renewed project at the San Francisco Refinery. We expect to complete the diesel hydrotreater conversion in mid-2021, which will
produce 8,000 barrels per day. Full conversion of the facility in early 2024 will produce over 50,000 barrels a day of renewable fuels.

This capital-efficient investment is expected to deliver strong returns and reduce the plant's greenhouse gas emissions by 50%. This project helps California to meet its low-carbon objectives.

In Marketing, we recently acquired 106 retail sites in the Central region through a joint venture. This aligns with our strategy of securing long-term placement of Phillips 66 refinery production and extending participation in the value chain of retail.

We've also advanced our digital transformation efforts, fostered innovation across our company and implemented new technologies, including digital systems for work processes, artificial intelligence to predict maintenance requirements and optimize processing unit performance. Our company is making investments to competitively position us for a low-carbon future.

Earlier this month, we announced our Emerging Energy organization. This group is charged with establishing a lower-carbon business platform. It will pursue opportunities within our portfolio, such as

renewable fuels, and work with our company's Energy Research and Innovation Group to commercialize Emerging Energy technologies.

For example, in collaboration with Georgia Tech, Phillips 66 received a grant from the U.S. Department of Energy that will support the development of electrolysis technology that has the potential to convert CO_2 into clean fuels. Our company is committed to addressing the global climate challenge, while at the same time deliver shareholder returns.

So, with that, I'll turn the call over to Kevin to review the financial results.

Kevin Mitchell:

Thank you, Greg. Hello, everyone. Starting with an overview on slide 4, we summarize our fourth-quarter results. We reported a loss of $539 million. Excluding special items, we had an adjusted loss of $507 million, or $1.16 per share. We generated operating cash flow of $639 million, including distributions from equity affiliates of $400 million. Capital spending for the quarter was $506 million, including $239 million for growth projects. We paid $393 million in dividends during the fourth quarter.

Moving to slide 5. This slide shows the $506 million reduction in adjusted results from the third quarter to the fourth quarter. Chemicals adjusted pre-tax income increased quarter-over-quarter, while the other segments declined. The income tax variance relates to favorable tax impacts we had in the third quarter related to our ability under the CARES Act to carry back net operating losses to previous periods.

Slide 6 shows our Midstream results. Fourth-quarter adjusted pre-tax income was $323 million, a decrease of $31 million from the previous quarter. Transportation contributed adjusted pre-tax income of $196 million, down $6 million from the previous quarter. The decrease was due to lower pipeline and terminal volumes driven by lower refinery utilization. This was partially offset by higher equity earnings on the Bakken Pipeline.

NGL and Other adjusted pre-tax income was $86 million. The $16 million decrease from the prior quarter was due to lower equity earnings, as well as reduced propane and butane trading results. This was partially offset by higher fractionation volumes, reflecting the ramp-up of Sweeny Fracs 2 and 3, which demonstrated operations above design capacity. The Sweeny fractionation complex averaged 376,000 barrels per day during the fourth quarter.

Also, at the Sweeny Hub, the Freeport LPG Export facility loaded a record 39 cargoes in the fourth quarter. DCP Midstream, LP adjusted pre-tax income of $41 million was down $9 million from the previous quarter, reflecting lower Sand Hills Pipeline equity earnings and timing of maintenance costs.

Turning to Chemicals on slide 7. Fourth-quarter adjusted pre-tax income was $203 million, up $71 million from the third quarter. Olefins and Polyolefins (O&P) adjusted pre-tax income was $216 million. The $68 million increase from the previous quarter is due to higher polyethylene margins, partially offset by higher turnaround and maintenance costs.

Global O&P utilization was 101%, supported by global consumer demand, including food packaging and medical supplies. CPChem polyethylene sales volumes set a new record in 2020. Adjusted pre-tax income for Specialties, Aromatics and Styrenics (SA&S) increased $8 million, primarily due to higher earnings from international equity affiliates driven by improved margins. During the fourth quarter, we received $215 million in cash distributions from CPChem.

Turning to Refining on slide 8. Refining's fourth-quarter adjusted pre-tax loss was $1.1 billion compared to an adjusted pre-tax loss of $970 million last quarter. Both periods reflect the continued impact of challenging market conditions. The decreased results in the fourth quarter were largely driven by higher turnaround and maintenance activity. Pre-tax turnaround costs were $76 million, up from $41 million in the prior quarter.

Maintenance costs increased primarily at the Alliance Refinery. We shut down Alliance in mid-September in preparation for Hurricane Sally, and it remained down for planned turnaround and maintenance activities

during the fourth quarter. The refinery safely resumed operations earlier this month. Crude utilization was 69% compared with 77% last quarter. The fourth-quarter clean product yield was 86%.

