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PSX.N - Q2 2023 Phillips 66 Earnings Call

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## OVERVIEW:

Company Summary

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**Brian M. Mandell** *Phillips 66 - EVP of Marketing & Commercial*

**Jeffrey Alan Dietert** *Phillips 66 - VP of IR*

**Kevin J. Mitchell** *Phillips 66 - Executive VP & CFO*

**Mark E. Lashier** *Phillips 66 - President, CEO & Director*

**Richard G. Harbison** *Phillips 66 - EVP of Refining*

**Timothy D. Roberts** *Phillips 66 - EVP of Midstream & Chemicals*

## CONFERENCE CALL PARTICIPANTS

**Douglas George Blyth Leggate** *BofA Securities, Research Division - MD and Head of US Oil & Gas Equity Research*

**Jason Daniel Gabelman** *TD Cowen, Research Division - Director & Analyst*

**John Macalister Royall** *JPMorgan Chase & Co, Research Division - Analyst*

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**Matthew Robert Lovseth Blair** *Tudor, Pickering, Holt & Co. Securities, LLC, Research Division - MD of Refiners, Chemicals & Renewable Fuels Research*

**Neil Singhvi Mehta** *Goldman Sachs Group, Inc., Research Division - VP and Integrated Oil & Refining Analyst*

**Paul Cheng** *Scotiabank Global Banking and Markets, Research Division - Analyst*

**Roger David Read** *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

**Ryan M. Todd** *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

## PRESENTATION

### Operator

Hello, and welcome to the Second Quarter 2023 Phillips 66 Earnings Conference Call. My name is Alex, and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded.

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

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### Jeffrey Alan Dietert - Phillips 66 - VP of IR

Good morning, and welcome to Phillips 66 Second Quarter Earnings Conference Call. Participants on today's call will include Mark Lashier, President and CEO; Kevin Mitchell, CFO; Tim Roberts, Midstream and Chemicals; Rich Harbison, Refining; and Brian Mandell, Marketing and Commercial. Today's presentation materials can be found on the Investor Relations section of the Phillips 66 website, along with supplemental financial and operating information.

Slide 2 contains our safe harbor statement. We will be making forward-looking statements during today's call. Actual results may differ materially from today's comments. Factors that could cause actual results to differ are included here as well as in our SEC filings.

With that, I'll turn it over to Mark.

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**Mark E. Lashier** - Phillips 66 - President, CEO & Director

Thanks, Jeff. Good morning, and thank you for joining us today. In the second quarter, we had adjusted earnings of \$1.8 billion or \$3.87 per share. We continued to execute on our strategic priorities and returned \$1.8 billion to shareholders through share repurchases and dividends. Our results reflect strong operating performance across our portfolio, demonstrating the commitment of our employees to maintain safe and reliable operations. We want to thank them for their dedication to operating excellence and delivering on our mission to provide energy and improve lives.

In Refining, we continue to run above industry average rates, and in Midstream, we had record NGL frac volumes. We continue to run our Sweeny Hub fracs and export terminal at above nameplate capacities to meet strong demand. We remain committed to operating excellence and continue to focus on our strategic priorities to create value and return cash to shareholders.

Slide 4 summarizes progress toward our strategic priorities. Over the last 12 months, we've returned 14% of our market cap or \$5.4 billion to shareholders through share repurchases and dividends. We're on track to return \$10 billion to \$12 billion over the 10-quarter period between July 2022 through year-end 2024.

In Refining, we had another quarter of strong operating performance with crude utilization of 93% and lower operating costs. As of the end of the quarter, more than \$300 million of the \$550 million run rate cost savings are attributable to Refining. Kevin will provide an update on our business transformation progress in a moment.

We're executing our NGL wellhead to market strategy and capturing DCP integration synergies faster than expected. Our current synergy run rate is over \$200 million. We've been successful in identifying additional opportunities to increase our target from \$300 million to more than \$400 million by 2025. In June, we completed the acquisition of DCP Midstream's public common units for \$3.8 billion, increasing our economic interest from 43% to 87%. We ended the quarter with a net debt-to-capital ratio of 35%. We expect leverage to be within our target range by year-end.

In Refining, we're converting our San Francisco refinery into one of the world's largest renewable fuels facilities. The capital to convert the facility to over 50,000 barrels per day of renewable fuels production is anticipated to be approximately \$1.25 billion. This is an increase from our original premise due to higher-than-anticipated material and labor costs as well as impacts related to weather and permitting.

The revised capital cost of around \$1.60 per gallon remains well below similar announced projects, and the expected returns are significantly above our Refining hurdle rates. The overall project timing and scope remains unchanged. We expect to begin commercial operations in the first quarter of 2024.

In Chemicals, CPChem completed construction of the 1-hexene unit in Old Ocean, Texas and expects to begin operations by the end of the third quarter. The new propylene splitter at its Cedar Bayou facility is expected to start up in the fourth quarter.

CPChem and QatarEnergy are jointly building world-scale petrochemical facilities on the U.S. Gulf Coast and in Ras Laffan, Qatar. On the U.S. Gulf Coast, the Golden Triangle Polymers joint venture has project financing in place. The Ras Laffan petrochemical joint venture expects to complete project financing later this year. Both projects remain on schedule to start up in 2026.

Now I'll turn the call over to Kevin to review the business transformation savings and second quarter financial results.

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**Kevin J. Mitchell** - Phillips 66 - Executive VP & CFO

Thank you, Mark. Starting on Slide 5 with an update on our business transformation progress. Our \$1 billion business transformation target includes \$800 million of cost savings and \$200 million of sustaining capital reductions. We have identified over 2,700 initiatives to permanently reduce costs, with employees across the organization actively engaged in the transformation process. We have completed 1,200 initiatives that are generating value today. .

