

Phillips 66 | Phillips 66 Partners

Phillips 66 | Phillips 66 Partners presentation delivered at the 2019 Energy Conference on Tuesday, June 18, 2019 at 10:50 AM ET

Phil Gresh: I'm Phil Gresh, the North American Integrated Oils and Refining Analyst. Here up with me on stage, is Jeremy Tonet, our midstream analyst.

We're going to tag team here, but we have Greg Garland, Chairman and CEO of Phillips 66. Greg, we're thrilled to have you here at the conference today. Looking forward to your thorough update, and then a few questions at the end. Thanks so much.

Greg Garland: Thanks, Phil. Good morning, everyone. It's great to be here with you at the JP Morgan Conference. Kudos to you guys. This is year four. You're really building into a world-class energy conference. Really well done.

Hopefully, I'll share with you today a little bit of the story of PSX. I'll do that in the context of our strategy about what we're doing, why we're doing it, how we think about capital allocation for Phillips 66 today.

This is our safe harbor statement. We're going to make some forward-looking statements today. Actual results could differ. Sources right here on this slide and our filings with the SEC.

This is our strategy. It's growth, returns, distributions built on an unwavering commitment to operating excellence and to be a high performing organization.

When we think about the growth opportunities, our investment decisions are still around investing in our higher returning, faster growing, more highly valued businesses as we seek to shift multiple for our company over time.

Clearly, in our Midstream business, we're building out infrastructure. It's integrated around our network. Pipes, crude pipes, natural gas liquids value chain. In our chemicals business, we've completed the Gulf Coast chemicals project. It is performing well.

In our Refining business we continue to be disciplined around our capital investments in refining. Most of those investments are around changing yield structure or access to advantage feedstocks.

In Marketing, we continue to do our reimaging program to capture brand value.

None of this works unless you have a high performing organization. We wouldn't be who we are without the 14,000 amazing people of Phillips 66 that live our values every day and execute really, really well for us.

Starting with operational excellence, I always like to talk about that. We believe that we create value for our shareholders by getting this part of our jobs right every day. We believe that every employee and every contractor goes home safe to their families every day. Nothing less is acceptable.

You can see across our platforms, in our Refining business, our Chemicals business and DCP, our Midstream that we lead our industry. In the Refining business for the last three years in a row, we've won the AFPM Distinguished Safety Award. That's recognition by our peers of the operating excellence at Phillips 66.

Last year, out of 15 refineries selected, the top decile, essentially, 6 were Phillips 66 refineries. CPChem has won Silver Elite. We have DCP Midstream and our own midstream business winning first place awards in their respective divisions.

Good operational excellence.

You can see that over the past five years we've run at or better than industry operating rates.

Environmental, social, governance—this is a topic that increasingly we find of interest with the owners of our company, with investors. Clearly, for us, it starts with the board. Our board owns ESG. The strategy, understanding the risks, the plans that we have in place to address this.

We start with a robust health, safety, and environmental program. There's no question that if you're working in our industry or you're working at Phillips 66 you're working in one of the safest places in all of US industry. We have a 14-year trend of reducing our emissions, as you can also see on this slide. We'll continue to do that.

We've had a 60 percent reduction over the last 10 years.

We're one of the few companies in our space that has a dedicated technology program where we're investing to understand our impacts to the land, air, and the water and how we can mitigate that through better operations, through investments, but also operating regimes that we would take at our refineries and our chemicals facilities.

We're also investing in fuels of the future. It could be renewable fuels, organic photovoltaics, or solid oxide fuel cells. We're looking at those next fuels that are coming out into the future and investing in that.

We think that it's important that we give back to the communities. Since 2012, we've invested $150 million back into our local communities. We are helping teach kids how to read better, incenting them to study STEM, science, technology, engineering, and math, cleaning up beaches, building houses for Habitat for Humanity, working with local first responders, whether it's fire or police departments. Our employees have donated hundreds of thousands of hours back in their communities.

