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EDITED TRANSCRIPT

PSX.N - Q1 2022 Phillips 66 Earnings Call

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OVERVIEW:

PSX reported 1Q22 adjusted earnings of $595m and adjusted EPS of $1.32.

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PRESENTATION

Operator

Welcome to the First Quarter 2022 Phillips 66 Earnings Conference Call. My name is Erica, and I will be your operator for today's call. (Operator Instructions) 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.

Jeffrey Alan Dietert - *Phillips 66 - VP of IR*

Good morning, and welcome to Phillips 66 First Quarter Earnings Conference Call. Participants on today's call will include Greg Garland, Chairman and CEO; Mark Lashier, President and COO; Kevin Mitchell, EVP and CFO; Bob Herman, EVP, Refining; Brian Mandell, EVP, Marketing and Commercial; and Tim Roberts, EVP, Midstream.

Today's presentation materials can be found on the Investor Relations section of the Phillips 66 website, along with supplemental financial and operating information.

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Slide 2 contains our safe harbor statement. We'll be making forward-looking statements during today's call. 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.

Greg C. Garland - *Phillips 66 - Chairman & CEO*

Okay, Jeff. Thanks. Good morning, everyone, and thank you for joining us today. In the first quarter, we had adjusted earnings of $595 million or $1.32 per share. Our results were impacted by seasonally lower margins across our businesses. In March, we saw substantially improved operating earnings. In fact, March provided the majority of our first quarter earnings. Both gasoline and distillate inventories coupled with strong demand will provide momentum as we head into the summer driving season.

We generated strong operating cash flow of $1.1 billion during the first quarter and returned $404 million to shareholders in dividends. In April, we repaid $1.45 billion of debt. And earlier today, we announced that we'll restart our share repurchases under our existing $2.5 billion authorization. In addition, we remain committed to a secure, competitive and growing dividend and plan to resume our cadence of annual dividend increases.

Earlier this month, we announced that Mark Lashier will become President and CEO of Phillips 66 effective July 1. Mark will lead a company that has a solid strategy, strong leadership and outstanding employees. We're all confident that Mark will serve Phillips 66, our employees, communities and shareholders well as the right leader to position the company to thrive in the years ahead.

And with that, I'll turn the call over to Mark to provide additional comments.

Mark E. Lashier - *Phillips 66 - President & COO*

Thank you, Greg. I'm excited to embark on this new role, building on the talents of our team and the strength of our assets as we continue to deliver shareholder value.

We remain focused on operating excellence and advancing our strategic initiatives. We're committed to improving our competitive position across our business segments to drive future performance in any market environment. Business transformation efforts were initiated last year, and a cross-functional team is focused on opportunities to sustainably optimize our costs and organizational structure across the enterprise.

We're targeting a sustainable cost reduction of at least $700 million per year, which equates to about $1 per barrel. We plan to provide regular updates on our efforts over the coming year.

In Midstream, we completed the buy-in of Phillips 66 Partners and at the Sweeny Hub, we expect Frac 4 to start up in the third quarter. The total project cost for Frac 4 is expected to be approximately $525 million. CPChem is pursuing a portfolio of high-return projects, enhancing its asset base as well as optimizing its existing operations. CPChem's total capital budget for 2022 is $1.4 billion, of which $1 billion is for growth projects with an average expected return above 20%.

This includes growing its normal alpha olefins business with a second world-scale unit to produce 1-hexene, a critical component in high-performance polyethylene. CPChem is also expanding its propylene splitting capacity by 1 billion pounds per year with a new unit located at its Cedar Bayou facility. Both projects are expected to start up in 2023.

CPChem continues to develop 2 world-scale petrochemical facilities on the U.S. Gulf Coast and in Ras Laffan, Qatar. A final investment decision for the U.S. Gulf Coast project is expected this year. We continue to progress Rodeo Renewed and expect to complete the final steps of the permitting process this quarter. Completion of the conversion project is expected in early 2024. Rodeo will initially have over 50,000 barrels per day of renewable fuel production capacity. In addition, the conversion will reduce emissions from the facility. The total project cost is anticipated to be approximately $850 million.

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Our Emerging Energy group continues to advance opportunities in renewable fuels, batteries, carbon capture and hydrogen. In March, our Humber Refinery made its first delivery of sustainable aviation fuel in the U.K. under a supply agreement with British Airways. Also, during the quarter, we entered into an agreement with H2 Energy Europe to form a joint venture to develop up to 250 retail hydrogen refueling stations across Germany, Austria and Denmark by 2026.

During the first quarter, we added a 2050 target to reduce Scope 1 and 2 greenhouse gas emissions intensity by 50% compared with 2019 levels. The new target builds on our 2030 target announced last year. Our targets reflect our commitment to sustainability while meeting the world's energy needs today and in the future.

Before we review financial results, we'd like to recognize our employees' commitment to operating excellence. We're honored that our refining and chemicals businesses were recently recognized for their 2021 safety performance. The AFPM recognized 3 of our refineries, including Sweeny, Billings and Bayway. The Sweeny Refinery received the Distinguished Safety Award, which is the highest annual award the industry recognizes. In chemicals, CPChem received 2 AFPM awards for its sites in Borger and Conroe, Texas. Congratulations to all the people working at these facilities. Well done.

Now I'll turn the call over to Kevin to review the financial results.

Kevin J. Mitchell - *Phillips 66 - Executive VP of Finance & CFO*

Thank you, Mark, and hello, everyone. Starting with an overview on Slide 4, we summarize our financial results for the quarter. Adjusted earnings were $595 million or $1.32 per share. The $158 million decrease in the fair value of our investment in NOVONIX reduced earnings per share by $0.27. We generated $1.1 billion of operating cash flow, including a working capital use of $115 million.