The chart on the left shows our progress toward the \$800 million cost reduction target, with \$550 million of run rate cost savings at the end of the second quarter. The stacked bar shows our actual cumulative cost reductions for the year by category.

Over the first half of 2023, we realized \$260 million in cost savings. The majority of these cost reductions relate to Refining, which has benefited by about \$0.40 per barrel.

Business transformation initiatives range from optimizing services across our portfolio of assets to establishing new tools to improve use of steam and energy. Organizationally, we strengthened our centralized model for core functions to drive consistency and efficiencies. We continue implementing cost savings initiatives and are on track to achieve our run rate target by year-end 2023. We expect to realize the full \$800 million of cost savings in 2024, which will include Refining cost reductions of \$0.75 per barrel.

Now I'll move to Slide 6 to cover the second quarter financial results. Adjusted earnings were \$1.8 billion or \$3.87 per share. The \$15 million decrease in the fair value of our investment in NOVONIX reduced earnings per share by \$0.03. We generated operating cash flow of \$1 billion, including a working capital use of \$1 billion and cash distributions from equity affiliates of \$239 million.

Capital spending for the quarter was \$551 million, including \$339 million for growth projects. We returned \$1.8 billion to shareholders through \$1.3 billion of share repurchases and \$474 million of dividends. We ended the quarter with 445 million shares outstanding.

I'll cover the segment results on Slide 7. Additional details can be referenced in the appendix to this presentation. This slide highlights the change in adjusted results by segment from the first quarter to the second quarter. During the period, adjusted earnings decreased \$199 million, mostly due to lower results in Refining and Midstream, partially offset by an improvement in Marketing and Specialties.

In Midstream, second quarter adjusted pretax income was \$626 million, down \$52 million from the prior quarter. The decrease was driven by the impact of declining commodity prices in our NGL business. This was partially offset by higher volumes in transportation.

Chemicals adjusted pretax income decreased \$6 million to \$192 million in the second quarter. The industry polyethylene chain margin increased by \$0.03 to \$0.20 per pound. However, this was offset by higher maintenance and turnaround costs in the quarter. Global O&P utilization was 98%.

Refining second quarter adjusted pretax income was \$1.1 billion, down \$460 million from the first quarter. The decrease was due to a decline in margins, partially offset by higher volumes and lower operating expenses. Realized margins decreased primarily due to the decline in distillate crack spreads and narrowing heavy crude differentials, partially offset by improved gasoline cracks. In addition, realized margins reflect the impact of losses from secondary products due to declining NGL and coke prices.

Marketing and Specialties adjusted second quarter pretax income was \$644 million, an increase of \$218 million from the previous quarter, mainly due to seasonally higher global marketing margins and continued strong demand. The Corporate and Other segments adjusted pretax costs were \$12 million lower than the prior quarter. The adjusted effective tax rate was 22%, consistent with the previous quarter. The impact of noncontrolling interests was improved compared to the prior quarter and also reflects our acquisition of DCP units on June 15.

Slide 13 shows the change in cash during the second quarter. We started the quarter with a \$7 billion cash balance. Cash from operations was \$2 billion, excluding working capital. There was a working capital use of \$1 billion, mainly reflecting an increase in inventory, which included the impact of unplanned downtime at the Bayway Refinery and seasonal storage opportunities. Year-to-date working capital is a use of around \$2 billion, primarily related to inventory that we expect to mostly reverse by year-end. We funded \$551 million of capital spending.

In June, we drew \$1.25 billion on a single draw term loan to partially fund the acquisition of the DCP units for \$3.8 billion. This transaction and the redemption of DCP's Series B preferred units of \$161 million are represented as repurchase of noncontrolling interests. Additionally, we returned \$1.8 billion to shareholders through share repurchases and dividends. Our ending cash balance was \$3 billion.

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, we expect the third quarter worldwide crude utilization rate to be in the mid-90s and turnaround

expenses to be between \$110 million and \$130 million. We anticipate third quarter Corporate and Other costs to come in between \$280 million and \$300 million, reflecting higher net interest expense from funding the purchase of DCP units during the second quarter.

In 2023, we expect our full year capital spend to be above the \$2 billion budget, reflecting approximately \$200 million of additional spending on Rodeo Renewed. In addition, we just closed on a \$260 million acquisition of West Coast marketing assets. This acquisition supports the high-return Rodeo Renewed project by optimizing the full value of our renewable fuel sales to end customers.

We continue to review our portfolio to determine if assets meet our strategic long-term objectives or if they provide more value to third parties. Earlier this year, we divested the Belle Chasse Terminal, and very recently, we sold our interest in the South Texas Gateway Terminal. Total proceeds from the 2 transactions are approximately \$350 million. Now we will open the line for questions, after which Mark will make closing comments.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question for today comes from Doug Leggate of Bank of America.

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### Douglas George Blyth Leggate - BofA Securities, Research Division - MD and Head of US Oil & Gas Equity Research

I'm not sure who wants to answer this, maybe Kevin, but we've obviously talked ad nauseam about what we think could be a new mid-cycle Refining outlook. But what we haven't taken into account is the continued upgrade to your synergy targets, the faster delivery of your cost reductions and more importantly, the continued appearance of deferred taxes in your operating cash flow. So Kevin, I guess my somewhat convoluted question is, what do you think your sustainable mid-cycle free cash flow looks like for the company post these recent series of changes that you've introduced?

