TRANSCRIPT

1Q 2020 EARNINGS CONFERENCE CALL

PHILLIPS 66 (NYSE: PSX)

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

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

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

Tim Roberts, *Executive Vice President, Midstream*

MEETING PARTICIPANTS

Neil Mehta, *Goldman Sachs*

Doug Terreson, *Evercore ISI*

Doug Leggate, *BofA Global Research*

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Jason Gabelman, *Cowen & Company*

TRANSCRIPT

Operator:

Welcome to the First Quarter 2020 Phillips 66 Earnings Conference Call. My name is David, and I will be your operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. Please note that this conference is being recorded.

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

Jeff Dietert:

Good morning, and welcome to the Phillips 66 First Quarter Earnings Conference Call. Participants on today's call will include Greg Garland, Chairman and CEO; Kevin Mitchell, Executive Vice President and CFO; Bob Herman, Executive Vice President, Refining; Brian Mandell, Executive Vice President, Marketing and Commercial; and Tim Roberts, Executive Vice President, Midstream. Today's presentation material can be found on the Investor Relations section of the Phillips 66 website, along with supplemental financial and operating information.

Slide 2 contains our Safe Harbor statement. We will be making forward-looking statements during the presentation and our Q&A session. Actual results may differ materially from today's comments. Factors that could cause actual results to differ are included here, as well as in our SEC filings.

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

Greg C. Garland:

Thanks, Jeff. Good morning everyone and thank you for joining us today. Before addressing the quarter, we want to comment on the current environment.

First and foremost, our focus continues to be on the well-being of our employees and their families, our communities, maintaining safe and reliable operations, and ensuring the financial and operational strength of our company. Our business is essential, and we're focused on providing critical energy products and services for our customers.

The safety and health of our workforce is our top priority. Phillips 66 has implemented appropriate steps to protect our workforce that is consistent with CDC, national, state and local directives. We have limited our operating facilities to business-critical staff and implemented strict protocols to prevent introduction and spread of the coronavirus.

In our Houston and Bartlesville offices, over 95% of our employees are working remotely. Our employees have stepped up to the challenge during these unprecedented times and are adopting new ways of working to ensure business continuity. Our plan today for our company, we have one in place to ensure a safe return to our normal operations.

We contributed $3 million to COVID-19 relief efforts in the communities where we live and operate. The funds will provide essential support for first responders, food banks, healthcare and other critical organizations serving vulnerable populations. We recently announced actions in response to the challenging business environment.

We are focused on conserving cash and maintaining strong liquidity to manage through this unprecedented downcycle. We have secured a $2 billion term loan facility and issued $1 billion of senior unsecured notes. We suspended share repurchases in March. We have taken action to reduce costs by $500 million this year. Our organization is doing a great job of identifying opportunities and efficiencies, and we're leveraging our AdvantEdge66 initiatives to achieve these cost savings.

We're reducing consolidated capital spending by $700 million. This reduction will be partly offset by a $400 million increase as DCP Midstream will not be exercising its option to participate in Sweeny Fracs 2 and 3 this year.

In Midstream, we've deferred the Red Oak Pipeline and Sweeny Frac 4 projects. Phillips 66 Partners has also deferred Liberty Pipeline and postponed its final investment decision on the ACE Pipeline.

In Refining, we are deferring and cancelling certain discretionary projects. We continue to fund sustaining capital to ensure safe and reliable operations, and we are executing the in-flight projects that are near completion. We've deferred some turnarounds until later this year and into 2021. We reduced refinery runs across the system in response to lower product demand and margins. In April, our capacity utilization was in the high 60% range.

These steps provide additional liquidity and flexibility as we navigate this global crisis. By doing so, we're protecting the company, the security of the dividend and our strong investment-grade credit rating. We remain focused on disciplined capital allocation and creating long-term value for our shareholders.

In the first quarter, total adjusted earnings were $450 million or $1.02 per share. We generated $217 million of operating cash flow or $736 million excluding working capital. We returned $839 million to our shareholders.

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

We are executing our strategy and progressing major growth projects. The Gray Oak Pipeline commenced full operations of West Texas service on April 1, and more recently the Eagle Ford segment of the pipeline started operations, marking completion of the project.

At the Beaumont Terminal, we added 2.2 million barrels of fully contracted crude oil storage, increasing the terminal's total crude and product storage capacity to 16.8 million barrels.

We continue to advance Midstream growth projects scheduled for completion this year, including Sweeny Fracs 2 and 3, Beaumont Dock 4 as well as PSXP's Clemens Caverns expansion and the South Texas Gateway Terminal. These projects are progressing well as planned.

In Chemicals, CPChem and Qatar Petroleum are jointly pursuing development of petrochemical facilities on the U.S. Gulf Coast and in Qatar. CPChem continues front-end engineering design for its U.S. Gulf Coast project and advanced joint-venture discussions with its partner. CPChem has deferred a final investment decision on the Gulf Coast project.

In Refining, we completed the FCC unit upgrade at the Sweeny Refinery to increase production of higher-value petrochemical products and higher-octane gasoline. The project was completed on time and within budget.

In Marketing, our West Coast retail joint venture is expected to close on the acquisition of approximately 100 sites in the second quarter of 2020 as previously announced. The joint venture enables increased long-term placement of our refinery production and increases exposure to retail margins.