We received distributions from equity affiliates of $585 million. Capital spending for the quarter was $370 million, including $221 million for growth projects. We paid $404 million in dividends. We ended the quarter with 481 million shares outstanding, including the 42 million shares issued for the PSXP merger.

Moving to Slide 5. This slide highlights the change in adjusted results by segment from the fourth quarter to the first quarter. During the period, adjusted earnings decreased $703 million, driven by lower results across all segments.

Slide 6 shows our Midstream results. First quarter adjusted pretax income was $242 million, a decrease of $426 million from the previous quarter. Transportation contributed adjusted pretax income of $278 million, in line with the previous quarter. NGL and other adjusted pretax income was $91 million compared with $138 million in the fourth quarter. The decrease was primarily due to the impact of rising prices on inventory, partially offset by improved butane and propane trading results.

The fractionators at the Sweeny Hub averaged a record 423,000 barrels per day, and the Freeport LPG export facility loaded 43 cargoes in the first quarter. Frac 4 is ahead of schedule and we expect start-up in the third quarter. DCP Midstream adjusted pretax income of $31 million was down $80 million from the previous quarter, mainly driven by unfavorable hedging impacts, partially offset by lower operating costs.

The hedge loss recognized in the first quarter was approximately $50 million compared with a hedging gain of approximately $50 million in the fourth quarter. Beginning this quarter, we are showing our investment in NOVONIX as its own subsegment to separate it from our core Midstream businesses. This investment is marked-to-market at the end of each reporting period. The fair value of the investment, including foreign exchange impacts, decreased $158 million in the first quarter compared with an increase of $146 million in the fourth quarter. Our initial investment in NOVONIX of $150 million had a fair value of $362 million at the end of the first quarter.

Turning to Chemicals on Slide 7. Chemicals' first quarter adjusted pretax income of $396 million was down $28 million from the fourth quarter. Olefins and Polyolefins adjusted pretax income was $377 million. The $28 million decrease from the previous quarter was primarily due to lower polyethylene margins as inventories normalized, following supply disruptions last year. This was partially offset by higher sales volumes. Global

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O&P utilization was 99% for the quarter. Adjusted pretax income for SA&S was $32 million, in line with the previous quarter. During the first quarter, we received $299 million in cash distributions from CPChem.

Turning to Refining on Slide 8. Refining first quarter adjusted pretax income was $140 million, down from $404 million in the fourth quarter. The decrease was mainly due to lower realized margins as well as lower clean product volumes driven by planned maintenance. Realized margins for the quarter decreased by 9% to $10.55 per barrel. Favorable impacts from higher market cracks were more than offset by higher RIN costs, lower Gulf Coast clean product realizations and secondary product margins as well as inventory impacts.

The higher RIN costs were primarily due to the fourth quarter recognition of the reduction in the 2021 compliance year obligation of approximately $230 million. Pretax turnaround costs were $102 million, down from $106 million in the prior quarter. Crude utilization was 89% in the first quarter and clean product yield was 84%.

Slide 9 covers market capture. The 3:2:1 market crack for the first quarter was $21.93 per barrel compared to $17.93 per barrel in the fourth quarter. Realized margin was $10.55 per barrel and resulted in an overall market capture of 48%. Market capture in the previous quarter was 65%. Market capture is impacted by the configuration of our refineries. Our refineries are more heavily weighted toward distillate production than the market indicator. The configuration impact was relatively flat quarter-on-quarter as lower clean product yield offset higher distillate cracks.

Losses from secondary products of $3.05 per barrel were $1.17 per barrel higher than the previous quarter due to rising crude prices. Our feedstock advantage of $1.01 per barrel improved by $0.83 per barrel from the prior quarter. The other category reduced realized margins by $6.42 per barrel. This category includes RINs, clean product realizations, freight costs and inventory impacts.

Moving to Marketing and Specialties on Slide 10. Adjusted first quarter pretax income was $316 million compared with $499 million in the prior quarter. Marketing and Other decreased $199 million from the prior quarter. This was primarily due to lower marketing margins, mainly resulting from rising spot prices as well as seasonally lower demand. Refined product exports in the first quarter were 134,000 barrels per day. Specialties generated first quarter adjusted pretax income of $113 million, up from $97 million in the prior quarter, mainly due to higher finished lubricant margins.

Slide 11 shows the change in cash during the first quarter. We had another strong quarter for cash generation. This was the fourth quarter in a row that cash flow from operations allowed us to return cash to shareholders, invest in our business and strengthen the balance sheet. We started the quarter with a $3.1 billion cash balance.

Cash from operations was $1.1 billion, which covered $370 million of capital spend and $404 million for the dividend, while also increasing our cash balance by $188 million. Our ending cash balance was $3.3 billion. In early April, we repaid $1.45 billion of maturing debt.

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, we expect the second quarter worldwide crude utilization rate to be in the low 90s and pretax turnaround expenses to be between $230 million and $250 million. We anticipate second quarter corporate and other costs to come in between $230 million and $250 million pretax.

Now we will open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Neil Mehta from Goldman Sachs, please go ahead.

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Neil Singhvi Mehta - *Goldman Sachs Group, Inc., Research Division - VP and Integrated Oil & Refining Analyst*

And Greg, you will be missed. Congratulations on your retirement. And Mark, congratulations on the new role.

Mark E. Lashier - *Phillips 66 - President & COO*

Thank you, Neil.

Greg C. Garland - *Phillips 66 - Chairman & CEO*

Thanks, Neil.

