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Phillips 66 (PSX)

Scotiabank Energy Conference

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CORPORATE PARTICIPANTS

Jeff Dietert
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Executive Vice President-Refining, Phillips 66

Mark E. Lashier
President & Chief Operating Officer, Chevron Phillips Chemical Co. LLC

OTHER PARTICIPANTS

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

MANAGEMENT DISCUSSION SECTION

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Good afternoon. Thank you for everyone joining us. Our next presentation or fireside chat is with Phillips 66. We have the whole team here, and that we have Greg Garland, CEO and the Chairman of the Board. We also have Mark Lashier, the President of the company. And then we Jeff and – sorry, I missed the last one.

Jeff Dietert
Vice President-Investor Relations, Phillips 66

It's Bob Herman.

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Jeff, can you hear me now.

Jeff Dietert
Vice President-Investor Relations, Phillips 66

Yeah. Bob Herman, EVP of Refining.

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Yeah. Yeah. I'm sorry. Bob, I'm sorry that I couldn't see your face while you're here. But anyway, so thank you everyone joining us.

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QUESTION AND ANSWER SECTION

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Q

So with that, let me start. Greg, Energy transition has been the buzzword. So just based on that, do you see any potential longer-term impact on your Refining and Midstream configuration? And how will Phillips 66 adjust your overall investment mix over the next five years?

Greg C. Garland
Chairman & Chief Executive Officer, Phillips 66

A

Yeah. Great. Well, first of all, thanks for having us, Paul. It's good to see you again, and nice to be with you today. So look, I think energy transition is the subject that's on everyone's minds. And certainly, at Phillips 66 we believe we have a strong role to play in the energy transition. We've got a lot going on around the portfolio and energy transition from the renewables that we're working on to the battery technologies, solid oxide fuel cells, the hydrogen work we're doing.

So, there is a lot of work around the portfolio just in terms of energy transition. As you know, we stood up a new group called Emerging Energy in our company, to really help chart pathway to a lower-carbon future and a pathway where we can bring value, add value that earn returns above our weighted average cost of capital which is important to us. So as you think about the transitions, they take decades; long time to achieve.

And as I think about this next couple years and what we have going on, I think we're going to see more disciplined upstream investment in the US. I think that translates to less investable opportunities in our Midstream business. And yeah, we've just come through a super cycle of investment in Midstream for the industry and a heavy lift actually for Phillips 66 too. If you go back to 2012, we had $450 million of EBITDA in our Midstream business; today, we're over $2 billion. So, significant growth in our Midstream over this period of time since we formed the company.

But as we look forward, I think there's going to be fewer investable opportunities in Midstream. So I think our capital budgets will come down. And so, this year we're at $1.7 billion. I suspect in the next couple of years we're going to be $2 billion or less, as we kind of look into the future and opportunities that we have. So, less investment in Midstream.

In the Chemicals business, Mark's business, pretty much self-funding. We got two nice big projects there that will – they'll move forward over the next few years. In Bob's business, we're pivoting to renewables. So we have $700 million to $800 million investment in renewables to really convert Rodeo from processing crude to not processing crude, but to processing essentially fats and soybean oils and beef tallows and used cooking oils to make 50,000 barrels a day of renewable diesel at that facility.

So, near term, those are the actions we're going to be taking. We continue to sell specialty graphite into the battery business to use in anodes for lithium ion batteries. We continue to work with battery manufacturers to tweak those formulations, get better battery performance. We're working on next-generation batteries. And so, we see those coming kind of in the middle part of the decade.

And then, as you move out 2030 and beyond, I think hydrogen is a great molecule. I think there's a lot of technology development that's yet to be done in terms of that. We're working with the Gigastack consortium in

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UK, taking renewable wind energy electrolyzers to make hydrogen that gets used in the industrial waste to Humber site to lower the carbon footprint of fuels that we make there, but that's scaling at kind of a 5 megawatt to a 100 megawatt facility.

And so, there is a lot of ground that's got to be covered really to drive that technology and to improve the investment case for green hydrogen. We're going to add two to three hydrogen fueling sites a year in Europe over the next couple of years. We already have our first hydrogen sites in. And so, as I said, there is a lot going on around the portfolio. So there's plenty that's going to keep us busy, and we're excited about the energy transition and our role to play.

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Q

And Greg, to a large degree that I think Phillips 66 is unique among the refiners that you actually have your own research lab and research department, which is quite unique. And so, when we're looking at energy transition, do you look at things that you are doing, whether you're seeing the battery, the solar, the hydrogen that's generating offset of the carbon to your core business or that you think that could become a new business for you?