In closing, we're honored that five of our refineries were recently recognized by AFPM for their 2019 safety performance. Our Ferndale, Santa Maria, Borger, Lake Charles and Bayway refineries received Distinguished Safety Awards. This is the highest annual safety award in our industry and the fourth year in a row that our refineries have received this honor. AFPM also recognized CPChem's Borger, Conroe, Orange and Port Arthur facilities for exemplary 2019 safety performance. Congratulations to all those facilities. We're proud of you. Really well done.

With that, I'm going to turn the call over to Kevin to go through the financials.

Kevin J. Mitchell:

Thank you, Greg. Hello, everyone. Starting with an overview on slide 4, we summarize our financial results. We reported a first-quarter loss of $2.5 billion. We had special items amounting to an after-tax loss of $2.9 billion. This includes a $1.8 billion impairment of refining segment goodwill and a $1.2 billion pre-tax impairment of the company's investment in DCP Midstream. After excluding special items, adjusted earnings were $450 million or $1.02 per share. Operating cash flow was $736 million excluding working capital. Adjusted capital spending for the quarter was $900 million, including $644 million for growth projects. We returned $839 million to shareholders through $396 million of dividends and $443 million of share repurchases. We ended the quarter with 437 million shares outstanding.

Moving to slide 5, this slide highlights the change in pre-tax income by segment from the fourth quarter to the first quarter. During the period, adjusted earnings decreased $239 million, driven by lower results in Refining. The first-quarter adjusted effective tax rate was 4%. The lower rate was primarily due to a higher proportion of income attributable to noncontrolling interests and foreign operations relative to domestic results in a low earnings environment. Our rate was further reduced by impacts from state taxes and recent tax changes under the CARES Act.

Slide 6 shows our Midstream results. First-quarter adjusted pre-tax income was $460 million, an increase of $55 million from the previous quarter. Transportation adjusted pre-tax income was $200 million, down $50 million from the previous quarter. The decrease was due to lower equity affiliate earnings largely reflecting reduced volume commitments on the REX Pipeline. In addition, decreased refinery utilization impacted volumes on our pipelines and terminals.

On April 1, the Gray Oak Pipeline began the full operation of West Texas service and later in April the Eagle Ford segment came online. The pipeline is now fully operational.

NGL and Other delivered record adjusted pre-tax income $179 million. The $59 million increase from the prior quarter was due to propane and butane trading activity, as well as record margins at the Sweeny Hub. The Freeport LPG export facility averaged 13 cargoes per month, and the fractionator ran at 114% utilization.

DCP Midstream adjusted pre-tax income of $81 million was up $46 million from the previous quarter. The increase reflects hedging gains driven by lower commodity prices as well as lower operating costs.

In response to the challenging environment, DCP Midstream is reducing costs, reducing growth capital by 75% and recently cut the quarterly distribution by 50%.

Turning to Chemicals, on slide 7, first-quarter adjusted pre-tax income was $193 million, up $20 million from the fourth quarter. Olefins and Polyolefins adjusted pre-tax income was $193 million. The $39 million increase from the previous quarter is due to higher polyethylene sales volumes reflecting increased demand in the first quarter, primarily for food packaging and medical supplies following lower season fourth-quarter demand. Global O&P utilization was 98%. Adjusted pre-tax income for SA&S decreased $23 million due to lower margins and higher turnaround activity. During the first quarter, we received $33 million of cash distributions from CPChem.

CPChem is taking steps to reduce 2020 capital by $600 million and operating costs by $300 million.

Turning to Refining on slide 8, Refining first-quarter adjusted pre-tax loss was $401 million, down from adjusted pre-tax income of $345 million last quarter. Across our system, the weaker results were largely due to lower realized margins and volumes as well as higher turnaround costs. Realized margins for the quarter decreased by 25% to $7.11 per barrel. Crude utilization was 83% compared with 97% last quarter. The first quarter was impacted by significant turnaround activity, economic run cuts as well as unplanned downtime. We completed turnarounds at the Alliance, Sweeny and Los Angeles refineries. In addition, we had outages at the Bayway and Ponca City refineries. Pre-tax turnaround costs were $329 million, an increase of $97 million from the previous quarter. The first-quarter clean product yield was 82%, a decrease from the prior quarter due to downtime on secondary units.

Slide 9 covers market capture. The 3:2:1 market crack for the first quarter was $9.82 per barrel, compared with $12.45 in the fourth quarter. Realized margin was $7.11 per barrel and resulted in an overall market capture of 72%. Market capture in the previous quarter was 76%. Market capture is impacted by refinery configuration. We make less gasoline and more distillate than premised in the 3:2:1 market crack. During the quarter, the distillate crack decreased approximately $4 per barrel and the gasoline crack declined by almost $2 per barrel. Losses from secondary products of $1.32 per barrel improved $1.03 per barrel from the previous quarter due to falling crude prices. Losses from feedstock were $0.21 per barrel. Feedstock advantage declined $1.23 per barrel from the prior quarter. The decrease is primarily due to timing of crude purchases relative to crude runs. The Other category reduced realized margins by $0.17 per barrel. This was an improvement of $0.37 per barrel from the prior quarter driven by clean product price realizations.