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### Kevin J. Mitchell - Phillips 66 - Executive VP & CFO

Yes, Doug. So we had guided to \$7 billion increasing to \$10 billion at Investor Day of cash flow. And the reality is some of the actions that bridge us from \$7 billion to \$10 billion we have executed on. And so at this point in time, on a traditional -- our view of Refining mid-cycle, we're probably somewhere in the \$8 billion range, maybe a little bit higher than that. But we're not all the way to \$10 billion because there are still other things we need to execute on. But we're certainly making good progress from the \$7 billion to \$10 billion.

Your comment on deferred taxes is a relevant one. This year, we actually expect to have a slightly larger-than-normal deferred tax benefit on cash flow. So I think I had previously guided to about \$400 million to \$500 million of benefit for the year. We expect that to be more like \$700 million to \$800 million, and that's mainly because of the impact of DCP buy-in on that. And after that, we should revert to a more traditional sort of \$400 million to \$500 million level.

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### Douglas George Blyth Leggate - BofA Securities, Research Division - MD and Head of US Oil & Gas Equity Research

Just to be clear, you have not changed your view of mid-cycle margins, is that right?

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### Kevin J. Mitchell - Phillips 66 - Executive VP & CFO

That is correct. We have not changed our view of mid-cycle, but we would acknowledge that we are in a stronger than mid-cycle margin environment currently. We have been for the last 1 year-plus, 1.5 years. And barring any major economic downturn, we actually think that will continue for a reasonable period of time, just given the overall supply/demand balances that exist globally.

**Douglas George Blyth Leggate** - *BofA Securities, Research Division - MD and Head of US Oil & Gas Equity Research*

Okay. My follow-up, just a quick one. The step-up in the buyback piece, is that a transitory perhaps as a consequence of the DCP process? I'm not quite sure what other things might have delayed you. But I guess my point is that if I look to the \$5 billion to \$7 billion buyback guidance you gave through 2024, 2 things come to mind, which is well, it seems to us you could maintain an elevated pace and certainly a pace well beyond 2024. So I could just -- I wonder if you could just touch on the cash return strategy, and I'll leave it there.

**Kevin J. Mitchell** - *Phillips 66 - Executive VP & CFO*

Yes, I think that's right. I mean as you know, we have been -- other than during the COVID period, we've been consistently buying back shares since really 2012 when we started the program. The elevated pace in the second quarter was not so much an impact of the DCP transaction. More it was a function of we recognize that relative to our share price at the time and our outlook, which was quite positive in terms of the overall business fundamentals, it seemed like a good opportunity to up the pace from where we had been.

And based on where things sit today, it looks like a good decision on our part. The \$5 billion to \$7 billion that we guided at Investor Day, that's a sort of minimum threshold that we expect to meet. It doesn't mean to say we can't either hit that total return \$10 billion to \$12 billion before the end of 2024, and it certainly does not mean that we stop once we hit that threshold either. And so I go back to our normal -- our traditional sort of guidance of at least 40% of cash flow returned to shareholders through the dividend and buybacks.

**Operator**

Our next question comes from Neil Mehta of Goldman Sachs.

**Neil Singhvi Mehta** - *Goldman Sachs Group, Inc., Research Division - VP and Integrated Oil & Refining Analyst*

I want to stay on the topic of capital structure. The net debt to capital, as you guys indicated, kind of ticked up to 35%, but you indicated that you expect it to move lower by year-end. Talk about some of the things that are moving back into your favor in addition to the strong margin environment, working capital or other items that we need to keep in mind. And how should we think about exit rate for that metric?

**Kevin J. Mitchell** - *Phillips 66 - Executive VP & CFO*

Yes, Neil. I think we had given guidance that we expected our debt to cap to increase once we completed the buy-in of the DCP units. And so it wasn't a surprise to us where we landed on that number. The 2 big drivers that will bring that back between now and the end of the year are what you pointed to, working capital. So that's about \$2 billion inflow in cash that we expect to see between now and the end of the year, and then also just the ongoing ability to generate earnings, generate strong earnings and build to equity.

So on our math, we think we end the year at right around the 30% level, so the top end of the range, but nonetheless, still within that overall target range. Obviously, this thing will move around quarter-over-quarter depending on what's going on in terms of market environment and cash items like working capital. But fundamentally, we think we're on a reasonable trajectory to be able to sustain in that target range.

**Neil Singhvi Mehta** - *Goldman Sachs Group, Inc., Research Division - VP and Integrated Oil & Refining Analyst*

And then the follow-up is just on Rodeo Renewed. Some changes, it sounds like in the capital scope here. Just can you walk us through the drivers of those changes? And then as we think about against the capital, the type of EBITDA that you can generate from the asset, how has your view of mid-cycle from that asset evolved as you spend more time on the project?

**Mark E. Lashier** - Phillips 66 - President, CEO & Director

Yes, Neil, it's Mark. I'll cover it at a high level and then Rich can drill in a little bit. But essentially, what we've experienced there as we commenced the project execution, we had a lot of heavy rainfall. And of course, even the start of the project was deferred a little bit because of permitting challenges. And we believe -- we recognize that the earnings from this are going to far exceed the earnings we realized to date from the San Francisco refinery so we wanted to stick to the schedule. So we incurred some more cost to compensate for the productivity loss during bad weather and delays around permitting.

We also saw some inflation. When this project was sanctioned, the big run-up in inflationary pressures hadn't hit yet. And so we realized that really is the only project in our purview where we're seeing that kind of impact or haven't accounted for the inflation at sanction, so we're having to take care of that.

So we still look at that \$1.60 a gallon as incredibly competitive. The overall competitiveness of the asset is strong. The location, we've got competitive advantage. The pull-through with our retail presence is a competitive advantage. And if you look -- at as we bring this facility online, we're taking off almost as much traditional diesel as we're bringing in renewable diesel to the market, so the market disruption will be minimal. So we really are bullish around this project, and we see that the economics are still very robust in spite of the cost increases. Rich, do you want to go...

