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Phillips 66 (PSX)

Simmons Energy Conference

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Ryan M. Todd
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MANAGEMENT DISCUSSION SECTION

Ryan M. Todd

Analyst, Piper Sandler & Co.

Thanks. Welcome, everybody, to a fireside discussion here. We're lucky enough to have a large chunk of the management team here from Phillips 66. We've got Greg Garland, Chairman and CEO; we've got Kevin Mitchell, CFO; Mark Lashier, who is – has been heading up the Chemicals business and President and COO; and Jeff Dietert here with us for Investor Relations. So, thanks everybody for joining. It's really a pleasure to have you here at the conference and we really appreciate your participation today.

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QUESTION AND ANSWER SECTION

Ryan M. Todd
Analyst, Piper Sandler & Co.

Q

If we could start off maybe with a couple on the strategy side. I mean, historically you've been composed of four businesses, each with let's call it, mid-cycle EBITDA potential somewhere in the $1.5 billion to $2.5-plus billion dollar range. You've talked about a combined mid-cycle business that was maybe roughly around $9 billion a year in EBITDA or $6 billion to $7 billion a year in cash flow. I mean, have you seen anything in the last 12 months that's changed the long-term view of how you view any of those of your core businesses?

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

A

Well, first of all thanks for having us Ryan. It's great to be here with you today. And I – we haven't seen anything mid-cycle in Refining for a year now. So – but just in terms of our long-term view now, let me step through each of those businesses if I can, and Mark and Kevin and Jeff can tag in here at any point. But as we think about – let me start with Mark's business, $2 billion of EBITDA business, essentially is our 50% share of CPChem.

We're constructive – the global outlook for Chemicals over the next several decades, we have hundreds of millions of people coming in the middle class, and so that's a business that's going to grow at GDP or better over the next couple of decades, and so we feel good about mid-cycle in that business and that $2 billion in mid-cycle earnings actually growing out into the future, as we execute growth projects like Gulf Coast 2 and the Qatar project et cetera. So, good there.

Midstream, when you think about our Midstream business, you go back to 2012, circa $450 million of EBITDA, that's over $2 billion today, good, stable, fee-based businesses that we've built in that business. So, I think we're still comfortable with that mid-cycle outlook in that business.

Our Marketing and Specialties business has just been a perennial stable performer, $1.4 billion, $1.6 billion and I think we're comfortable with that level. Refining, which mid-cycle EBITDA is $4 billion is a little harder to call. It's a very volatile business and as we look at that business, we see the profiles for North America and Europe, probably for gasoline, ultimately flattening to declining, just given improved auto efficiencies, given bios, given EVs in that space, we think distillate continues to grow with economic growth, and that distillate demand will be heavily levered to economic growth. And we're constructive of that as we move out in the next couple years.

So, Refining is probably the harder one for us to call. When we think about a mid-cycle crack, we're picking the 2012 to 2019 average and – but still, I think that as we're coming into the back-half of this year, we like the setup we see. We think there's a lot of pent-up demand from consumers. We think the vaccines are getting put out, and certainly by summer, most of the people that want to get a vaccine will be able to get one, and then you couple that with the cold weather we had and kind of the inventories being normalized are back below the five-year average. So, I think everything is pretty constructive on a go-forward basis. I'm going to have Jeff maybe just touch on what we're seeing globally in terms of shutdowns and how we think that could impact supply and demand balances.

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Jeff Dietert
Vice President-Investor Relations, Phillips 66

A

Yeah, so we've seen 3 million barrels a day of announced permanent closures, another 1 million barrels a day of temporary closures, some of which we think could go permanent. And then there's another 1 million barrels a day that's considering conversion to a terminal or something other than crude oil refining. And so, amongst that group, really offsetting about three years' worth of capacity growth. So, as we see demand getting back to 2019 levels, capacity rationalization offsetting new capacity adds, 2022 could be a mid-cycle environment.

