05-Jan-2023

Phillips 66 (PSX)

Goldman Sachs Global Energy and Clean Technology Conference - Fireside Chat

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Neil Mehta
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MANAGEMENT DISCUSSION SECTION

Neil Mehta
Analyst, Goldman Sachs & Co. LLC

All right. This is always the highlight of the conference for me, to have Phillips 66 here. You got keynoted a couple years ago at the conference. And gosh, a lot's happened in refining. And I don't think any of us, pre-COVID or in the midst of COVID, would have thought that refining margins would have ended up being where they are today.

So, we want to talk with the leadership team about how they're seeing the go forward, especially on the back of what I thought was a very effective Analyst Day with Mark Lashier here, President and CEO; Kevin Mitchell, CFO; and Jeff Dietert, Vice President and knows everything macro.

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QUESTION AND ANSWER SECTION

Neil Mehta
Analyst, Goldman Sachs & Co. LLC

Q

So, Mr. Lashier, maybe you talk about the response from investors on the back of the Analyst Day. What do you think was the most important message? And from an investment community perspective, how we can track your progress and hold the company accountable?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66

A

Absolutely. First, Neil, thanks for having us here.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC

Q

Thank you, too.

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66

A

It's great to be here, and happy New Year. We did enjoy our Investor Day. It was. – I think we had a good, strong message that we wanted to deliver. And really, at a high level, the takeaway is we want to be very focused and very disciplined. And we're going to be disciplined around returning value to our shareholders in the near term and the long term.

In the near term, we committed to returning $10 billion to $12 billion cash returns to shareholders from July of this year through the end of 2024. And that's a combination, of course, of dividends and share repurchases. Where we are today with the dividend, you can think about a little less than half of that number will come as dividends and the balance as share repurchases. And, and we have high degree of confidence that with our outlook on margins and a conservative view that we'll be able to deliver against that.

And then you go beyond that, then we had – we've talked a lot about our business transformation efforts that are underway to fixing some things in our refining business, reducing our costs and positioning us to compete in any environment. Refining, we're looking at cutting – reducing our costs by about $0.75 a barrel and also enhancing our ability to capture market, what the market gives us by about 5 percentage points, enhance the availability of our assets, create more flexibility.

On a bigger picture, our cost restructuring, we're targeting $1 billion in cash reductions by the end of 2024. And we've targeted about half of that this year, about half that next year. We're outperforming, so we've got good momentum going into next year on those metrics. And when you look at that $1 billion number, about $800 million is actual cash cost reductions, and then about $200 million in sustaining capital. And beyond that, beyond the end of 2024, we'll continue to accrue those sustainable recurring reductions through some modest capital investments. So, you'll see some upside to that number beyond 2024.

We also talked about our wellhead to market strategy around midstream, particularly NGL midstream and key part of that is the DCP acquisition. That acquisition will add about $1 billion a year in EBITDA. And of course, there'll be synergies associated with that as well, that we'll talk about once that transaction is complete. And other things

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we've got going on, whether it's in petrochemicals, the cost initiatives, all those things add up to about an incremental $3 billion in EBITDA that we will grow from our current base over the next couple years.

We're going to cap our capital investments to $2 billion to be very disciplined; about $1 billion worth of growth, about $1 billion in sustaining. I said we're going to reduce – we've been historically at about $1 billion. We're going to reduce $200 million of sustaining capital. But when you fold DCP in, their sustaining capital, suspect about $1 billion.

And so, that's really it. We're going to do things to improve our refining performance, to have a very focused and deliberate growth in specific areas, nothing getting out over our skis. We talked a little bit about what we're doing in renewables; mostly renewable fuels, the renewable diesel, sustainable aviation fuel, those kinds of things.

But as far as tracking that, we intend to deliver metrics. We talked about metrics at the very least at our earnings calls on a quarterly basis. So you can be able to track what we're doing and how we're capturing that. We don't count anything until the CFO says we can count. And so, we'll see scorecards, that sort of thing coming out around the cost reduction and the enhancements that we're driving, so we're pretty excited about it.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

That's great.