**Richard G. Harbison** - Phillips 66 - EVP of Refining

Yes, I think you covered most of that, Mark. Maybe I can add just a little bit of color to it. As we talked about, the primary drivers for the increase were material and labor costs. And when you think about the timing of this project, it was estimated and approved prior to the heavy inflationary period. So we're realizing that inflationary pressure that's occurred over the duration of the development of the project.

Half of those costs we'll experience this year. The other half will flow into next year's capital allocation. As Mark indicated, the project is still very capital efficient at \$1.60 a gallon, and we're very happy with that and that is very competitive versus other announced projects. And we continue to work full steam ahead on the construction, and it remains on track for commercial operation in first quarter 2024.

Now I know there's been a lot of focus around the lower LCFS credits over the recent change. But the reality of this, the economics around this project are centered around 4 programs as well as the retail price of diesel in the state of California and other markets that recognize renewable diesel. And those programs, 2 are federal and 2 are at the state level. And all of these seem to be working interrelationally with each other as well as impacting the feedstock costs as well. So when we look at the overall momentum and movement of all this interrelationship, we still see very strong economics for the project and continue to be very optimistic about the EBITDA returns on it.

**Mark E. Lashier** - Phillips 66 - President, CEO & Director

And when you look at those increases across '23 and '24, it will require a modest increase in our capital target of \$2 billion for this year, but we will manage that additional cost within our \$2 billion target going forward in 2024.

**Operator**

Our next question comes from Roger Read of Wells Fargo.

**Roger David Read** - Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst

I was hoping to follow up on the DCP transaction, just how that's gone so far. And while I understand you've raised the, I guess we would call it, cost savings, another part of this transaction was on the revenue synergy side, building a truly integrated model. So I was just curious what you've

seen to date, what you maybe expect in the near term on that or maybe even the medium term on that in terms of how the transaction comes together as a seamless organization.

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**Timothy D. Roberts** - *Phillips 66 - EVP of Midstream & Chemicals*

Roger, this is Tim. Thanks for the question. We started working on this as soon as we closed the initial part of the transaction last year, so we got the integration teams together. At the beginning of this back in the fall of last year, we felt we had a line of sight of \$300 million that we could get full value for all the way through the first quarter of 2025. And that's when some contracts were rolling off that we're going to third parties and we could bring them into our system. But most of that we felt would be captured by 2024.

Well, as we dug in, and we got the teams involved, engaged, everybody's working together, now the employees have done a really good job of digging deeper and finding a couple more gems in there. So now that's why we're comfortable talking about an increase going to \$400 million. And I'm actually hoping at some point, I can give you more upside to that as we continue to dig because this integration is going to continue through the first quarter of 2024.

The big driver right now, the teams are working together commercially and probably worth setting a tone there is that currently, when we had the \$300 million number, 1/3 was based on cost, 2/3 on commercial, we'll call it system optimization. But as we dug in and we've got to the \$400 million number, now that is more 50-50 on cost. We found more in our procurement, more in our maintenance, more in our operations. And then -- so 50% on cost and now 50% on, again, system optimization and commercial activities. So that's kind of the breakdown.

And the real driver right now for us through the first quarter of 2024 is systems integration. So a lot of good work being done by the team, but it just takes time and you got to get it right. So we are spending the time to do that, and we'll be done by the end of the first quarter. And then we'll be in what I consider a normal operation, steady-state mode with regard to how we run as a business.

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**Mark E. Lashier** - *Phillips 66 - President, CEO & Director*

Yes, I'd just like to comment a little bit on that, the integration impact. This really is a clear indication of how well the teams are integrating, the DCP team, the Phillips 66 teams coming together. And as Tim noted, once we had operational control of the entity after the Enbridge transaction, we were able to really hit the ground running and started executing against our targets.

And getting these teams integrated, 1 team, 1 culture, taking the best of the best and driving this, this is really the biggest visible measure of how successful that's been. And we see those numbers move up and we see teams excited about the future and looking at ways to capture more value, both from a cost perspective and a commercial perspective. And so this is going to be what they are and what they do from this point forward.

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**Roger David Read** - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Yes. And then the unrelated follow-up just to come back to the \$0.40 a barrel of Refining margin, cash OpEx savings, the goal to get to \$0.75. Can you give us an idea of -- I mean, I know you mentioned seeing cost reductions, things like that. But like what is this process allowing you to do? Is it best practices in 1 location being expanded, an overall centralized look at the cost structure? Just it's a very impressive number. It's certainly sustainable, it adds up over time. And so I was just curious kind of where did you start? How did you get here? How confident are you in the \$0.75 on the time line that you've set?

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**Richard G. Harbison** - *Phillips 66 - EVP of Refining*

Yes, Roger, this is Rich. We're well on our way, as you indicated, to our \$0.75 per barrel savings target that we announced or committed to during the Investor Day last November. And you know what's most exciting about this whole process for me has really been how the organization, the

entire organization is engaged in this process. So yes, there is some oversharing site to site of activity and best practices. But most of these activities are opportunities identified by that local organization, really accepting the challenge to improve the business.

And they're uncovering these opportunities to be more efficient in their work process, right? And changing -- and then fundamentally changing how that work process is occurring to drive inefficiencies out of the business, which ultimately reduce costs out of the business. So if you think about, we talked about \$0.40 a barrel already year-to-date. If you -- that's calculated by, if you take our barrels that we've run year-to-date and calculate to the \$0.40, you can back into the number that we're seeing drive to the bottom line of our financial report there. And that's been quite impressive.