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

A

The thing I would add, too, is as we're making more investments in renewables like Rodeo Renewed, the things we're doing around Humber, Ryze, et cetera, I think by the middle part of this decade, we could certainly have a $1 billion EBITDA business in Renewables and, by the end of the decade, something maybe $2 billion-ish, approaching something like that. So I think that – when you think about that $6 billion to $7 billion, I expect that $6 billion to $7 billion actually grows over time as we make these investments.

Ryan M. Todd
Analyst, Piper Sandler & Co.

Q

Well, that's great. You've touched on multiple – you knocked out a multiple of my questions I wanted answered, which is extremely efficient. And I want to turn to the – I want to return to the Renewable growth outlook a little bit later, but before we leave, I appreciate some of the macro comments on Refining. I mean, as we think of the near-term Refining environment, it's been interesting, right? I mean, RIN pricing – RINs pricing is super high right now. Headline margins have looked really attractive in the first quarter relative to what we've seen any time in the past 12 months, but we've had – you had noise from RINs, you've had noise from storm impact that you had in the middle of the quarter.

As you think about what you're seeing right now in terms of kind of underlying margins or fundamentals, what is the first quarter looking like?
What impact is this going to have kind of on underlying profitability in the first quarter, and what
are you seeing in terms of your ability to increase utilization rate in the near term? Are we not quite there yet?

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

A

So I'll just take a stab and Jeff can fill in. So, I mean, one of the things we saw in January and February, the cracks were moving up, was the RINs were moving up almost the same, and so that net margin for us, on the Refining side at least, really wasn't moving that much. But what we've seen here last couple of weeks is the cracks have actually moved higher than the RINs. And so we're starting to see a little margin open up. But I think first quarter is still really tough in terms of the capture rates and what we're going to see in the first quarter. If you think about rising crude prices and our inability to capture that into the marketing business, so we always get compression there in a rising crude price environment. I think you'll see that in the first quarter certainly.

Operates, they're coming up. Certainly, I think having a lot of refining capacity on the Gulf Coast is down due to the weather, clearing out inventories, kind of removing an overhang. Our view is that rates are probably in the high 70s, low 80s right now as an industry, that's probably about where we're functioning right now or are operating today. And that probably feels about right given where supply and demand is today.

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But as we start to approach the summer and the driving season, we think people are going to drive more, they're going to choose to get in the car and take a vacation where they didn't get to last year. And so, Ryan, I think that we're constructive as we think about the ability to move towards more of a mid-cycle crack and a more of a mid-cycle margin capture, as we move into the summer driving season in the back-half of the year. Jeff, I'll let you catch up on that one.

Jeff Dietert
Vice President-Investor Relations, Phillips 66
A

Yeah. I think you're right. With the winter storm and the reduced inventories that have impacted the margins, quarter to-date our composite crack is almost double what it was in the fourth quarter. Fourth quarter was $7. We're about $14 quarter-to-date, average. And as you mentioned, RINs has taken – RINs cost are up substantially. They averaged – the blended RIN was about $3.50 in the fourth quarter, and it's averaged about $5.50 quarter to-date. And real-time it's about $7. So that RIN cost is a headwind relative to market capture.

We talk about the 3:2:1 crack. I think other factors that will influence that market capture is one, the – we have costs on transportation and freight that's usually charged on a dollar per barrel basis, and so, when you've got a low crack that can be a larger percentage than when the crack moves up. I think, secondly we produce about 43% gasoline and 38% diesel, relative to the 3:2:1 crack, that's 67% and 33%. So when gasoline cracks are the primary driver, we usually lag that a little bit. But when diesel cracks are the primary driver, then we may outperform a bit. Secondary products are really a – the biggest variable is the movement of crude price, and we've been in a upwardly rising crude price environment, so that typically squeezes secondary margins.

Crude differentials, the Canadian heavy dip is a little bit wider in 4Q than what we saw – or excuse me – in 1Q than what we saw in 4Q. So that's a benefit. WTI Brent is pretty flat. When you look at some of our products, the distribution is such that they price with a lag. And so, in an environment where crude prices fall, you get a benefit, and when crude prices rise, it's a bit of a detriment that all washes out as crude prices stabilize. Other things I would say are important are, one, Refining utilization, and as Greg mentioned, our utilization was impacted by the winter storm, similar to the industry as a whole. And the second thing is turnaround expense. We expense turnaround activity and we've got into $200 million to $230 million of turnaround expense this quarter. So I think those are the factors that will influence market capture.