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

So, we're moving heavily in the execution mode. Last year was a lot about putting all this together, planning. And now, it's all about execution and delivery.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

Well, that's great. That's a good foundation for our conversation. Let's start on refining. And this question's for all of you, but maybe I'll pick on Jeff first. To your perspective, on where we are in the refining cycle, your perspective on cracks. When you actually set out the Analyst Day, which when you kind of do the math implied $13 of long-term EPS, you set it at a pretty conservative crack spread. Does that reflect some conservatism in the way you're thinking about the market and just where are we – what's the potential that we're above midcycle?

Jeff Dietert
Vice President-Investor Relations, Phillips 66
A

Yeah. So I think, one thing that was big that really happened since the pandemic is we've taken about 4.7 million barrels a day of refining capacity out of the market. And so, that rationalization has tightened up the market. Last summer, we saw demand back close to 2019 levels and saw margins, frankly, I didn't think we'd see and hadn't seen historically. And so, that is tight in the market.

Diesel, in particular, is very tight. Today, diesel inventories are 15% below the five-year average. Gasoline inventories are 7% below the five-year average, so the market is still tight. We've seen a little bit of softness in demand recently. Gasoline and diesel down, relative to 2019 levels, but still a tight market.

When we think about midcycle, we use the 2012 to 2019 period and average RIN adjusted crack during that period of time was $12 a barrel. And today, we're over $20 a barrel in January, which December and January are

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usually your weakest months of the year, weak demand period versus the summer driving season. We do have an above-average maintenance period. The industry as a whole does for the spring. So, maintenance is going to be heavy.

For Phillips 66, we have had our heavy maintenance period in 2022 last year, so we'll have something closer to normal turnaround year this year. But things look to continue to be tight as we are maximizing diesel yield year-round. And so, as we approach the summer driving season, we expect gasoline and diesel to be tight again this summer.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. China's an interesting wildcard because it can move two ways. And Mark, you've spent a lot of time looking at China in your experience, running chemicals businesses. What are your thoughts around reopening, and what that could mean for global demand, but also the offset, potentially, of higher product exports?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66

A

Yeah, I think that's a great question, Neil. We pay a lot of attention to that, both from refined product perspective, as well as petrochemical. I think from petrochemicals perspective, it really could be a catalyst that pulls us away from what we kind of see as the bottom of the trough right now. And those markets, it doesn't take a lot to catalyze a movement towards restocking and see margins expanding.

Refined products between COVID and China; and the sanctions on Russia; and crude oil from Russia going to China and India, and very soon, maybe refined products; and if you're a Chinese producer, do you run Russian crude through your refinery to produce refined products or do you import refined products? And the Chinese are very good at making buy versus make decisions. So, it's going to be an interesting dynamic to see how that all plays out. But I think that is the biggest wildcard, I think, that we're looking at in 2023, is how that equilibrium gets reestablished.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC

Q

Yeah, but to be clear, even though you used $12 a midcycle in the way that you set your long-term guide, you believe we're going to sustain above mid-cycle?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66

A

I believe we will. And I think there's a number of things driving that dynamic. I think the cost structure in the US is competitive globally. I think that Europe, while it's not having to blow out cost in energy that it was, it still is still going to be under pressure. It's going to put pressure on which crudes Europeans can process. And so I think that, that does create a structural advantage, at least in the near-term. And that may reset out in the future, but we're bullish for now.

[indiscernible] (00:09:56)

Jeff Dietert
Vice President-Investor Relations, Phillips 66

A

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...natural gas prices in the US, about $4 an MMBtu. In Europe it's about $24 an MMBtu. For us, that's about a $6 a barrel cash operating cost advantage in today's market.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC

Q

Yeah, that's real money. And higher European gas prices even though it has come off the cyclical peaks, still will defer European refiner from running a hydrocracker, but also from processing heavy crude. And I think that is showing up less in locational differentials in Western Canada, but in terms of quality differentials. And you guys have the largest Western Canadian crude buying capability of any refiner in America. So, can you talk about how you been able to take advantage of that here more recently?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66

A

Well, certainly, we've got refineries positioned to take advantage of that, both from the pipeline connectivity, as well as with the kits that they have on the ground. And so, it has been beneficial to our refinery. So, I think, Jeff, do you want to comment further?