And we've got a lot more in the queue, as Mark indicated on his comments, with the run rate. Our target is \$550 million. Over \$300 million of that is currently assigned to Refining. And of course, the run rate doesn't mean it's realized, right? But that just means it's identified, it's locked in. And now we've got to drive it to the bottom line, and that's what's most impressive about the organization, really pushing to get these identified opportunities pushed to the bottom line.

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**Mark E. Lashier** - *Phillips 66 - President, CEO & Director*

Yes. And if you see some commonalities between the mindset and our Refining organization and the Midstream organization, it's real. And it's this business transformation process, it's easy to talk about the cost impact and it's easy to have those cost targets. But really the most phenomenal thing going on is the mindset change and the drive that we see in the employees to get better at what they do every day. And you're seeing that move on from cost focus to just where do we create the most value, how do we create the most value together.

Whether it's the way we've organized and integrated our value chain optimization organization more synergistically across the refineries, having VCO folks sitting on the refinery leadership team every day, searching for ways to optimize and coordinate with other refineries. It's real. And that's -- it's that mindset, it's that drive that's going to make these cost savings and the synergy capture sustainable for the long term. And it's just not going to end. It's just going to be the way we do business going forward.

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## Operator

Our next question comes from John Royall of JPMorgan.

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**John Macalister Royall** - *JPMorgan Chase & Co, Research Division - Analyst*

So my first question is on the Bayway FCC. I think your last official statement was around mid-July for the restart. We saw reports after that, that it was end of July. I'm not sure if that's been confirmed. So if you can just update us on the status of the unit and when you expect it up and running full if it's not now.

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**Richard G. Harbison** - *Phillips 66 - EVP of Refining*

John, this is Rich. FCC repairs were complete and the unit is up and running as of July 20. That's the actual date that it was back online producing on specification material. The refinery itself is back to normal operations, so all the units and all the assets there are running to our plan. The Bayway team did a phenomenal job getting that repair work done very efficiently. Very excited about how they performed to complete that work.

And additionally, when Mark's just talking about this mindset activity, we saw other parts of our organization also really focused to help pick up our teammates that were struggling a little bit in Bayway. And we saw phenomenal performance in our refineries in Sweeny, Ponca City and Billings. They each had record performance as well as our assets on the West Coast, and it all ended up in a system-wide utilization of 93%, which is our highest crude utilization since 2019. So -- and we're looking forward to building on this momentum and continuing that into the third quarter.

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**John Macalister Royall** - *JPMorgan Chase & Co, Research Division - Analyst*

Great. And then I know it's early on but maybe sticking with Refining. If you could give us possibly some expectations on some puts and takes around captures for 3Q. And then relatedly, maybe you can weave in your view on WCS dips from here. We've widened out a fair amount off of bottoms but still look very tight. So any views there into 2H would be helpful.

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**Brian M. Mandell** - *Phillips 66 - EVP of Marketing & Commercial*

It's Brian. Maybe I'll just talk about product demand, give you a sense of what we're thinking for Q3. The strength in U.S. products basically starts with low inventories. Gasoline, we're under 5-year averages by 7%. Distillate, we're under averages, 5-year averages by 19%. That's a lot. We have a lot of new capacity coming online in the U.S., but we've had even more outages than the new capacity. For us, we're seeing gasoline demand up about 2% over last year in the U.S. and about 4% globally. So that's strong demand.

On distillate, we have the demand down a bit in the U.S., mostly on industrial manufacturing segments. But globally, we have it up. We have lots of pockets of really strong distillate demand in Latin America, up 9%; Asia, up 4%. And diesel cracks continue to remain strong. In fact, they've gotten a lot stronger and we believe that they'll continue to perform throughout the year as we head into higher demand planning season and into winter in the U.S. where distillate over gasoline every pad now.

And then finally on jet, jet's also strong. Low inventories, increasing domestic and international travels. Global seat demand is essentially flat to 2019 levels. TSA throughput numbers in the U.S. are back to 2019 levels. And interestingly, U.S. jet yields remain a little bit higher so that should add some marginal strength to diesel.

And then on the WCS, you're right. WCS has started to widen again, which is in our best interest here at -- we buy the most WCS of, I think, anybody that there is. And we've seen the widening mostly because of heavy crude dips, in general, have started to widen. We also see fall turnarounds in PADD 2 as being very strong. And then if you'll remember in September, which next month, we'll start to see Dillon blending, which will swell the volume of Canadian crude. So all those things have been putting pressure and widening the dips to our advantage.

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**Operator**

Our next question comes from Ryan Todd of Piper Sandler.

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**Ryan M. Todd** - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

We don't often talk that much about Marketing, but your Marketing business, as it continues to generally kind of exceed expectations on a regular basis, so I think first half contributions are fairly in line with last year's first half contributions, which was generally higher-than-expected year-end Marketing. Is that business maybe structurally -- just structurally stronger than we have appreciated and maybe you've guided to? Or what do you attribute kind of continued strength in the Marketing side?

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**Brian M. Mandell** - *Phillips 66 - EVP of Marketing & Commercial*

Ryan, this is Brian. Exceeding expectations is a good thing. We're happy about that. We did have a strong quarter in Q2. We've added a bunch of retail JVs since 2019. We're roughly at 750 retail stores, which have really performed well since we've added them and certainly in 2Q. We had higher margins, as Kevin mentioned, in both the domestic markets and in our Western European business. We had U.S. volumes up a bit.

And finally in our lubricants business, the base oil business has been performing really well as the feedstock prices have been falling more than the base oil prices. So I'd tell you for Q3, when you're thinking about Q3, our earnings should be in line with our mid-cycle expectations, assuming the kind of normal seasonal demand.