Slide 9 covers market capture. The 3:2:1 market crack for the fourth quarter was $7.84 per barrel compared to $8.17 per barrel in the third quarter. Realized margin was $2.18 per barrel and resulted in an overall market capture of 28%. Market capture in the previous quarter was 22%. Market capture is impacted by the configuration of our refineries. We make less gasoline and more distillate than premised in the 3:2:1 market crack.

During the quarter, the distillate crack improved $2.48 per barrel, while the gasoline crack decreased $1.74 per barrel, resulting in a modest improvement of our capture from the prior quarter. Losses from secondary products of $1.20 per barrel, or $0.60 per barrel, improved from the previous quarter due to improved NGL prices relative to crude.

Losses from feedstock were $0.46 per barrel compared to $0.35 per barrel last quarter. The Other category reduced realized margins by $3.08 per barrel. This category includes RINs, freight costs, clean product realizations and inventory impacts.

Moving to Marketing and Specialties on slide 10. Adjusted fourth-quarter pre-tax income was $221 million compared with $417 million in the prior quarter. Marketing and Other decreased $185 million due to lower realized margins, reflecting rising prices during the quarter. We were also impacted by lower volumes related to
COVID-19.

And while Marketing and Other results were lower in the fourth quarter, full-year 2020 adjusted pre-tax income of $1.24 billion was the highest since spinoff in 2012. Specialties decreased $11 million, largely due to lower finished lubricant margins. Refined product exports in the fourth quarter were 103,000 barrels per day.

On slide 11, the Corporate and Other segment had adjusted pre-tax costs of $235 million, an increase of $22 million from the prior quarter. This was primarily due to lower capitalized interest and higher employee-related expenses.

Slide 12 shows the change in cash for the quarter. We started the quarter with a $1.5 billion cash balance. Cash from operations was $639 million. This included a working capital benefit of $403 million, primarily due to the year-end drawdown of inventory.

Net debt issuances were $1.4 billion. This included $1.75 billion in senior notes and repayment of $500 million on the term loan. Phillips 66 Partners drew $125 million on its revolver. Capital spending was $506 million.

We paid $393 million in dividends; our ending cash balance was $2.5 billion. At Dec. 31, we had $7.8 billion of committed liquidity, reflecting $2.5 billion of consolidated cash plus available capacity on our credit facilities of $5 billion at Phillips 66 and $300 million at Phillips 66 Partners.

On slide 13, we summarize our financial results for the year. In 2020, we had an adjusted loss of $382 million, or $0.89 per share. We generated $2.1 billion of operating cash flow. Distributions from equity affiliates totaled $1.7 billion, including $632 million from CPChem. At the end of the fourth quarter, our net debt-to-capital ratio was 38%.

Slide 14 shows full-year cash flow. We began 2020 with a cash balance of $1.6 billion. Cash from operations was $2.4 billion, excluding working capital. It was a working capital use of approximately $300 million. We received a net $4.1 billion from our financing activities.

We added $3.75 billion of debt at Phillips 66 and approximately $400 million at Phillips 66 Partners. As cash generation recovers, we will prioritize debt repayment. We remain committed to a conservative balance sheet and strong investment-grade credit ratings.

Capital spending was $2.9 billion. We returned $2 billion to shareholders through $1.6 billion of dividends and $443 million of share repurchases. We suspended our share repurchase program in March. This concludes my review of the financial and operating results.

Next, I'll cover a few outlook items. In Chemicals, we expect the first-quarter global O&P utilization rate to be in the mid-90s. In Refining, crude utilization will be adjusted according to market conditions. In January, utilization has been in the low 70% range.

We expect first-quarter pre-tax turnaround expenses to be between $200 million and $230 million. We anticipate first-quarter Corporate and Other costs to come in between $240 million and $250 million pre-tax. For 2021, we plan full-year turnaround expenses to be between $550 million and $600 million pre-tax.

We expect Corporate and Other costs to be between $950 million and $1 billion pre-tax for the year. We anticipate full-year D&A of about $1.5 billion. And finally, we expect the effective income tax rate to be in the low 20% range.

With that, we will now open the line for questions.

Operator:

Thank you. We will now begin the question-and-answer session.

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

Doug Terreson:

Good morning, everybody. Greg, a notable feature of performance last year was that the company not only executed on its operating and capital cost reduction plans, but you guys also completed four to five major projects in what was one of the most tumultuous years in recent decades. So first, kudos to the team on a strong performance.

Simultaneously, while the benefits of diversification and taking care of business, like you did last year, were clear. The pace of change in the industry seems to be quickening, not only as it relates to energy policy and likely future energy mix, but also that which investors expect from their investments in the sector.

So, I've got a couple of questions. One, how do you think – or how do you guys think about how to navigate this evolving and changing environment; two, more tactical and strategic dexterity likely to be needed, maybe more than in the past? Or do you think it's about the same? And then three, are there obvious implications for a financial strategy for Phillips 66 along the way? So, three questions.