Ryan M. Todd
Analyst, Piper Sandler & Co.
Q

Thanks. Do you still have any lingering operational impacts from the storm?

Jeff Dietert
Vice President-Investor Relations, Phillips 66
A

So, on the Refining side, we're really back to normal operations. First quarter is an active turnaround period for us in March in particular, so we've got some turnaround activity underway. But there's no damage from the storm.

Ryan M. Todd
Analyst, Piper Sandler & Co.
Q

Great if we can could turn to Chemicals a little, I'm grateful to have – I really appreciate Mark joining us today and want to make sure we don't leave Chemicals towards the end. So, even before the pandemic, I mean, you had talked about a soft spot for polyethylene margins over the next year or two, given the capacity expansions that we saw over the last few years. Chemical margins, I think as we looked across 2020, have been relatively strong and a reasonable bright spot during the pandemic. I mean, can you talk about some of the differences in your

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business that mitigated some of the pressure during the downturn? And what's your outlook on pricing and recovery from here and other – in terms of that PE cycle?

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

A

Sure, Ryan. I think you're right, as we wound down 2019, things felt a little long. We got into 2020 and early 2020 we thought the pandemic may make that even worse, but in fact it was the opposite. Our portfolio seemed to have particular resilience with the pandemic. Many of the things that we produced go into products that provide hygiene, or that are related medical products. So, we actually saw record production, record sales throughout 2020 and that was continuing this year – late last year we were trying to build inventory for turnarounds that we were going to have in 2021, because like much of the industry, we didn't want to perform turnarounds, shut down the plant and have maintenance, have it open up and have several thousand contractors in, and somebody gets COVID and you're stuck with a plant that's down and everything's open up. So we deferred those into 2021 and we'll execute those this year.

So we've got the capacity that got tight because of hurricanes last year, drove down inventory. We're trying to build inventory for turnarounds. We got turnarounds that are coming this year, and then Winter Storm Uri hits and takes out 70% of the cracking capacity in the US, which just completely wiped out the ethylene inventories and the polyethylene inventories.

So, we're coming back, I think there are still crackers in the industry coming back online, maybe throughout the next quarter. We're pretty well back online, still ramping some things up. The derivatives are ready to go. The crackers are key because when you shut down a steam cracker suddenly like we did – we had to, like the whole industry had to when we lost power, lost nitrogen, they come down pretty hard and then things get damaged. But we're working our way through that and we continue to see the price of polyethylene move up, the price of ethylene move up, but the feedstocks are staying fairly stable, particularly ethane. So, we're seeing substantial margin growth there. It's going to take several quarters to rebuild that supply chain. We're going to meet the robust demand in the marketplace to continue to grow.

So, again, the net effect across that two- or three-year period is, we pulled a lot of inventory out, effectively capacity out because of conditions like the hurricanes and the winter storm, that, while the demand continued to grow throughout the COVID pandemic and into 2021. So, that's going to mitigate the softness we were suggesting we'd see in 2022 and 2023. It's going to take some of the edge off of that, and while that will be happening, some of that capacity will spread out a little bit. It's not all going to come on perhaps as aggressively as we thought it might. And so that's going to take the top off of that demand. It's going to actually increase the supply/demand balance and it's going to raise the trough a little bit as we go into there. So, it's going to be muted somewhat and it's similar to what we've seen in past cycles.

The cycle is still here, but things never play out the way we imagine them. It's a – this industry has got a very large base of demand and you have to add four or five crackers a year to meet the demand growth, and so, as these things come on and they don't come on as everyone planned, and they spread out over time, the down-cycle is muted. Every time we've seen that over the last two or three cycles, the down cycle is muted and we're going to see that again. And then beyond 2023 into 2024, we don't see a lot of new capacity coming on. So I think we'll see some room to grow margins there as well.

