TRANSCRIPT
4Q 2018 EARNINGS CONFERENCE CALL

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PHILLIPS 66 PARTICIPANTS

Jeff Dietert, *Vice President, Investor Relations*

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

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

MEETING PARTICIPANTS

Phil Gresh, *JP Morgan*

Doug Terreson, *Evercore ISI*

Neil Mehta, *Goldman Sachs*

Blake Fernandez, *Piper Jaffray*

Roger Read, *Wells Fargo Securities*

Paul Sankey, *Mizuho Securities*

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

TRANSCRIPT

Operator:

Welcome to the Fourth Quarter 2018 Phillips 66 Earnings Conference Call. My name is Julie and I will be your Operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session. Please note that this conference is being recorded.

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

Jeff Dietert:

Good morning, and welcome to Phillips 66's Fourth Quarter Earnings Conference Call. Participants on today's call will include Greg Garland, Chairman and CEO, and Kevin Mitchell, Executive Vice President and CFO. The presentation materials we will be using during the call 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. It is a reminder that we will be making forward-looking statements during the presentation and our Q&A. 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.

In order to allow everyone the opportunity to ask a question, we ask that you limit yourself to one question and one follow-up. If you have additional questions, we ask that you rejoin the queue.

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

Greg C. Garland:

Thanks, Jeff. Good morning, everyone, and thank you for joining us today. Phillips 66 delivered another quarter of strong operating performance and record-setting financial results for 2018. Adjusted earnings for the fourth quarter were a record $2.3 billion, or $4.87 per share, and we generated $4.1 billion of operating cash flow. We rewarded our shareholders with strong distributions during the quarter, returning $864 million through dividends and share repurchases. Refining operated at 99% capacity utilization and we sourced heavy Canadian crude and other advantaged crudes throughout our refining system to capture strong margins. In Midstream, we benefited from increased pipeline and terminal throughput across our integrated network.

For the year, adjusted earnings were $5.6 billion, or $11.71 per share. We generated $7.6 billion of operating cash flow. The record financial performance in 2018 demonstrates our Refining portfolio's ability to run well and capture market opportunities. Marketing provided pull-through of our refined products to achieve record adjusted earnings. Also contributing to our strong results were the Midstream and Chemicals growth projects which were placed into service during the past two years.

In 2018, we increased the quarterly dividend 14% and repurchased 10% of the shares outstanding, resulting in $6.1 billion of capital being returned to our shareholders. Since 2012, we returned $22.5 billion to shareholders through dividends, share repurchases and exchanges, reducing our initial shares outstanding by 30%. Disciplined capital allocation is a priority and we're committed to a secure, competitive and growing dividend. As we look to 2019, we expect to deliver another double-digit dividend increase. Through our ongoing share repurchase program, we continue to buy shares when they trade below intrinsic value, as demonstrated by our fourth quarter pace of repurchases.

Phillips 66 Partners achieved its five-year 30% CAGR target. It also delivered industry-leading distribution growth since its IPO in 2013. With its scale, financial strength and project opportunities, PSXP is well positioned to fund and sustain organic programs to continue to drive EBITDA growth.

We're investing in a robust portfolio of projects across our businesses, with attractive returns, to create shareholder value. The Gray Oak Pipeline will provide 900,000 barrels a day of crude oil transportation from the Permian and Eagle Ford to Texas Gulf Coast destinations, including our Sweeny Refinery. The project is supported by shipper commitments and is on schedule to be in service by the end of this year. Phillips 66 Partners is the operator and the largest owner. Gray Oak will connect with multiple terminals in Corpus Christi, including the South Texas Gateway Terminal, in which PSXP has a 25% ownership. The marine terminal will have two deep water docks, planned storage capacity of 6.5 million to 7 million barrels, and is expected to start up in mid-2020.

At the Sweeny Hub, we're building two 150,000-barrels-per-day NGL fractionators and adding 6 million barrels of storage at Phillips 66 Partners' Clemens Caverns. The hub will have 400,000 barrels per day of fractionation capacity and 15 million barrels of storage when the expansion is completed in late 2020. We continue to have strong interest from customers in additional fractionation expansion projects.

The growth in domestic crude production is expected to result in increased need for Gulf Coast exports. We're making investments at our Beaumont Terminal to capitalize on this opportunity. During the fourth quarter, we placed 1.3 million barrels of fully contracted new crude oil storage into service. This brings the terminal's total capacity to 14.6 million barrels. Construction is underway to further increase crude storage by 2.2 million barrels, with completion anticipated in early 2020.

DCP Midstream has a 25% interest in the Gulf Coast Express Pipeline Project and will transport approximately 2 billion cubic feet per day of natural gas from the Permian to Gulf Coast markets. Completion is expected in the fourth quarter of 2019. In the high-growth DJ Basin, DCP's O'Connor 2 plant is expected to begin operations in the second quarter of 2019.

CPChem's new Gulf Coast petrochemical assets are running well and generating strong free cash flow. A second Gulf Coast project that is expected to include both ethylene and derivatives capacity is under development. CPChem is also evaluating additional capacity increases across multiple product lines through debottleneck opportunities.