Greg Garland:

Okay. You gave me a lot to unpack there, Doug. Thanks. So, let's start at the top with kind of the overview. I think that for us, capital discipline – capital allocation remains core to our strategy and what we do. That's returning capital to shareholders as earnings returns above our weighted average cost of capital on what we choose to invest in as a company. Those are our guiding lights or guiding stars as we think about this, when we think about energy transition. I tend to think about it in three buckets, near-term, midterm and longer-term, Doug, in terms of our response and how we're going to navigate through it.

Clearly, in the near-term, we're building a renewable fuels pathway. What we're doing – so this year, midyear, we'll start up the first part of Rodeo 8,000 barrels a day. And by 2024, we'll have a full-facility conversion, more than 50,000 barrels a day there. We're working with Ryze Renewables for 11,000 barrels a day of renewable coming out of that facility. We're co-processing about 3,000 barrels a day at Humber today in the U.K., moving to 5,000 barrels a day. And so as we think about – as we approach to the middle point of the decade, we should have $1 billion-ish of EBITDA at our renewable fuels business. So that's certainly one pathway we
think about.

The second bucket is kind of more the medium-term. And as you know, we're a supplier of specialty graphite and to go into the anode production lithium-ion batteries. We continue to work to improve that, to help improve battery performance, but also lower cost. And so I think as we see EVs grow and they're going to grow, EV sales globally are going to grow, that portion of the business is also going to grow. And I think we can make nice contributions there in terms of what we bring to batteries and battery technologies.
And then maybe the third one is around hydrogen and that's longer-term. Certainly, today, we're building hydrogen fueling stations in Europe. So that's a first step. We're working in the United Kingdom with the Gigastack consortium, which is taking offshore wind, electrolysis to make green hydrogen. We're using that in our Humber Refinery to reduce the carbon content of our fuels produced at Humber. And so as I think about hydrogen, our industry as big consumers and producers of hydrogen, we really understand it. I think that hydrogen moving into transportation fuels in a big way is probably decades out. But we'll continue to build a pathway around hydrogen for the longer term. You may have seen that we got a grant from the DOE, and we talked about it in the opening comments today. But that's really around our solid oxide fuel cell technology and taking CO_2 and running through the fuel cells than to produce clean fuels. And so, there's probably a pathway there for us too.

So, our idea is we want to participate in energy transition. We want to do it where we can invest and earn returns that are above our weighted average cost of capital. We certainly want to exploit the technology base we have that uses existing equipment where we can convert it if we need to, like what we're doing at Rodeo. We try to find capital-efficient solutions where we can earn great returns.

I think the other thing I want to point out here, Doug, is you think about the challenges that we have before us of providing reliable, affordable, abundant energy; at the same time addressing the climate is something that's going to take a whole approach of the industry. But I think about the 10 million people that work in the industry today. They're problem solvers; they're engineers; they're scientists; they're marketing people. They're people that understand the complexity of the energy business today.

And I think they're some of the best people on the planet that are positioned to help solve this dual challenge that we have. And so, I'm an optimist always. And I think that this industry and our company certainly will have big roles to play in the energy transition as we move forward. And I know you asked three questions, and I don't know if I answered three, but I did the best I could with that. But maybe one last thing I…

Doug Terreson:

Well, I was just going to say, no, it sounds like a responsible shareholder-oriented strategy, but I didn't want to interrupt you. So go ahead and finish, Greg.

Greg Garland:

Well, I'm just going to tie it up with – I know my buddy, Joe made a point yesterday, and we'd be remiss, if we didn't say we recognize you're coming on a transition point, you've made some great calls. You've been at the top of your game for a very long time. And that's hard to do with the business that you're in, Doug.

You've been a friend of the industry and our company, but yet, you've had the courage to challenge us when we needed to be challenged, and you've always had shareholder interest at heart. So, I would tell you really well done. We're going to miss you, and we wish the very best for you. And hopefully, we'll see around the energy patch in the future.

Doug Terreson:

Well, thanks, Greg. Those are kind comments, and I appreciate them. You guys have been really easy to support because you've had a model for success, and you've executed. And so, you position this company very well for the future, you and the team best of luck, and thanks again for your example.

Operator:

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

Neil Mehta:

Good morning, team. I guess the first question I had is going back to the Analyst Day from a couple of years ago; it feels like an eternity ago, certainly a pandemic ago, but the company laid out a $6 billion to $7 billion long-term cash flow target. And obviously, 2020 is hard to capitalize going forward. But as you think about all the different pieces that went into that $6 billion to $7 billion, recognizing it's a moving target, but Greg, can you just share your perspective on one, do you still think that's the right anchor? And what are the pluses and minuses as far as you can tell right now at this point?

