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OVERVIEW:

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PRESENTATION

John Macalister Royall - *JPMorgan Chase & Co, Research Division - Analyst*

We'll get started now. So we're joined by Mark Lashier, President and CEO of Phillips 66. Mark took over the CEO role about a year ago after being in the COO for about a year. Prior to that, Mark ran the CPChem business. We also have Jeff Dietert, Vice President of Investor Relations. Jeff joined the company in 2017 after a long career doing what I do on the sell side and had some additional energy experience, I think, prior to that.

So Mark and Jeff, thank you very much for joining us today.

Mark E. Lashier - *Phillips 66 - President, CEO & Director*

Glad to be here, John.

QUESTIONS AND ANSWERS

John Macalister Royall - *JPMorgan Chase & Co, Research Division - Analyst*

So why don't we start with the balance sheet. You've set out a guide of 25% to 30% net debt to capital. You were at the bottom end in the end of 1Q. But you've recently closed DCP and presumably have moved up that scale a bit. Where would you like to be positioned within that range today, particularly given some of the uncertainty in the environment?

Mark E. Lashier - *Phillips 66 - President, CEO & Director*

Sure, John. We've been consistent in our messaging around where we want to be in our balance sheet. We set out the 25% to 30% net debt to capital in our Investor Day discussions last November. We -- if there's one thing we took out of COVID is that it's good to have a resilient balance sheet when -- particularly when there's potential headwinds. And so we are going forward with that same perspective that we have a kind of a minimum perspective of \$2 billion to \$3 billion to keep on the balance sheet in addition to the 25% to 30% net debt to capital, and we're above that cash level even after the transaction, we took about \$3.8 billion of cash off our balance sheet. Some of it was prefunded with bonds we put in place and a credit facility we put in place. And so we're comfortable there. And we've got the opportunity to continue to bring that debt back down below that 30% level, but we'll do it when we see debt maturities come in and do it pretty pragmatically over the next year or so.

John Macalister Royall - *JPMorgan Chase & Co, Research Division - Analyst*

And then maybe we can move on to capital allocation. You laid out a target of \$10 billion to \$12 billion returned to shareholders through 2024 at your Investor Day last year. If '23 and '24 finished below mid-cycle, is it possible you could come in below that guide? Or do you expect to execute on that guidance regardless of the direction of the cycle?

Mark E. Lashier - Phillips 66 - President, CEO & Director

Yes. I think we've got -- all those plans were premised on mid-cycle, but we actually had some cushion in that mid-cycle number. We're well above mid-cycle, halfway through '23, we're above mid-cycle. And so -- but our commitments, our capital allocation commitments really start with our sustaining capital, and we're at about the \$1 billion level. And then the dividend, we are committed to a secure growing competitive dividend. We've increased our dividend every year, including the COVID years when others backed away from dividends. So we -- that's a promise, that's a commitment that we've made. And today, our commitment level is about \$2 billion in aggregates. And we will continue to grow that dividend every year.

If you look at that commitment, the \$10 billion to \$12 billion over the 10 quarters from July of '22 to the end of '24, dividends will cover about \$5 billion of the \$10 billion to \$12 billion. And we don't see that aggregate dividend growing. But as we take shares out of play through our share repurchases, we'll be able to grow the per share dividend and stay within kind of that \$2 billion range. So that leaves another \$5 billion to \$7 billion in share repurchases. And through the first quarter, we were above the pace we would need to be at to hit the high end of that. And as we continue to see our share price below its intrinsic value, we're going to continue to be on that pace.

John Macalister Royall - JPMorgan Chase & Co, Research Division - Analyst

And then one of your big initiatives since taking over, Mark has been cost reductions. And I think the most recent number you've given is that you've achieved \$600 million to date or over \$600 million. I know you plan to give us a bit more on the 2Q call, but can you give us some details on the progress made so far on your cost save program? And maybe some of the key sources, the final piece is to get to your \$1 billion target?