Now, I will tell you, we are committed to being an inclusive company and to value in diversity. We believe we'll get to a better result. Our employees, every day, live our values of safety, honor, and commitment.

We've defined our leadership behaviors as a company. These behaviors influence how we work together as Phillips 66 employees, how we work with our customers, how we work with our partners in the industry, and, indeed, interact with the regulators and government officials that we deal with every day.

Our idea around behavior is very simple. It's work for the greater good. It's to create an environment of trust. It's to seek different perspectives and to achieve excellence. That's what we try to do every day.

This is our integrated network. You can see here our connections, our refineries, our assets, our chemical plants. Our midstream assets are integrated with our Refining, Marketing, and Chemicals businesses. We think we're uniquely positioned to offer our customers a value proposition based upon these assets.

You can see 21,000 miles of pipe, over 60 terminals. Today, we have 1.8 million barrels of LPG

product and crude export capabilities at our coastal refineries and midstream terminals.

Phillip 66 Partners remains an important part of our Midstream strategy as we execute that strategy today. It's grown rapidly since its IPO. It's delivered one of the highest distribution growths in this industry. It has scale. It has capability. It has financial strength to execute a strong organic program. Indeed, it's doing that today.

The other part of our Midstream business is our 50 percent equity ownership in DCP Midstream Partners. They have about 60 gas plants, 62,000 miles of pipes. Our Chemicals business is represented by our 50 percent equity interest in Chevron Phillips Chemical Company.

We've been busy around the Midstream side of our business. Given what we've seen in crude production, NGL production increases, it's created opportunities to invest in infrastructure around our integrated network. It's also allowed us to have crude optionality around our refineries and optionality for petrochemical feedstock.

If you think about our Midstream growth, it's really focused on crude pipelines from the key shale basins, production centers to the market centers in the US. It's also building out around the NGL value chain. Pipes, fractionation, storage, and LPG export.

I would say that this is integrated with our Central Corridor and our Gulf Coast assets. It gives us a chance to optimize them across that whole value chain for our enterprise.

Our Midstream projects generate good returns. They're underpinned with long term customer commitments. Over the next two years, we expect to have $400 to $500 million of incremental EBITDA that are coming from the projects underway. This would include our Gray Oak Pipeline, South Texas Gateway Terminal, as well as the Sweeny Hub expansion.

We continue to add capacity to our Beaumont terminal. We look at expansion on our existing network pipes.

Last week, we announced the Liberty and Red Oak pipes. I'm going to talk in more detail about those in just a second. At Sweeny, we're building an integrated hub around the NGL business. It's adjacent to our refinery, and we have transportation, fractionation, and export capability there.

CPChem is key to our growth in Chemicals. We just completed the Gulf Coast project last year. That is about a 30 percent increase in capacity. That is running above design. The cracker was rated 1.5. It's running 1.7 million tons a year. We've rerated that capacity up by 15 percent this year.

We continue to be constructive in terms of global demand for petrochemicals, exceeding global GDP. We think that the US Gulf Coast remains well positioned in terms of advantaged feedstocks.

CPChem has the second Gulf Coast project for both ethylene and derivatives under development today. We expect it will reach a FID point on that project in early 2020.

I'd point out that CPChem is well funded. It has a pristine balance sheet. It certainly has the capability to execute large projects while still continuing to make distributions back to the owners of CPChem.

I'll give you a quick update on Gray Oak. We continue to progress the 900,000 barrel a day Gray Oak Pipeline. This provides transportation for the Permian to Freeport, Texas and our Sweeny Refinery. 850 miles, all the pipes bought. The pipe is in the ground. There's 500 of the 850 in the ground today.

I think we're on schedule to meet a year-end in-service date for that asset. Gray Oak is going to connect to five refineries and four export facilities in the Corpus area, including the South Texas Gateway, which we own 25 percent of. That will have two deep-water marine docks, seven million barrels of storage, and ultimately capacity to move about 800,000 barrels a day.