Greg C. Garland
Chairman & Chief Executive Officer, Phillips 66

A

Yeah. I actually believe that's true. I think that we study our own operations to look where we can reduce our impact. Whether it's the air, the land, or water, it doesn't matter. We're interested in reducing our environmental footprint across all those dimensions. And our Energy Research & Innovation center helps us do that with technologies. But I also think, when you think about solid oxide fuel cells, that can be a new standalone business for the company, where we're taking a methane or a propane stream and through a chemical reaction generating electricity, and we generate two-thirds less carbon.

So we have some CO2 that comes out, but also water are the primary products of that reaction that happens. But we also have learned that we can actually run that backwards. So we can actually take CO2 and water and run the fuel cell backwards and generate methane or propane. And so, we just got a grant from the Department of Energy and we're working cooperatively with our partners at Georgia Tech to try to advance this technology. So, this could be a form of the direct carbon capture technology. So, I think we're excited about that technology. There's more to do in that area. But ultimately, as we move into 2030, I think you'll see carbon capture really starting to emerge as a viable technology for industry.

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Q

Yeah. And Greg and the rest of the team, over the last 12 months I think we have experienced something that we have never seen in our lifetime. And so, a lot of the business tactics or the operation has been changed accordingly. So just curious that what have you learned from that process? And is there any lesson you will be able to apply in the post-pandemic to make your operation even more efficient or better?

And also, from that standpoint, in a low-carbon world and in the post-pandemic, do you believe you have the right human organization and the skillset or that you may have some area that you may need to make some changes?

Greg C. Garland
Chairman & Chief Executive Officer, Phillips 66

A

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Bob, why don't you take that kind of Refining and maybe some lessons learned in Chemicals, and then I'll come back with the organization.

Robert A. Herman
Executive Vice President-Refining, Phillips 66

A

Okay. I think one of the things we learned during the last 12 months is, how low can you go, right? And I don't know that we've ever put as much technical effort into learning how to run such a low utilization rates, but still make quality products on the backside. So, we had to be pretty agile going into this to be able to run low utilization rates, but still make a slate of products that kind of balance out the refinery. So, I think that was good.

The second thing was a little bit fortuitous for us, Paul, in that. Over the previous 18 months, we kicked off AE66 and we have done a lot of work around digitization of our processes and putting tools in people's hands that allowed refinery workers to be remote, which 18 months before that I don't think we could have done that and had as successful outcome as we did. So I think one of the long-term takeaways is, we were able to springboard our use of technology throughout the refineries over the last 12 months to really do a lot more than we expected and to keep our initiatives on pace throughout the pandemic with a lot fewer resources on the ground. So I think that's one of the things we'll take with us and learn.

Probably the last point I'll make is, the resilience of our people. We ask a lot of our operating and maintenance folks and the folks that manage our refineries over the last 12 months, and it was truly a learn-as-you-go because the rules in Los Angeles were different than they were in Sweeny, and they were different than they were in Bayway. And we had to adapt very quickly to a changing landscape that seemed to change on us almost daily for the first couple of months of this thing.

And so, we've always known we had good people. They really stood up and showed us how agile, how efficient they could be and how adaptable they are to a changing market. So if you fast forward five years down the road and we need to run refining differently than we run it today because the product slate's a little different or our export markets are different or whatever, we're very confident that we've got the right people in place to figure it out and figure it out pretty quickly.

Greg C. Garland
Chairman & Chief Executive Officer, Phillips 66

A

Mark, do you want to...

Mark E. Lashier
President & Chief Operating Officer, Chevron Phillips Chemical Co. LLC

A

Yeah. I echo the same kind of comments that Bob had around the workforce resilience and the way that our workforce grows, the challenges that the pandemic presented. We kind of have the inverse on the demand side. We ended up running record rates, having record sales, record production because of our ability to adapt our production slate to the products that were needed in a pandemic.

The containers that shifted from more industrial use, delivery of food to more individual use and delivery of food from the containers that – for Clorox, Bleach or other disinfected products that was right in our wheelhouse, and we were able to shift production to meet that demand pretty dramatically. Even things like recreational equipment. No one's going on vacations, everyone's looking for things to do in their backyard and a lot of those things require some of our higher-end products.

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So, it was our ability and our employees' ability to adapt and be agile and all that. And at the same time, we put some pretty strong requirements in place to focus on reducing costs and generating cash, because our owners were in a very different place from a CPChem perspective. They were having operational challenges because of the collapse in demand. And so, they were looking for cash to support their needs. And we were just in the early stages of our own processes analogous to AdvantEdge66, and we were looking initially to save around $100 million a year.

Our team ended up targeting and hitting over $300 million a year in 2020 savings, and the run rate is several hundred million dollars a year in run rate savings. And so, they were able to – in spite of all the distractions around the pandemic and the threat of their family members being sick and will the economy collapse, they were able to focus and bring forth a lot of creative ideas and we're driving that on into the digital space as well. So, I would say, the watchwords there were resiliency and agility; and we're never going to turn back from those.