Mark E. Lashier - Phillips 66 - President, CEO & Director

Sure. We believe that our business transformation is really critical to setting the stage for our future at Phillips 66. The high-level view is that we're targeting \$1 billion in cost. And if you think of the breakout of that, about \$800 million is actual costs that you'd see flow through to the bottom line, about \$200 million is becoming more efficient in how we address our sustaining capital needs. And this has been a tough process with last year.

At the end of the year, we hit about \$500 million. About half of that was in organization design. That's a nice way of saying we eliminated 1,100 positions about -- and then about half of that \$500 million shows up in refining. So while this is an across-the-board exercise, every part of the company is being touched by this, the major impact is in our refining organization. And cost is one thing, but really underlying that is we're changing the way we work, the way we're organized. We're centralizing a lot of functions to support our refinery functions. We used to have every refinery as its own entity its own island.

Now where we're providing expertise and guidance from a more centralized perspective. We've got a -- we created a value chain organization several years ago, but we've enhanced its ability to really be a strong bridge between our commercial organization and our refineries. We've got people embedded in our refineries that report into value chain organization. They sit on the refinery leadership team. And then we've got people from our value chain organization sitting with our commercial group. So there's this direct line that allows us to optimize across the whole fleet every day, every minute and we're looking for value creation opportunities.

And in refining, we're focused on a couple of things. The cost piece is there. It translates to about \$0.75 a barrel in cost reduction. But key to that is making sure that we've got those assets available when the market is there. So we're focusing on increasing the availability of our refining assets. And then we're focusing on capturing as much from the market as we can. We've got a series of small capital projects that increase our flexibility on the crudes we process that enhance our ability to produce the higher-value products and to enhance our ability around processing crude at higher rates. So all those things are accretive to the value of our refining kit.

So above and beyond this -- the cold hard cash -- the cost numbers are changing the ways we're working and creating a more competitive mindset across the organization. We -- a year ago, when I would go into refineries to talk about business transformation, I'd see cold stony faces out in the

audience now. We're engaging with employees about it, and they bought into the process. They see the fruits of their labor starting to show up in the cost numbers and the way we execute turnarounds and the way we're creating value, and they now recognize that they own the future of the success or failure of our refining system and across our entire organization.

We've gone from a mindset where the world is not wanting hydrocarbons. They want us to go away. There's no residual value in our refining assets to one where we recognize refining is going to be not only around for a long time, it's going to be needed. It's going to be valued for a very long period of time, but we've got to get better at it every day. We've got to lower our carbon footprint. We've got to do it in a way that generates returns. And everybody in our refining organization, everybody across the enterprise is committed to that and energized by that. So it's really been this virtuous cycle both in the raw cost control, but also the competitive mindset of everybody in the organization.

John Macalister Royall - JPMorgan Chase & Co, Research Division - Analyst

So on the refining side of the business, there's been some news flow about the closure of an FCC at Bayway. Are these reports true? And how should we think about the impact on 2Q throughputs and captures if so? And just a general update there.

Mark E. Lashier - Phillips 66 - President, CEO & Director

Yes, John, we had an issue with the flu gas offtake line coming out of our FCC at Bayway. We did work on that. It was in turnaround several weeks ago. And then shortly after coming out of turnaround, this particular pipe failure in some refractory that was critical to its operations. So we had to take the FCC down. We did not have to take Bayway down in its entirety. It's still operating. The crude unit is still operating. And we'll be able to operate in this mode while we make that repair over the next few weeks, get it back online. And then we'll be able to process the intermediates that we're producing today through the FCC. So it's created some headwinds. Clearly, we're looking at utilization rates. Our guidance originally was in mid-90s, and we'll probably be in the mid to low 90s. So there is a modest impact on our aggregate utilization for the first quarter -- I mean, I'm sorry, for the second quarter.