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**Mark E. Lashier** - *Phillips 66 - President, CEO & Director*

Yes. I would just comment over again and compliment Brian and his Marketing team on the execution of the strategy that they've held for several years is to go in and participate through these joint venture opportunities in markets that make sense for us, that we have a competitive advantage that there's strength to capitalize on. And we don't go and do this everywhere. It's very surgical. It's very intentional, and it is exceeding expectations so it's a well-executed strategy.

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**Ryan M. Todd** - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Great. And maybe just a quick follow-up on Rodeo and some of your comments from earlier. Are there -- as we think about kind of the pathway from here until start-up in first quarter '24, are there any outstanding permits required, legal challenges that we should be looking at? Or any -- how do you view kind of potential risks that exist or things you're keeping an eye on between now and commercial start-up there?

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**Richard G. Harbison** - *Phillips 66 - EVP of Refining*

Yes, Ryan. Permitting to complete any project in California is very challenging, projects even to convert a conventional crude oil facility refinery to a lower carbon intensity transportation fuel production facility. So we did recently receive news on an appeal to our environmental impact report that is the supporting document for permits. This was filed by a couple of NGOs in the state.

And the good news is the court ruling found several issues in the favor of Phillips 66. And notably, most notably is the construction of the Rodeo Renewed project can continue with the county work to resolve 3 issues. So we're working closely with the county and the courts to provide necessary information to reconsider the open issues. And we remain very confident that the Rodeo Renewed project is on track to start commercial operation in first quarter 2024.

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**Operator**

Our next question comes from Jason Gabelman of Cowen.

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**Jason Daniel Gabelman** - *TD Cowen, Research Division - Director & Analyst*

I wanted to follow up on Ryan's question just now on Marketing and the outlook for 3Q. There were reports of droughts in the Rhine River. And I think typically when that happens, you're positioned to supply that region well and take advantage of margin moves there. Have you seen any strength in 3Q, early 3Q as a result of those outages? And would you expect, as a result, continued outperformance in Marketing in 3Q?

And then conversely, what you're seeing on chems, we've seen chain margins fall into July. Just any views on the outlook there into 3Q and then beyond that when you expect Chemical margins to move back to mid-cycle.

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**Brian M. Mandell** - *Phillips 66 - EVP of Marketing & Commercial*

Jason, it's Brian. So far in Western Europe on the Rhine, we haven't seen water levels low enough to benefit us. It is true if water levels do get low, we benefit from that. But the water levels haven't gotten there yet. Can't really predict where they're going to go in Q3, but if they get lower, then we'll have some benefit.

**Timothy D. Roberts** - *Phillips 66 - EVP of Midstream & Chemicals*

Yes. And with regard -- this is Tim Roberts on this. With regard to Chemicals, talk about currently where we're at with chain margins. Yes, it's been an interesting run here. Obviously, you've got supply, plenty of supply available, and demand, they're not matching up. So therefore, you've seen chain margins have been dropping over the last several quarters.

Where you're at right now, I think IHS added about \$0.12 chain margins. And really the way we would look at this and look at it going forward is, is that the high-cost producers, both in Asia and those that are in Europe are going to set the price. And those that are in advantaged feedstock locations will keep running and probably run hard, which is what we're seeing right now in North America and the Middle East. While those are having to shut in capacity or having to manage production or any other reasons I mentioned earlier.

Now fundamentally, though, you've got to get demand and supply to match up and you've got to start working off inventory. Ethylene inventories here in North America are above 5-year average. So that's -- that direction needs to start working its way down. And you're seeing the same thing in polyethylene, so 2 of the main products that we see with regard to our CPCChem JV. However, we're running really strong here. Exports are strong as well with regard to in North America because we're advantaged on feedstock.

So our outlook is that yes, you've got to hit the bottom before you can start working your way back up. I can't say this is the inflection point, but cash costs typically will drive where you get to the bottom and then how soon you can accelerate. And usually, as we would say and it goes in a lot of different directions is low cost, low prices solve prices. So fundamentally, we do think that the outlook is still going to be constructive and constructive in that you've still got population growth, you still have economies that have not been churning at their -- all cylinders, China being one of them.

And that's not a position of saying they never will, not at all. We think there's still going to be good solid economic growth, you're just not seeing it consistent global. So we do anticipate that, that will happen and that will help soak up some of the capacity that's out there, bring the markets back into balance and you get back into more of a mid-cycle case.

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**Jason Daniel Gabelman** - *TD Cowen, Research Division - Director & Analyst*

Great. That's really helpful. And my follow-up is just on acquisitions and divestments. You mentioned it at the top of the call that you continue to evaluate the portfolio. As you look across the various segments you operate in, any thoughts on where maybe you have noncore positions or you have some portfolio gaps? And how are you viewing the broader M&A market?

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**Mark E. Lashier** - *Phillips 66 - President, CEO & Director*

Yes. I think that again, as Kevin mentioned earlier, we looked across our portfolio, and there's different dimensions across our portfolio where others may have some interest in our assets and may place a greater value because it's not strategic to us, and we'll continue to evaluate that. I wouldn't comment on any specific opportunities.

And likewise, as we did with Marketing in California to -- we made some relatively small acquisitions to enhance the opportunities around Rodeo once it's up and running, and we've done a series of those and they're all doing quite well. And so we'll look at smaller opportunistic things. But you think about where we've come from, we've done some pretty significant transactions in Midstream. It's time to digest those and to drive value through those. And if we can find some very accretive small, midsized kinds of things, we'd look at them, but there's nothing in the queue and nothing that we'd want to comment on.