Greg C. Garland
Chairman & Chief Executive Officer, Phillips 66
A

So, organization performed really well; all 14,300 people at Phillips 66. So we're approaching 50% millennial-Gen Z, Paul, as a company. You've already pointed out one of the differentiators for us is our Energy Research & Innovation center, and that's truly a hub of innovation for our company. And then we're four years into this digital journey, which has made us kind of rethink and reassess the way we operate, the way we work together from the systems we use to the way we make decisions, for instance, general interest decisions around the company where we buy our crude, where we process it, where we sell the products. And so, I really think that the people of Phillips 66 today are really well-positioned to participate in this energy transition and to do it very, very successfully.

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.
Q

Greg, since you have mentioned about the digitalization, can you give us an update where is your program last I think the year before in 2019 in your Analyst Day you parsed out the AdvantEdge66 where we in that program. I mean given the pandemic are we seeing that being a accelerating or that is being delayed?

Greg C. Garland
Chairman & Chief Executive Officer, Phillips 66
A

Yeah I think, so first of all, at the 2019 Analyst Day we laid out like $1.2 billion EBITDA that we think $600 million to $700 fell to the bottom line essentially is what we said in 2019. So if you think about the $1.2 billion, about $500 million of that was around general interest. And so that's how we buy the crude to where we process it to how we sell it. And we change all of our systems around that, we compensate people for general interest decision versus just Sweeny Refinery let's say. And so that's a mid-cycle number and we're probably $100 million to $300 million into it today for mid-cycle margins I think we'd be above $500 million of value.

The next biggest bucket of costs was our – what we call our business operating model. And again this is how we make decisions, how we do work, a lot of transactional activity has been automated, Paul. Couple examples here one is so I go back four years ago we had 2 million spreadsheets in the company and people were downloading data out of the enterprise system trying to make decisions. And people may even show up at the same meeting downloading the same information that have two different answers to the question, and so all that's been eliminated. And no wonder our engineers they're not data miners anymore. We have the tools we can Tableau, they can use Tableau, the data is there for them. And now they can make smarter, better, faster, more agile decisions in the company.

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The other example is you know prior to AdvantEdge66, we ran everything on proprietary systems. We ran our own servers and we had zero in the cloud. Today 90% of our enterprise solutions are in the cloud. And we probably cut a third of the people that work in IT, a third of the IT cost by moving to the cloud. And so we're more efficient or lower cost, and so another example the business operating model. And then we probably saved a $100 million or so in purchasing by just leveraging purchasing, the 12 refineries we might buy 40 different gloves, they we buy two different gloves at all the same refineries.

And then there was about $200 million in what we call digital operations and maintenance. And I'd like Bob take just a quick moment and talk about what are the kind of the three main points that we're able to do, because this is really industry leading, it's first-in-time, best-in-class type of technologies.

Robert A. Herman
Executive Vice President-Refining, Phillips 66

A

Yeah, really. So, our AdvantEdge66 efforts in refining fall into three buckets. It kind of fall into equipment performance, human performance, and then what I'll call leading edge optimization. So if I come back to equipment performance, we've been successful in doing things like we've Wi-Fi'ed to our first refinery completely. So anywhere in the refinery now has Wi-Fi reception. First refinery that we know of that's been able to pull it off. So that allows – it opens the door to low cost sensors. So pumps and compressors and things that used to get monitored by human maybe once a month or once a quarter, we can now put on a continuous sensor on that is monitored 24 hours a day, gives us a heads up. We've got advanced monitoring in some of our bigger equipment that is showing us incipient failures that are coming that we would have never seen until something broke. Now, we know about it weeks in advance, we can plan that, we can take equipment out for service, we can fix it before it breaks itself.

On human performance, we've really gone after making our procedures and processes smart. So one of the biggest things we've been able to accomplish is we have digitized our workflow from the time an operator is doing his round which he does now on an iPhone. It has all the tools on an iPhone to use to communicate with subject matter experts. So whether that's chat or whether it's text or whether it's making a video of a piece of equipment attaching it to a work order which goes to a planner or which goes to the field with an iPad never has to go back to the officer to do his chair to plan the work, carries right on through our electronic work order. So we never lose the efficiency of what the operator needs to be done to what the mechanics going to do. That has yielded a huge benefits for us and just tightening up the communications within our operating ranks and the safety of our operating ranks, so that people know they're all on the same page the task we're about to do, we built in automatic risk type ticklers and things into the process.

And then on the extreme optimization front, one of the things we've done is so everybody has advanced control which looks at a million different process inputs on a unit, right, and continuously monitors it to make the most economic product slate of the day. We have now taken that to the next step where we've got multiple units connected with neural networks and now I've exceeded what I know to talk about but really align multiple units stacks to work together to optimize the slate.