Neil Singhvi Mehta - *Goldman Sachs Group, Inc., Research Division - VP and Integrated Oil & Refining Analyst*

I wanted to pick up on the cost point that you talked about, the business transformation. Can you put more meat on the bones around this point and help us quantify what the upside potentially could be either on a dollar barrel basis or across the fleet?

Mark E. Lashier - *Phillips 66 - President & COO*

Yes, we started this initiative last year. We are looking at the entire organization. And really, it's more than just the cost reduction. That's the primary focus. But we want to focus on recurring cost reduction. We want that to be a run rate. So that $700 million number, that's what we view as kind of the bare minimum that we have line of sight on, and we are focused on transforming the organization to ensure that, that cost reduction is sustainable.

And we've got about 800 people, employees and contractors working on that. We're looking at over 1,000 initiatives. So it's broad, it's deep. We're looking at simplifying structures, simplifying ways of working to ensure that, that number is sustainable. So there's upside to it. I don't know that we want to quantify any particular upside, but I guarantee you that we're relentlessly pursuing every opportunity across the organization.

Neil Singhvi Mehta - *Goldman Sachs Group, Inc., Research Division - VP and Integrated Oil & Refining Analyst*

And Mark, that's not just in Refining, that's across the organization?

Mark E. Lashier - *Phillips 66 - President & COO*

That's correct, Neil.

Neil Singhvi Mehta - *Goldman Sachs Group, Inc., Research Division - VP and Integrated Oil & Refining Analyst*

Okay. All right. And then the follow-up is around return of capital. Congratulations on being able to execute the share repurchase program. Again, just talk about your strategy around this, how you think about executing it going forward? When do you feel like you should be in the market and so on?

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Greg C. Garland - *Phillips 66 - Chairman & CEO*

Well, I think I'll take a stab and then Kevin and Mark can come in. Neil, I think as we think about that capital allocation, we think it's important to get back to a regular cadence in terms of the dividend and increasing the dividend. So that point was made, I think, in the opening comments. Certainly, share repurchases, we laid those down in 2020, as a result of the pandemic, to preserve cash. And I think it's just time to get back to that.

One of the great things, I think, that or opportunities we have is this tailwind we see in our base business in Refining. We're going to have excess cash. I think that's going to give us the opportunity to increase the dividend, buy shares back, pay down some more debt, at the same time, build some cash on the balance sheet. But I would say, we are, as a team, our Board of Directors, we're laser-focused on improving total shareholder return for our company.

Operator

Phil Gresh from JPMorgan, please go ahead.

Philip Mulkey Gresh - *JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst*

Greg, I also wanted to say congratulations on a fantastic career. You've always been such a balanced spokesman and visionary for the energy sector, and you will definitely be missed.

Greg C. Garland - *Phillips 66 - Chairman & CEO*

Thanks, Phil.

Philip Mulkey Gresh - *JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst*

If I could follow up, I guess, just around shareholder returns, how do you think about like the pacing? I mean, are you ready to move back to the 60-40 that you've talked about? Kevin, I think you've talked about a $12 billion gross debt target. Is that where you're still kind of eyeballing at this point? And how much cash do you want to maintain on a regular basis?

Kevin J. Mitchell - *Phillips 66 - Executive VP of Finance & CFO*

Yes, Neil. So the $12 billion gross debt target puts us back to where we were before the pandemic. And while that target is still out there, we feel that we're now -- we're on a pace to where we've taken care of $3 billion of the $4 billion we added. Cash generation is strong. The outlook, at least in the near term, is very optimistic. And so we feel comfortable that we can get back into share repurchases while still maintaining some line of sight to getting back to a $12 billion or thereabouts level on the balance sheet.

And I'll just remind you that as we look at our debt maturity profile, we have a lot of flexibility over the next year to 2 years with maturities and actually each of the next 4 years that are out there. So we're going to have a lot of optionality around that. I will say, in theory, if debt reduction is part of the use of excess cash flow, then it becomes another component in the 60-40.

And so we're going to be -- we'll have some balance between reinvesting in the business through the capital program, which we've said about $2 billion in aggregate for the next couple of years, returning funds to shareholders through the dividend. We're back in share repurchases but also working on the balance sheet with a continued -- some form of cadence to debt reduction and increased cash as you highlighted.

You look over the last year and our quarterly cash balance, I think, has increased every quarter-on-quarter. And while that trend will not necessarily continue forever, we do feel comfortable that having a cash balance that we used to say as sort of $1 billion to $1.5 billion sort of minimum cash

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level, we're probably looking more at a $2 billion to $3 billion level that we feel more comfortable with on an ongoing basis. And it's not that we need that much cash but they just provide us more flexibility.

Greg C. Garland - *Phillips 66 - Chairman & CEO*

I think maybe what's also been left unsaid here this morning is we've kind of given guidance about being very disciplined around our capital investments at our company. And then we've kind of guided to $2 billion or less for this year and next year, and I would say that guidance is still on the table this morning.

Philip Mulkey Gresh - *JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst*

Okay, great. A follow-up question on Refining. I guess, interesting comment that most of the money was made in March, it makes sense relative to what peers have said. You do have some higher maintenance, I guess, in the second quarter. As you look at the full year, are you still sticking with the $800 million to $900 million of maintenance? And if you could just elaborate a bit on the central corridor performance, where there was a loss in the quarter.

Mark E. Lashier - *Phillips 66 - President & COO*

Okay. I'll take a shot. I think there's 3 questions there but I'll get them all. So I think we were -- we had primarily maintenance activity in the month of March and really the back half of March as the weather warmed up in the north, we launched to get into turnaround mode. Again, primarily, in the central corridor. So we were -- we entered into that. We will have most of our turnaround activity wrapped up by mid-May. And certainly, all of our conversion units will be back online kind of middle of the month.