We expect that we'll be in operations by mid-2020 for the Gateway terminal.

Moving on to the Sweeny Hub, we're adding two 150,000 barrel a day NGL fractionators. We're adding six million barrels a day of storage capacity. We've completed about 50 percent of the site prep. The new caverns are drilled. The big towers and fractionators are on site. We're on track for our fourth quarter 2020 completion.

Once completed, the Sweeny Hub will have 400,000 barrels a day of NGL fractionation capacity. You'll have 15 million barrels of storage capacity.

The Sand Hills Pipeline, which is owned 2/3 by DCP Midstream and 1/3 by Phillips 66 Partners, has a capacity of about 500,000 barrels a day. It will feed the 400,000 barrels a day of fracs we have there.

Our fracs are integrated with our 200,000 barrel a day LPG export facility at Freeport, Texas. When you look at how that's positioned, it's closer to blue water. The port fees are lower. We think that it is an attractive option for many of our global customers.

As part of the Sweeny Hub expansion, Phillips 66 Partners is going to construct a long-haul ethane pipeline from Clemens Caverns to Corpus Christi, Texas. It will serve the new ExxonMobil SABIC petrochemical complex and other producers in that area. It's backed by long term commitments. We expect that we'll finish this pipe in 2021.

We've been working on this quite a while. It's not new. It's embedded within the $2.9 billion capital budget that we have. The project was just sanctioned recently. We're moving on with that project.

As we've said last week, we're going to proceed with the construction of the Red Oak and the Liberty pipelines. We've received strong shipper interest that will underwrite these with attractive returns with minimum volume commitments. We have great partners in these projects with Bridger and with Plains helping us build these pipelines.

We expect that these pipelines will be in service in early 2021.

Liberty has a great opportunity to service the Bakken and the Rockies and move it down to Cushing where you can connect with Red Oak. You can get to the Gulf Coast locations. This is going to be a 24-inch pipe. Phillips 66 will construct it and operate the pipe.

As you look at Red Oak, it's a 50/50 joint venture with Plains. Plains will actually construct, and Phillips 66 will operate. As I said, it's a 30-inch line.

As you look at the systems we're building here: Gray Oak, Red Oak, and Liberty, a very robust crude system. We'll be able to take Bakken, Powder River, Mid-Continent, DJ, Eagle Ford, Permian. We're going to give producers the opportunity to go to the refining centers on the US Gulf Coast.

They can also go to Corpus or Ingleside. They can go to Houston. They can go to Beaumont. Ultimately, they'll be able to go to Loop out of the Saint James area. They can access multiple export markets. We think that's a powerful proposition for many of the producers. It is going to be a competitive advantage for these assets.

When you look at our Refining business, it's to run well and optimize our business. Certainly, we want to protect the cash flows in this business. We have 13 refineries, 2.2 million barrels a day of capacity. We're going to be an efficient, safe, low-cost operator.

We'll make capital investments here. We have high hurdle rates. We need to be 30 percent plus return projects. We find those. We'll talk about some of those.

Our largest project to date is upgrading the FCC at our Sweeny complex. It's a circa $300 million investment. It will generate more than $100 million of annual EBITDA by making more, higher value petrochemical products, as well as higher octane on the gasoline side.

We expect that we'll complete this project in the second quarter of 2020.

Our US Marketing business has over 7,500 branded sites. It's closely aligned with our Refining and logistics business. It ensures ratable pull through from the refineries for us, particularly for our inland and West Coast refineries. We're focused on programs that help build brand value there.

We also have a branded presence in Mexico. It's through a licensing agreement. We have the option to supply fuel in Mexico if we choose to do that.

This year, we'll rebrand 50 existing sites. That will bring our total sites in Mexico to 100 sites.