We've got examples in our Lake Charles refiner where we have a very complicated naphtha processing system over there with multiple reformers and multiple splitters. For two decades we've been trying to optimize that system. The neural network taught itself how to optimize in about a month and has been optimizing itself for the last year. That one application is $10 million a year or more profit on what comes out the back side. So we're deploying those kind of technologies across our system really as fast as we can go.

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Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Q

That's impressive. And Greg just curious that I mean I think ever since you become a public company, you have made a very unique and also a very well defined cash flow usage system 60% for investment and 40% for distribution and 40% for distribution. In the post pandemic and also in the low carbon world, do you think that that distribution is still a reasonable proxy going forward or that that needs to be adjusted also?
And also that from a balance sheet standpoint even though we had some debt during this downturn, I mean do you still have a good partnership, but as I said that given the new world focus given the volatility in the market, do you think that on the longer term basis that you really want to drive your net debt balance significantly?

Greg C. Garland
Chairman & Chief Executive Officer, Phillips 66

A

Yeah. So I think that first of all what we think about is, it is a strong balance sheet for us that's BBB+ A3. And that's the most important metric in having strong balance sheet. And we proved to ourselves and we proved to others the benefits of having a great balance sheet through the COVID crisis, we're able to go at $4 billion of debt. We did it quickly. We had no pushbacks, and we did it at very efficient prices. And we're able to structure a lot of that debt where it can be repaid with no penalties. And so I think that demonstrates vividly the importance of having that strong balance sheet, Paul.

And so as we emerge from the pandemic, we think the 60%-40% is still the right number. There's some lead times when that changes. We've been 40%-60% before where we only invested 40% and we've returned 60% to our shareholders. We've done 50%- 50%. But over a long period of time we think 60%-40% is still the right number. And indeed if you look at 2012 through the kind of end of 2020, we're almost right on top of that 60%-40% split. And so, we think that's the right split going forward. We get back to mid cycle cash $6 billion to $7 billion of cash flow mid cycle. We have $1 billion of sustaining capital, we have $1.6 billion of dividend, and that – and a $6 billion to $7 billion cash generation business we have options about what we do.

So we do want to start paying down some debt as we are kind of entering mid cycle cash flow regimes again. Do we have to pay it all down before we get to some other things too? No. But we want to be on a good glide slope, we want to have credibility established, we're going to do what we say in terms of paying down our debt when it get back to raising the dividend, when it get back to buying our shares back. And then at some point in time, there's going to be growth opportunities we're going to want to invest in. I just think the next one to three year period growth is going to be constrained and you're going to see constrained capital budgets coming out of Phillips 66. And that gives us the optionality, the flexibility to really address these other issues we talked about debt repayment, raising the dividend and getting back to share repurchases.

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Q

Wonderful. Greg, I mean marketing is an area that has been a pretty strong contributor to your free cash flow and earnings over the last couple of years. And how would that fit into your long term portfolio, under a low carbon world? And then if at some point that a gasoline demand would come down, I mean how should we look at that business?

Greg C. Garland
Chairman & Chief Executive Officer, Phillips 66

A

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Yeah. So, yeah, our marketing and specialties business has been a great business, it's pretty, and it's generated $1.4 billion to $1.6 billion of EBITDA every year. And a very, very constant cash generation business, it is low capital intensity business for us. It generates 35% return on capital employed. So it's a strong business for us going forward. I should also point out they're using AI to predict lifting terminals and when our customers are going to take, they have a mobile pay application that was developed in cooperation with some of our banking partners and other technology partners. But really an industry first in terms of a mobile pay app at filling stations, service stations.

But when you think about energy transition what we can do with that network. So here's an example. In Europe, today, we're building hydrogen fueling stations in Switzerland. That's going to move to Germany and Austria. So that's an opportunity to build on that marketing network and provide alternative fuels.

I think we are looking at electric charging stations also at those facilities. And so, yes, we can take that marketing footprint and lever that into an energy transition. And same thing with all the renewable diesel. We want to be in control all the way to the last mile so that we get all of the credit, our CFS credit. So it's another great example of where that capture is so important in that total equation of creating value.

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Well, that's wonderful. Right now it's 02:25 in New York Time. So, I wish I had more time because that I can learn from you gentlemen. If I have time I can talk for another two hours. But with that I also want to keep you on schedule for your one on one. So, we will end the session here and thank you very much for your time and take time out on your busy schedule. We appreciate. Thank you, Greg, Bob, and Mark and Jeff. Really appreciate.

Greg C. Garland
Chairman & Chief Executive Officer, Phillips 66

Thanks, Paul.

Jeff Dietert
Vice President-Investor Relations, Phillips 66

Thanks, Paul.

Greg C. Garland
Chairman & Chief Executive Officer, Phillips 66

Good to see you.

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Bye, bye.

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