It really positions us well then to run very strong throughout the summer driving season, and we won't come back to any significant turnaround activity until after Labor Day.

I think on total activity for the year, we're really looking at -- we've executed our first half plan, and for the most part, has gone really according to what we've planned. Second half, we continue to look at primarily catalyst-type change-out turnarounds. And do we have a catalyst life left and we pushed some of those turnarounds into next year. And we've got some opportunity there, I think, in the back half of the year to squeak some of those out into next spring or maybe even next fall. So we are constantly trying to re-optimize around all that.

The other thing I would say about the Central Corridor results is we had a pretty good headwind in the Central Corridor with our lagged Canadian crude buying program. So that was a significant impact on a timing basis to what we saw as the results in the Central Corridor and it all basically lands there for us in our system.

So that's a timing issue. It has a lot to do with how quickly the crude ran up, particularly in the back couple of weeks of the quarter. We'll get that back over time as crude prices come off as they seem to always do and then we'll see it come back.

Kevin J. Mitchell - *Phillips 66 - Executive VP of Finance & CFO*

Yes. And just, Phil, in terms of the impact of that in the Central Corridor, it's about a $3 per barrel on the realized margin impact through that crude timing effect.

Operator

Doug Leggate from Bank of America, please go ahead.

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Douglas George Blyth Leggate - *BofA Securities, Research Division - MD and Head of US Oil & Gas Equity Research*

Greg, needless to say, I'll add my thanks and congratulations to both you guys and I hope we get -- I'm trying to encourage Jeff to do a retirement dinner for the sell-side, Greg. So hopefully, you can make a...

Greg C. Garland - *Phillips 66 - Chairman & CEO*

As long as you're buying, Doug.

Douglas George Blyth Leggate - *BofA Securities, Research Division - MD and Head of US Oil & Gas Equity Research*

Well, I will move mountains to be there, but thanks for providing all your insights and help over the years. Mark, look forward to seeing how you steer the company. So fellas, I've got 2 -- one big picture question. I also ask -- I want to ask a bit of a philosophical question perhaps for both of you guys.

First of all, on the industry level, look, we've obviously -- I think you're all familiar with our opinion on where we think we stand right now. But you have Humber, and like Valero, you have insights to what's happening in Europe and obviously, you are also responsible for shutting down to the facilities in the U.S. by the time we get to the end of next year.

So when you look at the structural shift that we appear to be going through right now, I'm just curious what you're thinking in terms of, are we seeing the U.S. move to a whole new level kind of mid-cycle advantage, if you like, relative to international, dare I say, European peers, and obviously, Humber gives you some insights to that.

Robert A. Herman - *Phillips 66 - EVP of Refining*

Yes, Doug, this is Bob. I'll take a shot and others can come in over the top. I think the last time we talked, I think it was at the beginning of your call on the golden age of refining. We were talking about the structural differences...

Douglas George Blyth Leggate - *BofA Securities, Research Division - MD and Head of US Oil & Gas Equity Research*

U.S. Refining.

Robert A. Herman - *Phillips 66 - EVP of Refining*

Yes, U.S. Refining. And at the time, gas prices were just, they were skyrocketing in Europe. And we had inside Humber -- Humber being by far the strongest refiner in the U.K. and a very strong refiner in Europe in particular, and one that doesn't use a lot of fuel gas. We're structurally advantaged there with the large coking capacity and generating most of our own needs, but it gave us a view.

And at the time, Humber was just kind of in a breakeven position. So we talked about the fact that European refiners had to be underwater and that the market would have to move to incent those marginal refiners to keep running and get back to making clean diesel. And in fact, that's exactly what we've seen happen, right? Diesel cracks have come up to incent that Humber's return to good profitability and the whole market works.

Sometimes it takes a while for that structure to kind of get itself right. But again, the market worked. I don't really see this changing anytime, right? Gas prices are up in the U.S. but certainly not anywhere near what we're seeing yet in Europe, and it really puts us at a structural advantage.

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If you add in the fact that Europe is basically hydrocracker-based, they use a lot of hydrogen, you got to buy a lot of fuel gas to make hydrogen for the most part, it does give us a cost advantage and one that should translate all the way back through improved kind of mid-cycle margins for U.S. Refining versus the rest of the Western Hemisphere. Brian, if you got anything you want to add?

Brian M. Mandell - *Phillips 66 - EVP of Marketing & Commercial*

I would just add that in the U.K. where we have our large refinery, gas prices have come off quite a bit. Last night settled at $16 an MMBtu versus most of Europe, which is still over $30. But our guesstimate is about $8 to $9 benefit through the U.S. versus the EU, given the price of natural gas here and the price of natural gas in EU currently.

Robert A. Herman - *Phillips 66 - EVP of Refining*

And probably an advantage also on crude feedstock with light sweet crudes having been traded up in Europe relative to the U.S.

Douglas George Blyth Leggate - *BofA Securities, Research Division - MD and Head of US Oil & Gas Equity Research*

Of course, well, Bob, just for everyone listening, your insights were extremely valuable as we prepared that thought.

So guys, my philosophical thought, and Greg and Mark, I think when we look back over the last 5 years, the volatility of the challenges that you guys, Greg, in particular, have had to navigate, your strategy obviously moved to be more defensive, if I say, diversified from Refining. And obviously, if we've got this reset going forward, you're perhaps a little less exposed than some of your peers.