Moving to Marketing and Specialties on slide 10, adjusted first-quarter pre-tax income was $488 million, $201 million higher than the fourth quarter. Marketing and Other increased $197 million from higher realized margins, reflecting the impact of falling refined product spot prices partially offset by lower volumes. Specialties increased $4 million due to higher finished lubricant margins.

We reimaged 250 domestic branded sites during the first quarter, bringing the total to approximately 4,440 since the start of the program. In our international Marketing business, we reimaged 11 European sites, bringing the total to approximately 90 since the program's inception. Refined product exports in the first quarter were 160,000 barrels per day compared with 157,000 barrels per day in the fourth quarter.

On slide 11, the Corporate and Other segment had adjusted pre-tax costs of $197 million, an improvement of $14 million from the prior quarter. The decrease is primarily due to lower employee- related expenses partially offset by higher charitable contributions.

Slide 12 shows the change in cash during the quarter. We started the quarter with $1.6 billion in cash on our balance sheet. Cash from operations was $736 billion excluding working capital. There was a working capital use of $519 million. Consolidated debt increased by $1.2 billion. We funded $900 million of adjusted capital spending and returned $839 million to shareholders including $443 million through share repurchases. On March 18, we suspended our share repurchase program. Our ending cash balance was $1.2 billion.

We are focused on conserving cash and maintaining strong liquidity in the current environment. At March 31, we had $6.9 billion of liquidity, reflecting $1.2 billion of consolidated cash, a $5 billion revolving credit facility at Phillips 66 and a $750 million revolving credit facility at Phillips 66 Partners. Phillips 66 has a commercial paper program for short-term funding needs.

In April, we paid off $525 million of maturing debt, executed $1 billion in bond issuances and secured $1 billion of incremental-term loan capacity which is currently undrawn.

S&P and Moody's reaffirmed Phillips 66 investment-grade credit ratings of BBB+ and A3, respectively.

This concludes my review of the financial and operating results. Next, I'll cover a few outlook items. In Chemicals, we expect the second-quarter Global O&P utilization rate to be in the mid-90s. In Refining, crude utilization will be adjusted according to market conditions. In April, utilization was in the high 60% range. We expect second-quarter pre-tax turnaround expenses to be between $45 million and $70 million. We anticipate second-quarter Corporate and Other costs to come in between $200 million and $220 million pre-tax.

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

Operator:

Thank you. We will now begin the question-and-answer session. As we open the call for questions, as a courtesy to all participants, please limit yourselves to one question and a follow-up. If you have a question, please press star, then 1 on your touch-tone phone. If you wish to be removed from the queue, please press the pound key. If you are using a speakerphone, you may need to pick up the handset first before pressing the numbers. Once again, if you have a question, please press star, then 1 on your touch-tone phone.

Your first question comes from the line of Neil Mehta from Goldman Sachs. Please go ahead. Your line is open.

Neil Mehta:

Good morning. Thanks, team, for taking the question. The first one is just around what you guys are seeing real-time on demand. You have a large marketing system, so any real-time data points would be valuable. Then if you could tie that into your comments on utilization; you ran in the high 60s in April and recognizing there's probably some commercial limitations in terms of how you're able to talk about how you expect that to go forward, any thoughts as you think about planning for May and June on the utilization side.

Brian Mandell:

Hi Neil. Thanks for the question. We have line of sight in Western Europe where we have stores and also in the U.S., so we'll start with Western Europe. At the worst of the demand destruction we were down about 70%. We've seen things come back. We're about 50% now. In Germany and Austria, they are starting to open up those communities a little bit, bigger stores can now open. If you come over to the U.S., we were seeing 40% to 50% demand destruction depending on rural or urban areas. Now that's up to about 35% so things are getting better.

In terms of refinery utilization, we are matching our utilization with demand, so as demand moves up, we are moving up our utilization as well. It got down to about 65% utilization when demand was at its worst.

Jeff Dietert:

Neil, as you think about gasoline demand, consumer driven, roughly 35% of gasoline demand is driving to and from work, and recent statistics show over 90% of the U.S. population under some form of lockdown, and the pace of recovery is going to be driven by the impact of COVID-19 and the relief from these policies. About 16 states have scheduled to lift stay-at-home policies and public opinion is starting to rally toward restarting the economy.

As people come back to work and start driving, they'll be greeted with lower gasoline prices, down about 40% year-on-year at retail, and support from a $6 trillion stimulus package which should support recovery as well.

Neil Mehta:

Appreciate that. The follow-up is on the Marketing side of the business where earnings came in better than at least our model for the first quarter. Just any guidance on the way we should think about that as we go into 2Q and 3Q, recognizing volumes would be down, but any thoughts in terms of how you see the next six months from a margin standpoint and whether that could be an offset.

Brian Mandell:

Thanks, Neil. Certainly, Marketing speaks to the benefit of diversity in our portfolio. As you might know, in Europe where we had very, very strong margins, we have about 80% of our stores in Western Europe are retail-owned, company-owned stores, so we get the benefit of the retail margin in that segment, and the retail margin was very, very strong. I'll say for the first quarter until about mid-March when COVID hit, we were running above budget volumes, and when COVID hit we came off, but for the quarter probably about 90% of volumes, but margins two to three times what we had budgeted for margins, so very, very strong margins. Typical of falling flat price, so really did a good job there.