In Refining, we continue to focus on high-return projects to improve margins. We have an FCC upgrade project underway at Sweeny Refinery that will increase production of higher-value petrochemical products and higher-octane gasoline. This project is planned to be complete in the second quarter of 2020. During the fourth quarter, we completed crude unit modifications at our Lake Charles Refinery to run additional advantaged domestic crudes. Also at Lake Charles, Phillips 66 Partners is constructing a 25,000-barrels-per-day isom unit to increase production of higher-octane gasoline blend components. This unit is expected to be completed in the third quarter of this year.

As we move into 2019, we remain focused on operating excellence and executing our strong portfolio of growth projects. We're optimistic about the future opportunities across our businesses and will invest in projects with attractive returns. Disciplined capital allocation is fundamental to our strategy and we'll continue to return capital to shareholders through dividends and share buybacks.

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

Kevin J. Mitchell:

Thank you, Greg. Hello, everyone. Starting with an overview on Slide 4, we summarize our financial results for the year. 2018 adjusted earnings were $5.6 billion, or $11.71 per share. We generated $7.6 billion of operating cash flow, including $2.9 billion in distributions from equity affiliates, with approximately $1 billion each from CPChem and WRB. This is the highest annual earnings and operating cash flow we have delivered since our Company's inception. At the end of the fourth quarter, the net debt to capital ratio was 23%. Our return on capital employed for the year was 17%.

Slide 5 shows the change in cash during the year. We began the year with $3.1 billion in cash on our balance sheet. Cash from operations, excluding the impact of working capital, was $7.9 billion. Working capital changes reduced cash flow by $300 million. We received $1 billion from the net issuance of debt. During the year, we funded $2.6 billion of capital expenditures and investments, paid dividends of $1.4 billion, and repurchased $4.7 billion of our shares, representing 10% of shares outstanding. Our ending cash balance was $3 billion.

Slide 6 summarizes our fourth quarter results. Adjusted earnings were $2.3 billion and adjusted earnings per share was $4.87. We generated operating cash flow of $4.1 billion, including distributions from equity affiliates of $840 million. Capital spending for the quarter was approximately $1 billion, with $648 million spent on growth projects. We returned $864 million to shareholders through $367 million of dividends and $497 million of share repurchases. We ended the year with 456 million shares outstanding.

Moving to Slide 7, as I mentioned on last quarter's call, we have changed our segment reporting to a pre-tax basis. Income taxes are reflected at the consolidated company level. This change makes our segment reporting more comparable with our peers. This slide highlights the change in pre-tax income by segment from the third quarter to the fourth quarter. Quarter-over-quarter adjusted earnings increased $804 million driven by higher results in Refining, Marketing and Midstream, partially offset by lower Chemicals results. The fourth quarter adjusted effective tax rate was 21%.

Slide 8 shows our Midstream results. Fourth quarter adjusted pre-tax income for the segment was $409 million, an increase of $97 million from the previous quarter. Midstream full year adjusted pre-tax income was a record $1.2 billion, more than $600 million higher than the prior year. Transportation adjusted pre-tax income for the fourth quarter was $234 million, up $25 million from the previous quarter. The increase was due to higher pipeline and terminal volumes for both our joint venture and wholly-owned assets. Our operated pipelines benefited from strong utilization at our refineries. In addition, fourth quarter throughput on the Bakken Pipeline increased and averaged more than 500,000 barrels per day. NGL and Other adjusted pre-tax income was $122 million, an increase of $48 million, primarily from inventory impacts. We continued to run well at the Sweeny Hub. During the quarter, the export facility averaged 10 cargoes a month and the fractionator averaged 116% utilization. DCP Midstream adjusted pre-tax income of $53 million in the fourth quarter is up $24 million from the previous quarter, primarily due to improved hedging results, partially offset by higher operating costs. During the fourth quarter, DCP completed the expansion of the Sand Hills Pipeline capacity to 485,000 barrels per day. Sand Hills is owned two-thirds by DCP and one-third by Phillips 66 Partners.

Turning to Chemicals on Slide 9, fourth quarter adjusted pre-tax income for the segment was $152 million, $111 million lower than the third quarter. Olefins and Polyolefins adjusted pre-tax income was $158 million, down $67 million from the previous quarter. The decrease reflects seasonally lower polyethylene sales volumes and higher turnaround and maintenance costs. Global O&P utilization was 95% in the fourth quarter. Adjusted pre-tax income for SA&S decreased $35 million due to lower earnings from CPChem's equity affiliates and higher domestic turnaround costs. The $9 million decrease in Other reflects the fourth-quarter increase of a contingent liability and the gain on an asset sale in the third quarter. During the fourth quarter, we received $300 million of cash distributions from CPChem.

