TRANSCRIPT
Q4 2015 EARNINGS CALL

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TRANSCRIPT

Operator

Welcome to the Fourth Quarter 2015 Phillips 66 Earnings Conference Call. My name is Saly; and I will be your Operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session. Please note that this conference is being recorded.

I will now turn the call over to Clayton Reasor, Executive Vice President, Investor Relations, Strategy, Corporate and Government Affairs. Please go ahead, Mr. Reasor.

C. Clayton Reasor – Phillips 66 – Executive Vice President, Investor Relations, Strategy, Corporate and Government Affairs

Thank you, Saly. Welcome to the Phillips 66 Fourth Quarter Earnings call. With me today are Chairman and CEO, Greg Garland; President, Tim Taylor; and Chief Financial Officer, Kevin Mitchell. The presentation material we'll be using during the call 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. It's a reminder that we'll be making forward-looking statements during the presentation and our question and answer session. Actual results may differ materially from today's comments, and factors that could cause these changes or these actual results to differ are included on the second page as well as well as in our filings with the SEC.

So with that said, I'll turn the call over to Greg for some opening remarks.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Thanks, Clayton. Hey, good morning, everyone. Thanks for joining us today. We had a good year in 2015. Adjusted earnings were $4.2 billion, which was our highest since 2012. We generated $5.7 billion in cash from operations. This allowed us to maintain a strong balance sheet and financial flexibility while funding our capital program and returning $2.7 billion to Shareholders through dividends and share repurchases.

We made significant progress on our growth projects in Midstream and Chemicals, and we continue to improve returns in our Refining and Marketing businesses. Despite the difficult environment experienced throughout the energy industry, a diversified asset portfolio has performed well. We continue to execute our plan. For us, it all starts with operating excellence.

We spent $1.2 billion in sustaining capital in 2015 and from an operating reliability perspective, our businesses ran well. 2015 was a very safe year for us. We tied our best year ever for recordable injuries; and Refining, Chemicals, and Midstream were top performers in injury rates.

We also maintain the improvement in our environmental performance that has been demonstrated in previous years. We ended 2015 with a solid quarter, especially when considering the current commodity price environment. Adjusted earnings were $710 million or $1.31 per share. Market cracks were down significantly in the fourth quarter from the highs that we saw last summer, but our global Refining business continued to run well with 94% utilization. Marketing earnings were healthy and this continues to be a high return business for us. 2015 adjusted return on capital employed was 35% for this segment.

In Midstream, we commenced operations of the Sweeny Fractionator One and supporting Clemens storage caverns. 2016 will be another busy year for us with several other Midstream projects scheduled for completion. Our Freeport LPG Export Terminal is now 80% complete. It's on track and on budget with an expected startup in the fourth quarter of 2016. The Dakota Access and ETCOP Pipeline projects also continue to make good progress and remain on schedule for completion by the end of this year.

Our master limited partnership, Phillips 66 Partners, remains an important part of our Midstream growth strategy. The fee-based assets within PSXP's portfolio continue to perform well and are not impacted by the current market conditions. PSXP continues on track to achieve its stated growth objective of a five-year 30% distribution compound annual growth rate through 2018. Adjusted EBITDA was up nearly 90% for the year at PSXP, while distribution growth and coverage were also strong. In addition, PSXP was able to raise $1.5 billion of low-cost capital through the debt and equity capital markets in 2015.

DCP continues to work on reducing cost and converting contracts to fee-based structures to improve its financial strength and flexibility. The equity contributions from the owners in the fourth quarter helped in that regard. We expect that DCP will be self-funded going forward.

In Chemicals, cash margins fell during the fourth quarter; however, they remain strong by historical standards. CPChem's geographically advantage footprint allows us to remain profitable and able to self-fund its growth projects. Development continues on CPChem's US Gulf Coast Petrochemicals project, which will increase CPChem's US ethylene and polyethylene capacity by over 40%. Overall progress on the project is approaching 70% complete with startup planned in mid-2017. This project remains on time and on budget.