Greg Garland:

Yeah. I think I'll start off and then Jeff and other folks can help me. I don't think we're ready to make a call that midcycle has changed yet. I think that it's early to do that.

In terms of how we've reoriented the capital plan here in response to COVID-19, I think as an industry itself has kind of paused in terms of the upstream and the midstream opportunities available to us. Certainly, we're probably going to run $200 million to $300 million under the growth plans we announced on that day, simply because we're not going to do the Red Oak Pipeline. We're not going to do the ACE Pipeline and some of the other things that we had laid into the plan that we just stopped working on.

But we may well find other opportunities. So, you have Rodeo Renewed that's going to come in. It's going to be a big, big EBITDA generator that wasn't in those numbers. AdvantEdge66 would continue to prosecute that. If you remember, somewhere $600 million or so of that was around our value chain strategy optimization work we're going to do. And all that's midcycle predicated. So, we've done a lot of work around there. We haven't been in midcycle conditions. And so, in 2020, we're not achieving the results we thought we achieved there, but I think as we move into 2021 and into 2022, we're pretty optimistic that we get back to a recovery to midcycle conditions around that part of the portfolio.

So, Jeff, I don't know if you want to tag on there or add anything to that, but I think that would be my views.

Jeff Dietert:

Yeah. I think within the Marketing segment, we had $1.4 billion of EBITDA kind of baked in, and they generated $1.6 billion of EBITDA in a market where we had some demand hits in 2020. It was supported by the JV retail acquisition that we made early last year. The Midstream contributions have held up nicely with the fee-based approach that we've had there, $2.1 billion of EBITDA this year in tough market conditions, obviously strong, with Sweeny Fracs 2 and 3, Clemens, South Texas Gateway, all contributing to a full year in 2021. CPChem, we've not really changed the outlook there, and there's a potential for future contributions from Gulf Coast 2 and Ras Laffan project. So, I think there's still a lot to be encouraged about as we look forward.

Neil Mehta:

Thanks, guys. And the follow-up is just on Refining. Obviously, it was a tough fourth quarter. And utilization, let's call it, systemwide, I think 69%, and you're running low 70% in January. Do you have a view on sort of the trajectory of utilization for the industry, recognizing in the near term, it's going to be very much demand-dependent? And is there a good rule of thumb of refining utilization, when it gets to a certain level, you think the business is back to generating pre-tax profit?

Robert Herman:

Yes. This is Bob, Neil. I think when we think about the near-term future and how do we get back to higher utilizations, it all kind of starts with the vaccines that Greg referenced in his opening comments, right? We got to get people back to normal life and back out on the road using their cars, going to school, going to

work, going where soccer mom turn arounds on the weekend. That's the kind of the first step and that leads to a demand signal for gasoline and distillate to a lesser extent, and it starts pulling utilizations up. I think you'll see we'll be following the market to add capacity back.

And if you think about the timing, we believe the government will get more efficient at getting people vaccinated as the months go by here. But certainly by summer, we would expect that a good portion of the American public can get out and burn the fuels that we make. And that should lead to a more normal-type summer level. We don't have a rule of thumb of what we've got to get back to. But obviously, running more is better and spreading out our costs over more barrels. Some of our plants get more efficient at higher run rates. The market gets more efficient at higher run rates, and we kind of return.

We always think about – you got to have that clean product crack signal to get utilization up. That leads to covering your cost. And then really, we need more normalized crude differentials in the market. And those will all play out together because as utilization rises across the industry; there's going to have to be a pull primarily on Saudi heavy barrels that should help move the crude spreads back out, and that's really how we capture more and more of our crack and kind of get back on the path to high utilization rates and a lot more profitability.

Operator:

Phil Gresh, JPMorgan. Please go ahead. Your line is open.

Phil Gresh:

Yes. Hi, good afternoon. First question just on the Chemicals business. I wanted to get your thoughts there on the outlook. And in particular, for your own business, I think margins have been extremely strong and continue to be here in the first quarter. And many of your peers have put up strong results as well. It seems like your results maybe had a little bit more of a lag effect or some cost headwinds there in the fourth quarter. So, I was hoping you might be able to elaborate on that a bit and your outlook here as we enter 2021?

Greg Garland:

Well, we're constructive on Chemicals, Phil. I think that demand is still really strong in that segment, and we see that across all regions where there's China, Europe or North America. CPChem has run really well, had record sales volumes. The other thing we've seen is we've seen delays in the startup of new facilities. Part of that's been an economic-related, part of that's just been COVID-19-related as people have either slowed construction or paused construction due to the density of workers on these big sites. So, these balances actually look better to us at this point in 2021 than they did at the equivalent point last year.

And so I think we're pretty optimistic around operating rates. Margins are – and the delta of the market margins, it's not unusual to see CPChem kind of deviate off IHS market margins. We've seen that many times in the past. And certainly, it's timing. It's the portfolio. It's geography, as you think about that.