Then in the U.S., where most of our stores are dealer-owned or wholesaler-owned stores, still decent volumes in the U.S. Margins not as good as overseas, but we had good margins in the U.S. too with falling prices.

Operator:

Your next question comes from the line of Doug Terreson from Evercore ISI. Please go ahead. Your line is open.

Doug Terreson:

Good morning everybody.

Greg C. Garland:

Good morning.

Doug Terreson:

Greg, you guys have been an originator of the disciplined capital management approach, and it's obviously served your shareholders well during the upturn and now the downturn too, so kudos to the team for that. And while you reiterated your commitment today, we're in an unusual period of high industry stress, which is usually associated with consolidation if financial and strategic merit is available. So, my question is while you've historically used your internal capital management program to drive value and you guys have obviously been successful, peers have often used acquisitions, and so I wanted to see how you would frame the strategic opportunity set today, whether you think it's that different from prior downturns, and also any other notable color or philosophy that you could share on this topic.

Greg C. Garland:

Sure. Thanks, Doug. This is 40 years for me in the business. This is my first global pandemic, but I've been through several economic crises. What I always tell people is that single-point-in-time forecasts in the middle of a crisis are always dangerous and often wrong and that was true when crude was $100, and crude is $20. We always view our businesses through the lens of midcycle, Doug. We think that's the appropriate way to do it. We've had this 60/40 allocation framework, 60% kind of reinvested back in our business and 40% returned to shareholders. We still think that's a good framework. Obviously, there's times when you're going to be on the other side of that, like in the current crisis. Liquidity is king, you've seen us take the steps to defend liquidity, and the real purpose of that is to protect the investment-grade credit rating and protect the dividend as we go through that. But we're going to come out of this on the other side of this.

As I think about $6 billion or $7 billion of cash flow at midcycle and I acknowledge we're certainly not midcycle today, we always start with the sustaining capital, that's the first dollar, that's $1 billion a year and our dividend is second at $1.6 billion. Then we've kind of guided to $1 billion to $2.5 billion of share repurchase, $1 billion to $2.5 billion of growth capital.

But as I look at all the capex cuts that I'm seeing in the upstream business, you know, 30% in that range or higher for some, I think that the midstream investable opportunities are going to be challenged in 2021, and so while we're a long way to December when we would normally set our capital budget, today I would tell you we would probably guide to the low end of that and just in terms of the organic investable opportunities that meet our hurdle rates.

Then as you think about that, we think as we get into 2021, we're back towards more midcycle conditions for the most part in terms of Refining margins, Chemical margins, etc., so cash certainly, generation will improve.

We'll probably pay down some debt and have the opportunity to restart the share repurchase program.

As I think about the dividend today at $1.6 billion, it's very affordable for us. In our normal cycle, we would look at probably increasing the dividend at kind of midyear, and this is certainly the prerogative of the board. But as you think about we're three times the 10-year average dividend yield of the S&P 100, I don't think there's a necessity for us to do something immediately because as we get into the back half of the year, we'll have a lot of opportunities to think about what do we do with the dividend in terms of increasing it in the back half.

To your question around M&A or acquisitions, so first point is never try to catch a falling knife, obviously. As I think about PSX and how we're positioned, great diverse portfolio, strong balance sheet, we're well-positioned to do what we need to do. The best thing is we don't have to do anything on the M&A front. We have great opportunities to create value for our shareholders so we can be highly selective. There's a lot of examples out there today of folks who have done M&A side of it and it's really hard to create value doing that, and so while I do think that there will consolidation that comes both in upstream and midstream through the balance of this year and into 2021, just given the stress levels that people have, there could be opportunities to pick up assets if not even whole companies.

I think you'll see us look at everything, but we'll be very, very careful and very selective about what we might do, Doug.

Doug Terreson:

Okay, good framework, Greg. Thanks a lot.

Greg C. Garland:

Thank you.

Operator:

Your next question comes from the line of Doug Leggate from Bank of America Merrrill Lynch. Please go ahead. Your line is open.

Doug Leggate:

Thanks everyone. I'm a bit reticent. I want to check if you can hear me okay.

Jeff Dietert:

Yes, you're coming through clear, Doug.

Doug Leggate:

I'm having some − I think Chevron cut their IT budget it seems. Anyway.

I've just got a couple of questions. I guess first of all, Greg, when you look at what's happening to gasoline and distillate, they've got kind of contrasting fortunes right now. Valero made a comment on their call the other day that they expect the market or the industry to move quickly to rebalance the distillate side of the equation. I just wondered if you could offer your thoughts as to what Phillips 66 thinks of that situation and how you might try and address it at your level. Then I've got a follow-up, please.

Greg C. Garland:

Yes. Let me just make some overarching comments and then Brian or Jeff can come in. I actually think that you think about the energy space, the energy sector, Doug, I actually think refining may well lead that space out of this, and I suspect in the U.S. it's going to be around gasoline. People have been cooped up; they want to drive. I think they are going to be reluctant to go get in the middle seat on an airplane, at first. I think that will come. We saw that certainly after 9/11 and people took a while to get back in the space. I think being in quarantine and being cooped up and just going crazy in the house, people are going to want to get out. That should actually bring gasoline demand back pretty good. Indeed, we've seen gasoline cracks move up, not quite on parity with the split.