We had another strong cash flow quarter. We generated $1.5 billion in cash from operations. We used $1 billion of that cash flow on capital spending to support Midstream growth and maintain operating integrity in our Refining system.

We also continue to return capital to our Shareholders. During the fourth quarter, we returned over $700 million through dividends and share repurchases. Over the last three years, Shareholder distributions have totaled more than $9 billion.

Looking forward to 2016, our focus remains on operating well and executing our $3.9 billion capital budget. We continue to target a 60/40 split between reinvestment and distributions, and have targeted a dividend increase in 2016 of at least 10%.

So now I'd like to turn the call over to Kevin Mitchell to take us through the quarter's results.

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

Thanks, Greg. Good morning. Starting on Slide 4, fourth quarter adjusted earnings were $710 million or $1.31 per share. Reported net income was $650 million, including several special items excluded from adjusted earnings. These special items decreased earnings by $60 million, and included $104 million in impairments at DCP and a $33 million lower of cost or market write down of inventory at our Wood River-Borger joint venture, offset by an $88 million gain tied to favorable changes in German tax law. Excluding negative working capital changes of $300 million, cash from operations was $1.8 billion.

Capital spending for the quarter was $1 billion, excluding the $1.5 billion contribution to DCP Midstream. Dividends and share repurchases in the fourth quarter totaled $704 million; and excluding special items, our adjusted effective income tax rate was 31%.

Slide 5 compares fourth quarter and third quarter adjusted earnings by segment. Quarter-over-quarter, adjusted earnings were down $937 million. All segments had lower earnings, but Refining accounted for most of the reduction.

Next we'll cover each of the segments. I'll start with Midstream on Slide 6. Transportation benefited from higher equity earnings and volumes. In NGLs, Sweeny Fractionator One came online during December. Included in the transportation and NGL results is the contribution from Phillips 66 Partners. During the quarter, PSXP contributed earnings of $37 million to the Midstream segment and increased its quarterly LP distribution by 7% over the third quarter. DCP Midstream continues to work on its self-help initiatives to reduce costs, manage its portfolio, and restructure contracts.

2015 adjusted return on capital employed to the Midstream segment was 5% based on an average capital employed of $6.8 billion. The return for this segment continues to reflect the impact of increased capital employed driven by our significant growth investments as well as the impact of low commodity prices on DCP earnings.

Moving to Slide 7, Midstream's fourth quarter adjusted earnings were $42 million, down $49 million from the third quarter. Transportation adjusted earnings for the quarter were $78 million, up $1 million from the prior quarter. NGL adjusted losses were $2 million for the quarter. The $34 million decrease from the prior quarter was largely driven by the timing of adjustments related to the tax extenders bill signed in December, as well as additional costs associated with the Sweeny Hub. Adjusted losses for DCP Midstream were higher in the fourth quarter, mainly due to lower natural gas and natural gas liquids marketing margins as well as the impact of lower commodity prices.

In Chemicals, the global olefins and polyolefins capacity utilization rate for the quarter was 92% and margins trended lower. SA&S was negatively impacted by planned turnaround activity. The 2015 adjusted return on capital employed for our Chemicals segment was 19% based on an average capital employed of $4.9 billion.

As shown on Slide 9, fourth quarter adjusted earnings for Chemicals were $182 million, down from $272 million in the third quarter. In Olefins and Polyolefins, the decrease of $80 million was largely due to lower cash margins; however, demand for polyethylene and normal alpha olefin products remained healthy during the quarter.

Adjusted earnings for SA&S declined to $9 million on lower equity earnings driven by lower volumes due to turnaround activities at CPChem's equity affiliates and lower margins. This was partially offset by higher volumes in Specialty Chemicals.

In Refining, realized margins were $9.41 per barrel for the quarter as market crack spreads decreased significantly. Market capture increased from 72% to 74% in the fourth quarter as we saw improvements in clean product differentials and lower losses on secondary products. Refining crude utilization was 94%. Clean product yield was 85%, representing a record quarter. Pretax turnaround costs were $130 million compared to guidance of approximately $150 million due primarily to the deferral of some planned maintenance. 2015 adjusted return on capital employed for refining was 19%. This is based on average capital employed of $13.6 billion.

