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PSX.N - Q1 2023 Phillips 66 Earnings Call

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OVERVIEW:

PSX reported 1Q23 adjusted earnings of \$2b and adjusted EPS of \$4.21.

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PRESENTATION

Operator

Welcome, everyone, to the First Quarter 2023 Phillips 66 Earnings Conference Call. My name is Sierra, 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 of 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 Mark Lashier, President, CEO; Kevin Mitchell, CFO; Brian Mandell, Marketing and Commercial; Tim Roberts, Midstream and Chemicals; and Rich Harbison, Refining. Today's presentation material can be found on the Investor Relations section of the Phillips 66 website, along with supplemental financial and operating information.

Slide 2 contains our safe harbor statement. We will 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 Mark.

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

Thanks, Jeff. Good morning, and thank you for joining us today. During the first quarter, we delivered strong financial and operating results. We had adjusted earnings of \$2 billion or \$4.21 per share, a record first quarter. In Refining, we successfully executed major planned maintenance and

ran above industry average rates. Currently, our refineries are running at high utilization to meet demand and capture market opportunities as we enter summer driving season.

We returned \$1.3 billion to shareholders through dividends and share repurchases. In February, we raised our dividend 8% to \$1.05 per share, demonstrating our ongoing commitment to a secure, competitive and growing dividend. Our integrated diversified portfolio provides us with the ability to generate strong cash flow, return substantial cash to shareholders and invest in the most attractive projects. We remain committed to operating excellence and disciplined capital allocation as we execute our strategy.

Recently, our Midstream, Refining and Chemicals business were recognized for their exemplary safety performance in 2022. For the third consecutive year, Midstream was awarded the American Petroleum Institute's Distinguished Pipeline Safety Award for Large Operators. This is the highest recognition by API for the midstream industry. The American Fuel and Petrochemical Manufacturers recognized 5 of our refineries for outstanding safety performance. Sweeny Refinery received the Distinguished Safety Award for the second year in a row. Bayway, Borger, Santa Maria and Ponca City refineries also earned safety awards. In Chemicals, 4 CPChem facilities were recognized with AFPM Safety Awards. We're honored to receive these awards and would like to recognize our employees' commitment to operating excellence. Congratulations to all the people working at these facilities, well done.

We started the year off well and continue to advance strategic priorities from our Investor Day late last year. Slide 4 summarizes progress toward our targets to create value and increase shareholder distributions. Since July of 2022, we've returned \$3.7 billion to shareholders through share repurchases and dividends. We're on track to meet our target to return \$10 billion to \$12 billion over the 10-quarter period between July 2022 through year-end 2024. We had strong refining operational performance in the first quarter and market capture increased to 93%.

In Midstream, we're advancing our NGL wellhead to market strategy. We recently achieved an integration milestone with the transition of DCP Midstream employees to Phillips 66, enabling continued synergy capture. In anticipation of the DCP buy-in, we issued bonds and executed a delayed draw term loan. We expect to close on the transaction by the end of the second quarter. We're advancing our business transformation initiatives, and we're on track to deliver \$1 billion of annual run rate savings by year-end. Next quarter, we'll provide a more detailed update on the cost savings achieved through the first half of the year.

In Refining, we're converting our San Francisco refinery into one of the world's largest renewables fuels facilities. The conversion will substantially reduce emissions from the facility and produce lower carbon-intensity transportation fuels. In February, we safely shut down the Santa Maria facility as we continued to advance the project. We expect to begin commercial operations in the first quarter of 2024. Upon completion, Rodeo will have over 50,000 barrels per day of renewable fuels production capacity.

In Chemicals, CPChem is pursuing a portfolio of high-return projects, enhancing its asset base and optimizing its existing operations. This includes construction of a second world-scale 1-hexene unit in Old Ocean, Texas and the expansion of propylene splitting capacity at its Cedar Bayou facility. Both projects are expected to start up in the second half of 2023. CPChem and QatarEnergy are jointly building world-scale petrochemical facilities on the U.S. Gulf Coast and in Ras Laffan, Qatar, with start-up at each facility expected in 2026. We look forward to continuing to update you on our strategic priorities.

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

Kevin J. Mitchell - Phillips 66 - Executive VP & CFO

Thank you, Mark, and hello, everyone. Starting with an overview on Slide 5, we summarized our financial results for the first quarter. Adjusted earnings were \$2 billion or \$4.21 per share. The \$12 million decrease in the fair value of our investment in NOVONIX reduced earnings per share by \$0.02. We generated operating cash flow of \$1.2 billion, including a working capital use of \$1.3 billion and cash distributions from equity affiliates of \$369 million. Capital spending for the quarter was \$378 million, including \$228 million for growth projects. We returned \$1.3 billion to shareholders through \$486 million of dividends and \$800 million of share repurchases. We ended the quarter with 459 million shares outstanding.