Jeff Dietert
Vice President-Investor Relations, Phillips 66

A

Yeah. I think we're experiencing really wide differentials today, $27, $28 a barrel discount to WTI. We do expect that to soften next year. The SPR, a lot of the crude pulled out of the SPR in 2022 was medium sour crudes, but still, expect strength there. The forward curve's about $23 a barrel for 2023. So, that's still a nice advantage for us.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. Okay. Let's talk about the operational improvement journey and the self-help because that's really important. So, we spent some time, we saw each other over the summer and we you talked about, you're doing some diagnosis to try to figure out the root cause of why uptime hasn't been as good as you wanted it to be? And what do you think, as you look back and diagnose the initial issues, what they were? And what is the structural fix to ensure that you're operating at first quartile going forward?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66

A

Yeah, I think it's a number of things. As the Head of our Refining division, Rich Harbison talked about, on Investor Day, that we have taken our eye off the ball a little bit with respect to refining. Refining was kind of the beat up industry for a couple of years. And we're focused on growing midstream. We were on developing other opportunities. Refining was facing existential crisis, and frankly, across the globe. That's changed.

And now we've got the opportunity to correct those things, and to come back and actually make some fairly minor investments to enhance our ability to operate. I think we've come through a very heavy turnaround season post-COVID. The kits are running well. They're running incredibly well. Even through the winter storm, they showed great resilience. So, I think, that we've turned the corner there from – a bit on our ability to operate, but we're going to continue to focus on enhancing that availability.

Now, if the market is there, we want to be able to run. And we think the market's going to be there for at least a couple years and to be able to capture those margins that are out there, and at the same time, reduce our costs

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and enhance our ability to process crude. If the WCS [ph] discontract (00:13:30), we want to be able to shift to lighter crudes that are available in North America.

So, we want to focus our ability on key assets to be able to compete for the very long term. So, we're talking decades now instead of a set of years. And we're in for the long haul in refining. And we've got to make the right moves to make sure those assets are ready to fight in whatever the market environment is.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

It strikes me one of the practical implementations of this is shifting from really a hub-and-spoke type of a model where each of the businesses ran as independent refiners to one where it's a lot more centralized. Is that fair assessment?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

Yes. Yeah, that's a fair assessment. That's a very accurate assessment. Frankly, we want to simplify the business. We want to standardize the way we run our refinery business. We want to optimize across the platforms. Technologies that we have put in place will enable that. And we really think it's the way to position ourselves competitively. And it's being embraced by the organization today.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

Okay. Well, we saw you guys ran really well in Q3, so our eyes open, Q4 sounds good.

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

All right, more to come.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

All right. So, in midstream, let's talk about DCP to the extent you can. And where are we in terms of bringing that business into the fold? And because you now have a controlling interest in the entity, it sounds like you can already make forward progress on driving the synergies out of the business?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

We are making progress. We're already taking action. We are essentially operating the business now. We've identified, we're driving synergies. Kevin is actually the chairman of the DCP board, so maybe I'll let him address the question.

Kevin J. Mitchell
Executive Vice President & Chief Financial Officer, Phillips 66
A

Yeah, Neil, I mean, you're right, we're limited on what we can say. And I think that one thing you can be sure of is when we have something to tell you, you'll be the first to hear, we'll be public on that. And just from a perspective in terms of what that means, timeline, once we have an agreement – and this whole process is a negotiation with the Special Committee of the DCP board. They have a fiduciary responsibility to the LP investors, and so, they

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have to go through their process. Obviously, our motivation is to be able to conduct this transaction at the lowest cost, lowest price we can, but they're motivated the other side of that. So we're working through that process and when we have something to say, we'll certainly be in a position to do that.

But just to kind of think about the timeline, once we reach agreement, there's about a, probably, four-month period before we close because it's still an acquisition of a public entity. And so, there's a defined process around that, and it takes a little bit of time. So, realistically, if you assume we get something done in the not too distant future, it's still going to be a second quarter closing. But to Mark's earlier point, we already control the entity. We're already executing on integration plans.