But then as the economy starts to pick up, my view is that distillate demand is also going to pick up as we get the economy moving again. The real answer to the dilemma that we're facing today in energy impact for many companies is we've got to get demand going again.

Brian or Jeff, if you want to come in on top of that, please do.

Brian Mandell:

I would say too, Doug, if you take a look at refinery yields between January and April in the U.S., you can see gasoline was down from 50% to 44%, jet was down from 11% to 5%, half as much jet made, and distillate was up 9%, from 29% to 38%, so a lot of the jet into the distillate. Refiners moved from a gasoline economy to a distillate economy.

As a refiner, we continue to watch the cracks. As an example, now gasoline is over distillate in the West Coast, and so we think about that, and we think about opportunities to move our refineries to make the products that the people want. I think you also see some gasoline come out of storage now, and you'll see some distillate go into storage as demand starts to continue to increase.

Distillate, if you take a look at the distillate contango and the crude contango, it's about the same from prompt to December, so there's an incentive to distillate as well and I think you'll see some storage as well.

Doug Leggate:

That's really helpful color. Thank you. I guess my follow-up is we've all been asking, at least in those that have reported so far, the E&Ps, how they respond to price signals in terms of how quickly they'll go back to putting rigs back to work and all the rest of it, and I realize that's a longer-dated question, but I wanted to ask you the same question about refinery utilization because the export market has obviously been a big sink for I guess excess product for a number of years now. So given the uncertainty in the global market, whether you've got maybe a more specific issue here in the U.S., how do you think about − when you see margins rebound, how quickly do you think you'll move your utilization up? Would you also be a little bit more paced or measured than the way that you respond to the levels of margins to maybe get themselves a little stability at a higher level before you start moving to a higher level? I just to think from a behavior standpoint, how you guys are anticipating coming out the other side of this?

Greg C. Garland:

Maybe I'll address the margins side. First, the margins will lead us where we'll go, Doug. It will tell us where we need to increase rates or not. You don't want to increase rates just to increase rates, I think. Maybe it would be good, Bob, if you would talk − we've really prepared the refineries to bring them back if we need to and you may want to talk a little bit about that, and I'll let Jeff come in over the top and then talk, but Bob, if you would.

Robert A. Herman:

As we ramped our refineries down, we actually found ways to get down to lower utilization than we would have ever imagined I think going into this, Doug. We've been pretty careful about how we park the units that we've shut down completely, and we do have some FCCs down and reformers to unmake gasoline in the middle of this, but we've kept our subject-matter experts busy making sure that we're ready to run when the signals are there. I think we're going to be pretty careful though about not bringing capacity back on too quickly because the last thing we or anybody else wants to do is start a unit up and then shut it down a week later or a couple of weeks later. So I think we're going to look for a pretty strong and a pretty stable demand signal from the market before we start ramping up units that might be idled right now.

Jeff Dietert:

Yes, I think as we think about demand, it's really the combination of domestic demand and exports into the international market, so it's a combination of both, and as you know, China had the COVID first and it's recovering. We're seeing that 80%, 90% back up, so strong recovery in China. Europe and then the U.S. kind of got hit next and those markets are starting to improve. Latin America, Central America were the last ones to get hit with the COVID impact and so we're seeing a little bit of weakness there, but it's really a holistic approach to demand overall that we're using as a guide to run our refineries at the rate that matches that recovery.

Operator:

Your next question comes from the line of Roger Read from Wells Fargo. Please go ahead. Your line is open.

Roger Read:

Thanks. Good morning.

Greg C. Garland:

Hi, Roger.

Roger Read:

Just kind of following up a little bit on Doug's question there about how things come back and all that. Do you have a feeling for what is the inventory overage as you think about it from the refining down to the retail level? I mean obviously we get the gasoline stats every week, but would your view be that, that's as stacked full of inventory as everything else we look at, or that might be a little bit better? I'm just trying to think of the timing of recovery here as demand slowly starts to pick back up.

Jeff Dietert:

I think as we look at inventories as a percent of shale capacity, crude inventories running at a higher percentage than products, and especially at Cushing, there's about 92 million barrels a day of shale capacity there. If you look historically, Cushing inventories have kind of maxxed out about 75% of shale, so that would be about 70 million barrels at Cushing and we're currently at 63 million barrels, so that's an area where crude inventories are high relative to the capacity that's available.

Gasoline distillates and the products, lower utilization of shale capacity at this point, but obviously regional and local dynamics are extremely important and we're factoring that into how we run the refineries to meet demand and the infrastructure that's available there.

Brian Mandell:

We have the addition of a flywheel for gasoline because PADD 1 is an import market, Roger, and if you take a look at just the last DOEs, 160,000 barrels of gasoline came into PADD 1. That's about 25% at this time of year or less − 75% less, 25% of what typically comes in PADD 1, so that's kind of the flywheel as we think about gasoline demand in the U.S.

I think the bottom line is refiners will produce just what demand is. We won't overproduce and that will keep us from filling up. We're far from filling up now globally − or U.S. wide, so we don't have any concerns on clean products.

Roger Read:

Okay, great. Thanks.

Then, Greg, this question is probably for you. The performance of Chemicals utilization in Q1 and the guidance for a pretty strong Q2, can you give us an idea of what's driving that? Why Chemicals has been managed or is managing to stay a lot stronger on demand side and what we're seeing across most of the rest of the business ops.