Moving to Slide 6. This slide highlights the change in adjusted results by segment from the fourth quarter to the first quarter. During the period, adjusted earnings increased \$66 million, mostly due to higher results in Chemicals and lower corporate costs, partially offset by a decrease in Marketing and Specialties. Slide 7 shows our Midstream results. First quarter adjusted pretax income was \$678 million compared with \$674 million in the previous quarter. Transportation contributed adjusted pretax income of \$270 million, up \$33 million from the prior quarter. The increase was primarily driven by seasonally lower operating costs.

NGL and Other adjusted pretax income was \$420 million compared to \$448 million in the fourth quarter. The decrease was mainly due to the impact of declining commodity prices in the gathering and processing business. The fractionators at the Sweeny Hub continued to run above nameplate capacity, averaging 554,000 barrels per day. The Freeport LPG export facility loaded a record 282,000 barrels per day in the first quarter.

Turning to Chemicals on Slide 8. Chemicals had first quarter adjusted pretax income of \$198 million compared with \$52 million in the previous quarter. The increase was mainly due to improved margins from lower feedstock costs, higher sales volumes and decreased utility costs. The industry polyethylene chain margin increased by \$0.10 to \$0.17 per pound during the quarter. Global O&P utilization was 94% for the quarter.

Turning to Refining on Slide 9. Refining first quarter adjusted pretax income was \$1.6 billion, down \$18 million from the fourth quarter. The impact of lower volumes from turnaround activities was mostly offset by higher realized margins and lower utility costs. Our realized margins increased by 5% to \$20.72 per barrel, while the composite 3:2:1 market crack decreased by 5%. In the first quarter, turnaround costs were \$234 million, crude utilization was 90%, and clean product yield was 83%.

Slide 10 covers market capture. The market crack for the first quarter was \$22.39 per barrel compared to \$23.58 per barrel in the fourth quarter. Realized margin was \$20.72 per barrel and resulted in an overall market capture of 93%, up from 84% in the previous quarter. Market capture is impacted by the configuration of our refineries. We have a higher distillate yield and a lower gasoline yield than the 3:2:1 market indicator. During the first quarter, the distillate crack decreased \$19 per barrel and the gasoline crack increased \$7 per barrel. Losses from secondary products of \$2.56 per barrel were \$1.03 per barrel lower than the previous quarter due to falling crude prices. Our feedstock advantage of \$2.34 per barrel was \$2.37 per barrel improved compared to the fourth quarter, primarily due to running more advantaged crudes.

The Other category improved realized margins by \$2.19 per barrel. This category includes freight costs, clean product realizations and inventory impacts. First quarter was \$1.73 per barrel higher than the previous quarter, primarily due to improved clean product realizations.

Moving to Slide 11. Marketing and Specialties had a solid quarter, reflecting stronger-than-typical first quarter margins. Adjusted first quarter pretax income was \$426 million compared with \$539 million in the prior quarter, mainly due to lower international marketing margins. On Slide 12, the Corporate and Other segment had adjusted pretax costs of \$248 million, \$32 million lower than the prior quarter. The improvement was mainly due to higher interest income and recognition of a transfer tax on a foreign entity reorganization in the fourth quarter of 2022.

Slide 13 shows the change in cash during the first quarter. We started the quarter with a \$6.1 billion cash balance. Cash from operations was \$2.5 billion, excluding working capital. There was a working capital use of \$1.3 billion, mainly reflecting an increase in inventory, partially offset by a decrease in our net accounts receivable position. During the quarter, we issued \$1.25 billion of senior unsecured notes in support of the pending buy-in of DCP Midstream's publicly held common units. We funded \$378 million of capital spending and returned \$1.3 billion to shareholders through dividends and share repurchases. Our ending cash balance was \$7 billion.

This concludes my review of the financial and operating results. Next, I'll cover a few outlook items for the second quarter. 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 mid-90s and turnaround expenses to be between \$100 million and \$120 million. We anticipate second quarter Corporate and Other costs coming between \$260 million and \$290 million, reflecting higher interest costs. In March, we issued senior unsecured notes of \$1.25 billion and entered into a delayed draw term loan of up to \$1.5 billion in support of the DCP Midstream buy-in transaction, which is expected to close during the second quarter. Now we will open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Neil Mehta with Goldman Sachs.

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

The first question is around Refining utilization. It was better than expected in the quarter, and the guide for Q2 also looks a little bit better. So could you -- you talk about what improvements that you're making on the ground, and it's been a choppy 18 months in Refining from a utilization standpoint. So what conviction can you provide the market that we've turned the corner here?