In fact, where the integration planning is done, we are executing on integration. And you saw some of the changes that were announced at the end of the year. And so, we're marching quickly down that road. And the only downside is, at this point in time, any synergies, we only capture the 43% benefit net to us. Once the roll-ups completes, then its 87% to us, so we'll continue to progress down that path.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

It's understandable, it's hard to provide what those synergies numbers are until you've closed. The transaction.

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

That's right. That's right.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

What does DCP provide to Phillips 66? And how is the weakness in the NGL market changed your thinking around the investments, or has it not at all?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

Well, we've got a long-term view on the strength of the NGL markets and the resource base in the Permian, the DJ, where we can access is going to be around for a very long time, and it fits well. It integrates well into our view of petrochemical markets. So, they're going to drive demand, long term, for NGL their products, as well as gas.

And gas is becoming more important. Natural gas is becoming more and more important. DCP acquisition and the roll-up of the public units is key to our strategy to have a wellhead to market strategy. So, we can be a one-stop provider for producers in the Permian, for instance. And they know that they can have their molecules – that their NGL molecules or gas molecules can be taken to market without going through multiple parties, where they've got to have somebody that does a GMP, somebody does a transportation, somebody does a fractionation. We've got the whole value chain now. We see that as where we want to be to drive future growth.

Jeff Dietert
Vice President-Investor Relations, Phillips 66
A

Neil, if I could add just sort of macro perspective, NGL and petrochemical feedstocks have grown at a pace faster than overall GDP, as opposed to crude demand, which grows at a fraction of GDP. So, the growth there has been sustained for quite a while and we expect that to continue. NGL production in the US has outperformed crude and

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natural gas for many years. And in 2022, NGLs grew 8% to 9%, crude was up 4% and natural gas was up 3%. So, it continues to grow at a faster pace than the other products.

Kevin J. Mitchell
Executive Vice President & Chief Financial Officer, Phillips 66
A

And I would just – to add further, if you look through the pandemic, DCP held up extremely well during the pandemic period, which was a little bit of a surprise to us, to be honest, but it really did, which speaks to the resilience of those molecules. The other factor is their business is about 70%, 75% fee-based. So it's not 100% commodity exposure. There is some residual commodity exposure there and honestly, for us in our portfolio, we're okay with that because, as you know, we have significant commodity exposure anyway. So, that works for us

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

And as you talk to ratings agencies, they're okay with you taking on a little bit more leverage because of the higher fee-based comp [indiscernible] (00:19:36).

So, that's actually a great pivot over to chemicals. And Mark, I'll turn this one over to you. We went from euphoria to depression as a market in a matter of a couple of months, I thought refining was volatile. What the heck happened and how do we get out of it?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

I guess the cure for high prices is high prices. But what you're seeing is, really, when chemicals demand was strong, and polyethylene demand was strong across COVID for a number of reasons that included weather disruptions and just strong demand. Demand continues to be strong, but there's been quite a few capacity additions in North America. And those are kind of running their course now over the next year. Demand continues to increase globally, though, there could be an impact of recessionary influences and what happens in China.

But the fact is, we're kind of running our course on the near-term demand or the supply additions, and you're seeing the demand continue to increase. So, we believe margins are pretty well bottomed out. And if you look at the data, they've flatlined and they're starting to show some life again. And this season low typically is towards the end of the year. And so, we see things starting to improve probably maybe the second half of this year and then continue to 2024.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

So, you always do a good job of putting this in terms of cents per margin integrated basis. And so, I think your midcycle over the years has been about $0.30?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

Correct.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

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And we peaked out at what, $0.50?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

Approaching $0.60.

Jeff Dietert
Vice President-Investor Relations, Phillips 66
A

Yeah, it was in the $0.60.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

And where did we trough out?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

It's about...

Jeff Dietert
Vice President-Investor Relations, Phillips 66
A

[ph] $0.278, (21:17) so in the last four months or so, it's bottomed out.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

And now, we're flattening out?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

Yes.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

And so your view is, by 2024, we can start to get back towards midcycle.

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

I think you would start moving toward midcycle, yeah, correct.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

Because we still have to digest some new capacity...

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

Correct.

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Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

...coming including in North America.