Next, on Slide 10, we will cover Refining. Crude utilization was 99%, compared with 93% in the third quarter. The fourth quarter clean product yield was 86%, and pre-tax turnaround costs were $130 million, an increase of $75 million from the previous quarter. The market crack declined 36% from the previous quarter. Realized margin was $16.53 per barrel, 24% higher than the third quarter. The chart on Slide 10 provides a reasonable view of the change in adjusted pre-tax income, which increased $745 million, primarily from strong results in the Central Corridor and Golf Coast regions. For the full year, Refining generated adjusted pre-tax income of $4.6 billion. The Atlantic Basin results increased as the Bayway Refinery returned to normal operations following third-quarter downtime. Gulf Coast adjusted pre-tax income of $468 million increased $247 million due to higher clean product realizations, improved heavy Canadian crude oil differentials and increased volumes at the Alliance Refinery following third-quarter downtime. The higher clean product realizations benefited from declining market prices. Capacity utilization in the Gulf Coast region was 100%. Adjusted pre-tax income in the Central Corridor was $1.2 billion, an increase of $342 million, reflecting expanded discounts on Canadian crudes. Capacity utilization in the Central Corridor was 106%. In the West Coast, the increase was mainly due to higher realized margins driven by widening crude differentials, partially offset by higher turnaround costs.

Slide 11 covers market capture. The 3:2:1 market crack for the fourth quarter was $9.11 per barrel, compared to $14.21 per barrel in the third quarter. The realized margin was $16.53 per barrel and resulted in an overall market capture of 181%. Market capture was impacted by the configuration of our refineries. We make less gasoline and more distillate than premised in the 3:2:1 market crack. The gasoline crack spread declined by $8.75 per barrel during the quarter, while the distillate crack improved by $2.20 per barrel. Losses from secondary products of $0.29 per barrel were improved $1.33 per barrel from the previous quarter, due to the decline in crude oil prices relative to NGL, fuel oil and coke. Advantaged feedstock improved realized margins by $3.79 per barrel, an improvement of $1.29 per barrel from the prior quarter primarily due to widening Canadian crude differentials. The Other category improved realized margins by $3.57 per barrel primarily due to

optimization across our logistics network to capture market opportunities associated with widening crude differentials. Realized margins were further improved by Gulf Coast clean product price realizations.

Moving to Marketing and Specialties on Slide 12, adjusted fourth quarter pre-tax income was a record $592 million, $207 million higher than the third quarter. Marketing and Other increased $205 million from improved margins associated with sharply falling spot prices. Refined product exports in the fourth quarter were a record 249,000 barrels per day. We re-imaged 466 domestic branded sites during the fourth quarter, bringing the total to approximately 2,600 since the start of our program. For 2019, an additional 1,800 sites are scheduled for re-imaging. Specialties adjusted pre-tax income increased $2 million during the quarter primarily due to higher lubricants margins.

On Slide 13, the Corporate and Other segment's adjusted pre-tax costs of $201 million improved $22 million from the prior quarter. Lower net interest expense was due to interest income on a higher average cash balance and increased capitalized interest. The Corporate overhead costs decrease was due to employee severance costs recognized in the third quarter.

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

In Chemicals, we expect the first quarter global O&P utilization rate to be in the mid-90s. In Refining, we expect the first quarter worldwide crude utilization rate to be in the mid-80s and pre-tax turnaround expenses to be between $140 million and $170 million. We anticipate first quarter Corporate and Other costs to come in between $210 million and $240 million pre-tax.

For 2019, we plan full year turnaround expenses to be between $550 million and $600 million pre-tax. We expect Corporate and Other costs to be in the range of $850 million to $900 million pre-tax for the year. We anticipate full year D&A of about $1.4 billion. Finally, we expect the effective income tax rate to be in the low-20s.

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

Operator:

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

Phil Gresh from JP Morgan, please go ahead, your line is open.

Phil Gresh:

Hi, and congratulations on a solid quarter here. Greg, I guess the first question here would be, if we look back at 2018, I mean, this is the third straight quarter where you've handily beaten the consensus expectations. It seems to be driven by different parts of the portfolio. Obviously, Refining has been strong, but even other parts of the portfolio have been very strong as well. So, how do you think about the performance this year? Do you see some kind of sustainable structural improvement going on at Phillips that's underappreciated, or is this just Jeff Dietert, you know, keeping control of the sell side better?

Greg C. Garland:

You guys are doing a great job, Phil. Look, I think that there's no question the market environment we find ourselves is playing to the strength of our portfolio, and it's two things, it's distillate, right, and differentials, and so no question the fourth quarter, the WCS differentials drove a lot of the value creation. We improved our distillate yield, we're up another 1% in the fourth quarter, so 39% distillate yield. Versus our peers, we're at the high end of the range on distillate. And given our coking capacity and our ability to run heavy, it's differential. The other thing I would just say we've got the—these Chemicals assets are up, they're running, they're performing well. That's going to continue to drive earnings improvement, versus mid-cycle,

for us. Then, you think about our Midstream business starting to kick in, we actually made more in Midstream than we made in Chemicals in 2018.

So, across the portfolio, the things we've been investing in are starting to show up and deliver value, and then, finally, we continue to run really well. Operational excellence is key for us, we continue to emphasize that. In the quarter, where we needed to run well, we ran 106% utilization in the Central Corridor, we ran 100% on the Gulf Coast, and it showed up as value.

I don't know, Jeff, if you have any comments on other structural changes.

Jeff Dietert:

Yes, I think the projects that Greg's talking about, $1.5 billion of EBITDA, and incremental projects added across—kind of evenly distributed between Chemicals, Midstream and Refining, that's improved our overall cash flow from operations in a normalized environment.