Richard G. Harbison - *Phillips 66 - EVP of Refining*

Yes. Thanks, Neil. This is Rich. Good question. And it's a number of things coming together here for us. Back in November, we outlined a number of opportunities to improve Refining's performance. One of them was asset availability. Optimizing our turnaround durations, we've done a really good job executing those in a pretty heavy turnaround quarter for us, and that's a big component of allowing us to operate at that 90% crude unit utilization. It's really executing those turnarounds in a very high-performing status.

On the Gulf Coast, our assets performed very well. They increased their crude flexibility. That also allowed us to open up the utilization window and also allowed us to capture additional market as well, which you saw as well, the Refining market capture rate of 93% was very good for the quarter as well. The key assets there are running the assets, focusing on what we can control in our business, Neil, and that is executing our turnarounds well. And we were able to do that coming in below guidance this year or this first quarter, continuing a trend that started last year with us coming in below guidance.

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

Yes, Neil, this is Mark. I'll just come over with a little bit relating that back to the Investor Day commitments that we made those commitments based on the groundwork that had been underway for some time, the fairly small projects that we were going through, the blocking and tackling that we were taking on, and we're really starting to see those come to fruition now. And we're pleased with what we're seeing out there.

And really, I think the biggest impact of business transformation has been the hearts and minds of our employees. They are all in. Wasn't that way a year ago when first started the initiative, but now they see the things that they're doing, the hard work that they're doing are starting to impact their results and turnarounds, starting to impact the operational effectiveness of the plants as well as they're seeing it in the cost. And that's just been a very virtuous cycle for our employees. There's a stronger competitive edge out there and they really want to own their future now.

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

Rich, you want to talk about some of the projects that were completed last year?

Richard G. Harbison - *Phillips 66 - EVP of Refining*

Yes. I think that plays into the Refining capture rate of 93% for the quarter for us. Last year, we actually implemented 12 projects focused on market capture. The result of the impact of those projects is a 1.2% improvement in market capture with mid-cycle pricing assumptions. We implemented \$225 million worth of projects, and the net return on those or the EBITDA generation for that investment was \$158 million at mid-cycle pricing.

2023, we actually have additional 18 projects identified that are in flight, and the estimate is a 1.4% improvement in market capture. So I think what you're seeing here is the plan we laid out in November is starting to really come to the bottom line of the performance of the Refining.

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

That's a lot of good color there. The second question is around the decline we've seen in crude prices. And that should manifest itself in different parts across the business, so I would love any perspective on how we can think about it from a modeling perspective. Specifically around Marketing, which tends to be a tailwind, capture rates, declining crude prices tends to help secondary products but also can be a headwind for working capital. So if the crude price decline sustains, how should we think about that in terms of Q2 movements?

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

Well, let me start, Neil. This is Brian. Talking about Marketing and probably noticed we had very strong marketing earnings in Q1. Pretty happy about that. You know that we have a geographic diverse portfolio with assets both, here in the U.S. and Western Europe, which is great. But we also market through a number of channels; wholesale, branded and retail. And what we've been doing is trying to focus our sales on the higher-margin parts of our business, particularly in retail.

And we purchased retail in the past few years. In fact, in mid-2019, we had 50 retail JV stores in the U.S. Now we have 1,000 retail JV stores in the U.S., and we also spent some time reimagining all of our stores to get higher margins in business. And I would also say that in the lubes business, that it's also performing quite strongly in both, base oils and finished products. So as you mentioned, as spot prices come off, that generally benefits the Marketing business because marketing margins, generally, or marketing prices generally fall slower.

Richard G. Harbison - *Phillips 66 - EVP of Refining*

Yes. On the Refining side, as you framed up the question, Neil, it's the -- flat price drop in accrued does reduce usually the secondary product losses. So they tend to tighten up a little bit there, so that has a positive impact for us in refining. But really, in refining, it's -- for us, it's the differential that we make our money off of on the light heavy sweet differential, and that's what we keep a close eye on. Kevin, any additional color to add to that?

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

Yes. Neil, just on the working capital impact. As you've highlighted, with the declining prices, we will have a working capital hurt, because we're in a net payables position. So you think about a system that's essentially 2 million barrels per day and a longer duration on the payables outstanding than on the receivables. So the approximate rule of thumb is somewhere in the order of \$40 million to \$50 million of working capital hurt per \$1 of price reduction.

And that assumes that the crude and the products move together, and the crack stays at the same level. But as you know, also, there's a lot of other moving parts in working capital, what's happening to inventories and so on. But as a rule of thumb -- simple rule of thumb, you can use that \$40 million to \$50 million per \$1 movement in price.

Operator

Doug Leggate with Bank of America.