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

Yeah. And I think, you know, when we look at CPChem's US Gulf Coast to potentially [ph] our LPP (00:21:42), those coming on in 2026, 2027, that turns out to look like a pretty fortuitous time to bring assets on because there's not a lot – you look at – everyone pulled back hard through COVID looking at capital investments.

And if you wake up tomorrow and say, gee, I want to build a petrochemical complex, it's about a 10-year horizon. And so I think that the things that you would see come on in 2026 and 2027 have to be pretty well baked at this point in time, and there's not much going on, so, yeah.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

Interesting. Because as we talk to the majors and we'll hear from Aramco and others over the course of this conference, I think a number of them are looking at the demand profile, exactly what Jeff said. Gasoline looks tough. It looks pretty good in chemicals. And so, there's a tendency to move towards building out – a desire to build out in areas where growth is more significant. But your point is, it's different to do the work and analysis around project versus get into FID?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

Correct. Correct. It's a long process to develop these. And there's a handful of companies that have the wherewithal to do it. There's been a fair amount of discipline over the years.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

So, at your midcycle margin how should we think about the returns on your recent Gulf Coast FID? And why are you excited about that project?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

Yeah the Gulf Coast FID, it's going to be you know mid-teens and we've always seen upside to those kinds of projects. There's always debottleneck opportunities. And so, I think – and that's consistent with what CPChem's done over the last 20 years, so we won't – we take a very conservative [indiscernible] (00:23:27) view. The capital looks good. We worked hard to get it to where it is.

The construction is going to happen at a good window. There's not a whole lot of other competing construction projects. We've got a line of sight on labor so we're comfortable with that. And inflationary pressures I think have been taken into account in that number, and we see those starting to ease by the time we really hit the heavy construction. So, we're feeling pretty good about it.

Kevin J. Mitchell
Executive Vice President & Chief Financial Officer, Phillips 66
A

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If I can just add a little bit on the returns. So, that mid-teens is a project-level return, right? And that project is being financed at a sort of 50/50 level. So, one, in terms of the effective returns to CPChem and to us is greater than that because of the benefit of the leverage. But that also plays out in terms of the capital funding commitments to it.

So, you've got a 51%/49% joint venture, and then 50% financing. And so when you do the math and you then figure that to spend profile over about a four-year period, the capital commitments to CPChem really are very manageable, and in fact, quite a bit less than the original Gulf Coast project, which did not have financing and was 100% CPChem level.

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

Yeah. CPChem will also be the marketer for the offtake, and so there'll be an uplift for them there as well. And also because it is located, and we'll tap into existing CPChem infrastructure that they'll see additional return benefit there. That'll be incremental above what the project [indiscernible] (00:25:06).

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

Okay. That is helpful. So, then, the question is the composition of the business. It's really been balanced across these four different pillars. If you look at our sum of the parts, equal-weighted marketing, chemicals, refining and midstream, is there a conscious effort and decision here to say, all right, refining because we're worried about this on a long-dated basis. We're going to start investing a little bit more in chemicals, and so one was going to make up for the other?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

Yeah. I think that it really is all about what you believe about growth and how you can position yourself to take advantage of growth and secure those returns that our investors expect and that will drive it. And so, we see the growth in NGL, we see the growth in chemicals, we see modest opportunities. And I like what John said about bullets versus cannons in renewables because that's exactly what our strategy has been. We put our toe in the water of several places.

Renewable diesel is a lot closer to home. We've got assets that are very amenable to that. So, that's been a bigger step for us. But the other renewables are longer term. We'll continue to press down that path, but we're going to be cautious on some of the more long term, more exotic opportunities. And so you're going to see that balance. Some of those things may show up in refining, like Rodeo, or if we do anything in sustainable aviation fuel.

But you're going to see chemicals obviously attracting more capital, NGL attracting more capital. Marketing has been low capital, high-return, and we continue to look – we've got a very specific strategy, targeted strategy there that we like that's been successful across COVID, across a number of different market conditions. And so, we're going to continue to make modest investments there as well.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

Yeah, let's talk about marketing. That has been a consistent surprise relative to our model. And you did raise your midcycle view of that business. What's going on that drive higher cents per gallon, effectively?