Greg C. Garland:

Yes, I would probably say, given kind of normalized mid-cycle, we used to say $4 billion to $5 billion, we're kind of $6 billion to $7 billion now of cash flow on a normalized basis.

Phil Gresh:

Got it, okay, thanks. I guess the second question, just looking at the guidance for the first quarter, the mid-80s utilization in Refining and the turnaround costs there, would you say that the entire impact on utilization is the turnarounds or are you seeing an environment here for yourselves and for the industry that is warranting some run cuts here in the first quarter?

Greg C. Garland:

Most of that guidance is centered around turnaround activity. We pulled a few things, maybe, from the back half of the year into the front half of the year where we could, making sure that we can run in the back half, but that's around the margin, Phil, there wasn't a lot of work there. So, it's mostly focused around our turnaround activity.

Phil Gresh:

Got it, okay. One last one just for Kevin. How do you feel about the balance sheet levels here? Obviously, earlier in the year you issued some debt to buy back some shares, finishing the year really strong on cash flow, clearly, so how do you feel about desires to pay down debt from here?

Kevin J. Mitchell:

Yes, Phil, feel pretty good about where we got to. In fact, we basically—you know, we replenished the cash from where we had been with the strong third and fourth quarter this year, so $3 billion of cash. Debt to cap is at 29% on a fully consolidated basis, 23% net of cash, so we feel good on that. We have some debt that's available for pay-down, but we'll look at that in the overall context of how the start of the year shakes out. We'll have a little bit of turnaround on working capital, that's typically a use of cash in the first quarter, and so we'd expect to see that happen, as it typically does, but the nice thing is we'll have flexibility to work through. So, we have weak margins for any kind of extended period, we have the flexibility to continue to work through that and fund all of our obligations.

Phil Gresh:

Okay, thanks. I'll turn it over.

Jeff Dietert:

Thanks, Phil.

Operator:

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

Doug Terreson:

Good morning, everybody.

Greg C. Garland:

Hey, Doug.

Jeff Dietert:

Good morning.

Doug Terreson:

Your 17% return on capital employed and your 10% reduction in shares outstanding are the best in the U.S. energy industry, so kudos to the team on exceptional results, that's really good work there.

Greg C. Garland:

Thank you.

Doug Terreson:

My question is on your outlook for the key businesses. Starting with Refining, with margins on variable costs for conversion capacity unusually low, do you think that utilization is going to decline for some of these processes there? Because weakness is often seasonal this time of the year, is throughput going to remain high? So, the question is, how are you guys thinking about managing converts and utilization given these circumstances, and also how do you think it plays out across the industry?

Greg C. Garland:

I'll take a stab and Jeff can correct me, how about that? Look, I think, you know, everyone's concerned about the high gasoline inventories at this point in the cycle. There's no question the fourth quarter, the market environment was encouraging you to run, given the diesel cracks that we had and gasoline cracks weren't that great, but we're heading into the spring turnaround season, there's some operational issues out there, so our assessment is we're probably a little above normal in terms of outages for this time of year, and then you get to, you know, stop putting butane in gasoline, it comes out of the gasoline pool, and that's all directionally helpful for gasoline. We're still constructive overall demand. We think gasoline demand in North America is going to be flat for 2019. We see distillate demand up, 1.2%, 1.3%, in that range. Then, you add on IMO, and I know there's a debate about IMO and that, but it's still going to be some level of tailwind. So, as we look at 2019, for the year, we're still mid-cycle or better in terms of refining cracks, Doug.

Doug Terreson:

Okay, thanks, Greg. Jeff, did you want to say anything, or did he cover it?

Jeff Dietert:

I think he covered it well.

Doug Terreson:

I didn't mean to interrupt. Anyway, on Chemicals, you guys—

Jeff Dietert:

Go ahead, Doug.

Doug Terreson:

Well, I was just going to ask a question about Chemicals. Specifically, you guys have increased capacity in the last couple of years and the same position for more spending in the area, based on Greg's comments today, so I just want to get an update on your constructive view on Chemicals, which is a little bit more constructive than some, and so the basis for increased investment in that area, why are you guys optimistic for Chemicals?

Greg C. Garland:

First of all, you think about a growing global economy, and albeit '19 is probably going to be a lower growth year than what '18 is globally, but we're still constructive demand, particularly for polyethylene, which is mostly what CPChem makes. In our view, demand is going to grow faster than capacity in 2019, so it should be constructive for operating rates and margins in 2019. Then, you look at all the advantaged feedstocks that are still available in the U.S., Doug, and so that really says you should build into that if you have a great position, which CPChem does, access to advantaged feedstocks, great technology, great return business, and so it's the business that we should want to invest into.

Jeff Dietert:

Polyethylene grew by 6% last year, substantially above GDP growth. We did have some weakness in the fourth quarter. We experienced the typical seasonal softness in demand, but it was compounded by a 35% decline in crude prices. As we started the year, margins were soft, but crude prices have rebounded and CPChem is seeing signs of demand improvement. Healthy demand is expected to drive some polyethylene price increases in the first quarter.

Operator:

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

Neil Mehta:

Good morning, team, and I'll add my congratulations on a good quarter here.

Greg C. Garland:

Thanks, Neil.