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

Guys, I want to ask a follow-up to Neil's question on the capture rate. So should -- I mean, obviously, reliability was a bit of a question mark over the past year. So should we now think about this level of capture rate, should we anticipate that, that's kind of a new normal? And if I could risk it, just a bolt-on to that, the same kind of seems to be true of the cost-cutting progress. It looks like you're a little bit ahead of schedule there. So as

we wrap it all together, the earnings power of the business overall, it looks like you're kind of past the hump and trending higher. So I just wonder if you could kind of characterize whether we're thinking about that the right way.

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

Great questions, Doug. I'll let Rich address the capture rate, and I'll come back in on the cost-cutting progress.

Richard G. Harbison - *Phillips 66 - EVP of Refining*

Yes. So capture rate has a lot of moving parts to it, so it's very difficult to predict that, the configuration component of it, secondary products, feedstock costs, others. But back to focusing on what we can control in our business, Doug, is we're seeing continued maturity in our reliability programs. And these saves are coming on a regular basis where we're catching issues early and preventing larger events from occurring.

And also, under asset availability, as I mentioned earlier, the turnaround execution is going very well for us. We've significantly improved our predictability on this. That takes a lot of leg work over time to improve those processes. And most importantly, even though we're hitting our turnaround execution goals, we are continuing to complete all the necessary work to operate the equipment safely and reliably over time. So that program is continuing to mature, we'll continue to see that. And that will allow our utilization rates to be available to operate in the market if the market is there.

And then as you mentioned, the cost side of it is a big component of this as well. We have a clear path that we've identified reducing our costs by \$500 million by the end of this year on a run rate basis. Over half of the \$400 million run rate cost savings that Kevin mentioned in his comments are coming out of Refining. And that's good news for us. And probably more importantly, as Mark has indicated, our entire organization is uncovering opportunities to lower cost. We're being much more efficient in how we work and accepting the challenge to improve the business, which all should directionally support improved market capture and utilization.

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

Yes. Thanks, Rich. Doug, we've really come a long way on the business transformation efforts. It was a heavy lift, a major focus really for the last 18 months or so, and we're seeing great progress. We beat our goal of \$500 million by year-end of '22. And we're accelerating right into '23, hitting more than \$600 million in the first quarter. And as I mentioned in our comments, we'll take you on a tour of those realized savings at the second quarter call.

And we're excited, the organization is excited. We've made major changes in the structure of the organization that eliminates a lot of inefficiencies. We've got feedback loops that we put in place to make sure that these savings are real and that they're sustainable. And we're seeing it and people have bought in. We're using some really state-of-the-art tools to make sure that we're capturing what we think we're capturing and delivering those results to the bottom line. So it's just an incredible change in the organization that we've witnessed over the last 6 or 8 months as things start to be realized.

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

A lot of progress in a short period of time, Mark. I guess my follow-up is fairly predictable, and I apologize for this demand. Your large -- one of your large competitors talked about big increases in deal demand year-over-year and a healthy outlook for gasoline. And market doesn't seem to believe that right now. I just wonder through your marketing channels, if you could share what you're seeing on both of those trends.

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

Yes, Doug, this is Brian. Maybe I'll talk about kind of what we're seeing in the market, and that kind of what we're seeing in our business as well, although our volumes are somewhat off because of California flooding and because of some maintenance. But generally, for U.S. gasoline, we're seeing demand better than last year, and we're seeing global demand about 3% better than last year. We're now heading into gasoline driving season as was mentioned, with kind of the lowest U.S. gasoline inventories in almost 10 years. We're also seeing a very strong octane spreads. They're about 1/3 larger than they were first quarter of last year, \$0.27. We would expect demand to hold better than last year, particularly given that the -- we have lower retail prices versus last year as well.

On the diesel side, the year did start off weaker early in the year with a warmer winter, but has begun to firm with the mid-continent planning season. Currently, we're seeing U.S. diesel demand about 3.5% under last year. But that said, global distillate demand is a bit stronger than last year. And some countries are seeing particularly strong diesel demand. In Latin America, we're seeing demand at 10% over last year and China 4% over last year. And finally, I'd say that in the U.S., it's been bouncing back and forth between max diesel and max gasoline [PAD5s.] I've been in max gasoline since mid-February, pretty much PAD1 signaled max gasoline in mid-April. And so this bodes well for helping the firm up distillate throughout the summer.

Operator

Ryan Todd from Piper Sandler.

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

Great. Maybe you basically said that you were not going to talk about this until next quarter but was wondering on the cost reduction side. I mean, you've made great progress there. I mean can you talk a little bit about where -- you've been ahead of schedule where you've had some success there and whether -- I mean you've already hit the \$200 million kind of sustaining capital reduction target. Is there further upside to that versus your prior target? And as you continue to trend ahead of schedule, does -- have your expectations changed at all in terms of the ultimate amount of cost savings that you might find available?