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Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66

A

Yeah. The higher cents per gallon because we're getting more exposure in targeted markets to retail margin. And we're here and we're focused on markets where there is a retail margin to capture. And we've partnered with entities that know more about running the convenience store part of it than we do. And we bring a strength to complement that.

And so you've got an evolution going on in the marketing, where we used to supply gasoline, diesel to literally moms and pops that were out there running these stores. They've grown to [audio gap] (00:28:00) 60, 100 stations, but maybe the third generation is not interested in it. So, we know the business really well. We know the assets. We know the environment really well. And so, we're partnering with those that know how to run convenience stores, so we can then participate in the [audio gap] (00:28:19). And we do it in a [audio gap] (00:28:23) in that. We know what we're looking for in specific markets to take advantage of that.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC

Q

What are you seeing in terms of real-time demand through your marketing system?

Jeff Dietert
Vice President-Investor Relations, Phillips 66

A

So, we're seeing gasoline demand down about 5% relative to 2019 levels and diesel down about 4% recently. So, we've seen demand soften a little bit. Relative to last summer, we were approaching 2019 levels.

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66

A

Yeah. And those are – that's published government numbers across the industry, not us specifically, so.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC

Q

And as you've done the analysis and you kind of tried to ascertain why we're trending lower in pre-COVID level, despite the economy being bigger than we were back then. Is it the remnants of COVID? Is it work-from-home dynamics? Is it the consumer wallet being impacted by inflationary forces? How do you think about that?

Jeff Dietert
Vice President-Investor Relations, Phillips 66

A

Yeah, there's some of all of that. I think we've seen it hit on the East Coast and the West Coast more significantly than the central part of the country. We've not seen commuters go back to that 33% that was pre-pandemic component of overall US gasoline demand.

There's been more in the press about Gavin Newsom, trying to take ICE vehicles out by 2035. The concern over inventories on the East Coast it's been in the news a lot more. And we know that when it's in the news, it tends to impact consumer behavior, where it's been not as much in the news in the central corridor and the Gulf Coast, so it hasn't had as big an impact. So, I think, all those are variables.

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66

A

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Yeah. And I think that, still, the airlines were perhaps hit hardest during COVID, their demand destruction. And the industry was able to ratchet back and make jet fuel go away in different ways. But I think that the rapid recovery in travel, I think the airline industry has struggled to keep up with that. And I think it's still limiting the growth in jet demand, it's just the capacity of the airline industry to keep planes moving, to keep everybody happy. It look like it's getting better, and then maybe two steps forward, one step back.

Jeff Dietert
Vice President-Investor Relations, Phillips 66
A

Jet's actually the tightest market today. Jet cracks are the highest in diesel, and gasoline is lagging.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

Yeah. That's been interesting to see the difference between the distillate complex and the gasoline complex. Gasoline is basically at the five-year this time of year, diesel and jet trading very strong. You have a [indiscernible] (00:31:27) heavy refining kit. Are you running max diesel right now? And how do you think about that spread between these two products, especially in an environment where European gas is still elevated, but it's not, it's not $12 a barrel elevated. It's $6 a barrel elevated.

Jeff Dietert
Vice President-Investor Relations, Phillips 66
A

Right, right, right. I think – hit me with the first question again.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

How do you think about the spread between...

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

Yeah. Yeah, so diesel – we max diesel all year last year. I think the industry did as well. There was incentive to [audio gap] (00:32:05) – historically, we max gasoline yield in the summer month [audio gap] (00:32:11), but even – so we ran hard through the summer. There's a heavy turnaround season in late September, October. And then the industry ran hard November and December.

We looked at early December, the industry was running 95% utilization. Typically, in December, we're running 88%, 89% utilization. And so, gasoline inventories recovered somewhat but they're still 7% below the five-year average. And we see heavy maintenance this spring and likely to go in with pretty tight inventory situation into the summer driving season, again, even – so we're expecting to max diesel throughout the year.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

Okay. That makes a ton of sense. So, let's spend some time on low-carbon. And we'll finish off on the fun stuff, how we think about your midcycle cash flow. Because I think that's going to be really important for investors to think about how to value your businesses. What is the low-carbon strategy and help us – I think it was at this conference, Jeff, right, three years ago that you guys announced that you were starting to develop – two years ago you're starting to develop that low carbon platform?