If you think about the fourth quarter, probably high-density polyethylene contract prices were essentially flat October, November, they go up in December. And then if you think about your contract portfolios, there could be lags of 30 to 60 days of really fully realizing those price increases through the portfolio. So, the part of that is just geography. Probably one-third of CPChem sales are export-oriented sales.

And so, if you think about the U.S. market price, usually the Europe price is higher, and it's usually higher by about the price delta. The Asian price has probably been $0.20 under the North American price. And so you have that geographic mix that also comes into play when you're looking at that. But having said all that, we think that margins are certainly above midcycle today, and we have a good line of sight to what we think are above midcycle margins for 2021. So, we feel confident. I think, Tim, you want to talk about propylene and some of the things going on there, too.

Tim Roberts:

Yes. I think really to summarize and Greg, to your comments, what's probably important is you had COVID-19 come along, and it really had an impact on a lot of different industries with regard to demand. But with regard to Chemicals, what we did see is demand didn't wane much, especially on the consumables side. So, consumables remain very strong, which benefited CPChem, which really has a larger exposure to that. Durables really fell off.

So, what you see now, I think, Phil, is as durables are coming back, some of the other competitors out there have more exposure to durables. So, you're just seeing that rebalancing that's going on. But it's a good thing overall because if people are out still buying consumables, which is good and now they're back out buying durables, which is good. So again, building to an economy hopefully that's starting to pivot back toward where it should be.

Phil Gresh:

Got it. Okay. Thank you. A second question, I guess this is probably for Kevin. As you think about 2021 and the progression of cash flow generation and the balance sheet, I think you've talked about in the past a tax refund that will be coming in as one factor. But how do you think about that plus the free-cash flow profile, dividend coverage and balance sheet targets? Thanks.

Kevin Mitchell:

Yes, Phil. So, one element of our cash generation in 2021 will certainly be a, it will show up as positive working capital, and it will because we'll be collecting on the tax receivables. So, we have a tax receivable at year-end of about $1.5 billion. And we expect about two-thirds of that to come in, in the first half of the year, probably second quarter, and then the remainder toward the end of the year. So that's a significant component of cash generation.

And so when you step back and think about it in 2020, as bad as things were in 2020, we're projecting better conditions in 2021 when you think about the full-year 2021 compared to full-year 2020. So, we had $2.4 billion of pre-working capital cash generation in 2020. So, we'd expect a stronger number than that, plus the positive impact from working capital. And so to us, there's a pretty clear line of sight to not only covering the capital program, which is $1.7 billion, so we've taken a lot out of the capital program relative to previous years to $1.7 billion of capital, the dividend is $1.6 billion, and then we'd expect to be able to make some progress on paying down some of the debt.

And as we've talked before, we have a lot of flexibility around that in terms of debt that's either coming due or debt that is callable without any penalty to do that. So, I think we feel pretty confident that we'll be able to make some good progress, not getting all the way to where we want to get to over the next probably a couple of years. We'd like to be able to get the debt that we've added over the course of 2020 paid down and have the balance sheet back to where we want it to be. And that's important to us. It's important that we maintain those strong investment-grade credit ratings, A3, BBB+ we feel good about those. We want to be able to maintain that sort of financial flexibility and strength.

Operator:

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

Roger Read:

Good Morning. How are you all doing. Maybe to follow a little up on kind of the path that Phil was going down. You talked about issues that hampered CPChem this quarter, but I was taking a look at all the things that you started up late, Q3 through Q4 in the Midstream area. So I just wanted to maybe see if you could quantify some of the issues there, not so much as I guess a missed revenue but, more so on the cost, and then, the type of expectation on performance in Q1, and maybe in Q2 given the pace of startup.

Tim Roberts:

Well, Roger, this is Tim Roberts. I'll chime in a little bit here, a couple of things. Clearly, we're down – well, we're up quarter-over-quarter, but our expectation is higher. And with transportation in some of our pipelines being down over what we've projected or have performed at before, it's really related to refinery utilization is one key part of that. So that's driving the piece of that.

In the meantime, as well, we've also seen some of the producers out there, which has had an impact clearly on people putting volumes through the pipes. So that's shown up. It's shown up a little more on the crude side. The one bright spot we've seen actually has been in the NGL space. And we're anticipating that to continue on here into 2021.

But really those – it's been a little bit. We've brought this new capacity on. In fact, I would say that in the fourth quarter as you go 3Q to 4Q, we had a plus $30 million improvements in our Sweeny Hub and that was really related to bringing on the two Fracs 2 and 3. And then subsequently having a record performance with regard to shipments at the LPG export facility, which also contributed to that $30 million increase quarter-over-quarter.

Had a little bit with regard to some trading activity with our propane and butane, which we trade around our business, to make sure we optimize our system. It's really to make sure we get the right molecule, at the right place. And so, we had a little bit of market-to-market impact there and also on some inventory, which impacted us.