Neil Mehta:

The kick-off question for me is on Western Canadian crude differentials, which obviously were a big tailwind in 4Q and have reversed here in 1Q. Our view is that, ultimately, it will settle out towards transportation economics, which is wider than here, but just your latest thoughts on how this plays out in 2019, and then longer term, as there still a lot of uncertainty around the pipe and how you're adjusting your business to take advantage of that.

Jeff Dietert:

Yes, we've gone from an unsustainably wide discount for Canadian heavy to an unsustainably narrow discount, we believe, with mandated cuts. There was substantially more volume that came off the market than what the 325 [thousand barrels per day] targeted amount was. We also had some economic run reductions, production reductions, and so we're running well below what the producing capacity is in Canada. We do expect, similar to your comments, to move to rail economics as this passes. I think a number of the Canadian producers have argued for moving away from the mandates, and so we expect the differentials to go back to kind of rail economics, WTI minus 20-something, in that area.

Neil Mehta:

That's helpful, and then the follow-up is something a little more specific. Slide 11 of your deck, on Refining margins, Kevin, you walked through Configuration and Feedstock that made a lot of sense. The Other number felt bigger than normal, $3.57, but it was a big part of the strength in the realized margins. Can you talk about what that is in a little bit more detail and how should we think about that? Is that just a function of crude prices coming down precipitously, or can we carry any of that forward?

Kevin J. Mitchell:

You're probably on to that, Neil. It does cover—there are a variety of things in that Other category, but the big drivers why that's a positive of $3 plus per barrel this time is a function of, one, realizing stronger prices on product realizations, a lot of which is a function of the declining—the overall declining market helped on the price realizations, and then the other is just on the crude side, the crude differential side, being able to optimize how we're moving barrels around our network to capture opportunities as they're available, which, in that kind of market environment, we saw in the fourth quarter, so it lends itself to us being able to do that. So, you think about both of those and not really—it was good to have in the fourth quarter, good that we could capture it, but not something you would assume is ratable.

Operator:

Blake Fernandez with Piper Jaffray, please go ahead, your line is open.

Blake Fernandez:

Guys, good morning, and congrats as well on the strong print there. I know you covered Chemicals already, but in the release, you talked a little bit about some potential debottlenecking and I was hoping you could maybe elaborate a little bit on that. I'm assuming that's totally separate from a potential second cracker. I'm just trying to get a sense of how significant that could be, and maybe timing around that.

Kevin J. Mitchell:

Yes, Blake, it's Kevin. In terms of the debottleneck opportunities, those are not of anything like the scale of the next major project; i.e., a second cracker project. These are what I would consider to be—in a portfolio like CPChem has, we're always able to identify opportunities for incremental investments to drive incremental production, and usually very strong returns on those investments. So, I don't think we look at any one of those as significantly large, but they typically screen pretty high to the list of priorities for investment, because, by nature of them being incremental to the existing portfolio, usually very attractive returns.

Greg C. Garland:

The Gulf Coast Project was, like, 33% capacity increase. A debottleneck is typically on the order of 5%, maybe 10%, Blake, but it's not across all the products. We have very specific places where we think we can get some more capacity out of the derivatives, and, actually, some of the ethylene units, too. But, they're certainly worth pursuing when you look at the returns.

Blake Fernandez:

Yes, got it. The second one really is just on—I guess it's a focus on moving toward light sweet, given the compression in heavy differentials in the market, so maybe if you could just give an update on where you are in your system as far as ability to flex back and forth between light sweet, and then I guess, while we're on it, maybe the same with distillate and gasoline, if you're at max distillate mode at this point.

Jeff Dietert:

Yes, we have shifted. Given the economics in the marketplace, they've really driven a move towards maxing diesel, and so we're there, we've been there, and so we're making about as much diesel as we can, given the current economics. Similar on the light product side, we're about 50% sweet and 50% sour, that's about a million barrels a day, or so, of sweet crude. There's a potential to go maybe another 100,000 barrels a day. It's obviously dependent on economics. We'd need the economic incentive to do that. But, that's what our upside potential is there.

Operator:

Roger Read with Wells Fargo, please go ahead, your line is open.

Roger Read:

Yes, thanks. Good morning.

Greg C. Garland:

Good morning.

Roger Read:

I guess maybe we could talk a little bit about the Midstream segment, and obviously you've highlighted Gray Oak, and so forth, but as I think about the performance in the quarter, looking into '19 and '20, in an E&P industry that seems to be slowing its spending a little bit, and maybe slowing production, how does that environment compare to the baseline that you've laid out in terms of your expectation for future pipeline investments and, I guess, NGL fractionation, etc., as you think about what may get the trigger pulled on it in '19 or '20? I guess, at the heart of it, I'm trying to understand what maybe the growth prospects are for at least the transportation and NGL side of the Midstream as we look over the next year or two.

Greg C. Garland:

I would start with, you know, we're just not going to build speculative capacity, Roger. I think that the Midstream projects we have in the queue are subscribed with T&D, and long-term contracts, these are seven and ten-year contracts with good counterparties on the other side, so I think that's the starting point. I think you're right, to the extent that the drill bit slows down in North America, some of these additional investments will slow down. To the extent we can't get these things subscribed, we're not going to build them, is probably the starting point on that. Gray Oak is fully subscribed, Frac 2, 3 is fully subscribed. But, you know, it's interesting, we're still seeing good interest in additional frac capacity. We're out in open seasons at Red Oak and Liberty, and I'd say interest level is good on those, we'll see, I don't know exactly where we'll end up yet, when people want to sign, and we just completed a successful open season on DAPL, going to 570 [thousand barrels per day]. So, we're still seeing good interest level out there from the producers, and having infrastructure to clear from the production centers to the market centers.