Slide 11 shows a regional view of the change in adjusted earnings compared to the previous quarter; the refining segment of adjusted earnings of $376 million down $676 million from last quarter. The reduction was primarily due to lower market cracks in all regions.

Atlantic Basin adjusted earnings were lower this quarter due to lower gasoline and distillate margins, partially offset by higher volumes as capacity utilization exceeded 100%. The Gulf Coast region saw lower margins and had lower volumes due to downtime at Lake Charles and Sweeny.

In the Central Corridor, market cracks dropped by more than $8 per barrel, which accounted for approximately 90% of the $251 million reduction in adjusted earnings from the third quarter. In addition, Wood River and Ponca City also had downtime due to turnaround activity.

In the Western region, gas cracks fell nearly $15 per barrel. Volumes and controllable costs were also impacted by a major turnaround at our LA Refinery that we completed in the fourth quarter. Santa Maria continued to be impacted by the plains pipeline outage.

Next, we will cover market capture on Slide 12. Our worldwide realized margin was $9.41 per barrel versus the 3:2:1 market crack of $12.77 per barrel, resulting in an overall market capture of 74%. Market capture is impacted in part by the configuration of our refineries as it relates to our production relative to the market crack calculation.

With 85% clean product yield for the quarter, we made less gasoline and slightly more distillate than premised in the 3:2:1 market crack. Losses due to secondary products were lower this quarter as the price differential between crude oil and lower valued products, such as coke and NGLs, narrowed. Feedstock advantage was somewhat higher than the third quarter, but still below average as crude differentials generally remained tight.

The other category mainly includes costs associated with RINs, outgoing freight, product differentials, and inventory impacts.

Let's move to Marketing & Specialties where we posted the solid quarter thanks to favorable global marketing margins; however, Specialties saw reduced earnings on lower lubricants margins. The 2015 adjusted return on capital employed for M&S was 35% on average capital employed of $2.7 billion.

Slide 14 shows adjusted earnings for M&S in the fourth quarter of $227 million, down to $117 million from the third quarter. In marketing and other, the $93 million decrease was largely due to lower margins in both domestic and international marketing, which decreased from the notably high margins in the third quarter. This was partially offset by the renewal of biodiesel tax credits. Specialties adjusted earnings decreased to $29 million due to narrowing base oil and finished lubricants margins and lower finished lubricants volumes.

On Slide 15, the Corporate & Other segment had an after-tax net cost of $117 million this quarter, an increase of $5 million from the third quarter. Net interest expense increased by $4 million, primarily due to lower capitalized interest, while corporate overhead and other expenses were in line with the prior quarter.

On Slide 16 we summarize our financial results for the year. 2015 adjusted earnings were $4.2 billion or $7.67 per share. Excluding negative working capital changes of $200 million, cash from operations was $5.9 billion. Capital spending for the year was $4.3 billion, excluding the $1.5 billion contribution to DCP Midstream. Total Shareholder distributions were $2.7 billion.

At the end of the fourth quarter, our adjusted debt-to-capital ratio, excluding Phillips 66 Partners, was 25%; and after taking into account our ending cash balance, our adjusted net debt-to-capital ratio was 17%. The adjusted return on capital employed for 2015 was 14%.

Moving to Slide 17, our 2015 adjusted earnings were higher than 2014 as lower earnings for Midstream and Chemicals were more than offset by improvements from our Refining and Marketing& Specialties businesses. We had an 11% increase in adjusted earnings and adjusted earnings per share increased by $1.05 or 16%.

Slide 18 shows cash flow for 2015. We began the year with a cash balance of $5.2 billion. Excluding working capital impacts, cash from operations was $5.9 billion. Working capital changes reduced cash flow by $200 million. In the first quarter, $1.1 billion in debt and approximately $400 million in equity was issued by PSXP. We also retired $800 million in Philip 66 senior notes.