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Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66

A

Yeah.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC

Q

What's your EBITDA expectation from that business and target, and how should we think about your strategy there?

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66

A

Yeah. We've talked about a $2 billion EBITDA by the end of the decade. I think that we're not going to move heaven and earth to realize that. We really are focused on how do we get the kinds of returns that we expect that our shareholders expect from emerging energy opportunities, from energy transition opportunities, and that landscape's evolving. And so, really from a lower carbon perspective, it starts with our existing hydrocarbon business. How do we lower the carbon footprint of our hydrocarbon business?

So, we've got goals in mind there. We've published our Scope 1, Scope 2, Scope 3 emissions targets there. But then, our next nearest neighbor, that is our aspirations around renewable fuels. And primarily the first move is renewable diesel, taking used cooking oil, the vegetable oils, animal fats, converting those to renewable diesel. We've got an asset in California that's being converted to a Rodeo facility. It's got hydrotreating capacity. That's perfect. It's almost as if it was just put there for this purpose. We can put new catalysts in there, put a front end on that to clean up all these different cats and dogs that we'll bring in to process there. It's in a great market, great logistics location. We've got access to feedstocks. And there's a unit running today, Unit 250 that's proving the concept.

So we've got great company there. It's going to be a high return project. The next nearest neighbor to that is sustainable aviation fuel. There's strong market demand for sustainable aviation fuel. Every airline has made net zero commitments. And really, the only opportunity for them out there today would be sustainable aviation fuel and there's not enough to go around. So, there's a market pull, there's government support, so that's starting to look interesting as well.

I think the key there is to not compete for the same feedstocks that renewable diesel consumes into sustainable aviation fuel. We do produce small amount of sustainable aviation fuel co-processed in Rodeo. We do produce a small amount at our Humber facility in the UK. But longer term, I think, it's to be on purpose production of sustainable aviation fuel.

Then we start looking at things like hydrogen and carbon capture. I personally believe that carbon capture is going to be very important because it's going to be hard to get away from the high-energy density of liquid hydrocarbons for a very long period of time. And the only way to mitigate that carbon, that the Scope 3 emissions is carbon capture. So, we believe that carbon capture is going to be important. We're not doing fundamental research in carbon capture, but we believe that the technologies are out there and they're going to become very important and necessary.

Hydrogen, we know a lot about hydrogen. We know a lot about the cost of hydrogen, how hydrogen is produced. And I think hydrogen is over the horizon a bit. From a cost perspective moving to an entire hydrogen economy is – I think, it's going to require nuclear fusion, or something like that long before that happens. But we are shooting

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bullets in that direction. No cannonballs yet, but we're tracking that. We've got technologies that we're looking at around hydrogen.

And we've got our battery opportunities. We could believe both EV batteries, lithium ion batteries for EVs as well as storage batteries to facilitate the use of wind and solar power are important. We aren't investing in wind. We're not investing in solar, but we certainly are looking at helping others invest in wind and solar around our facilities, so we can again lower our carbon footprint of what we do today.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

Yeah. I'm not even – I'm not sure if I'm even allowed to ask you about needle coke, given all the sensitivities, how much of the market you're involved in. But just talk about the contribution from that business. It does seem to us that pricing has firmed up a little bit there.

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66
A

Yeah, pricing is firmed up. And I think that you look at, the scarcity of materials to meet the world's aspiration around lithium-on batteries, one of those that are challenged most – most is graphite and synthetic graphite. And our needle cock goes into synthetic graphite production. It's a very good precursor to synthetic graphite.

So, that's why we are looking at that value chain, to find out where can we capture the most value? And is it at the needle coke. Is it at synthetic graphite? Is it somewhere further down the battery value chain? But again, we're walking before we run. We've made our investment in NOVONIX. We're learning a lot about that business today. There's going to be ecosystems built up around lithium-ion batteries in North America and in the UK – or in Europe. And we're well-positioned from Lake Charles and from Humber of the UK to supply those ecosystems or participate in them, if it looks like the right thing for us to do.