We've got a great backbone there and history has shown that the strong backbone in that industry can attract smaller investments that are quite attractive. So think in terms of small, very accretive, high-return opportunities like we've done in Marketing would be on our scale. But we're going to stick with our disciplined approach going forward. We've got a commitment for around \$2 billion for 2024, and anything around that would be very disciplined and high return.

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**Operator**

Our next question comes from Manav Gupta of UBS.

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**Manav Gupta** - *UBS Investment Bank, Research Division - Analyst*

I want to start on the East Coast. That was like a 52% margin capture. That's a significant drop from the last quarter. Was it primarily the outage at Bayway? Can you talk about some of the factors that led to such a significant drop on the East Coast and margin capture?

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**Richard G. Harbison** - *Phillips 66 - EVP of Refining*

Yes. Manav, this is Rich. Over, Manav, what we refer to it as the Atlantic Basin, we did have higher volumes and lower costs due to less turnaround activity at Bayway quarter-over-quarter when you look at those. But a lot of those were offset by lower margins. The realized margin was lower primarily due to a weaker market crack. Configuration impacts also played into this with the gasoline cracks increasing by \$10 a barrel and then the distillate crack decreasing by \$18 a barrel. That played into the market capture quite a bit. And there was lower product differentials there.

And then the other 1 that goes a little bit unnoticed in this market is really the secondary product cost and margins on those secondary products. And both the NGLs for both Bayway and Humber were lower. And then the petroleum coke that sold out of Humber also experienced lower product differentials. So those are the primary reasons you saw lower market capture there in Atlantic Basin.

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**Manav Gupta** - *UBS Investment Bank, Research Division - Analyst*

Okay. Can you also talk a little bit about the TMX expansion? There's a lot of capacity coming on and moving the crude to the West Coast starting next year. What would -- how would that change the WCS WTI differential outlook in your opinion?

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**Brian M. Mandell** - *Phillips 66 - EVP of Marketing & Commercial*

Manav, this is Brian. Well, first, I think our view is that TMX will probably come on later in the year, although line fill is forecasted for early Q1. I think the line will not be filled completely. That's our view. I think those are -- on the lines, I feel like some of those barrels will be exported to Asia. We'll see if that happens. It's hard to get VLCCs there. In fact, you can't load VLCCs. You have to load them ship to ship outside of L.A. So it's -- we'll see what happens going forward. But certainly, it could be a benefit to the West Coast having more of that crude.

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**Operator**

Our next question comes from Matthew Blair of Tudor, Pickering, Holt.

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**Matthew Robert Lovseth Blair** - *Tudor, Pickering, Holt & Co. Securities, LLC, Research Division - MD of Refiners, Chemicals & Renewable Fuels Research*

On the Midstream side, did Phillips unwind any of the DCP NGL and nat gas hedges? And if so, could you quantify the impact that flowed through the Midstream EBITDA in Q2?

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**Kevin J. Mitchell** - *Phillips 66 - Executive VP & CFO*

Yes, Matt, this is Kevin. We did. We did unwind them or we let them roll off but we have less of that. We don't have that same hedging on our exposure to the nat gas NGL commodity price that we have -- that DCP has historically had in our overall portfolio. And when you also factor in

our position in Refining as a consumer of those project products, it felt more appropriate just to let the natural offsets flow through. And so we have done that.

I don't think we've given a number. I know we haven't given any specific number out there. What we have done is updated the sensitivities for Midstream to reflect the fact that those hedges are no longer in place. And so you see a slightly higher Midstream sensitivity to the commodity price than before.

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**Matthew Robert Lovseth Blair** - *Tudor, Pickering, Holt & Co. Securities, LLC, Research Division - MD of Refiners, Chemicals & Renewable Fuels Research*

Okay, sounds good. And then I don't know if I missed it, but did you give out a number for refined product exports in Q2? I think a year ago, it was 153,000 barrels per day. How did it trend this year? And are you seeing a mix shift with more barrels headed to Europe and fewer to Latin America?

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**Brian M. Mandell** - *Phillips 66 - EVP of Marketing & Commercial*

This is Brian. We exported over 200,000 barrels this quarter, which was up. In large part, our Sweeny refinery was making some more higher sulfur diesel that we exported to Latin America. Like others have said, we have been exporting more distillate to Europe as trade flows from Russia change and Russia is importing more barrels, particularly into Brazil, 120,000 to 140,000 barrels and where U.S. exporting more barrels to Europe.

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**Operator**

Our next question comes from Paul Cheng of Scotiabank.

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**Paul Cheng** - *Scotiabank Global Banking and Markets, Research Division - Analyst*

I think this is for Mark. Mark, if we look at California, you still have the Carson and Wilmington, that combined refinery. Today, probably 60% of the diesel in California being consumed by the renewable and biodiesel. And that in several years' time, you may end up that to be 100%. So what's the role of that facility going to look like and how your configuration may need to change?

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**Mark E. Lashier** - *Phillips 66 - President, CEO & Director*

Yes. I'll help cover that at a high level. Paul, I think Brian has some views on what's going on there as well. I think at one end of the spectrum, we're well connected to LAX from that facility. And jet is a big opportunity there, and we would certainly look at doing what we could to provide more jet.

I think that 1 mitigant of that is as we take the San Francisco refinery offline, that diesel production will go away and leave the market. And it's almost a gallon-for-gallon replacement with renewable diesel so that is an opportunity there as well. And so we -- I think that there are exports from California today and Brian can comment further on that, but that's an opportunity to balance things out.

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**Brian M. Mandell** - *Phillips 66 - EVP of Marketing & Commercial*

And Paul, I would add, the best amount of distillate produced at L.A. is actually exported by pipeline to neighboring states. So we don't make a lot of California distillate at that refinery. So it's, for us, at least a nonissue.