So when we look at your relative share performance over that 5-year period, it seems to us you behaved more like an integrator than a refiner. So I'm curious, Mark, as you look forward, how do you think about differentiating the investment case relative to that, let's say, pure-play refining peer group as opposed to the more, I guess, glacial kind of share buyback type of situation we're now starting to see with some of the majors? How do you think about the relative investment case? And I'll leave it there.

Mark E. Lashier - *Phillips 66 - President & COO*

Yes. I think that, Doug, the relative investment case really revolves around a couple of different things. First of all, we want to make sure that we take care of our refineries, that we operate them well. They're going to -- you've referenced the North American golden age. We want to make sure that we are able to be a full participant in that.

But then as we generate cash, what do we do with that? I think there's a number of things we want to do around Refining to position our refineries for the long term, so to drive them more towards the refinery of the future, maybe producing more petrochemicals.

We will continue to look for growth opportunities through CPChem. They've got 2 mega projects teed up, but they've got several midsized projects and then they've got a lot of debottlenecks that build on their advantage. So they've got good, high-return opportunities to drive down the refining side of things. And then we continue to look for where we're going to play in emerging energies. And we see some real opportunities to leverage our existing assets and to leverage our technologies to create sustainable value in Emerging Energy.

So think about it as -- and then there's Midstream that we've got opportunities in Midstream to both optimize our Midstream asset base as well as drive some consolidation there. So we've got that leg as well. So we'll continue to drive down those segments, each a little unique, but each delivering value in its own way.

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Douglas George Blyth Leggate - *BofA Securities, Research Division - MD and Head of US Oil & Gas Equity Research*

Understood. Congratulations, again, Greg.

Operator

Roger Read from Wells Fargo, please go ahead.

Roger David Read - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

And yes, my congratulations to you, Greg, and to you, Mark, for getting to take over and step into a big pair of shoes to fill.

Mark E. Lashier - *Phillips 66 - President & COO*

Yes, they are big indeed. Thanks, Brian (sic) [Roger].

Roger David Read - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Just to jump on in here. I guess the first thing, if I look at your presentation, I know I'm going to make Jeff squirm a little bit here. But well, the amount that you can earn in terms of guidance on diesel margins. And Greg, this will be near and dear to your heart, and you've talked so many times about Phillips really benefits from diesel or the distillate crack.

I'm not even going to throw the numbers out there if I were to calculate off of New York harbor diesel crack right now, but what is the right way for us to think about what Phillips can do in this environment? I know you got turnarounds but everybody always has turnarounds. Just how we should think about some of that guidance and some of the capture possibilities on the Refining side?

Jeffrey Alan Dietert - *Phillips 66 - VP of IR*

Yes. I think the focus is going to be on operating well and being in the market and able to take advantage of the margins that are available. I think we've talked about some of the exposures that we have on diesel, on heavy sour dips, on premium cokes. And all of those environments look favorable as we look into the summer months.

I think there's some moving parts. We were hindered this quarter on timing issues with -- in the Gulf Coast on product timing and in the Central Corridor on crude purchasing and timing issues there. So I think those will normalize out and we'll see that profitability show up in later periods.

Roger David Read - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Okay. But I mean, I guess, just to clarify, is the -- should we presume that the broad guidance is still pretty reasonable even at these levels? There's not some sort of deterioration we should think about and capture as we go forward?

Greg C. Garland - *Phillips 66 - Chairman & CEO*

No, I don't think we see that. I mean, Brian can speak to what we're seeing in the current market. It's hard to predict the net income but I watch cash. And we've seen just cash just strengthening as we've come in the back half of March and on into April. And so I mean, to me, that suggests that capture rates are definitely have improved. Brian, I'll let you comment.

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Brian M. Mandell - *Phillips 66 - EVP of Marketing & Commercial*

Yes. I would add that, as Jeff said, timing is an issue so prices continue to increase from here. There'll be a lag in terms of the amount of money that we can capture, but we will capture that over time. But in terms of the crack margins, we're absolutely in a position to capture those and we do every day.

Jeffrey Alan Dietert - *Phillips 66 - VP of IR*

I think one thing I would emphasize, Roger, just the amount of volatility that we're seeing on a daily basis with crude trading in a $5 to $10 a barrel range on a daily basis, and products, especially diesel trading in wide range on a daily basis, that average crack you see at the end of the day, there was a lot done across that period of time. And so I think when we see this kind of volatility, the indicators are not going to be as accurate as they typically are when volatility is not so high.

Roger David Read - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

That's fair. There's a lot of room for error, given where cracks are right now.

One follow-up question. The $700 million cost savings goal, how does that fit into what was laid out in the fall of '19? And I know a lot of things happened since the fall of '19, but how should we think about that $700 million within the overall framework that was laid out at that point?

Mark E. Lashier - *Phillips 66 - President & COO*

Roger, this is going to build on what we did around AdvantEdge66. There were a lot of things done there, a lot of value capture and some things were moved out into the future, some things were captured in a one-off fashion. A lot of digital innovation was introduced, and we're going to leverage those innovations to simplify what we do to drive efficiencies in the organization. So this is additive to that.

Roger David Read - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

So should we think about -- it's just a logical next step in the process? It's not iterative as opposed to like something brand new or radically different?

Mark E. Lashier - *Phillips 66 - President & COO*

Well, this -- yes, it's building on that. It's probably getting more into the organization structure as well and how we can capture efficiencies and transform how we drive our business. We're not going to change what we do but how we do it. I think we'll become more efficient. So I think it does build on it and is additive to that.

Jeffrey Alan Dietert - *Phillips 66 - VP of IR*

Yes, there's a substantial incremental effort that's going into place now.

Operator

Ryan Todd from Piper Sandler.