But also, we saw a little bit of an impact as well in the fourth quarter, if you go from 3Q to 4Q on ethane rejection. Ethane was getting back into the NGL barrel in 3Q. And it's really gone – now it's going back into rejection, and so that's impact in NGL volumes and where does it impact us? A little bit of our equity ownership in Sand Hills.

And then the other part is, we've got two JV fracs as well that had lower volumes and lower margins. Most of it was driven by just cracking a heavier barrel and there were fewer barrels coming down the pipe.

Jeff Dietert:

Roger, with respect to the new project contributions, I'd pointed to the investor update and our Midstream project updates. We outlined all the capital spending and the kind of six to eight multiple of EBITDA kind of investments. Sweeny Fracs 2 and 3, $1.4 billion, we've got South Texas Gateway, Clemens contributing as well.

So, those were kind of a one-quarter contribution in 2020 that we'll get full-year contributions in 2021. C2G Pipeline scheduled to come on midyear. So, we'll get half a year of contribution from that asset in 2021. I think those are the increments to be aware of, supporting 2021 profitability and ultimately 2022 profitability in the Midstream.

Kevin Mitchell:

I'd just like to make a comment on costs as well, Roger. And we've talked about costs were up quarter-over-quarter. And we've talked about that. But if you step back and look at the year, we reduced costs. Our full-year costs were $650 million lower than 2019.

So, we had a $500 million cost reduction target. And as we step back and look at everything we've done; we actually feel extremely good about where we came in on costs. When you also factor in all the project activity work that we had and the new assets that came up and came online. So overall, we actually feel very good about where we are.

Roger Read:

Yeah. I wasn't trying to criticize you on the cost side. I was more just trying to understand if you had a full-cost impact in Q4 with startups, but not a full-volume impact. As you ramp up volumes, things would look

better in Q1. That kind of was where I started the question.

Tim Roberts:

Yeah. That's right. There's an element of that in there, Roger.

Roger Read:

Okay. And then just as a follow-up question, also kind of piggybacking on Phil there on the cash flow side, you mentioned in the year with the $2 billion of cash flow. I think about three-quarters of it coming from equity partnerships. What would be the expectation for that kind of cash flow performance as we look at 2021? Is there any of that, that has to be paid back? Or if debt was taken on at those partnerships, does that have to get paid down before we would expect additional cash flows to come through? In other words, 2022 will be fine, but 2021 may be constrained a bit.

Kevin Mitchell:

Yes. In terms of the distributions from equity affiliates?

Roger Read:

Yes.

Kevin Mitchell:

No, I would – just thinking high level through that. I don't see why that number wouldn't continue at that level. In fact, it may go up certainly from a CPChem standpoint, so we had $632 million from CPChem in 2020; we would expect CPChem to probably come in stronger in 2021 given the trajectory on margins and what they're doing there. So that element, and that's by far the biggest single equity distribution we receive. And the rest of them, no real reason to think they would come off dramatically. So, I think if anything, we would expect a slight positive on that.

Operator:

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

Doug Leggate:

Thanks. Good morning. Good morning, guys. Happy new year. I wonder if I could, Kevin just hit the balance sheet question again, just a real simple question. We've obviously seen a lot of different levels of volatility than perhaps any of us thought was through the cycle. How does that change your view of where you want the balance sheet to be medium-term once we consider the other side of this? Do you reset the absolute debt metrics to a lower level is my first question?

Kevin Mitchell:

Yes. As I think about that, Doug, if we were a refining-only business that may be something that we need to consider. And certainly, you would expect for refining-only, you would need to run at lower leverage because of the volatility. But as we've been growing all the non-refining segments, I think we actually feel pretty good maintaining that same construct around how we think about the balance sheet, both in terms of absolute debt levels and debt-to-capital ratios.

And as you know in the past, we've talked about 30% debt-to-capital target; that's really more of a sort of guideline. It's an easy number to calculate, and it's a useful indicator. But ultimately, we're really focused on the credit ratings, maintaining the strong investment-grade credit ratings. And I feel that we added $4 billion over the course of last year. If we can take care of that or something very close to that. When you factor in the growth in the other parts of the business, I think we'll be in a very good position from a balance sheet

perspective.

Doug Leggate:

Okay. I appreciate the full answer. My follow-up fellows, I'm afraid is a micro question. I'm just hoping you can offer a little bit of color as to what's going on with the fairly substantial recovery, not anywhere near midcycle, of course, but nevertheless, substantial recovery in the cracks in just the last two or three weeks. Demand has come back. Inventories are still high. And we're just trying to kind of figure out what's going on. I just wondered if you could offer some color on what your perspective is and then I'll pass it on? Thank you.