Greg C. Garland:

I think you start with a geographically diverse sales mix for CPChem, and the fact that the high density products that they make go into more consumer-type markets. A lot of the chemical peers have a lot more exposure in automotive and automotive has been hit really hard, but if you think about detergent bottles, bleach bottles and hand sanitizer bottles, those things are flying off the shelf and those are the kinds of things that CPChem makes. And then you're seeing a resurgence of disposable packaging as communities banned reusable bags and go back to the disposable bags. That's been it.

I think that one of the things we've seen is really strong demand across all segments of all geographies, so good demand in Asia, good demand in Europe and good demand in the U.S. It's really product- portfolio driven.

Operator:

Your next question comes from the line of Phil Gresh with JP Morgan. Please go ahead. Your line is open.

Phil Gresh:

Yes, hi there.

Greg C. Garland:

Hey, Phil.

Phil Gresh:

The first question I have is probably best for Kevin. Just wanted to get some of your thoughts on the moving pieces here in the first quarter on cash flow. Free cash flow was negative in the quarter. There were some line items in CFO that looked negative there that didn't really have much of a description to them, but also then as I think about the underlying performance, the refining capture rates, pretty varied depending on the region. Just any underlying color you could give about performance in the quarter there.

Kevin J. Mitchell:

Yes. Phil, I mean it's − Q1 is usually a weak cash-generation quarter anyway, and you're right that on the cash flow statement if you dig into the details, so deferred taxes was a use of cash and normally that's an add-back. That is specifically associated with the DCP impairment, and so if you sort of normalize for that, you would have had a sort of modest $200 million inflow on cash on that particular line item. There are certain details like that, that have an impact on the overall, but I would say I think we're pretty pleased that from a working capital standpoint typically a use of cash in the first quarter. It was this time, but probably less than what we've historically seen. Some of that is a function of − you may remember in fourth quarter we did not recover all of our 2019 working capital the way we had anticipated, and the reality is a lot of the inventory drawdown in the fourth quarter rolled into Q1 of this year from a cash standpoint, just based on the timing of when those barrels were sold.

We've also been pretty aggressive in looking at other opportunities to sort of optimize around working capital.

Then the other comment, just from an overall standpoint − and we announced actions to reduce capital, reduce costs, but in the context of the first quarter, our spending really was − those activities were already sort of set in place and very little ability to directly influence capital, so it's on a − if you annualize our capital number for 1Q, you'll get quite a higher number than what we expect the full year to be, and there's no doubt we did consume cash. We issued $1.2 billion of debt over the quarter, and we ended the quarter with less cash than we started, so that is the reality of the environment. It was a tough environment and, of course, the high refining turnaround costs are a drag as well that you typically don't have in a normal steady-state quarter.

I think I'll leave it at that.

Phil Gresh:

Okay. That's helpful.

My second question is on Chemicals, probably for Greg, given your experience in this business for a long period of time. We've clearly seen oil prices come down, naphtha feedstock is getting more competitive. You announced that you're deferring the decision on the two crackers to 2021, but is there anything about this situation that you think has structurally changed in any way that the feedstock is managed of your facilities vis-a-vis naphtha, these facilities longer term? As we look at the current environment, how do you think about trough fundamentals for Chemicals for your business? Are we essentially there at this point? Thanks.

Greg. C. Garland:

First of all, there's no question that as crude prices have come down that the spread between natural gas and crude is certainly diminished for LPG crackers such as CPChem, and that's true in the Middle East or U.S. Gulf Coast. I want to also say that $20 crude is not sustainable in our view. We think crude will ultimately normalize, and we'll see that spread opportunity capture come back to us. Today our view is there's certainly sufficient NGLs to crack but when you look at the cracks play today, naphtha is pretty competitive in that crack space, the C5s, the C4s are very competitive in that crack space.

One of the things that we're seeing in Chemicals today, though that's unusual, is given the automotive downturn. We're not consuming tires, and so making the butadiene go away is becoming a bigger and bigger issue. As you know, naphtha makes a lot of coproducts of which butadiene is one of them, and so industry is looking − the tanks are full. Industry is looking at co-cracking butadiene now just to make it go away, and so that will ultimately start to impact the economics of naphtha in that mix because it's so highly dependent on the value of the coproducts.

I would suggest that for the balance of this year, you should expect the feedstocks in that Chemicals chain to be quite volatile, but they've all kind of converged around that same space. There's still a million barrels a day probably of ethane in rejection, and so we're still highly confident that this next wave of crackers coming on, there's going to be plenty of LPG feedstocks, albeit that they're going to be competing head on head with naphtha, at least through the balance of this year until crude gets back to normal.

Roberts, you've had a lot of experience in Chemicals also. You want to add anything to that?

Tim Roberts:

No, I think you've got it, Greg. I think this is what it is for the moment, but I think it's just a moment. Crude has to − I think it's going to work its way back up, and you'll get that typical normal delta will come back for advantaged feedstock.

Jeff Dietert:

Phil, one thing I would say is we're starting to see delays in the construction of new capacity, both domestically and in Asia, so pushing out the startup of planned capacity.

Secondly, I'd just say the polyethylene chain margin that we reported in our supplement was $0.178 per pound in 1Q. The April index is about $0.14 a pound, so that's where we are today.

Greg C. Garland:

It could go single digits, though. We've seen it there before, and so I think we'll just have to watch as we go through the year.