Jeff, do you want to comment?

Jeff Dietert:

Yes, there's still substantial resource available, and with new infrastructure coming, the potential that activity resumes—you know, we're looking at NGL production growth that's been around 500,000 barrels a day year-on-year. We're not adding

that type of capacity in 2019. So, as production continues to grow, the need for infrastructure will continue. The challenge is matching the timing with production growth and infrastructure growth, and so that's what getting projects fully contracted attempts to do.

Roger Read:

Okay, great, thanks, and then shifting gears back to Refining. Greg, you mentioned kind of mid-cycle or better assumption on margins for Refining in '19. It seems that, on a macro front, we get more concerns raised by investors that globally new capacity coming online will be faster than demand growth. I'm not asking you to forecast demand growth, that's too tough for any of us, but as you think about the new capacity coming online, how much of that do you think is really aimed at the transportation market versus what is nominally aimed at the petrochemical side in terms of feedstock?

Greg C. Garland:

We have a couple in China, one in the Middle East coming on in 2019. The transparency into China is probably a little harder for us. Our view is that those two refineries are probably more petrochemical feedstock-oriented and less gasoline-oriented, and we think that they're probably towards the back half of 2019. So, yes, there's capacity that's going to come on this year, but I'm not sure it's going to be as big an impact, particularly, through the first half of the year, as what some people think.

Jeff, do you want to comment?

Jeff Dietert:

Yes, I think, on the Chinese side, it's petrochemical-focused, as Greg mentioned, but with low diesel yields, as well.

Operator:

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

Paul Sankey:

Good afternoon, everyone. Greg, you made some interesting comments recently to us about China demand, keeping on with the general demand picture. Your sales there, I think have held up very well. Could you expand on what you were saying about the global markets for petrochemicals? We also, as you may know, had Exxon saying that there's weakness because of excess capacity, which I think you've already referred to earlier on this call, but—or rather, I should say new capacity. Could you just talk a little bit about how the markets could be clearing, and particularly the markets that are concerned about China? Anything you could add on that would be interesting. Thanks.

Greg C. Garland:

Yes, absolutely. Thanks, Paul. Well, first of all, we're still constructive petrochemical demand coming into 2019, still driven by hundreds of millions, if not billions, of people ultimately coming into the middle class over the next decade or so, so I think the fundamentals are set up well there. China, I mean, it's interesting. When you see crude prices fall as drastically as they did in the fourth quarter, they always slow down, because they know that petrochemical prices are going to follow those down and they'll wait to try to time the bottom and start buying again, so we did probably see some slowdown activity in the fourth quarter around China, but as we look into China, through into the base demand in China, it's still pretty healthy. I'd say North American demand, European demand is still relatively healthy in terms of growth, and so I think that's been the surprise to the upside in the Chemicals environment. So, still constructive.

The other thing I would say is our fundamental view on 2019 for Chemicals is that demand on Chemicals was going to grow faster than capacity additions, and the other thing is we may see some slippage on these other projects that are slated to come up in 2019.

Paul Sankey:

Great, thank you, and then the follow-up is a pretty large strategy question, but it relates to your cash return versus cap ex framework, which is 60/40, as we know, at the moment. I was wondering over what timeframe and for what reasons that might shift, given the scale of the Company, for example, is getting so large. Thanks.

Greg C. Garland:

Yes, if you think about '12 to '18, and consider our investments in equity affiliates, we are right on top of the 60/40, 60% reinvested back into our Company and 40% back to shareholders through a secure, growing, competitive dividend and share repurchases and exchanges. In 2018, we were 60/40, it was just the other way, we were 60% distributions and 40% investment back into our business, but, Paul, I think, kind of over three-year horizon, the mid-term. Most of our projects we're investing in, in Midstream or Refining, kind of have two-year horizons on them. The Chemicals projects tend to go into a three- to four-year horizon on them. But, if I want to think about a three-year horizon, I still think 60/40 is about the right place for us to be.

Operator:

Paul Cheng from Barclays, please go ahead, your line is open.

Paul Cheng:

Hey, guys, good morning.

Greg C. Garland:

Hey, Paul.

Paul Cheng:

A couple quick questions. Greg, you talked about China. Can you talk about Mexico, where do you see on the export market there? I mean, we have heard early in the year that some widespread pipeline outages will impact your export volume, and have you seen any change in the trend? That's the first question. The second question is on the crude differential. Exxon have said that in the fourth quarter versus the year before fourth quarter, their crude differential benefit is about $1.2 billion after tax, and Marathon, if you look at their chart, it looks like it's about $1.6 billion. I'm wondering is there a number that you can share?