Brian Mandell:

Well, I would say that we have seen product inventories come down. Product inventories are in the five-year average; gasoline was actually below the five-year average, probably 3%. So, we're seeing that. And I think as the vaccine gets out there, people are optimistic, traders when they think about markets, they think about future markets and the future looks bright. So, gasoline cracks have been moving and distillate cracks as well.

Doug Leggate:

Yeah. I think I was thinking more on a demand adjusted basis. We haven't really seen any tightening of the system, I guess, was my point. I appreciate your context. I just wondered if there's anything unusual going on right now, maybe it's stockpiling ahead of maintenance or unusual maintenance or even with spring maintenance, perhaps another round of turnrounds, but if you think it's just the normalization of inventories and...

Brian Mandell:

I would make one comment. If you think about RINs, we think RINs are in the cracks. So, when you think about product prices and crack prices for products, the RIN is in there. So as the RIN goes up, you would expect that to show up in the crack margins of both gasoline and distillate cracks.

Doug Leggate:

All right. Great stuff, guys. Appreciate the time. Thanks so much.

Operator:

Paul Cheng, Scotiabank. Please go ahead. Your line is open.

Paul Cheng:

Good morning. Greg, just curious. I mean, you make some reconfiguration in California. And we're looking in your portfolio, how Europe will fit into the longer-term portfolio, given arguably that maybe even a more challenging regulatory environment that we are seeing there? Is there any meaningful adjustment do you need to do in that business? That's the first question.

Greg Garland:

How Europe fits in the portfolio? I was going to start with California. Okay. But let's go Europe. I think you think about Europe, I mean, first of all, return on capital employed, it's 35%-plus returns. So, it's actually one of the stronger businesses in our portfolio from a return standpoint. The Marketing business is business that we excel at in that part of the world and doing a really good job with it. Then you move over to our Humber Refinery in the U.K., we think it's one of the better refineries in Europe. It certainly has been a contributor around our specialty coke, needle coke businesses. And so, we like that value proposition with that asset.

So, we tend to like the continental business that we have in Europe. We like the position that Humber

enjoys, not only from a cost standpoint but from an environmental standpoint, in that European theater. Bob, I don't know if you want to add on to that, you can.

Robert Herman:

Yeah. The one thing I would add on to is we were talking about energy transition earlier and the anode for the batteries. And so Humber coke, right, is going to be a player in that, and if you look at the even the laws in the U.K. after Brexit in their ambitions to have EVs, they want local content produced batteries. So, I think that opens up an opportunity for Humber, and we really like where we're sitting today with that.

Humber also has the advantage of being designated in the U.K. sitting in a cluster that the government there is very interested in developing the green hydrogen and the blue hydrogen schemes and things like that, that Greg talked about. So, we see a lot of opportunity in kind of the medium-term, I think, for Humber and just beyond being a strong fuels provider in the U.K.

Robert Herman:

And I would just add on the marketing side, maybe in the United States, people less familiar with our brands, COOP and JET. We're the best brand in Switzerland. We're the second-biggest brand in Austria and then third in Germany. So, we have a very, very strong brand; as Greg said, a very strong return on capital employed.

Paul Cheng:

Okay. Great. Second question that I think in the past has been asked on Phillips 66 Partners with you at 13%, I mean, strategically, that is there any benefit having that as a public trade company? And with that – I mean, I think that you guys have been saying that you don't want to rush into that. But what kind of timeline would give yourself in looking at whether that structure makes sense for you to maintain?

Kevin Mitchell:

Yes. Paul, it's Kevin. I think I would just sort of reiterate what we've said in the past that, clearly, there's a big – there's a significant DAPL overhang on Phillips 66 Partners that's creating uncertainty, which is understandable. And Phillips 66 Partners has actually worked extremely well for us. You look at the growth and where that entity has come from and where it is today.

And so, at an objective measure, you look at that, and we feel very good about it. But obviously, the unit price we don't like. We've got this uncertainty around DAPL, and we just don't feel it will be appropriate to make any rash decisions right now while there's this cloud of uncertainty over it and doing something different. We just don't think it's the right timing to be considering that.

Paul Cheng:

Hey, Kevin, can I just – maybe as a side question. You mentioned earlier that to Doug's question that you think the longer-term balance sheet debt ratio is really didn't change compared to the pre-pandemic levels because you have all the other diversified business.

But if we're looking at that, other than Chemicals, your other business, whether it is the transportation, the NGL, is still hydrocarbon or fossil fuel-related. And if indeed that we're going through the energy transition, those business will also get impact. So, from that standpoint, should we still go with a far more conservative balance sheet?

Kevin Mitchell:

Well, they're hydrocarbon-based businesses, but you don't have the margin volatility that you have in the traditional fuels refining business. And so our assets are fundamentally supported by long-term contracts, committed volumes – minimum volume commitments.