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Ryan M. Todd - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Maybe a follow-up on Chemicals from some of your comments earlier. First quarter was a very strong quarter. I think we came into this year, and I think your messaging had been expecting margins to trend back towards mid-cycle levels from the peaks that we saw last year.

But it seems like they may have inflected a little bit higher lately. And can you talk about how you see the market trending from here? And how market dynamics in crude and natural gas pricing are driving relative advantages in your portfolio versus European and Asian plants?

Mark E. Lashier - *Phillips 66 - President & COO*

Yes. Thanks, Ryan. I think that your closing comment really touched on it. Since the last call, with crude moving up and ethane to a crude advantage becoming enhanced, that's driven margins wider for CPChem and the entire industry. And we're well positioned to take advantage of ethane both here in the U.S. and in the Middle East.

So that's there, and I think that, that's going to persist. You're going to see the ethane extraction value driven to a point to attract more ethane out as more consumption comes online. That consumption is going to provide a headwind in new capacity as we go into seasonally stronger margins. So you kind of see those 2 things balancing off each other, so we see kind of a status quo in those margins going forward into the next quarter.

Ryan M. Todd - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Great, that's helpful. And then maybe can you talk about any update that you have on timing of permits at Rodeo, the next steps in the process there and maybe what you've seen in terms of the operating environment for the renewable diesel volumes that you've been able to produce so far year-to-date?

Robert A. Herman - *Phillips 66 - EVP of Refining*

Yes, it's Bob. The permitting process is really moving forward quite well and as we expected. We've had conditional approval from the Planning Commission in Costa County. As usual in that part of the world, it was appealed. It goes to the County Board supervisors who have actually set a special meeting to address our permit on May 3. Coming out of that, we would expect the Board of Supervisors to grant the permit and allow us to start work shortly after that. Everything we can see, we've got good support in that community.

Realize that while there's great drive in California to have alternative vehicles and everything else in the marketplace, that renewable diesel is a needed fuel now. And the quicker we can get going, the quicker we can get the unit up and running and starting to provide those fuels to the California driving public. So we expect that permit to come here just very, very shortly.

On the Unit 250, the renewables we've been running there, we continue to see profitability on that unit. And really, what we've come to understand is that the price of soybean oil, the price of California diesel, the price of low carbon fuel standard credits, RINs, cap and trade, they all seem to sort of work in concert to incent us to continue to make renewable diesel and put it in the marketplace.

So we're very encouraged by what we see there kind of on the commercial side, and we're very happy with what we've learned on the operating side about how to run bean oil type feedstocks through the units. So we're really looking forward to the next phase and getting Rodeo Renewed permitted hopefully next week and then get going and looking for start-up in early '24.

Brian M. Mandell - *Phillips 66 - EVP of Marketing & Commercial*

And I would add, we're able to get all the volume out of Unit 250 to the end consumer through our retail and wholesale network in California.

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Ryan M. Todd - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

That's great. And congratulations, Greg, on your retirement and Mark on the new position. It's been a pleasure with both of you.

Mark E. Lashier - *Phillips 66 - President & COO*

Thank you.

Greg C. Garland - *Phillips 66 - Chairman & CEO*

Thanks.

Operator

Manav Gupta with Credit Suisse, please go ahead.

Manav Gupta - *Crédit Suisse AG, Research Division - Research Analyst*

I have more of a strategy question here. For a long time, Midstream was a growth vehicle for PSX to grow earnings. Now you've brought in PSXP. How should we think about Midstream growth here? Is it basically going to be a small growth? Or if you actually come across a really good opportunity which is even capital-intensive, then you would still be willing to invest capital and grow the Midstream business, even though PSXP doesn't exist? So help us understand now, where does Midstream sit in terms of your overall growth strategy going ahead?

Timothy D. Roberts - *Phillips 66 - EVP of Midstream*

Manav, this is Tim. Thanks for the question. When you think about it with the roll-up, that simplification helps us both commercially as well as takes out some complexities in dealing with reporting and what we do and takes out some cost in that process. So you roll it out, but our strategy really hasn't changed. Fundamentally, yes, we were on a very fast growth trajectory, a lot of opportunities. We've built out the MLP and built out our Midstream business.

But as we've said before, we've slowed that down because the pipes appear to be in place. Infrastructure is well caught up. So in our world, we're looking at optimization and how we can best find incremental high-return opportunities and optimize our set as well as build out our further NGL integration.

So if the right opportunity comes up, it's going to compete like all our projects do. And if it meets the right threshold and it's the right thing to do overall from PSX view, it would be considered. But outside of that, we're really optimizing the kit at this point in time.

Manav Gupta - *Crédit Suisse AG, Research Division - Research Analyst*

And the second is more on the growing the energy transition business. So I think the first part of the question is obviously, you have a very good project in Rodeo. Would you like to do it all alone? Because some of what you're seeing out there is people bringing in partners for capital and other expertise.

So the first part of the question is, would you like to keep it the renewable diesel project on to yourself or you're open to a partner? And second part is, besides this bigger project of Rodeo, what else can PSX do to grow its cleaner fuel franchise or energy transition business?

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Brian M. Mandell - *Phillips 66 - EVP of Marketing & Commercial*

Well, I would say with Rodeo, we have it funded through our capital program this year and next so we don't need a partner in that way. Some folks have gotten a partner because they need a commercial expertise. We have a very strong commercial organization. We've been buying used cooking oil for a long time.

As you know, we have a deal with a soybean producer. We have run soybean, canola oil, distilled corn oil in the Rodeo Unit 250. We met with tallow producers and have leads to buy tallow as well. So we are in a very good position. Our Marketing business is building out portfolio so we can sell the renewable diesel to the end users. So we don't really need the expertise that others might need and we don't need the funding.