During 2015, we funded $5.8 billion of capital expenditures in investments. This included $4.3 billion of capital spend, including $3 billion in Midstream and $1.1 billion in refining. We also distributed $2.7 billion to Shareholders in the form of dividends and share repurchases. We ended the year with 529 million shares outstanding. Excluding the DCP contribution, 61% of our available cash went to reinvestment and 39% to distributions. At the end of 2015, our cash balance was $3.1 billion.

This concludes my review of the financial and operating results. Next I'll cover a few outlook items. For 2016 we expect full-year of turnaround expenses to be between $525 million and $575 million pretax. We expect corporate and other costs to come in between $480 million and $500 million and we expect full-year D&A of about $1.2 billion. In the first quarter Chemicals, we expect the global O&P utilization rate to be in the mid-90s; in Refining, we expect the worldwide crude utilization rate to also be in the mid-90s; and pretax turnaround expense to be approximately $150 million. In Corporate & Other we expect after-tax costs to be between $120 million and $125 million; and company-wide we expect the effective income tax rate to be in the mid-30s.

With that, we'll now open the line for questions.

Operator

Thank you. We will now begin the question and answer session. If you have a question, please press star, then one on your touchtone phone. If you wish to be removed from the queue, please press the pound key. If you are using a speakerphone, you may need to pick up the handset first before pressing the numbers. Once again, if you have a question, please press star, then one on your touchtone phone.

Faisel Khan from Citigroup is on line with a question.

Faisel Khan – Citigroup

Thanks guys. Good afternoon.

Tim G. Taylor – Phillips 66 – President

Good afternoon, Faisel.

Faisel Khan – Citigroup

Hi. Just a couple of questions. On the Midstream projects, DAPL and ETCOP given that some of the partners look like they may need capital over the next couple of years as their cost to capital gets higher, I just want to understand would you be willing to take sort of a bigger interest in those assets if the opportunity presented itself?

Tim G. Taylor – Phillips 66 – President

Yes, Faisel. This is Tim. You know, I think that with our partners on DAPL and ETCOP been exploring various options on that. I think our commitment is where we'd like it to be at this point but certainly we'll consider that it's all about what delivers the best value for us.

Faisel Khan – Citigroup

Okay. Got you. Then the—you talked about in your prepared remarks your targeting a dividend growth rate of 10% for this year. I mean is that sort of locked in or is there sort of a wiggle room if markets change or if things become a little bit more dynamic?

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Yes. We said at least 10%. Yes. We delivered a dividend of 12% last year, but I'd say—I think we'll take a look at that. Obviously, needs the Board approve this too, but we had given guidance three years ago that we'd do double-digit increases in '14, '15, and '16 and we stand by that guidance.

Faisel Khan – Citigroup

Okay. Last question for me; in the Atlantic Basin, you guys ran over 100%. Throughput was strong and so was up time. Did that—is this sort of a new set of reliability in the Atlantic Basin or is this an unusual circumstance where things just ran sort of at a higher level for the quarter?

Tim G. Taylor – Phillips 66 – President

You know, when look at that—and you'll remember we just came out of a Humber turnaround, really came out of that in good shape, good clean refinery. So I think that it reflects that. Then at Bayway we continue to run a lot of processed inputs to fill out our downstream units in that facility. So it was really good quarter and I would anticipate, obviously pending market conditions that we continue to try and run as full as we can.

Faisel Khan – Citigroup

Got it. Thanks, guys.

Tim G. Taylor – Phillips 66 – President

Yes. Thank you.

Operator

Paul Cheng from Barclays is on line with a question.

Paul Cheng – Barclays

Hey, guys. Good morning.

Tim G. Taylor – Phillips 66 – President

Hi, Paul.

Paul Cheng – Barclays

Just, maybe that this is for Greg; with the changing market conditions related to the market acceptance for the funding model in the MLP sector. How that is going to impact your way of the drop down that I think previously that you've been looking for maybe up to $2 billion a year. I don't know whether that you have changed. Also that—I mean, from the cap ex that if you spent $3.9 billion and dividend about $1.3 billion, with your cash flow from operations, you don't have much for the buybacks, so should we assume that if you can't do much of the drop down you will correspondingly scale down your buyback or that you're going to increase your balance sheet to maintain the buyback at a certain rate?