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

I'll touch a couple of those things, Ryan, at a high level. And then Kevin can drill into how the savings are distributed. But really Refining has performed very well. With respect to business transformation, we're seeing that. On the sustaining capital, I just want to make it clear that, that's really not an outright reduction in sustaining capital opportunities. It's becoming more efficient and more productive in how we're spending that, and we're going to continue to do that. You'll see really that impact in any of our capital projects that we look at going forward. And we're not really capturing that.

So it's going to be a continuous process to look at how to get more and more efficient around sustaining capital. And we're not going to end this adventure when we get to the end of the defined program at the end of next year. We have outlined goals. We expect to continue to generate more savings on into 2024 and beyond. There are some things that we aren't even talking about today that require modest capital that will further enhance cost savings.

So we're instilling this as part of our culture, Ryan. And this is just going to be an ongoing march of continuous improvement, greater competitive edge. We've got 14,000 employees that want to win out there every day, and they're highly motivated. Now Kevin can give you a little insight to where you're going to see these numbers.

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

Yes. Thanks, Mark. So as we said, over \$600 million run rate at the end of the quarter when you adjust for the fact that some of that's capital from an EBITDA standpoint, it's a north of \$400 million run rate. And as we look at the detail in the quarter, we are seeing the proportionate share of that show up. It's not necessarily obvious from the externally reported data just because of the other things happening like consolidation of DCP into our results and so on.

But of that \$400 million-plus run rate, half of that or even a little bit more is showing up in Refining, which is where you would expect it to be, given that, that's the largest spend area in the company anyway. We're doing this through a combination of organization work. We completed that last year, and we're seeing that benefit flow through this quarter between the sort of centralization of some of our activities across the organization.

We've done a lot of work around our processes where we've been looking for ways to standardize and simplify the way we do work and in some cases, just eliminate work. And so we've optimized the sort of overall business support model around all of those activities. And then we continue to work on our external spend, the third-party sourcing activities and leveraging the technologies that we really put the foundation in place with Advantage 66 in terms of the digital progress we have made in those areas. So a lot of different elements to that. And we'll give more specifics this time next quarter as we have the half year results available.

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

Great. And then maybe -- I mean, you mentioned the importance of crude differentials to Refining profitability. Can you talk a little bit -- I mean, we've seen some pretty big moves on crude differentials (inaudible) widening and then coming in some Canadian heavy differentials narrowing. Can you talk about what you're seeing out there, what your outlook is for some of these crude differentials over the remainder of this year?

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

Sure, Ryan, this is Brian. I think overall, as you pointed out, sour gained strength since the beginning of the year. And this strength was a number of factors. You have -- now it's starting to weaken, but you have new refinery capacity in China and in Kuwait. You have new U.S. refinery additions on the Gulf Coast at Port Arthur and Galveston Bay. We had an unexpected OPEC cut, 1.1 million barrels. Don't know how much of that cut will actually happen but that's a large cut.

Chinese economy has been very strong. And you can see that the economy coming back with more people driving, more people flying and then lack of sour barrels on the market. So a combination of things firmed it initially and then, the market started to weaken. I will point out that even though the market has come off since Q1, when you think about the sours, it's useful to remember that while they're weak, they're still weak. But relative to historical perspective, so if you look at Latin American sours like (inaudible) Maya, they're still about \$4 to \$6 weaker than 5-year averages. So those differentials are still weaker than historical, although they firmed up some since Q1.

Operator

Manav Gupta with UBS.

Manav Gupta - *UBS Investment Bank, Research Division - Analyst*

I just wanted to first touch base a little bit on the Chemicals earnings seeing a strong rebound. It really helps you out. I think you have a \$0.10 improvement in ethylene chain margin. So just trying to understand from you, from the demand point on the Chemicals side, what are you seeing? And should we expect a further recovery in Chemical margins, given the strong global demand?

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

Yes, Manav. This is Tim Roberts. So on the Chemicals front, what you got really are -- yes, we did benefit. The benefit was really related to lower advantaged feedstocks, ethane, propane, butane, namely here in the United States. So you saw that advantage as those prices dropped, they became advantaged in the crack. And subsequently, that showed up in the margin. The other side of that as well is lower natural gas prices, which of course, is driving that whole structure. Also helped with regard to utility cost. So you had lower utility costs, better feedstock advantage, so it really helped in the quarter.

You still got a supply issue and you have a demand issue. On the supply side, fundamentally, you've got more capacity that's coming on board here in the United States. So you're going to have to work through that new capacity. The demand side is coming around, but you're still trying to work off a lot of inventory that happened as you had the supply chain disruptions out there in the marketplace. So you got to work through that inventory. And you also need to see China coming back stronger.