In Europe, we have a strong, high return retail business operating under the Jet and the COOP brands. We have over 1,600 sites which we continue to add to.

As we think about the competitiveness of our refining portfolio, I think we have a great portfolio that can capture the margins that are available to us today, but also the potential margins that we could see in terms of the implementation of IMO 2020.

We have the highest coking capacity on the globe. Our fuel oil production is very low across our portfolio, but also yield a high distillate compared to our peers. We think we're very well positioned. We have a constructive outlook for diesel margins and as well as high sulfur fuel oil.

We're also the largest imported Canadian crudes in the US, about 500,000 barrels a day. We think differentials for WCS need to go to rail economics. That's a $20 differential. We believe that given our portfolio, our infrastructure, and our capability to use this, it's a competitive advantage for Phillips 66.

We have a portfolio of return projects we're working on in Refining. In total, it's about $120 million of capex over the next couple years. These projects exceed a 40 percent return. They're pretty quick payback projects for us.

Many are swinging distillate yield and reducing our fuel oil make at our refineries.

In terms of Marketing, a lot of work around building the brands in the United States. As I said, this is a great business in terms of ensuring ratable pull through and offtake from our refineries. We've been working to roll out our signature sites for the Phillips 66, the Conoco, and the 76 brands.

Where we've done this, we've seen heightened customer interest. We're seeing outside activity at the pumps and inside activity in the stores go up from one to three percent in the rebranded sites.

During 2018, we reimaged 1,300 sites. Since the program inception in 2015, we've reimaged 2,900 sites. We expect that we'll complete them all by the end of 2020.

In Europe and in the UK, we've been investing, building new sites. We added 20 new sites last year. We expect to do 20 to 30 this year. We've added 88 new sites for Jet and COOP. We've also rationalized some of the less profitable ones in Europe.

We'd like to mention what we're doing in renewable fuels. We've done a lot of work over the past couple of years. We're pursuing multiple angles here. One is to leverage the existing capabilities and knowledge, and infrastructure that we have at PSX. It's also to partner with others that bring expertise and technology into this space.

All of them are around producing renewable diesel from waste fats, recycled cooking oils, and other renewable feedstocks. If you sum all the products together, it's about 40,000 barrels a day of renewable diesel.

These are very capital efficient projects. They're going to generate strong returns for us. It's going to help us to meet low carbon fuel standards, particularly on the West Coast of the United States.

Looking at our adjusted EBITDA and our cash generation, if you start with 2018, it was a great year with $10 billion of EBITDA. We generated record earnings across the portfolio. We're also starting to see the investments that we've been making starting to contribute to our results.

With completion of over a dozen large growth projects over the past two years, we've added an estimated $1.5 billion of EBITDA at mid-cycle margins across our Refining, our Midstream, and our Chemicals portfolio.

Our mid-cycle cash flows increased from $4 to $5 billion a year to $6 to $7 billion a year. That's a result of the growth projects we've been investing in, as well as the lower income tax rates from US tax reform.

Last year, we generated our record cash flow, $7.6 billion.

We will remain disciplined allocators of capital. It's fundamental to our strategy. We believe we create value for our shareholders by being very disciplined.

Our long term objective is to take the $6 to $7 billion of cash flow that we generate on a mid-cycle basis and reinvest 60 percent of that back into our business, providing we can find projects that meet our return hurdle rates for our company.

40 percent we're going to give back to our shareholders through our secure, growing, competitive dividend and buying our shares back when they trade below intrinsic value.

At mid-cycle cash flow, we can certainly afford a billion dollars of sustaining capital. That's our first dollar expenditure. The second dollar goes to dividends, $1.6 billion. If you think about $1.6 billion in the context of $6 to $7 billion of cash flow, we've got room to continue to grow our dividend.

Then you'd expect we've got choices. We'll do $1.5 to $2.5 billion of growth investments and $1.5 to $2.5 billion of share buybacks during that period of time.