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Well, okay, so let me kind of start with the question around the MLP —certainly we understand the question, Paul. You know, as we look out there, there's a lot of stress in the space with people that are over-levered and will have difficulty accessing the capital equity markets given their prohibitively high cost to capital. You know, we look at PSXP, strong sponsorship, strong investment grade rating. You might even call it's a drop down titan maybe, but a great portfolio of existing EBITDA that can be dropped. We've got these projects lined up in the queue that are in-flight that really add to that, then you kind of look at where PSXP is trading kind of around 3%. So I think the investors look at PSXP. They get the growth story. They understand the growth story, and I think that's a confidence in our ability to execute that.

So we would say that we think the capital markets are going to be open to us in 2016, our plan is to be out there in there. You've got the number about right. We've kind of said kind of $2 billion a year that we need to be through the capital markets and the debt markets to hit this $1.1 billion of EBITDA in 2018 at MLP. So we stand by that guidance and we stay there.

We should generate $4 billion to $5 billion mid-cycle of cash and you kind of add another $1.5 billion to $2 billion coming out of the MLP. So I think we're fine in terms of funding our capital program and in terms of funding—growing distributions to increasing our dividends and we'll have—as long as our shares are trading below interesting value, we're going to take shares in.

Paul Cheng – Barclays

Mm-hm. The second question, Greg, on DCP, I mean you guys have that capital restructuring with Partner in the fourth quarter, but the market conditions continue to deteriorate in that business. So is that a possibility that later this year, whether it's due to—if there's any more debt being mature, do we need to do additional capital infusion into that or that you really is confident that you already fixed the problem at this point?

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Well, I think that the contributions by both SE and ourselves has gone a long way towards fixing the balance sheet issues at DCP. The other thing you've got to give the folks at DCP a lot of credit. They've done a great job of pulling costs out, restructuring contracts where they can in the portfolio, and so if you look kind of pre-2015, cash break evenly at about $0.60 to breakeven on cash on NGLs and as kind of we exit 2015 we had moved that down to about $0.40 a gallon breakeven, and then the actions that are being further taken in 2016, we expect that the cash breakeven will be somewhere mid-$0.30s. So I think DCP is going to be fine in this environment that we're in for 2016.

The other thing I would say is DCP doesn't have a debt due until 2019. DPM actually has one due in 2017, but DPM is in pretty good shape. So I think our view is that DCP is on pretty strong footing. We've purposely set them up for success in this low commodity price environment.

Tim G. Taylor – Phillips 66 – President

You might want to say something on capital.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

The other thing is we haven't really announced the capital, but DCP capital this year is going to be down about 50% from what it was last year. I think our share of DCP capital is about $233 million this year, thereabouts give or take. So we're continuing to manage capital at DCP. There'll be more cost taken out of DCP this year. More work around the restructuring of the contract this year. So, I think they're in pretty good shape.

Paul Cheng – Barclays

Can I have a final question, one last one?

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Yes, sure.

Paul Cheng – Barclays

If I look at—right now you are investing a number of project that you commit on the Midstream, so that's why you're cap ex last year and this year for the total calculation are pretty high $4.3 billion and $3.9 billion; and if we base on you suggest that you're still targeting on the long-haul 60/40 between reinvestment and the payout to the Shareholder. At 60%, if we, say, snap at $3 billion that would translate into a $5 billion cash flow. So from that standpoint should we assume after the next one to two years we should see your cap ex drop back down towards into the $2.5 billion to $3 billion range or that when you say 60/40 you're also including the drop down proceed in that calculation?

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Yes. Well, yes to both. I think capital probably does come down in the years. We've always said '15 would be a peak year for us and so you see that coming down at PSX, you see it coming down at DCP. Also, at CPChem, their capital budget for this year is going to be done about 20%, so there'll be $1.045 billion will be our share of the CPChem capital for 2016. So truly I think '15's a peak year for us, but, yes, you need to add in the proceeds from the drops in the MLP to the cash and I then think about that in terms of your total amount for distributions.