As Brian mentioned, there is some strength there in travel, driving. So some good things there needs to also show up in consumption on that side as well as production to meet global demand for products made out of polymers. So fundamentally, I think it's still going to take us a little bit of time to work through those 2 imbalances. We're not expecting anything to happen by the end of the year that's going to be a significant bump. But I would throw one caveat as China is a significant impact in the market. If they're clicking on all cylinders, you can see things change rapidly. But at this point in time, we've got an inventory to work off, and we need to see some additional demand come back, especially from Asia.

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

Yes. And the only thing I would add, Manav, is CPChem's operations have been very strong. And I think their ability to outproduce their competitors is based on their strong operations and their solid cost position and they're delivering -- in a tough environment, they're delivering and outperforming.

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

Yes. And I do think, Mark, exactly on that point, though, is that also their product slate is geared towards consumables. Durables are a little bit -- you're seeing it slow up a little bit on the durables front, and they don't have as much exposure to that.

Manav Gupta - *UBS Investment Bank, Research Division - Analyst*

Perfect, guys. My quick follow-up is if you can get some updates on your -- the progress you are making on your renewable diesels project. And hopefully, it starts up by year-end or early 2024.

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

Yes. Manav, we're making good progress on the project out at Rodeo. You heard me mention we shut down the Santa Maria facility, which is basically a feed prep unit for the Rodeo facility. The project is moving along. And there are lots of weather challenges out there but the team has fought through it and dealt with it, and we're looking forward to having that on in the first quarter of next year.

And I'll remind you that we've had a unit there operating and producing renewable diesel, what we call Unit 250 since April 2021. And I'll tell you what, it's exceeded both, our operating expectations and our commercial expectations. And frankly, we're ready for more. We've got a great strategy out there, and we are implementing and executing. And I'll let Brian touch on more of those details.

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

Manav, just to follow up on Mark's point, the margins that we've seen at Unit 250 since we started the unit in Q1 of 2021 have been better than we premised every single quarter. And if you remember, we premised Unit 251 running soybean oil feedstock only, but we've also run distillers corn oil, canola oil and pretreated used cooking oil, and we're actively blending feedstocks at the plant now. And in general -- just a general comment, we're seeing 3x the volumes of low CI imports into the U.S. now than last year. And we're also seeing more crushing capacity for vegetable oils.

And then on the Marketing side of the business, we're selling almost all of our production through our branded and retail outlets directly to the end consumer. And we've also sold volumes to geographic locations that offer higher credit incentives than California for some of the feedstocks. And then finally, on the credit side, the LCFS programs are currently available in California, Oregon, Washington and Canada, as you know, but we're seeing other states proposing these programs, and in fact, Minnesota and Pennsylvania are 2 states that recently proposed an LCFS program.

And then Mark, that's the kind of the commercial side. Mark mentioned the operating side, too. And on the operating side, we're seeing higher than premised yields of RD at greater than 95%. And we're also making 30% more renewable diesel production at the plant than we originally thought. So as Mark pointed out, we're looking forward to Rodeo Renewed. And Rodeo Renewed will also have the flexibility of producing up to 10,000 barrels of renewable jet fuel with very little capital.

Operator

John Royall with JPMorgan.

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

So my first one is on OpEx. Can you talk about OpEx trends in Refining into the second quarter? It's an item that you don't guide to, but 1Q ticks down, presumably on lower natural gas prices and despite higher maintenance. In 2Q, you'll have an even lower price presumably and less maintenance, and of course, your efforts around costs. So any color on expectations on the Refining OpEx side in 2Q and going forward?

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

John, this is Kevin. I would just say -- I mean, your points are valid. We'll see -- we'll benefit from lower maintenance turnaround costs. And the natural gas prices are settling in at a pretty low level, and so you would expect to see a drop, 1Q to 2Q. We're not giving specific guidance on the number. Now the other side of that is utilization will be higher, so some of the variable costs, you'll see a small impact from. But that's a good thing. But net-net, I think you should see a small -- a modest sequential decline.

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

Great. And then just on the share buyback in 1Q. You paced a bit ahead of your quarterly pace that you need to hit your longer-term guidance, but 2Q does have an outflow from the acquisition. So should we be expecting a slowing in 2Q? And then further, if the environment were to continue to deteriorate from a crack's perspective, could that impact your pacing as well?

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

Yes. John, I wouldn't be too concerned about buyback pace being driven by the -- funding the buyback, because we are at a \$7 billion cash balance at the end of the first quarter. We had drawn -- we had issued \$1.25 billion of notes, but we have the term loan facility, which has not been drawn yet. And so we will draw on that as we fund the buy-in. So even all other things unchanged, we'll still have a healthy cash balance at that point in time.