I think it's going to range, depending on the opportunities set in front of us, to know where our share price is trading relative to intrinsic value.

I think a lot of people are interested in Red Oak and Liberty and what's that impact for us. I know this guy sitting here is because he's probably got 10 questions on that for me unless I can run the clock out in the next nine minutes.

You think about this year, our budget is about $2.9 billion. I think that we're going to try to pull some of that Liberty and Red Oak forward. We've got a little bit of cost increase that will show up for Gray Oak this year.

I think 2019 is going to move in that $3 to $3.5 billion range as we think about that.

If you think about Liberty and Red Oak, the heavy lift is for us in 2020. I suspect that we'll be to the higher end of the guidance range in '20, towards the $2.5 billion of growth capex. That's going to come down and towards the middle of that range as we move into '21.

The other thing I would tell you about this is if you think about this in the context of distributions back to shareholders, we're resolute. We're actually very committed to maintaining distributions back to our shareholders through growing our dividend and repurchasing our shares.

I think you can see our demonstration is on this slide in terms of our cumulative distributions. We raised the dividend and 25 percent compound annual growth rate since the first dividend in 2012. We returned $23 billion back to our shareholders through dividends, share repurchases, and share exchanges during this period of time.

Capital discipline is a focus for our company. We will remain true to that.

As we move to the total shareholder return, I'll wrap up here and leave Phil a little bit of time.

Since our company's formation, we've returned excellent returns back to our shareholders. We continue to believe that this is a compelling investment opportunity.

We think that our strategy around growth, returns, distributions built on an unwavering commitment to being a high performing organization and the operational excellence puts us in the right place to optimize value and to continue to create value for our shareholders.

Thanks for being here today. Thank you for your interest in our company. I'm going to let Phil ask some questions.

Phil: I'm going to ask a couple here and then I'll let Jeremy ask you a couple.

Let's start with your capital spending number that you just provided, the $3 to $3.5 billion in 2019, up from the $2.9 billion. How much of that is Grey Oak escalation versus starting some of the spending on Liberty and Red Oak, if you have it?

For 2020, towards the higher end of that range. Still, obviously, in that 60/40 split that you've always talked about. If you look at the queue of other opportunities, have you pretty much put everything in there that you'd be thinking about at this point?

Greg: Maybe we can start, when we're thinking about Red Oak and Liberty. Let's just call it $4 billion dollars or so of capital. Obviously, we're partnering to reduce risk with great partners, with Bridger and with Plains so the $4 billion becomes net $2 billion to PSX. We do intend to project finance these so the $2 become $1 billion.

Then, you think about the lift of a billion dollars over two years. It's not quite as strong of a lift as you might expect with a $4 billion project.

We like the idea of delivering the returns. These are kind of across the Red Oak, Liberty…these are, call it, seven to eight times multiple builds for us. Certainly, by the time we can optimize the volume through the pipes, by the time we project finance it, we'd expect returns pushing into the high teens on these projects for excellent returns for midstream pipe and investments.

Gray Oak is probably $100 million-ish, to your question of how we move that. The balance would be some combination of Red Oak, Liberty, and other projects that we have going on.

To your point, what else is in the portfolio? We have the permits on a fourth frac in Sweeny. We're probably close to FID, maybe this summer, Frac Four at Sweeny. That would be a circa $500 million investment for us. It's a high-teens return. It's a project that we want to do in our midstream portfolio.

As we think about the balance of reducing risk in terms of partnering, project financing this, and making it all work within the existing guidance and framework of the 60/40 that we've talked about, we are committed to live within that, Phil.

Phil: How do the projects that are coming on stream potentially change the six to seven range over time?

Greg: I started with the projects we have and find over the next two years. With $400 to $500 million of EBITDA coming off those projects. That does not include Red Oak or Liberty.

As you think about our refining investments we're making, there's probably another $300 to $400 million of EBITDA coming off those. You start pushing towards a billion dollars of new EBITDA coming in over the next two years across the PSX portfolio.