Ryan M. Todd
Analyst, Piper Sandler & Co.

Q

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And what is – what does all of this mean for your – if we think about potential for additional capacity growth for you – for you all internally. Is there – does this change as a pull-forward? Does it impact the timing of another potential leg of expansion?

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

A

Well, as you know, we've been looking at a couple of projects with our partners in Qatar, one in the US, another one down the road a little farther in Qatar itself. And we've – we did take a pause as the dynamics were changing, as things felt a little long, as the pandemic struck, as the economy was in turmoil, and we didn't know what our demand was going to look like. Our demand has been more robust. We're seeing the fundamentals improve. We've also taken the opportunity to look at the capital costs of these projects and drive that down because that's one thing we can control on the front-end somewhat. And we're working hard with our partners to drive toward an FID. All of these things that we talked about are constructive towards those projects. So we think the fundamentals are improving and we hope to make an FID sometime, sometime in the not-too-distant future.

Ryan M. Todd
Analyst, Piper Sandler & Co.

Q

All right, thanks. Maybe if we could if we could shift gears a little bit back to the Renewables business. I mean, you talked about – and you mentioned this earlier, you said, as we talked about those four core businesses, and that mid-cycle EBITDA, and you talked about how you thought that the Renewables business or the low carbon solutions business, could be a $1-billion business five years out, and a $2-billion business 10 years out, I mean can you – what do you see is the potential growth opportunities, both within Renewable diesel, as well as within other parts of the energy transition, that could drive that low carbon business into another one of these core pillars of the company longer term?

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

A

Well, certainly the easiest one to see, Ryan, is the one right in front of us, which is the renewable diesel with Rodeo Renewed, what we're doing at Humber, what we're doing at Ryze, and I think we probably have a couple other opportunities across the portfolio where we can utilize underutilized hydrocracking equipment to make 5,000 barrels a day here and there. So, I think we can continue to grow that piece of the business. I – you know, when you think about the low carbon fuel standard, everyone goes to California, and that's the right place to go, but it's also going to – we think – march up to the West Coast in the US. We think it's going to Washington State, to Oregon. You know, there's states on the East Coast, the Coalition states talking about a low carbon fuel standards.

So, I do think that we'll see that that low carbon fuel standard may migrate with time into more than just the state of California and so I think that'll create an opportunity for additional renewable diesel type of sales. You move beyond that, then we think about the portfolio, and certainly we have especially graphite that goes into lithium ion batteries and the anodes, we continue to work with battery manufacturers to tweak that to make the performance of the batteries better. We're working with next-gen batteries, Lithium-Sulphur, et cetera. So we've got great opportunities in the portfolio, we think, around batteries to continue to move forward.

You know, longer term, we have our solid oxide fuel cells as you start to approach the 2030 timeframe. I think carbon capture storage is going to be one hydrogen – hydrogen is very topical today. A lot of interest in hydrogen and this industry knows hydrogen. We make it. We use it. The Chems business knows it and uses it a lot. You

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know we're building hydrogen fueling stations in Europe today. We've got some up and running. We've got – we'll build two or three a year over the next few years.

We're participating in the Gigastack Consortium in the UK to use renewable wind energy. Electrolyzers produce hydrogen and then utilize the hydrogen in the Humber side industrial base, or the carbon footprint of the fuels we produce at our Humber refinery, but that's a 5-megawatt electrolyzer. We're going to try to scale up to 100 megawatt, and there's a lot of work that needs to be done and a lot of investment and a lot of technology that's got to happen between now and then, to scale up these electrolyzers. So today, the world's largest electrolyzer is 20 megawatts and so that's 4 5-megawatt trains strung together.

We actually looked at doing hydrogen – renewable hydrogen at our facility in Rodeo and we just came to the conclusion that we just – it wasn't quite ready for prime time. We need about 100-ish million standard cubic feet a day of hydrogen at Rodeo Renewed. And you think about 50,000 barrel a day facility, a relatively small facility compared to a refinery, a big facility for renewable diesel plant. But still, you know on the order of 100 million standard cubic feet a day of hydrogen, we would need 750 megawatts of electrolyzer capacity to make that 100 million cubic feet of hydrogen.