And so I don't think – I think your question is maybe a – maybe you get far enough out there, and there's a different point on that. But within a reasonable time horizon, I still think we feel good that those businesses are going to provide solid, stable generation of earnings and cash and, therefore, can support the debt that we would have on the balance sheet.

Operator:

Jason Gabelman, Cowen. Please go ahead. Your line is open.

Jason Gabelman:

Yes. Hey, guys. Thanks for taking my questions. On to the first, asking on the Refining business end, it's been, I think, a little weaker the entire year than we had expected it to be. And this other bucket has been a big headwind. It looks like it's been the past couple of quarters around $3 a barrel headwind versus the base crack; I think last year, it was under $1.50. So, can you just talk about what is exactly going on there? I know RINs are part of it and there are timing impacts. But why has that headwind expanded this year? And do you see that reversing next year? And I have a follow-up. Thanks.

Robert Herman:

Yeah, it's Bob. You're right, it is a headwind, but that is the category where we kind of put the cats and dogs. So, RINs is a big piece of it, right? If you just look at the fourth quarter, and we draw the box just around refining. So, we're not talking about what we recover downstream on the RIN or anything. But on the refining per barrel basis in the fourth quarter, it was $2 of that $3.08. So, it is a big part of that Other category.

The other big one in there is what we spend to get our products from the refinery gate to market. So, there's distribution costs that come back in there. And some of those are per barrel, but some of those kind of fall into the fixed category.

So, we've got tankage rented down streams, or we've got take-or-pays on pipelines that we need to pay on minimum volumes. That all kind of comes back to those costs then elevate when you've got less volume or pushing through there. So, by definition, those costs will come back down in and get smaller as we ramp volumes up here through the first part of 2021. And that really kind of accounts for the two big drivers in that Other category.

Jason Gabelman:

Got it. And just on the RINs, technically, the headwind in Refining should be a tailwind in the Marketing business. Is that the right way to think about it?

Robert Herman:

Yes, that's correct. We recover a portion of those costs downstream of the refiners.

Brian Mandell:

We blend the majority of the gasoline produced by our refineries in our Marketing business. And as we add retail for the integration of our Refining business, particularly in Middle America, where it's much more difficult to export, we will get more capture of that RIN.

Jason Gabelman:

Got it, great. And then, I just wanted to ask about DAPL, which was just mentioned and the litigation process. Can you just discuss the path forward? I believe there's a case being heard in the lower court

about the ability to keep the pipeline shut down while this permit process is ongoing in terms of trying to get the new EIS in place to support the permit.

So just wondering what the next steps are in that litigation process? Can Biden step in and shut down the pipeline without kind of going through the adjudication process and any other thoughts on that? Thanks.

Jeff Dietert:

Yeah. I think as we look at the Bakken Pipeline, it's operated extremely well. We think it should continue to operate, as we're working through the environmental impact statement. I think it's hard to speculate on how the legal proceedings are going to play out. We review and analyze many scenarios and how we will react, depending on how this plays out. But the courts are going to have to continue to work through the process. And we'll react accordingly.

Operator:

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

Manav Gupta:

Hey guys. First, a quick question, I think your Gulf Coast operations got hit pretty hard by the hurricane. And then you decided to move forward some turnaround. So, for two quarters, your Gulf Coast refineries have been in a kind of a turnaround. I'm just trying to understand from here on, how do you stabilize those operations? And when do you get the refineries back to, let's say, even 70%, 75% utilization versus where they have been operating for the last two quarters?

Robert Herman:

Yeah, Manav, you're absolutely right. So, if you kind of look at the three refineries that we've got in there, we've got Sweeny, which really operated per the market conditions the entire quarter. Alliance, we chose to have down for the entire quarter. So back in September – second half of September, we came down because we had a hurricane pointed straight at us; the hurricane moved at the last minute, but while we were down since we were only a couple of weeks away from shutting down for some reform or catalyst change work, we decided to stay down. We executed that work.

And then usually, the market conditions in the fourth quarter in the U.S. Gulf Coast are pretty tough. So, we took advantage of that and kept the refinery down and pulled some difficult-to-do turnaround work that we would have done late this year or early next year. We pulled it forward and got it out of the way. So, that was a conscious decision to keep all that down. That's Alliance before it came down was in 180,000 barrels a day range from an operating standpoint.

And then Lake Charles with the two hurricanes that came running through there, we were just about back up and running after the first one, and then we came back down, but the second one waited on electricity again for a few days and then came back up. And we've had a couple of operating issues coming back out of that that we're dealing with. But the most part, Lake Charles is up and running and processing crude. We restarted Alliance in early January, and they're up and running at the market rate that we want them to be at. So, other than kind of normal turnaround work and stuff that we've got going on, we don't anticipate any other issues in this quarter or next in the Gulf Coast.

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 Shannon or myself. Thank you.

Operator:

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