Paul Cheng – Barclays

I see. All right. Thank you.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

You bet.

Operator

Doug Leggate with Bank of America Merrill Lynch is on line with a question.

Doug Leggate – Bank of America Merrill Lynch

Thanks. Good morning, everybody. I guess I'll start with—can you hear me?

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Yes.

Doug Leggate – Bank of America Merrill Lynch

Yes. Sorry. I thought you couldn't hear me there. I'll start with Chemicals if I may. I think Kevin mentioned that there had been some downtime. It looked to us that given your vertically integrated Chemicals business has normally been somewhat resilient compared to some others, it looked a bit weaker this quarter to us. Was it just the downtime, in which case, can you quantify the opportunity cost, or is there something structural there you see as changing in this lower commodity environment?

Tim G. Taylor – Phillips 66 – President

Hey, Doug. This is Tim. You know, I looked at delta between Q3, Q4 to about $90 million. I would say that about $50 million of that or so was compression in the margin in the polyolefins chain margin, and the other remaining amount was largely the impact that turnaround costs and then some impact from the volumes as a result of that.

Doug Leggate – Bank of America Merrill Lynch

Okay. So are we done now or do we bounce back in terms of our operating activity Q1?

Tim G. Taylor – Phillips 66 – President

Yes. So I think we've got it to higher operating rate in Q1 with that. These were actually turnarounds in polymer units, so there's always some of that, but generally volumes come back. The real question about the margins, I think largely depend on where you think crude prices end up, but as prices fall and gas price doesn't fall as much in the ethane price, then you get some compression there. But I will say that we continue to see good demand. We don't see inventories building in that and that demand really is around the globe. So, for us, we've been looking at the underlying fundamentals and still see the demand piece there. The moving piece really is going to be around the energy price and what happens. But barring a significant change, we would expect similar industry margins that we saw in the fourth quarter.

Doug Leggate – Bank of America Merrill Lynch

Tim, I don't want to labor the point, but you said the downtime of the turnarounds were in your polymer units. So would that mean that you didn't have the vertical integration benefit in Q4 that would normally have cushioned you a little bit?

Tim G. Taylor – Phillips 66 – President

Yes. If you're thinking about—when you don't have the pull on the derivative units, you can impact the total output on the total integrator between ethylene and polyethylene specifically.

Doug Leggate – Bank of America Merrill Lynch

That's what I was getting at. All right. Okay. That's helpful. Thank you. Just staying with Chemicals for a second, so Sweeny is up and running now. I think your previous guidance was $400 million to $500 million of EBITDA. What does that look like in today's environment in terms of the contribution?

Tim G. Taylor – Phillips 66 – President

The Export LPG terminal?

Doug Leggate – Bank of America Merrill Lynch

Right.

Tim G. Taylor – Phillips 66 – President

Yes, I think that we're at the lower end of that because there was some commercial opportunity, we've said, about 80% fee-based in that number and so we're still in that range when you look at both the frac and the dock and the caverns and the services that that provides. Then what's happened today, the arbs between the US and other markets in the world are narrower, but I will also say that we see shipping constraints being alleviated. So I think we're kind of influx about what the arb will ultimately be, but we still look at the market here and know that the NGLs need to find another home outside the U.S. So I think there're still fundamental drivers that will push that and the real question is how much of the arb—do we have $100 million of EBITDA from the arb or something different.

But on the long-term, I think we feel there's going to be a significant commercial opportunity as well as the fee-based, but the primary driver on those projects are the fees.