Mark E. Lashier - *Phillips 66 - President & COO*

As far as other opportunities, we are doing things at our Humber Refinery today. The rules are a little different in the U.K. than they are in the U.S. so they can co-process renewable feedstocks through their facility, and they're producing sustainable aviation fuel today that they're supplying to British Airways. And so there are British Airways planes flying today using sustainable aviation fuel from Humber.

We can also -- if the economics drive it, we can produce sustainable aviation fuel at Rodeo when we have the facility fully on stream. And so it's going to be, what are the economic drivers? We're looking at other opportunities, other technical routes to sustainable aviation fuel. They're still under development. But ultimately, we think that sustainable aviation fuel has legs. It's difficult to fly planes with things other than hydrocarbons. And we've had a number of airlines, a number of jet manufacturers approach us hoping to look for solutions for their future. So we see both renewable diesel and sustainable aviation fuel as great opportunities.

Operator

Theresa Chen from Barclays, please go ahead.

Theresa Chen - *Barclays Bank PLC, Research Division - Research Analyst*

I want to offer my congratulations to Greg as well. May your peace of mind go up and your handicap go down, Greg. And congratulations, Mark, on the new role.

I wanted to revisit the discussion on Chem. Just because your margin came in a lot stronger than your indicator and sensitivity would have suggested, how much of this is owed to the portion of your sales that are contracted by nature versus sold on a spot basis? And if you can, can you help us break down like the portion of each on a run rate basis?

Mark E. Lashier - *Phillips 66 - President & COO*

Yes. I think that in that universe, there's -- the contractual commitments are a little bit fuzzier than you might be used to in other environments. So I don't know that there's -- that they're seeing any margin capture do that. CPChem's margins contracted substantially less than the IHS marker. And I think that, that has to do with product mix more than anything. The high-density business that is their primary driver. It came up a little slower than the marker and now it's coming off slower than the marker. And so it's really driven by that and perhaps some discipline in how they're managing the business. But I don't know that there's a great driver in their contractual position that you can attribute that to.

Theresa Chen - *Barclays Bank PLC, Research Division - Research Analyst*

Got it. And on the OpEx reduction side, the $700 million number, just to clarify, does that compare to the state of OpEx where you had lines within their system? Or is that pro forma of the line shut down?

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Mark E. Lashier - *Phillips 66 - President & COO*

That is in addition to the alliance shutdown.

Operator

Matthew Blair from TPH, please go ahead.

Matthew Robert Lovseth Blair - *Tudor, Pickering, Holt & Co. Securities, LLC, Research Division - MD of Refining and Chemicals Research*

Greg, congrats on a great run. And Mark, congrats on the new role here. Mark, my question is on the Chem side. I think in the past, you've talked about opportunities in hydrogen but more so on the Refining side. And so I was wondering if CPChem has any hydrogen opportunities? And if so, could you maybe flesh those out?

Mark E. Lashier - *Phillips 66 - President & COO*

CPChem really is technically a producer of hydrogen out of the large steam crackers. They've got relationships often that allow them to monetize that. It has to be cleaned up, but -- or some of it is consumed as fuel in the facility. So there probably is an opportunity for CPChem to grow that presence as they grow their cracking capabilities.

Matthew Robert Lovseth Blair - *Tudor, Pickering, Holt & Co. Securities, LLC, Research Division - MD of Refining and Chemicals Research*

Okay. And then could you talk about the general trend in marketing margins so far in the second quarter? Has there been any sort of recovery compared to the low numbers in Q1?

Brian M. Mandell - *Phillips 66 - EVP of Marketing & Commercial*

Generally, marketing margins are better in the second quarter, just seasonality. The headwind we have typical marketing margins now are the rising prices, keep margins. Margins don't move as quickly as the rising prices in the marketplace. So we'll see. We would expect to do slightly better next quarter, but we'll see depending on where the prices of products go.

Operator

Jason Gabelman from Cowen, please go ahead.

Jason Daniel Gabelman - *Cowen and Company, LLC, Research Division - Director & Analyst*

Congrats, Greg, on your retirement and Mark on the new role. I have 2. The first, there's been some conflicting comments between what the DOE is putting out and what some of your peers are saying in terms of demand, particularly on the gasoline side. And so I'm wondering if you're seeing demand disruption in your system, consistent with what the DOE has been showing weekly or if demand is holding up.

And then my second question is kind of, I guess, a broader longer-term Refining question. Greg, you've probably been more bearish than your peers on the Refining margin outlook in the past. This is obviously a pretty insanely strong margin environment that we're in right now. I'm just wondering how you expect this all to play out over time and if these higher margins are here for a good while or if you'll see some maybe normalization and what would drive that.

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Mark E. Lashier - *Phillips 66 - President & COO*

So I'll take a stab and then Brian can come out. So I mean, we had the luxury of a diversified portfolio. We've had the opportunity to be bullish about other parts of our business. And for the most part, I think we're probably right on those calls. And when you think about -- we started at '12 with $450 million of EBITDA at Midstream and we're $2.2 billion, $2.3 billion today. So really kind of the strategy of growing a more highly valued business in terms of multiple, some of the, et cetera.

I would tell you though that as we're coming into this year on the Refining business, we're probably as constructive on Refining. So we've been in a long time. I think that's a combination of the capacity that we've seen shut down over the last 24 months, the capacity newbuilds has either been delayed or slowed down that's coming on where we see global inventories today and where we see global demand. So I think that whole combination together really puts us in what I think is going to be a mid-cycle or a better environment for Refining for the next 12, 24 months' time. And Brian, you can comment on what we're seeing in real time.