The fortunate thing is that demand has really held up well across that chain and that should be good.

Operator:

Your next question comes from the line of Paul Cheng from Scotia Howard Weil. Please go ahead. Your line is open.

Paul Cheng:

Hey guys, good morning.

Greg C. Garland:

Good morning.

Paul Cheng:

Two questions. Greg, I had looked beyond just this year and next year, so going into 2022, 2023, in the post-COVID world, is there in any shape or form that change your investment criteria and your outlook for the market. One may argue that the budget cuts from the upstream companies probably are going to see at least 2 million barrels per day of oil production exit from late last year to the end of next year, and we probably won't get back to early this year production level until maybe 2024 or even 2025. Is that a change in your view about that business at all?

Greg C. Garland:

We probably look at exit over exit in a 2-million to 3-million-barrel range, Paul. We're probably maybe a little north of you on two of where we see the exit rates. We do think that we're in a recovery phase. It's probably less investable opportunities in midstream, and I think that forces us to rethink our Midstream growth opportunities, but you've seen us do this before. In '15 we were circa $6 billion of consolidated capital and in '17 we cut that to $1.8 billion, and so we're certainly willing to do that again if that's what the market tells us to do if we can't find investable opportunities, Paul.

Longer term, I think we definitely keep coming back to when this pandemic will be over. There could be another one in the future we just don't know about, but the last one was 1917, so I mean the odds are good that we're going to get back on a growth trajectory here. There are still literally hundreds of millions of people that are coming into the middle class that are going to be consumers. They're going to need petrochemicals. They're going to be consumers of energy. I think directionally that should be positive for a return to growth.

What we don’t know is does the growth go back to where it was, or do we start growing from where we’re at today? I think that’s the real question that is to be answered in front of us.

Jeff, I don’t know if you want to come in as you’re thinking about out in ’23 and ’24, you’re seeing things different?

Jeff Dietert:

No, I think that was well said.

Greg C. Garland:

Okay.

Paul Cheng:

Then the second question is for Kevin. That you guys always have a conservative balance sheet, but after COVID-19, if we’re looking out again, it’s not so much about this year or next year but on a longer term, is your financial parameter, whether it’s on the debt level or debt-to-capital ratio or anything, or even that how you deal the PSXP as a vehicle for you, have those in any shape or form changed?

Kevin J. Mitchell:

Yes, Paul. I don’t think long term we would change our view on expectations around the balance sheet and leverage. We have historically talked about at the PSX level a leverage ratio, sort of 30% debt-to-cap ratio, 25% to 30%, and obviously we’re higher than that right now, and we’ve been working both sides of that equation, between the writedowns had an impact on the denominator and obviously we’ve added some debt, and so we’re sitting above that. But one of the reasons why we target what a lot would consider a very conservative leverage is so that when we come into times like this, we have the ability, the capacity to issue some incremental debt, weather the storm, come through that the other end and not have a detrimental impact on credit ratings and our ability to access debt markets.

I think we feel very good that our financial strategy has really played out the way we would expect in times like this. I do think that as cash flow improves, we will have short-term debt coming out of this. Greg mentioned earlier, we will put priority on eliminating that debt and we would expect that over time we would get leverage back to within our sort of target level range.

Operator:

Your next question comes from the line of Manav Gupta from Credit Suisse. Please go ahead. Your line is open.

Manav Gupta:

Hey guys, some time back, maybe four or five years, you sold a refining asset on the East Coast which was then specifically configured to produce jet fuel. I’m trying to understand what happens to these assets across the world which was specifically designed to produce jet fuel in the current environment in which we are.

Greg C. Garland:

We’re all looking at each other to see who wants to answer that question.

I guess I’ll lead off. I’m glad we sold it when we did. I don’t know.

It's really hard, and Bob, you may want to comment, but it's really hard to move that configuration a lot to produce jet fuel. I'm not sure that the refinery is running that much different in terms of its output today or yield structure than at least at the margin.

Robert A. Herman:

Yes, I think you just look at it over time, they've prioritized making jet fuel even when maybe the margins didn't drive them to do that because of their ownership structure. There's only so many kerosene molecules in a barrel of oil, and it's hard to get anything else from that and they trade away the rest of the products for jet fuel, and that's kind of their business model.

We don't have any insight to what they're doing today when nobody − when they don't want the jet fuel and their parent company doesn't want the jet fuel and nobody wants to trade them for jet fuel.

Manav Gupta:

Okay. A quick follow-up is we were monitoring global capacity additions for the next two or three years, and I think Jeff mentioned this on the Chemicals side. Is there a probability that some of these refinery expansions also get delayed, postponed or just completely scrapped off because of the credit crunch and other issues that we are seeing on the refining side?

Jeff Dietert:

Yes, I think that's right. Typically, even in a profitable market with open financial markets, those projects, new projects tend to get delayed and startup periods tend to longer than anticipated. But that's especially the case with COVID activities impacting labor forces and construction, and the financial markets not quite as generous as what they have been.

We would definitely expect to see refining projects get pushed out. This year, we're expecting something comfortably under a million barrels a day of capacity adds and probably trending lower at this point. So, yes, I think you've got a good point that, both on the Refining side and the Chemicals side, new capacity additions are getting pushed out.