Jeff Dietert:

I'll take the Mexico question. We are seeing some impact on exports to Mexico, as their demand has gone down with the pipeline shutdowns. Mexico demand is about 800,000 barrels a day gasoline and about 350,000 barrels a day of diesel. They import about 75% of that from the U.S., at least in 2018. As you know, refining utilization averaged about 38% last year, and we're expecting it to go down lower from that this year. We have seen some impact on exports into Mexico and those volumes are down. We're seeing some signs of movement into some of the interior, but some of that demand is going to be lost permanently as they're able to get product back into the center of the country, and that will resume their imports, but we are seeing that down somewhat.

Paul Cheng:

Jeff, have you seen any sign that exports to Mexico have started to recover or increasing?

Jeff Dietert:

Yes, we have seen a little bit of relief recently, but it's probably going to be an area where don't have a lot of transparency in, as they try to recover from these pipeline outages.

Paul Cheng:

Thank you, and how about crude differential?

Greg C. Garland:

On your first question, when you look at WCS/WTI kind of year-over-year '17 versus '18, it's about $13, and $1.00 is about $100 million. So, on an EBITDA basis, it's $1.3 billion for us, Paul.

Paul Cheng:

Perfect. Thank you.

Operator:

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

Kalei Akamine:

Hey, guys, this Kalei on for Doug. Thanks for taking the question. My first is a follow-up to Phil's question about the use of cash. I'm just wondering, with your balances reloaded, does this affirm the high end of your $1 billion to $2 billion buyback target for 2019?

Greg C. Garland:

I think we'll guide to the range of $1 billion to $2 billion.

Kalei Akamine:
All right. My second question is a follow-up to Neil's question. Just on the WCS differential, the Alberta cuts have worked, but perhaps they've worked too well, since the diff is now out of the money as it relates to rail, so my question is do you see a sharp slowdown in rail and do you think that this could be a catalyst for a sharp widening of the diff, maybe not to October levels, but towards that direction?

Jeff Dietert:

Yes, we are seeing a reduced utilization of rail as we come into February. I believe some of the Canadian producers that ship by rail have acknowledged a reduction. Those economics are closed, the arb's closed, and the marketplace is starting to react.

Greg C. Garland:

It's interesting. It looks like to us—you know, we've pulled inventories, which was the whole idea of the government intervention, and we've overshot on the differential, and it looks like to us inventories are starting to build again in Canada. So, I think that we will get back to the point where we have a differential, at least to clear by rail, and so if you think about a fully loaded rail cost kind of $18 to $20 a barrel, you look at variable cost, it's probably $15 to $16. So, I think we'll get to a variable cost and then we'll move to variable cost as the year goes on.

Operator:

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

Prashant Rao:

Thanks. Good morning, and thanks for taking the questions. My first sort of straddles Midstream and Refining a bit. Thinking about storage capacity and needs, particularly in the Gulf Coast, and through logistics needs and opportunities over the

next couple of years, I sort of see at least two event windows, one being IMO—and I'm thinking about longer hydrocarbon chains here, leading to longer hydrocarbon chains. One is IMO, and we were expecting storage and extra fuel oil storage needs for different sort of distillate, changes in crude trade lanes and dynamics, and the second being the waves of barrels that we expected to hit the Gulf Coast for export as we get towards 2020, 2021. I'm curious to know sort of your thoughts on how the existing infrastructure, where it stands in terms of capacity to handle the demand that'll be there along these various lanes, and sort of where's the opportunity for Phillips—since you're invested in projects that are all through the value chain, I figured you might have a view into sort of where the best sort of incremental opportunities are and how these play off against each other.

Jeff Dietert:

We do expect the growing production to largely be exported as the pipelines are announced. Most of the major pipelines have associated export terminals tied with them, similar to our Gray Oak and South Texas Gateway Terminal. We've got export capacity out of Beaumont, and we're continuing to build out that facility. We've got LPG export capability out of Sweeny, and as more and more fractionation comes online, a lot of that LPG is going to need to be exported. So, we do see those opportunities across many of our value chains.

Operator:

Manav Gupta with Credit Suisse, please go ahead, your line is open.

Manav Gupta:

Hey guys. Can you talk about the benefits of Bayou Bridge on your entire Gulf Coast refining system and the actual start-up date?

Greg C. Garland:

Bayou Bridge, we have expectations for it to start up in March and provide service into St. James. Bayou Bridge also provides service from Beaumont into Lake Charles and our Lake Charles Refinery. At Lake Charles, we've had projects there to increase our ability to use discounted domestic crudes, and so we're benefiting there from the Bayou Bridge access to crudes. Then, the Bayou Bridge, Lake Charles to St. James provides opportunity for Ace Pipeline, which is in open season, and that open season is continuing with strong interest, and hopefully we'll have more to report on that in the near future.

Manav Gupta:

A quick follow-up, Jeff. Two areas you first feel a recession coming is polyethylene demand and distillate demand. Demand softness is one thing, but you are very close to both those end markets. Is there any sign in any of those two markets that we are probably approaching a recession?

Jeff Dietert:

I think Greg covered the polyethylene side of the equation, and perhaps more information there, but when we look at diesel, demand is very strong, tonnage up 8% year-on-year, most recent information, global airline revenue miles up 6% year-on-year. We're continuing to see strong diesel demand in the markets in which we participate, so we don't see any signs as of this point.