Brian M. Mandell - *Phillips 66 - EVP of Marketing & Commercial*

Jason, it's Brian. So in terms of demand in the U.S., we're seeing everywhere but on the West Coast, demand back to 2019 levels. On the West Coast, they got out of COVID a little later than the rest of the country and prices have been particularly high, so we've seen a bit of demand trimming. So they're a little bit lower.

But we've seen very good demand. On the distillate side, demand over 2019 globally. So we're pretty happy there as well. I think inventories are really the driver, gasoline inventories, of 5-year lows and distillate inventories are the lowest they've been since May of 2008 and PADD 1 is the lowest it's been since April of 1996. So with these low inventories, we would expect to see strong demand going forward.

Operator

Paul Cheng from Scotiabank, please go ahead.

Paul Cheng - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Greg, just congratulations for your retirement. It has been a fun 10-year ride. And Mark, congratulations on the new role going forward.

Two questions. I think, one, is a really short one. At the beginning of the year, I think the company has put out a turnaround expense, call it, $800 million to $900 million. Based on earlier comments, is that still a good estimate or that number has been changed? Because it doesn't look like you have mentioned, there's a lot of major turnaround. There's more catalyst change. And the first half of the year, your spending is only about, say, probably at $330 million or $350 million kind of range. So I want to see that how should we look at the overall spending level from the turnaround standpoint.

Secondly, if the company believe the energy transition is happening and may even see at some point. In your Midstream business, your transportation system is linked directly to the gasoline and diesel demand in this country. And so from that standpoint, maybe this is a curve ball for Mark. Longer term, over the next 3 or 4 years, will the company start to deemphasize or maybe scale back in that segment and trying to reposition and put the capital into someplace else?

Robert A. Herman - *Phillips 66 - EVP of Refining*

I'll take a shot at the turnaround again. As we talked, we're finishing up the turnaround program that we had for the first half, and we've guided towards a total of about $340 million of spend in the first part of this year. During the summer or during gasoline season, right, we're prepared to

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run hard, and so we won't have any turnarounds again until the fall. We continue to look at all of our turnarounds that are in the back half of the year, catalyst life and can we push those out.

We expect to push some of those turnarounds out. We're not ready to update the budget. But I think you can expect that we will spend less money on turnarounds than we originally guided to as we are able to slide some of those out of the back half of '22 into '23.

Mark E. Lashier - *Phillips 66 - President & COO*

Paul, on the energy transition impact on the Midstream assets, we've got a diversity of pipelines in our Midstream business. And you go from the NGL side, which we think has got tremendous upside potential for the long term, primarily delivering to petrochemical facilities and exports, things like propane and butane as well. And so we see a very, very long horizon for those pipes.

The crude pipes bringing crude into our refineries and then taking refined clean products out of those refineries, those will evolve with what our refineries produce. And we believe that liquid hydrocarbons are going to be around for a long time, but we're going to look at ways to lower the carbon intensity of the products, lower the carbon intensity of the operations. There may be opportunities to repurpose those assets for other molecules that will emerge from the energy transition. So we're always looking at how we can maximize the value of our Midstream assets, repurpose them. We do that today and we'll do that in the future as well.

Operator

Prashant Rao with Citi, your line is open.

Prashant Raghavendra Rao - *Citigroup Inc., Research Division - VP*

I'd like to echo congratulations, Greg. It's been great getting to know you and hearing your outlook and all your thoughts on the energy industry at large. And Mark, I look forward to working with you more and congratulations.

I'll keep it to one. Just on chemicals, and this is a bit bigger picture. You talked about incremental projects that are north of 20% return on invested capital. And looking back, the last time several years ago when there was an announced expansion and you had projects in the queue, is a higher margin environment and you targeted pretty good returns.

And since then, what happened is we all know the margin environment kind of depressed but you were still able to hit targets. You were at high teens, there was low 20s ROCEs, combination of expenses, volume increases. I'm curious because there seems to be -- history sometimes doesn't repeat itself but it sometimes rhymes. We're coming out of a high-margin environment in Chemicals right now and it seems to be settling slowly.

So just wondering, as you look ahead with the cost takeout, where the margin outlook is on the volumes, can you kind of triangulate? You've done it before, obviously, historically, it's shown up. You're able to hit those return targets. But as we look forward now, just could you help sort of piece together what are the levers to sort of ensure that, that sort of the lower end of the return range we could get with just like you did, I guess, post 2014? And I'll leave it with that.

Mark E. Lashier - *Phillips 66 - President & COO*

Thank you. I think it's a great question. CPChem's got a long history of executing mega projects and have really never tried to time them to any particular market conditions. They focus on the fundamentals. The long-term growth in ethylene demand, the long-term growth in polyethylene demand, both at a multiple of GDP as we go forward. And so that's what drives the opportunities. And then we think about that growth, we put those assets where we can access low-cost feedstocks.

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And today and for the foreseeable future, we see that as ethane. That's why you see us doing something in the U.S. around our U.S. Gulf Coast 2 project. That's why you see us looking at another project in Qatar, to take advantage of large baseload infrastructure and advantaged feedstocks that we can tap into. And I think that's what delivers the long-term value, staying focused on those fundamentals and not getting caught up in any short-term dislocations and then having an outstanding ability to take those products into the marketplace and capture value consistently around the planet.

Operator

We have reached the end of today's call. I'll now turn the call back over to Jeff.

Jeffrey Alan Dietert - *Phillips 66 - VP of IR*

Thank you, Erica, and thank all of you for your interest in Phillips 66. If you have further questions, please contact Shannon or me. Thank you.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. You may now disconnect.

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