Operator:

Your next question comes from the line of Brad Heffern from RBC Capital Markets. Please go ahead. Your line is open.

Brad Heffern:

Hey good morning everyone. Obviously, April was a crazy month in the crude markets, you know, the play on the physical side. I was just curious if you could talk about how Phillips 66, how much you guys were able to sort of capture those discounts, both in terms of the sort of regional basis dips and then also in terms of the contango that we've seen, and then how long you think that that sort of thing can go on for.

Brian Mandell:

Well, I'll say that one of the great things that we did, and we talked about it at Investor Day as part of AdvantEdge66. We had a group called the Value Chain Strategy and Optimization Group, 36 employees, best and the brightest from around our different segments, and they were able to really, during this period of time − it was very fortuitous that we had them in place − think about how to optimize the entire system. I'll give you an example. When prices for crude really fell, we were able to push barrels around into the refinery, use storage in the refinery that we might not have used, used storage, third-party storage and take advantage of the really strong contango in the market.

Contango is good for refiners. There are other things that are in play when you're analyzing value for refiners, but we were able to take advantage of a lot of the opportunities. We also have Midstream assets where we can store product when there are large contangos, so it was good for us.

Jeff Dietert:

Brad, I might just add contango is typically a benefit for refiners on crude purchases, but we do have a number of different domestic crude contracts that impact or reflect the impact of contango and backwardation, but there's a number of other variables that impact pricing and margins: the timing of crude purchases versus product sales, location and transportation differentials, quality differentials, and product placement options all influence market capture relative to the 3:2:1 benchmark cracks that you guys follow. There are a number of complexities to consider.

Brad Heffern:

Okay, got it. Thank you.

Then you guys touched some oil export barrels. I'm just curious on how you think the outlook for that looks, both in terms of the demand for U.S. crude given the obvious weakness in global product demand, but also sort of what happens if we see significant shut-in volumes. Thanks.

Brian Mandell:

Obviously, if we see a lot of shut-in − and we're seeing probably 30% shut-in right now − there will be less exports. We think there will be less exports probably in the 2.5-million-barrels-a-day range going forward, but our crude is still needed. As Jeff mentioned, Asia is starting to come back and particularly China, South Korea, Japan and Thailand, so I think you'll see barrels continue to be exported. We export some of our light crudes, Bakken crudes and others overseas. I think you'll see that continue.

Operator:

Your next question comes from the line of Matthew Blair from Tudor Pickering. Please go ahead. Your line is open.

Jeff Dietert:

Good morning, Matthew.

Operator:

Matthew Blair, your line is open.

Your next question comes from the line of Jason Gabelman from Cowen. Please go ahead. Your line is open.

Jason Gabelman:

Good morning. How is everyone doing?

Greg C. Garland:

Good morning.

Jason Gabelman:

Great. I wanted to ask a question first about the potential recovery in refinery margins. As investors try to figure how long that takes, I think a useful corollary is prior recessions and downturns, and in the past few recessions it's taken a couple of years for refining margins, global margins, to really come off their lows based off the data we're looking at. Can you just discuss some of maybe the similarities and differences between the current situation we're in and past recessions, and how that's going to impact the recovery in refining margins? Thanks.

Jeff Dietert:

I think it will be a factor of demand recovery and how rapidly demand recovers. In a number of previous cycles there's been an oil price spike in front of the recessionary period that's really had a big and long-lasting impact on demand, whereas this has been much more around the COVID impact. So, I think as businesses get back to work and consumers drive to and from work that we'll see demand recover and that will really drive the margin environment. We're likely to be a in a supply long environment for a period of time, which is supportive of positive demand elasticity as well as low-cost of goods sold for refiners. I think there are some reasons for optimism in this cycle relative to previous cycles.

Robert A. Herman:

One thing I want to add on that.…

Jason Gabelman:

Understood, yes.

Robert A. Herman:

Maybe one thing I'd add on that, too, just if you think about refining margins, in a $30 crude environment, a $15 margin is a lot more advantageous to refiners than it was maybe in past times when we came out and we had $80 crude or $100 crude just because of the coproduct impacts. I think you could see refining margins rebound quickly.

Jason Gabelman:

Sure, thanks.

Then just moving over to the Marketing business, it was touched upon earlier in the Q&A, but we don't really have good visibility into what margins are doing right now, clearly. The first quarter was very strong given the rapid decline in crude prices, but how are refining margins trending now as oil prices have stabilized, and then also if you could extend the comments to how volumes are doing relative to what you've discussed in terms of overall demand destruction. Thanks.

Brian Mandell:

Was your question on marketing margins or refining margins?

Jason Gabelman:

On marketing margins.

Brian Mandell:

The margins in Western Europe are still very, very strong. We expect them to remain relatively strong. In the U.S., the margin is starting to stabilize some, but we still see them as being relatively good. Now, remember in the U.S., a lot of our volume is wholesale volume and wholesale margins are smaller than the retail margins overseas, but we would expect demand to continue to increase and the margins to come off in the U.S. some, and that's it.

Jeff Dietert:

David, do we have anyone else in the queue?

Operator:

We have no further questions at this time. I will now turn the call back over to Jeff.

Jeff Dietert:

All right. Thank you very much for your interest in Phillips 66. We appreciate your time and interest. If you have further questions, please contact Brent or me. Thank you.