Jeremy Tonet: Just a couple questions on Red Oak and Liberty here, some thoughts. Just wondering if you could expand on the vision for this pipe and how this came together. It seems like there's a lot of logistics players chasing something very similar here. What's enabling you guys to succeed when there's stiff competition here?

Greg: A couple of things as we think about that. I talked about our values earlier. I talked about our leadership behaviors and how we want to interact and treat people.

I think there's a part of that in that people want to do business with our company and Phillips 66. I think we've picked great partners to help execute the projects, to reduce and manage risk. I think the company, in general, has a really great track record of building projects, executing them, getting them up and running, and delivering on promises in terms of that.

We step back and we look at this robust system in terms of crude hitting all the major basins with the exception of the Marcellus and the Utica as opportunistic. I think the fact that you've got 1.8 million barrels a day refining capacity hanging off the end of the pipe is also a big benefit in many people's minds.

The access that we're providing into the export. As we talk to producers, they want to optimize their value and optimize their returns. You want these options to be able to hit the water. I think that both Red Oak and the Gray Oak systems help them to do that with multiple options.

Jeremy: Maybe just on the other side of the Bakken there, the Dakota Access pipe. It seems like there's ability to expand there. Just wondering what you can say on that. Does that run any interference with Liberty or do you see them as distinctly different markets that you're pulling from?

Greg: I think Liberty tends to drain the west side, right, and DAPL with central and east side, if you will. We don't think there's going to be a lot of overlap there between those projects.

As you know, DAPL conducted an open season, highly successful. They moved it to 570 MBD. They actually had shipper interest that exceeded that.

You think about the size of that pipe. That pipe could probably do 800 MBD a day, easily. I think that our partners who are working through, where do we go with that line ultimately?

The DAPL's been a great investment. It's run full. It's been a great opportunity to move barrels south on that system. We like our position in DAPL. We're very supportive of continuing to expand DAPL.

Phil: Greg, the refining business has always been more of a cash cow business for Phillips 66, perhaps more than some others. There has been some increased caution recently, just around the macro environment.

Seasonally, obviously, the second quarter is going to look better than the first but there are some capacity additions coming in the global industry. Various agencies have been talking about slowing demand growth recently.

I'm curious if you're seeing anything out there that would be supportive of these data points or how you're generally viewing the macro environment today?

Greg: You think about these as a long cycle investment, four to five-year horizon. As we think out four to five years, the supply side is a little easier to see than the demand side.

I was in Europe with Phil the week before last. There's a lot of concern by investors on the economy. Where's the economy going? What's the impact of tariffs on the global economy?

I think that's the question mark as we think about that. I'd say we're constructive, generally, in terms of refining and in terms of supply and demand as we look out on the three to four-year horizon.

As we think about 2019, coming into '19, certainly fourth quarter you're a hero and the first quarter you're a goat. That's the way it works in our business. We think about margins collapsing between the fourth quarter and first quarter.

We saw an improvement in cracks in the US coming out of the first quarter. The second quarter, certainly, will be much better than the first quarter for the refining industry in our view.

Utilization rates are relatively high. When we look at demand in the US, gasoline is flat-ish. Distillate demand is up about one percent is what we're seeing across our system.

Globally, there's no question the economy is slower today than it was in the first half of 2018 as we come slowing into the second half of '18. I think tariffs are having an impact on that. I think you're seeing that and slower Chinese economic growth.

I think a lot of our European friends we talked to two weeks ago were very concerned about that. I think you add all that together. I think we're still constructive on the refining outlook. We still have IMO yet to kick in in the second half, which I think is going to be very constructive, although maybe not as constructive as people thought in the first half of 2018.

I'll leave it there since the clock is...

Phil: I think we're running out of time here. Thanks so much, Greg. I really appreciate you being here. Thank you.

Greg: Thank you.