We're still generating cash. And so I think that our buyback pace should still be at a very respectable level in the second quarter. The balance sheet is in a good position. The operating cash flow is still strong. We've seen some weakening in Refining margins. But relative to our mid-cycle assumptions, the business is still looking really good. So I'm not too concerned about the buyback pace being impacted by the DCP buy-in.

Operator

Matthew Blair with TPH.

Matthew Robert Lovseth Blair - Tudor, Pickering, Holt & Co. Securities, LLC, Research Division - MD of Refiners, Chemicals & Renewable Fuels Research

I was hoping you could expand a little bit on the dynamics in the Central Corridor in Q1 and then heading into Q2 as well. I think you ran at 89% utilization in Q1 were Wood River and Borger still impacted by some of the issues from Q4. And then it looks like your margin capture was actually pretty good in Q1, 116%. Was that a function of wider WCS dips? And then, I guess, would we expect lower margin capture in Central Corridor heading into Q2 with narrower WCS dips?

Richard G. Harbison - Phillips 66 - EVP of Refining

Yes, this is Rich. So Central Corridor, I think the first thing to remember, the quarter-over-quarter analysis. Fourth quarter, we had some pretty heavy headwinds with the Keystone shutdown and the winter storm effects, so that kind of sets the baseline. In the first quarter, we did see improved feedstock advantage running the heavy crudes. And more importantly, we are able to actually increase our crude slate percentage of these crudes that we were able to run. That impacted our market capture there as well.

Now some of that was offset by the unplanned downtime impacts that carried on -- initiated fourth quarter, carried on into the first quarter. That unplanned downtime, primarily at Wood River was -- is now repaired, and that facility is back up and running. We did slide one turnaround from the first quarter to the first half of the second quarter. That turnaround is now wrapping up this week here. So we do expect the utilization rates to get back to higher levels for the WRB assets.

There -- also, there was other some slight turnaround impacts as well to that first quarter results and a little bit lower market cracks also that played into that result. But that's how we see the Central Corridor kind of moving forward. We expect our utilization rates to turn back upwards.

Matthew Robert Lovseth Blair - Tudor, Pickering, Holt & Co. Securities, LLC, Research Division - MD of Refiners, Chemicals & Renewable Fuels Research

Great. And then thanks for the comprehensive RD update. I just had one follow-up there. Could you talk about how the process is going for getting LCFS pathways? Some of your peers have mentioned that CARB is pretty backed up, and it's taking longer than expected. As you bring on the full site in Q1 '24, would you expect to have all your LCFS pathways at that time, or is that a risk to the earnings contribution?

Richard G. Harbison - Phillips 66 - EVP of Refining

Well, we -- this is Rich again. We anticipated this flood of activity that would occur for -- to get these LCFS pathways approved. And we've been working diligently to get these approved even ahead of the start-up of the project. Any pathway that was approved for the Unit 250 operation is also applicable to the Rodeo Renewed project as well. So while we are concerned, I would say that there is a flood of applications to pathways. We think we're in a good position, and that should meter into our system, consistent with the start-up of the project.

Operator

Paul Cheng with Scotiabank.

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

Mark, just 2 questions. First, with the new California windfall profit penalty, that being passed, how does that change your view? Or does it change your view about your California asset, both in the Refining and Marketing?

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

Yes. Paul, that's been taking up a lot of intellectual capacity for, I think, the entire industry since that was rushed through. Before that, California was a tough place to manage Refining business, and I think this just makes it even a little more difficult. We're like everyone else, working hard to understand both, the intended and unintended consequences of SBX1-2.

And it certainly, at a fundamental level, creates more uncertainty, and it's going to make it more difficult for people to step up and invest in the supply chain that the consumers need, because even though you've got a lot of things coming over the hill to reduce demand. Today, demand is strong, and you can see what happens when there's disruptions, and the supply chain can be pretty tight there. So it's really tough for us to see how this new law is going to benefit the consumers at the end of the day.

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

Mark, do you think you or the industry is going to challenge them in court, because I'm not sure how -- yet, the industry has not been proven to have done anything wrong, why that will be slapped with a penalty?

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

Yes. I think that it's logical to assume that industry associations will defend and protect the interests of the industries, and even individual companies may take action. That's certainly going to be up to each company. But from an industry perspective, I think that, that's an angle that's obviously being looked at.

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

Okay. The second question, I think this is for Kevin. Kevin, you mentioned about in the Refining capture in your presentation, in the Other columns, it's a very big positive. And I actually went back to the last, say, 4 or 5 quarters. I think mainly without exception, that column is always a negative, yet that is helping your margin instead of, say, benefiting like what we've seen in this quarter. I think you sort of talked a bit in your prepared remarks. Can you elaborate a little bit more that what that column really represented and why we have seen such an improvement and whether those is sustainable?