Jeff Dietert
Vice President-Investor Relations, Phillips 66
A

Yeah. From a demand perspective, we're optimistic as well. Obviously electric vehicle market is growing and we serve that. But also, the steel manufacturing electric arc furnace has a smaller carbon footprint than traditional steel manufacturing. And we are seeing the addition of new electric arc furnaces into the market. So both aspects of demand look positive.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC
Q

We only have a couple more minutes and we're going to make sure people get food for lunch as well. But I thought it's Kevin. I'll finish with you on just the numbers, right. You always do a good job of helping bridge from midcycle cash flow to thinking about how you're going to use the cash. So walk us through the numbers.

Kevin J. Mitchell
Executive Vice President & Chief Financial Officer, Phillips 66
A

Yeah. So what we laid out at Investor Day, midcycle cash flow on a 2022 basis of $7 billion, obviously 2022 actual cash generation, significantly stronger than that, but on a mid-cycle basis, $7 billion growing to $10 billion by 2025. So, that's $3 billion increment. And it comes from a combination of the midstream growth that is driven primarily by the acquisition and integration of DCP. There are some other components to the midstream growth, but that's a large piece of the $3 billion in cash flow growth. We also see Rodeo Renewed coming online in 2024,

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and that's another approximately $700 million of EBITDA, which is going to translate into about the same from a cash standpoint.

And then, the third major element to that is the business transformation efforts. And so the business transformation, by that point in time, it's $1 billion run rate, of which there's a couple hundred million of sustaining capital, $800 million on the cost side of it. And so, when you put all that together, you're at this approximate $3 billion growth in cash generation.

But I think what's really important when you measure that against our commitment to returning cash to shareholders, we actually can deliver on that commitment based on the 2022 midcycle. So, that $7 billion – the dividends, just under $2 billion. And we're committed to competitive, secure and growing. So, you can continue to expect to see an increase in the dividend on an annual basis. And effectively, that will get funded, that increase will be offset by the impact of share repurchases. So, $2 billion on the dividend, the capital program at a $2 billion level, approximately $1 billion of sustaining and $1 billion of growth.

You saw the capital budget that we laid out for this year, very consistent with what we said on that. And so that's $4 billion that's consumed. That leaves $3 billion for share repurchases, any incremental work going to do around the balance sheet, but it gives us a lot of flexibility, especially when you consider that we're actually in an above midcycle environment. We were significantly above mid-cycle last year. We will go into 2023 with a strong cash position. And yes, we've got the DCP buy-in to fund, but the DCP buy-in also funds a sizable component of that cash generation growth. And so that will start accruing to us pretty soon once we're able to get that transaction completed and announced.

And just one other comment from a balance sheet standpoint. We did – you may have noticed in December, we paid off $0.5 billion of debt at the Phillips 66 level, and that was debt that was maturing anyway early this year. At the DCP level, we also redeemed $500 million of preferred equity that became callable in December. At that point, it also went from a fixed coupon structure to a variable rate structure, which would have put it at about a 10% cost of funding. So, that was a very straightforward financial transaction that also goes to continue help clean up the balance sheet.

So, I think, we can do all of that and stay within our stated objectives of a 25% to 30% net debt to capital level, which we feel very comfortable given that, that will include the – we already have consolidated the DCP debt and the funding associated with that.

Jeff Dietert
Vice President-Investor Relations, Phillips 66

A

And Neil, just to put that in perspective, $10 billion to $12 billion for a company with a $45 billion to $50 billion [audio gap] (00:43:04) returning 20% to 24% to shareholders over 2.5 years, 10 quarters. Yeah. It's great.

Neil Mehta
Analyst, Goldman Sachs & Co. LLC

Well, thank you. Story's very, very clear post the Investor Day. Well done. Wish you guys a wonderful 2023. And thank you for coming to Miami.

Mark E. Lashier
President, Chief Executive Officer & Director, Phillips 66

Thanks for having us, Neil.

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Jeff Dietert

Vice President-Investor Relations, Phillips 66

All right.

Kevin J. Mitchell

Executive Vice President & Chief Financial Officer, Phillips 66

Thank you.

Neil Mehta

Analyst, Goldman Sachs & Co. LLC

And we got food outside. And then we've got the [indiscernible] (00:43:28) coming up onto the stage. Thank you so much.

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