Doug Leggate – Bank of America Merrill Lynch

Last one for me if I could follow Mr. Cheng's lead and squeeze another one in. The heavy light differentials, obviously spreads have come in for light crude. You guys are heavy—relatively resilient. You spend a lot of time telling us how much effort you were moving to maximize your light secret crude throughput. What are you doing today and how much flexibility do you have to swing back if you chose to? I'll leave it there. Thank you.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Yes. We've talked a lot, in fact, all of last year, about how much more lights could we run. I think the amazing thing about our system is we have the ability to flex. I think even in the fourth quarter, we probably ran 3% more medium sours. We didn't run quite as much heavy sours because of turnarounds at Los Angeles at Lake Charles during the quarter as we probably would've liked to. We ran a little bit more Canadian heavy during the quarter. But, yes, I think we have the ability to flex that. I think we're still in max gasoline mode, as you want to think about it that way. But, yes, I think the important spreads for us this year are going to be the light heavy, the sweet, sour and the WTI/WCS spreads.

I think, you know, Brent and LS is going trade near purity and it's going to be a very volatile market and things are going to move around. You know, in terms of the WTI/Brent differentials. So we'll just have to watch that.

Tim G. Taylor – Phillips 66 – President You know, Doug, there's actually—we have a project at Billings to continue to go to even heavier sour grades there that would improve and kind of capitalize in that light heavy, and then at Wood River we're doing some work around light steep on bottlenecking that will allow us to push more heavies into that facility. So we're taking some incremental steps to increase our ability to handle heavy and medium sour crudes.

Doug Leggate – Bank of America Merrill Lynch

Thanks, guys. We hope to be seeing you in a couple of weeks.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Okay. Take care.

Operator

Roger Read from Wells Fargo Securities is on line with a question.

Roger Read – Wells Fargo Securities

Yes. Good morning.

Tim G. Taylor – Phillips 66 – President

Hey, Roger.

Roger Read – Wells Fargo Securities

I guess a couple of things we always like to talk about: product exports, what are you seeing in that market here Q1 and thoughts on what a lot of people are focusing on in terms of some softness in the diesel side.

Tim G. Taylor – Phillips 66 – President

Well, I think globally, just to comment on distillate inventories, that that's always something that we're, and clearly with the warm winter, unless industrial activity is seeing softness in that demand, we still expect growth on the distillate. On the export side of the U.S, we have the options to either place product in the U.S or export and we just simply pick the best value at the time when we make that decision. But we still feel there's still good demand that when we look across the globe for both gasoline and distillates out of the U.S.

Roger Read – Wells Fargo Securities

Okay. Great. Then shifting gears to the Midstream segment, the new Fractionator online, the export facility later this year. Can you give us an idea of how we should think about the impacts of those two events as we look at the EBITDA guidance originally for those projects, you know, kind of thinking Q1 this year probably to Q1 of next, and what's the reasonable progress of how that works its way in.

Tim G. Taylor – Phillips 66 – President

So the first step on those is the Fractionator, a relatively minor piece of that total $400 million to $500 million EBITDA guidance that we gave. The next big step is later in the year when you really reach what the LPG Export Terminal, a larger fee-based component, as well as some commercial opportunities. So smaller impact at the beginning and then toward—you know, assuming that we start up on time in the third quarter, in the fourth quarter you begin to see then that full impact of the $400 million to $500 million.

Roger Read – Wells Fargo Securities

Just a quick follow-up on that; once the export facility is available, is that something where you've ramped to full utilization fairly quickly or should we think of that as a step process? I'm not familiar with those type of units, so I was just wondering what the expectation should be.

Tim G. Taylor – Phillips 66 – President

Yes. Well, we're connected both to our fractionator and say it's 150,000 barrels a day equivalent initially, roughly 40,000 or so of propane comes off with our new frac, and then we're connected to Mont Belvieu and other facilities to supplement that. So it really is about getting the capacity in place, the commercial agreements, and then you've got the capacity to not only take the output from our frac, but also supplement that with feeds out of the NGL system on the Gulf Coast.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

I think we said, though, we'd expect about eight cargoes a month coming through the terminal, and I would say we've made great progress in contracting those eight cargoes.

Roger Read – Wells Fargo Securities

Has margin on that been affected at all by the change in pricing or is that—I mean since it's more tariff-related we don't have to worry as much about the lower prices today?