Kevin J. Mitchell - Phillips 66 - Executive VP & CFO

Yes. Paul, the big driver of the change this quarter, especially comparing to last quarter is around the product -- clean product realizations or clean product differentials. And that was a particular negative item in the fourth quarter, because the way we do our market crack. For Atlantic Basin, we use a New York Harbor-based crack. And the distillate crack or the jet crack was particularly strong in New York Harbor. It was weaker in Europe. And our capacity is approximately 50-50 between New York, Northeast and Europe. And so our Europe distillate production is causing a negative relative to that market.

And so that pulled down the overall capture, and that shows up in Other. We had a little bit of a similar phenomenon going on in the West Coast as well, where we used an LA marker for the entire West Coast, which includes Northern California and the Pacific Northwest. And so when those markets are out of sync with each other, that can drive differentials in our actual product realizations, and that will show up in that Other. That's the biggest single driver in there, Paul.

Jeffrey Alan Dietert - Phillips 66 - VP of IR

And it was really negative impacts from -- in the fourth quarter.

Kevin J. Mitchell - Phillips 66 - Executive VP & CFO

Yes.

Operator

Jason Gabelman with Cowen.

Jason Daniel Gabelman - TD Cowen, Research Division - Director & Analyst

The first I wanted to ask was on kind of global Refining margin structure. There are stories out there that Asian plants are cutting [runs] while U.S. cracks are still really healthy, \$20 a barrel. So the question is, is that kind of a leading indicator that some of that weakness will ultimately make its way over into the U.S. via lower margins? Or is it an indication that the global margin environment could be at a floor because we're cutting around somewhere?

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

Jason, this is Brian. I'd say that, as you know, refineries in the U.S. are advantaged relative to European and Asian refineries. And as margins in Asia and Europe have begun to fall, like you said, we're beginning to see [runs] trim, particularly in Korea, Taiwan and Europe. Also, China is heading this month into a turnaround season, which should, along with the low U.S. inventories and the fact that we're stepping into summer driving season, begin to help strengthen, in our opinion, global margins.

Jason Daniel Gabelman - TD Cowen, Research Division - Director & Analyst

Okay, great. And my follow-up is on DCP. And I understand the deal isn't closed yet but just maybe wanted to get some early indications on progress. And specifically, I think part of the rationale for the deal was the combined Midstream platform of Phillips and DCP would attract more acreage to fill Midstream assets within that platform and support growth there. And so the question is, are there any early indications that upstream companies do view this combined platform as more favorable to partner with, to support future Midstream growth for Phillips?

Timothy D. Roberts - Phillips 66 - EVP of Midstream & Chemicals

Yes, Jason. This is Tim Roberts. Yes, a couple of things. First thing on the second part of the deal, which is the [buy-in and] the public units. We're expecting to get that done here in 2Q, probably the latter portion of the second quarter, get that completed and get that behind us and increasing our economic interest of close to 87%. So the next part, as far as rationale of the deal, what we found is that those that were integrated, wellhead -- especially in the NGL space, wellhead to the market, we're more advantaged than those that maybe only participated in a portion of the value chain, i.e., GNP or the transportation logistics, fractionation exports.

And so being able to go into a major and being able to sell -- the ability to get some wellhead all the way to the market is tough to do if you don't participate all the way there. So bringing the GNP portion of DCP together with Phillips' portion, which was the transportation all the way to the dock, we think that created that infrastructure now that can go out and compete.

Now to your question, has that shown any interest or do we have any interest percolating out there from producers who like that? The answer is yes. We've had a lot of activity and a lot of engagement, as you would expect. People want options and more alternatives. And so we're bringing a viable option and alternative as well as the ability to get barrels out of the Houston Ship Channel and get them down to a less congested area down in the Freeport (inaudible) area. So yes, it's been so far, so good. We just need to make sure we convert those into bottom line.

Operator

That concludes the question-and-answer session. I will now turn the call back over to Mark Lashier for closing remarks.

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

Thank you, Sierra. I just want to recap a few key things. We had a strong start to the year. We had solid first quarter results, and we raised the dividend and increased our share repurchases, which are on pace to deliver our targeted return of \$10 billion to \$12 billion from July of 2022 to year-end 2024. We've made great progress in Refining with strong turnaround execution, improved market capture and lower costs.

In Midstream, just as Tim mentioned, we advanced Midstream integration. And we remain confident in capturing \$300 million of synergies. We expect to close on the buy-in this quarter. We're progressing our business transformation initiatives, and we're on track to achieve \$1 billion of annual run rate savings by year-end. We remain committed to financial strength, disciplined capital allocation and returning distributions to our shareholders. We look forward to updating you on our progress. Thank you for all your interest in Phillips 66.

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