John Macalister Royall - JPMorgan Chase & Co, Research Division - Analyst

Great. And then next one is on renewable diesel and the Rodeo conversion. How do you view the attractiveness of the RD market today and the returns in today's market relative to your initial expectations and maybe particularly in light of the news that's come out about the RVO.

Mark E. Lashier - Phillips 66 - President, CEO & Director

Sure. John, we've -- we're well underway with the execution of our project and what we call Rodeo renewed where we will make the step of taking a refinery that is north of San Francisco on the bay. It will take it off of crude oil processing and it will go to 100% renewable processing to produce about 50,000 barrels a day of renewable products. Today or since 2021, we've been operating a smaller hydrotreater that we did enough work to make it flexible and give it the ability to produce renewable diesel. And we believe that, that has greatly derisked the larger project that's coming on. We call it Unit 250.

Unit 250 has been running at about 30% higher rates than we premised. It's running at a higher selectivity to renewable diesel, and it's outperformed our expectations operationally and commercially. So we're seeing higher returns than we expected. And -- so we're able to also process a broader array of feedstocks through this unit that has no pretreatment capability. And then when we're done with Rodeo renewed we'll have a very large pretreatment capacity, so we'll be able to process an even broader range of low CI materials through this facility.

So we've already got CI pathways established, and we know that process in California. We know how to do that. So we've got a high degree of confidence in our ability to process the feedstocks and to deal with the regulatory environment around that. And then finally, one of our keys to success there is we've converted 600 of our retail outlets in California for direct sale to consumers of renewable diesel. So we're controlling the value of that product all the way out to the consumer. So we're not leaking any maybe the benefit to third parties, and you can go into one of our

76 stations, big orange logo, but you'll see a green logo on the renewable diesel pump. And if you had a diesel truck out there, you can fill it up with this and it's a direct drop in for diesel and you can buy today.

And so we're seeing great uptake of the product there, and it really has led our appetite for this additional increment. And Rodeo will be one of the largest renewable diesel facilities on the planet. It's well situated logistically on the water in San Francisco Bay. We can bring in feedstocks from Asia. We can bring feedstocks from by rail. Our commercial team has been out accessing feedstocks today. They've seen the volume upside become into reality. They see -- they're seeing about 3x the volume of renewables coming into the country versus last year. They've secured what we need to start up and operate this facility. And in fact, they're actively selling to other consumers what we're not consuming today, and then we'll bring that into our own facility when it comes online early next year. So we are in good shape.

I think with respect to the RVO announcement today, it's -- I think it's been described as bearish. It's bearish compared to what people were hoping for. I think what the early analysis from our team is that it will keep the RIN bank, it's kind of this esoteric thing that not a lot of people understand, but the RIN bank will still be very tight, which means the excess ability to bring -- to buy RINs when you need RINs is still going to be very thin.

So that says that if there isn't enough RIN generation, if there's not enough incentive to produce renewable diesel very quickly, the bank will dry up and there will be an incentive to run more renewables. And so it's -- they've created a very fine edge to that. And what we've seen with our Unit 250 operation is you've got so many different incentives in play. You've got LCFS in California, you got LCF in Washington. You've got the ability to capture similar incentives from Canada. You've got RINs that come into play RIN obligation, RIN values. You've got blenders tax credits that have been reimplemented in the Inflation Reduction Act.

All of these things come to bear to incent us to produce renewable diesel. And we've seen them all act in concert to incentivize renewable diesel production. So if RINs come off a bit, like we're seeing them this morning that you tend to have other incentives that kick in that encourage renewable diesel production. So we continue to be very, very bullish on this facility. It's got strong returns, probably the strongest return project in our portfolio today, particularly for this size of an investment. So we're ready to get it on, bring it into the market.