There's a wind farm next door that's 20,000 acres that makes 500 megawatts and so we don't think the power is there, but two, you just think about the costs and the scale issues, we're trying to scale from a 5-megawatt unit to something that's 750 megawatts. And so it's not quite ready for prime time, but I do think an area that's primed for technology development and investment and is something we're highly interested in pursuing at Phillips 66.

Ryan M. Todd
Analyst, Piper Sandler & Co.

Q

Yeah. Thanks. I mean you talked about some of these other businesses. The European majors have put the retail and marketing arms of their business kind of at the center of their energy transition efforts in a – that direct contact with customers is a big focus of a lot of their growth plans. I mean what role do you envision your retail and marketing business playing in the transition over time? Is there a chance that we see you expand into EV charging stations or hydrogen stations or is this not – do you not see it playing a material role in terms of an attractive place to put capital going forward?

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

A

No I think that Europe is certainly is one example. So, as I said, today we're building hydrogen stations in Switzerland. We're looking at doing that in Germany and Austria as well. And so, I do think that there will be an opportunity for us to think about where we touch that customer and how we touch that customer. Certainly, charging stations could be added to our retail sites in Europe and we're thinking about that. In the US, as you know, we have more of a wholesale model and our retail exposure is really limited in the US, although it's – we've added some retail through our joint ventures that we've done. And we're looking of course to move biodiesel through our renewable diesel through those sites, but also we're considering electric vehicle charging in different areas that – where we can touch that customer and provide a service that the customer wants and needs.

Ryan M. Todd
Analyst, Piper Sandler & Co.

Q

Perfect. If we – sticking on renewable diesel, there's a lot of focus on incremental RD capacity coming onstream over the next three to five years. If we – if you put on your refiner's hat, if I think about the Refining business and investors tend to have some idea in terms of kind of a relative cost curve, where refineries stack up around the

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US and the globe in terms of competitive advantages or disadvantages, it feels like at this point, maybe because of limited information that the market's treating all incremental RD capacity as kind of the same, which is probably not fair, but I mean as you think about the Rodeo facility and what's going on there, if you put on your refiner's hat, like how would you characterize the strengths and weaknesses of that facility in terms of operating expense, feedstock access and pricing, and product market access, the yield flexibility, all that kind of thing. What are the strengths and weaknesses of that facility as you see it?

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

A

Well, we think Rodeo Renewed is going to be a very competitive asset. I mean first of all, it sits in the middle of the market, which is a good place to be. It has great access, either rail or water access. In fact we've actually I think landed our first cargo of renewable feedstock. We're getting ready to start 8,000 barrel day increment this summer at Rodeo. So, we're starting to bring feedstocks in, getting ready for that run. The other thing I would say is, as refiners, we like scale, and a 50,000-barrels-a-day unit, well, it's not the biggest, it's going to be one of the biggest. When you think about kind of this dollar per gallon of investment, certainly, it appears to us to be the most cost-effective capacity that's been put into service.

And then the other thing that you get with the 50,000 barrels a day is you get that unit scale cost advantage. Albeit we are in California, and it's more expensive to operate an asset in California than it is in, say, Texas, but on balance we like the proximity to the market, we like the fact this asset has scale. It's going to be the lowest unit cost asset to be built and that it has good rail and good water access in terms of getting the right kind of feedstocks in.

And ultimately, this will be a very flexible facility because we're designing to run any kind of – from used cooking oil all the way up to soybean oil, and we're going to be optimizing that facility for the lowest carbon intensity that we can get relative to value so that we can generate the most value coming out of that facility.

Jeff, if I missed something, please fill me in.

Jeff Dietert
Vice President-Investor Relations, Phillips 66

A

No, I think you got it.

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

A

Okay. Good.

Ryan M. Todd
Analyst, Piper Sandler & Co.