Operator:

Chris Sighinolfi with Jefferies, please go ahead, your line is open.

Chris Sighinolfi:

Hi, Greg. Thanks for taking my questions. I have two, they both relate to Marketing and Specialties. I guess, first, very strong results here in the fourth quarter, and if I look at how things performed versus our expectations and history, it appears international fuel margins were a particularly bright spot, so I'm wondering, with the near—it's almost a doubling of the foreign margin quarter-on-quarter, I believe it's the second consecutive record for you on fuel margins there. I just wanted to check in about any particular drivers of that and if anything structural is afoot that you'd caution us to pay attention to.

Greg C. Garland:

I'll maybe start with in Europe, our markets are focused around Germany, Austria, Switzerland and the U.K. In Germany, we had low water levels with the Rhine and that presented some logistical challenges, and so we were able to use our infrastructure and logistics systems to capture some of the opportunities, an advantage. As you know, we're kind of reimaging, rebuilding about 30 new Jet sites a year in Europe, and so we're seeing some increased uplift from that. So, that's a piece that—I don't know if it's structural or not, but it's certainly an adder, and then we're moving into the U.K., doing some similar work in the U.K. around the Jet brand in the U.K. So, a combination of a logistical opportunity created in the fourth quarter and just some good nice growth opportunities.

Kevin J. Mitchell:

I would just add on that, that the overall environment, the falling price environment had the benefit you would expect to see in those markets, as well, like we saw in the U.S.

Chris Sighinolfi:

Right, all right, okay, thanks, and I guess, secondly, you've continued to execute that re-imaging effort on the branded side here, you noted in the release, I think, a roughly 2% same stores sales growth figure for the re-imaged sites last year, and I'm just curious how that would compare to sites that have yet to be re-imaged.

Greg C. Garland:

I think 2% is a really good number. That's we see inside/outside in terms of the uplift. The sites are certainly more attractive, it's drawing people in and they're spending money, and that's the whole reason we're doing the campaign.

Operator:

Jason Gabelman from Cowen & Company, please go ahead, your line is open.

Jason Gabelman:

Yes, I was going to ask about the international margin, so thanks for addressing that. I guess my other question is just going back to Refining margins. I'm wondering, with oil prices falling as they did, just in terms of secondary product realizations, which geography do you see the highest uplift from those secondary products?

Jeff Dietert:

We do see uplift across all our regions. As you know, we have cokers at all our refineries, except for Ferndale and Bayway, and so there is some contribution, meaningful contribution from all the different regions. We saw it benefit coke, NGLs and fuel oil during the quarter, so it was really across all the products, and there was meaningful contributions from each of the regions.

Jason Gabelman:

Okay. So, you wouldn't say, just a more in general way, that one region tends to benefit more than others, it sounds like?

Jeff Dietert:

Yes, it's across the board.

Jason Gabelman:

All right, and then just a quick follow-up. It looks like CapEx ran a little high in 4Q, obviously not a big concern given the cash flow you generated in the quarter, but I was just wondering what that was from and if that results in maybe cap ex coming in a bit lower next year.

Kevin J. Mitchell:

This is Kevin. You just look at the two large projects that we sanctioned last year and the timing of when spend really started to ramp up on those, so that was Gray Oak and the expansion of the Sweeny Hub with the additional fractionation capacity, and so you're just seeing the impact of the spend level ramping up on those projects, and that's already factored into our capital budget for 2019, that we communicated back in December.

Operator:

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

Matthew Blair:

Hey, good morning, everyone. It seems like your Gulf Coast refining system really outperformed peers. Do you think that was the result of bringing down the WCS barrels, or was there anything unusual or anything that stood out this quarter?

Jeff Dietert:

I think, as we optimize across the integrated logistics network, we did—or are able to allocate the Canadian heavy volumes to the areas that are most beneficial. We did consume a fair amount of Canadian heavy in the Gulf Coast. We also benefit from the wide Bakken differential, with the Bakken Pipeline feeding into the Gulf Coast and across Bayou Bridge into Lake Charles. So, those were big contributions. Configuration is a meaningful impact on Gulf Coast because we produce less gasoline and more diesel than is in the 3:2:1. Product realizations from pricing lags in a declining oil price environment were a positive. I think, finally, the Alliance Refinery was down for maintenance during part of the third quarter and ran during the fourth quarter, so we had higher volumes and lower turnaround expense there.

Kevin J. Mitchell:

A hundred percent utilization for the region for the quarter always helps, too.

Matthew Blair:

Sounds good, and what kind of impact, if any, are you expecting from this recent Keystone Pipeline outage?

Jeff Dietert:

It's a little bit early to know what the impact is going to be. We are a shipper on the pipe, so there's the potential for some impact, but we'll have to wait and see what the details of that situation are.

Greg C. Garland:

We've got workarounds. We actually talked about that this morning. I guess Platts is down, too. I think we're prepared, but, again, as Jeff said, I think we need to see more details about how long the pipe is going to be down.

Operator:

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

Jeff Dietert:

Thank you, Julie, and thank all of you for your interest in Phillips 66. If you have additional questions, please call Brent or me. Thank you.

Operator:

Thank you. Ladies and gentlemen, this concludes today's conference, you may now disconnect.