Jeffrey Alan Dietert - Phillips 66 - VP of IR

Yes. I would say the economics that we assumed in the FID are continuing to hold. We've seen volatility in the LCFS and the RIN and the feedstock cost and the diesel values, but they've all worked in concert to sustain the profitability that we had in the FID. I think one other important thing to mention is that we expect our emerging energy projects to compete competitively with other segments of our portfolio on returns.

Mark E. Lashier - Phillips 66 - President, CEO & Director

Right. I think -- and I mentioned the blenders tax credit. We didn't have any benefit in our economic analysis for blenders tax credit. So that adds \$1 a gallon in value to this project literally overnight. We didn't have any benefit for sustainable aviation fuel production with some modest capital, we can produce some renewable aviation fuel that can be then blended up to make sustainable aviation fuel. So there's additional upsides there. The IRA made sustainable aviation fuel more competitive with renewable diesel production. So it's a benefit longer term to that project as well.

John Macalister Royall - JPMorgan Chase & Co, Research Division - Analyst

And that's a good segue. Maybe we can stick with sustainable aviation fuel. And I know you're producing that SAF at Humber. Are there learnings from being a producer on Humber that can be applied to Rodeo? And if you could just maybe elaborate a little bit more on the opportunity set for SAF at Rodeo?

Mark E. Lashier - Phillips 66 - President, CEO & Director

Sure. It's -- there are different regulatory regimes. In the U.K., you can co-process renewables in the refinery. So we don't have to have a separate facility like what we're doing at Rodeo. The regulations in the U.S. require you to have a separate facility to be able to account for these productions and get the incentives. In the U.K., we're producing -- we're processing things like used cooking oil through the FCC, along with traditional crude feedstocks and some other renewable feedstocks to produce sustainable aviation fuel.

So if you put in a barrel of renewables, you can count a barrel of sustainable aviation fuel coming out the other end, it's at a high level, that's how it works. And we're providing that to British Airways today. It's being consumed and it's working great. And so we know that the demand for it is strong. You look at the commitments the airlines have made out there is going to take a tremendous amount of sustainable aviation fuel to meet those -- that demand, there's -- the government is setting out lots of aspirational targets for sustainable aviation fuel.

We believe long term, sustainable aviation fuel has got legs because decarbonizing aviation is really, really tough. It's going to be tough to see long-haul aircraft that run off of batteries or even run off. There's aspirations to run aircraft off of hydrogen, but you just don't have the density of energy that you need for long hauls. And so we believe sustainable aviation fuel is going to be key to that. And so we're looking at other pathways in addition to coproducing it in renewable diesel facilities that are the pathways that we can go down to more intentionally produce SAF to meet that demand that's out there?

John Macalister Royall - JPMorgan Chase & Co, Research Division - Analyst

And then I have one more on Rodeo, which I think you've answered, but I just -- I'll ask anyway just to be sure. In the hypothetical where we kind of come to year-end and West Coast refining feels very strong and RD maybe looks less attractive kind of during that time period. Is there a chance the project gets delayed and the facility continues to run as a refinery just to maximize near-term cash flow?

Mark E. Lashier - Phillips 66 - President, CEO & Director

Yes, I think that we are totally committed. We're making progress, and we're at the point of no return on that. So we will back out crude by the end of this year. If you look at our projections, we'll produce -- we'll generate about \$700 million a year in EBITDA from this facility. And I think we're bullish that it is the right time to do it and incented to do it. And also, once we make that conversion, it will no longer be considered a refinery under California's regulations. And so it's under a different regulatory regime. So there's substantial benefits there as well and substantial reduction in the carbon footprint of the facility.

And we think about it, we're actually pulling gasoline and diesel out of that market and then just putting diesel back into the market. And so I think that actually just the ability to provide CARB diesel, whether it's traditional diesel or renewable diesel, there's going to be a strong demand pull for that diesel gallon, diesel barrel. And then we're converting the terminal assets there to be able to move gasoline into that market from other refineries and other locations to make sure that the Northern California has access to the gasoline that they need to supply that market.