Q

Is there a – and regarding the flexibility in terms of the feedstock flexibility there, do you have – when you think about kind of a base case – and I know the flexibility means it's going to move all over the board, but is there kind of a targeted range on that?

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

A

You want to take that?

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Jeff Dietert
Vice President-Investor Relations, Phillips 66

A

Yeah. So we've got the flexibility all up and down and it'll be a lot like our refineries where we're running linear programs to optimize feedstocks and yields. And with this, it'll be feedstock cost and, of course, the lower carbon intensity fuels feedstocks have higher LCFS credit, and that kind of evolves as we go through the end of the decade. We're looking at something in aggregate in the middle 30s from a CI perspective. So used cooking oil on up.

Ryan M. Todd
Analyst, Piper Sandler & Co.

Q

I think you had many conversations with – I'm guessing you're involved in conversations at this point, and how are the conversations with feedstock suppliers at this point? Has it been challenging, not challenging, to try to get visibility on the type of feedstocks you'd like to run?

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

A

We're buying 3,000 barrels a day of used cooking oil for Humber today and have been and so we're in those markets. We know those markets. You know we buy 4 million barrels a day of crude oil. And so we're buying out of Houston, out of Calgary, out of London, out of Singapore, and we've got a global network. And so that network is really well positioned as you think about, to go out and to search the markets for the used cooking oil, but we think those are going be volatile markets and I think that as you know there's a lot of announced renewable capacity, we'll see if it all gets filled, but we're all going to be chasing those same molecules at the end of the day. And so I think that organizations that bring a lot of commercial expertise and breadth, like a Philips 66 commercial organization, is certainly a competitive advantage in our view.

Ryan M. Todd
Analyst, Piper Sandler & Co.

Q

Great. And maybe I don't – we're just about out of time, but maybe one last, one last question for you, Kevin. I mean, as we think about – as we think about emerging from kind of the relative darkness of what the last 12 months has been, in terms of an operating environment, you know, I think your balance sheet – you went into this with one of the better balance sheets in the sector, like everybody else you've had to lean on that balance sheet a little bit over the last 12 months. As we think about coming out of this, free cash is going to start to inflect materially higher as we normalize into 2022. One of the priorities for the use of that cash in terms of debt reduction versus growth and distributions et cetera.

Kevin J. Mitchell
Executive Vice President, Finance and Chief Financial Officer, Phillips 66

A

Yeah, Ryan, that's exactly right. So, we added $4 billion of debt last year to see our way through that darkness, and it's going to be our near-term priority to reduce debt. If you look at our plans for 2021, we were at $1.7 billion capital budget, so quite constrained compared to prior years. The dividend is $1.6 billion, so that's $3.3 billion. As we move back towards mid-cycle cash generation, which is sort of $6 billion to $7 billion, you can see that we'll have a lot of flexibility to start making inroads to paying down debt, and hopefully, we'll also be in a position to

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increase the dividend. We can potentially get back to share repurchases and when the opportunities are there, when the right opportunities are there, start to work on the growth capital.

But, with that amount of headroom, relative to current dividend and CapEx levels, even at cash generation that's slightly below mid-cycle, we should still have good visibility to – a good line of sight to paying down debt and starting to get to some of those other priorities that we've got. So, we don't have to pay down all the $4 billion before we do anything else, but we just want to be making good progress and have a good sort of glide path to getting there. Unfortunately, the way our debt is restructured between current or so the maturities that are coming up and callable notes that we have, we have an excess of $4 billion that's available to pay off without any premium make-whole over the course of the next two years or so. So, we're actually pretty well positioned from that perspective.

Ryan M. Todd

Analyst, Piper Sandler & Co.

Perfect. Well, I think that's all the time we have today. I really appreciate all of you joining us and appreciate the very thorough answers and discussion today. So, thanks again.

As a reminder for those that are planning on attending the next call, this will be followed by a discussion with Hest Corporation. As a reminder, you do need to close this window and click on the link to open a new window to join that discussion.

Again, Phillips 66, we really appreciate it and we will talk to you later.

Greg C. Garland

Chairman & Chief Executive Officer, Phillips 66

Take care. Thanks.

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