**Paul Cheng** - Scotiabank Global Banking and Markets, Research Division - Analyst

Okay. So you think that. And do you think that on the longer-term basis, that, that should be part of your portfolio? Or given the political environment and everything, that, that may -- I mean, is there any plan to do something that -- like what you have done to Rodeo?

**Mark E. Lashier** - Phillips 66 - President, CEO & Director

Well, Paul, we're looking at everything we can do to keep the L.A. refinery competitive in that environment, but it is, frankly, a difficult environment. And it's been very publicly, politically challenging there, whether it's EV mandates. But we believe that it's going to be challenging for California to implement their aspirations around EVs so I think that may be overplayed. But we're watching the markets environment very carefully and doing everything that's in our control to keep the LA refinery competitive and supplying products in that market.

**Paul Cheng** - Scotiabank Global Banking and Markets, Research Division - Analyst

Okay. And final one, I think this maybe is for either Rich or Kevin. When we look at your margin capture or your margin realization in Central Corridor, you're actually doing better than we thought. Is there any one-off benefit that we see or it's just normal market condition and that recovery from the downtime in the first quarter?

**Richard G. Harbison** - Phillips 66 - EVP of Refining

Paul, this is Rich. I'll start it off here with an answer. The Central Corridor, the primary reason that you're seeing this is really strong performance from our facilities there, specifically Ponca City and the Billings refinery. Both of those facilities have been running very, very well over the last several quarters and continue to operate, exceeding expectations on utilization as well as clean product yield, which is improving the market capture there.

**Kevin J. Mitchell** - Phillips 66 - Executive VP & CFO

And just to clarify, it's not a function of one-off items that are benefiting. It is all operational, as Rich described.

**Operator**

Our next question comes from Joe Laetsch of Morgan Stanley.

**Joseph Gregory Laetsch** - Morgan Stanley, Research Division - Research Associate

So I wanted to go back to a couple of topics we've already hit on. But first on Chemicals. So with the 2 CPChem projects starting up in the back half of the year, could you just give us a sense of earnings contribution and uplift, probably 2024 on a normalized margin environment from those 2 projects, just how we should think about that?

**Timothy D. Roberts** - Phillips 66 - EVP of Midstream & Chemicals

Yes. On that, Joe, probably to clarify, those projects aren't expected to start up till 2026. And so -- on the hexene units, okay. So with regard to the hexene unit, yes, that was completed. We're looking at that -- my apologies here. I was thinking of the bigger projects. 1-hexene has been completed down at Sweeny. They'll be in start-up mode through the third quarter. And you should probably start to see some level of earnings start to show up in the fourth quarter.

The splitter project, which is up at Cedar Bayou, that project also is in the final completion at this point or they're going to be ready to get everything completed by the end of sometime in the mid-fourth quarter, excuse me. So you're really probably not going to see anything meaningful as they go through shaking out the units, getting them started up. And probably for both of them, you may be probably landing more towards a grueling first quarter before something really starts to show up there.

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**Mark E. Lashier** - *Phillips 66 - President, CEO & Director*

Yes. And CPCChem executed the hexene project, brought it in under budget as well, so I think that's notable in this environment.

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**Joseph Gregory Laetsch** - *Morgan Stanley, Research Division - Research Associate*

Great. And then just going back to Rodeo. I know you all have talked about the potential to produce renewable jet fuel out of that facility as well. Can you just talk about any progress you've made there? Any thoughts on timing when a decision could be made to produce SAF?

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**Richard G. Harbison** - *Phillips 66 - EVP of Refining*

Yes, this is Rich. The project, as it's designed, will be able to produce SAF. What's really missing from the whole equation is the market indicator to do that. And as soon as that's in place, we will quickly shift to a renewable jet/sustainable aviation fuel production. The facility will have the capability of producing 20,000 barrels a day of sustainable aviation fuel on the backbone of 10,000 barrels a day of renewable jet that's blended with traditional crude oil-based jet production.

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**Mark E. Lashier** - *Phillips 66 - President, CEO & Director*

Yes. And that's not saying negative around SAF. We believe that SAF will be an important part of our path toward renewable fuels. But today at Rodeo, the economics favor renewable diesel, so we would maximize renewable diesel, produce some -- there are some that you just will produce just because of the yields. But any additional investment to produce more SAF would require something that would incent us to divert away from renewable diesel into SAF.

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**Richard G. Harbison** - *Phillips 66 - EVP of Refining*

And there is capability to invest and increase that production level.

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**Mark E. Lashier** - *Phillips 66 - President, CEO & Director*

Yes.

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**Operator**

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

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**Mark E. Lashier** - *Phillips 66 - President, CEO & Director*

Thank you, Alex, and thanks to all of you for your questions. We delivered strong second quarter financial and operating results as we executed on our strategic priorities by focusing on the things we control, most importantly, the commitments we made to our owners in November. We continued

a healthy pace of returning cash to shareholders. And in Refinery -- Refining, we had another quarter of strong operating performance with above industry average crude utilization and lower operating costs.

We're executing our Midstream NGL wellhead to market strategy and completed the buy-in of DCP's units and raised our synergy targets to over \$400 million, wrapping up a series of foundational transactions to drive value creation in our NGL business. We're realizing our business transformation initiatives and are on track to achieve at least \$1 billion of annual run rate savings by year-end while driving a transformative mindset across the enterprise.

As we deliver on our strategic priorities, we remain committed to financial strength, disciplined capital allocation and returning cash to shareholders. Outstanding operational performance will position us to capture the current strong market environment in the third quarter. And we look forward to updating you on our progress. Thank you all for your interest in Phillips 66.

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### Operator

Thank you for joining today's call. You may now disconnect your lines.

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