John Macalister Royall - JPMorgan Chase & Co, Research Division - Analyst

And just back to traditional refining. I'm just thinking about the gasoline crack now. We're in the beginning part of summer driving season. How are you thinking about gasoline cracks right now? And how do you think about expectations for summer driving season? It seems like things are off to a decent start coming off kind of a tough year last year.

Mark E. Lashier - Phillips 66 - President, CEO & Director

Yes. I think we're seeing strong demand in gasoline. I think we're seeing demand for gasoline up versus last year. Globally, we're seeing it up in North America, Jeff is great at going into the details of the numbers. But yes, we're seeing strong consumer behavior across the economy. I think diesel, you're seeing a little bit of a contraction because of, I think, recessionary pressures. It seems like -- it always seems like the consumer is out

there, buying -- maybe buying less stuff, but buying more experiences, and those experiences require you to move and so they require you to drive or to fly. And so we're seeing that in gasoline and jet fuel demand increased. And you've got very low inventories in gasoline similar to last year, you actually have low inventories in diesel, but the relative demand isn't there--this time last year, diesel demand was just blowing right through the summer driving season and gasoline margins were strong, too.

We're getting called to the White House to talk about pain at the pump last year. Of course, it was an election year and you had all those dynamics. This year, you also have much lower crude price. And so the flat price of gasoline is going to be lower, but with strong crack spreads. And so there's going to be -- it's kind of a win-win where we're seeing good margins for gasoline, but the consumer is not seeing honestly high prices that could impact demand for gasoline. And so we're bullish around gasoline demand and gasoline crack spreads for the summer driving season.

Jeffrey Alan Dietert - Phillips 66 - VP of IR

John, I'm going to add a couple of comments there. I think with the 4.5 million barrels a day that was rationalized globally out of the system, the supply and demand balance for refined products has tightened and we see about 1 million barrels a day of capacity additions on a net basis for '23, '24 and '25 in a normal economic environment, we would expect that much demand growth. So a continuation of tight markets.

The second thing I would mention is we view the European refinery as being the marginal refinery in the world. And last year, with European natural gas prices spiking, we saw cracks go up to cover the higher European cash operating costs. We've recently seen European natural gas prices bump up again. And I think that's been supportive of gasoline cracks in particular, but also diesel cracks. And so that will be important to watch with, I think, a tight natural gas market in Europe.

John Macalister Royall - JPMorgan Chase & Co, Research Division - Analyst

Then maybe on to a business that Mark has spent a lot of time in, the Chemicals business. ethane-based, ethylene margins have recovered modestly off of bottoms. In 1Q would seem relatively flat for most of the year. What are your expectations for margins in the second half? And can margins show a strong recovery in the event of a less robust reopening in China?

Mark E. Lashier - Phillips 66 - President, CEO & Director

Yes. Thanks, John. Yes, we have seen margins recover from fourth quarter last year, not really from polyethylene price recovery, but more of the ethane price coming off and that puts CPChem in a relatively strong position, both from accessing low-cost ethane in the U.S. as well as their position in the Middle East. And so they've been able to run at high rates and capture the demand that's out there, though, the margins are, of course, well below mid-cycle. They've recovered a bit from last year.

I think that really China demand is kind of the missing link out there for a catalyst for recovery. And it's -- the performance of the Chinese economy, I think, is disappointed on a number of fronts. And if they -- if their recent announcement of more stimulus for the economy kicks in gear, that would be, I think, beneficial to petrochemical in particularly polyethylene demand. But I think our view is that we'll wait and see. We're not going to call that and say that they're on the road to recovery because it's a bit of a black box, I think, for all of us right now.

Jeffrey Alan Dietert - Phillips 66 - VP of IR

I would just add that the IHS indicator margin for high-density polyethylene increased from \$0.08 in the fourth quarter to \$0.17 in the first quarter. So far, it's averaged about \$0.20 in the second quarter. But we expect that to kind of be choppy in the back half of the year as opposed to a continued run higher.

John Macalister Royall - JPMorgan Chase & Co, Research Division - Analyst

Okay. We have about 4 minutes remaining. Do we have any questions from the audience?

No? Okay.

So Mark, we're finishing up the second quarter here and Jeff, and we've gone from cracks looking pretty weak in April to a nice recovery in May and June, particularly on the gasoline side, which we discussed. Any early expectations you can give us going into the 2Q quarter?

Jeffrey Alan Dietert - Phillips 66 - VP of IR

Going into -- in the second...

John Macalister Royall - JPMorgan Chase & Co, Research Division - Analyst

The print, the 2Q print.

Jeffrey Alan Dietert - Phillips 66 - VP of IR

I think you're right. We saw it weakening in the first half of the quarter and then strengthening in the back half. And a lot of that was tied with the response to higher natural gas prices in Europe. I think from a market capture perspective, we have talked internally about the things we can control and a number of low capital, high-return projects that Rich Harbison and his team are implementing to improve our market capture.

We had a number of projects last year that will improve it by 1% to 1.5%, similar for 2023. However, there are issues that we don't control on commodity prices that are going to have an impact. We've seen weaker diesel cracks this quarter and the Canadian heavy differential has narrowed substantially. Maya discount has narrowed some, and those will have a negative impact on market capture. So we're focused on improving the things that we can control and floating with the market as far as cracks and dips scale.

John Macalister Royall - JPMorgan Chase & Co, Research Division - Analyst

And let's stick with crude differentials that you brought up, Jeff. And what's your view on coastal light-heavy differentials for the remainder of the year. Maya has come in since the OPEC+ cuts were announced, but still feels relatively elevated relative to history. What are the key drivers there? And what should we look for in terms of coastal light heavy diffs?

Jeffrey Alan Dietert - Phillips 66 - VP of IR

Yes. I think you're exactly right. They have narrowed in with, I think, the OPEC cuts being a primary contributor there. And the OPEC cuts have taken medium and heavy sour barrels off the market. I think a key factor for the back half of the year is do we see the recovery in China that is projected, both in the IEA and EIA statistics. And when you look out in the back half of the year, it does look to tighten substantially, which would cause OPEC to likely put those heavy sour barrels back into the market.

I think the other thing that we're seeing is Venezuelan barrels coming into the market and there could be some incremental volumes there, probably modest increments, but we are seeing Venezuelan barrels into the market, and they're attractive for our portfolio, we can consume them both at Sweeny and at Lake Charles. So I think those are going to be kind of the key factors for the back half of the year.

John Macalister Royall - JPMorgan Chase & Co, Research Division - Analyst

I think I have time to squeeze one more in. So you had a heavy first quarter maintenance period that followed a heavy 2022 maintenance year. Is your system fully caught up now in terms of the refining? And are you moving back to a more normalized schedule for turnarounds?

Mark E. Lashier - Phillips 66 - President, CEO & Director

Yes. We -- like a lot of the industry, during COVID, we deferred turnarounds as much as we could to avoid the cost and to avoid opening up a refinery and then have an entire fleet of people out there and get COVID and not be able to put things back together. So it was the right thing to do, but that pushed a lot of our turnaround activity into 2022 for us. And so we had a much higher than normal, almost 2x normal load. This year, we're back to a normal -- kind of a normal cycle. And so it's -- we've got the opportunity to run really well the rest of the year, and we're going to execute, and we're going to do that.

John Macalister Royall - JPMorgan Chase & Co, Research Division - Analyst

Great. Well, we're right up against time here. So I just want to thank Mark and Jeff for coming and I appreciate it, and have a good rest of your day.

Mark E. Lashier - Phillips 66 - President, CEO & Director

Very good. Thank you, John.

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