Tim G. Taylor – Phillips 66 – President

The tariff impact has been where we thought in terms of fee. That's about 80% of that. What is narrower today's the commercial opportunity, although we expect that to widen again with shipping constraints removed and as markets begin to equilibrate, you establish that.

Roger Read – Wells Fargo Securities

Okay. Great. Thank you.

Operator

Blake Fernandez with Howard Weil is on line with a question.

Blake Fernandez – Howard Weil

Hey, guys. Good morning. Greg, you mentioned max gasoline mode and I guess historically we've always viewed PSX as having kind of one of the highest distillate yields and that's been an advantage until just recently where the markets obviously shifted in favor of gasoline. Are there any opportunities that you're looking at to maybe reconfigure or change your opportunities to kind of capture some of the gasoline strength that we've been seeing?

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Yes. At the margin, but I think we ran 44% gasoline in the fourth quarter and that's—I think that's pushing the max of what we can do, Blake.

Blake Fernandez – Howard Weil

Okay. So there's no capital investment projects or anything that you're evaluating?

Tim G. Taylor – Phillips 66 – President

We do have a project that we've authorized at Bayway to improve the yield on the FCC there what would incrementally add some volume to that, and as we go around our system, we're looking at that, but those take a bit longer because they are capital. But I think as Greg said, in terms of optimization a day, we're doing all we can to push that given where the market is.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Yes. I think the FCC upgraded Bayway's 2018, yes. So we're a couple of years out on that project, but we're executing it right now.

Blake Fernandez – Howard Weil

Got it. Okay. The second one—this may go nowhere quickly but I'll ask it anyhow. So Buffet continues to increase his stake holding and I'm just curious what, if any, dialogue you're having in any sense of what the longer-term intentions are.

Tim G. Taylor – Phillips 66 – President

You're right. It's going nowhere.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

You know what, Blake, we don't comment on conversations with Shareholders.

Tim G. Taylor – Phillips 66 – President

It's a good question though.

Blake Fernandez – Howard Weil

Fair enough. Thanks.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Take care.

Operator

Ed Westlake with Credit Suisse is on line with a question.

Edward Westlake – Credit Suisse

Hi there. Good afternoon and congrats on everything you achieved last year and looking forward. Quick question on risk. Really in the Midstream area, I mean obviously oil prices, gas prices are low; volumes are going to be coming down across the piste. So just to maybe give us—I don't know if you've done an assessment of volume and counterparty risk, I'm thinking less about your new projects, which obviously you've spent a lot of time working on, but more maybe in some of the legacy and DCP area.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Well, I think that we look across the DCP portfolio and 90% of it is kind of investment-grade. So I think that they have good counterparties on the other side of that. You know, as we think through the volume risk side of it in the portfolio, we think Permian's probably going to do a little better; we think DJ is going to do pretty good; Scoop (phon38:50) is going to do good; Eagle Ford is going to decline as we think across that. So I would say just from a pure volume metrics perspective, we're probably going to be flat to maybe slightly lower in '16 at DCP.

You know, we think that gasoline demand is going to be good; we think distillate demand is going to grow, although we have challenged inventories there; we think petrochemical advance is going to grow. So on balances, we think across the portfolio Midstream kind of flat to down t DCP. Of course, we're going our Midstream with what we're doing with the frac coming up export facility, Bayou Bridge, DAPL coming on late '16. So we'll see increased volumes in the transportation segment there that flow through and then we think petrochemicals will be okay. Tim if you want to add on that?

Tim G. Taylor – Phillips 66 – President

I think I think that that really is and—you know, I just think we're—you know, looking at the macro environment, it's—with the production breaking over in the US, there's not going to be a lot of extra volume drive through that and so I think it's just a question of how much decline occurs around that. We do think the gas markets will continue to have a pretty good pull and that's a piece of what underlies DCP as well.

So to this point, we've not been concerned, and I think to reiterate, the counterparties on our Midstream business look very solid.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

You might just talk a little bit about our view and what that does to PSXP and the investment portfolio that we're thinking out in 2018 and beyond.

Tim G. Taylor – Phillips 66 – President

Yes. You know, to date we've done—we've expanded on the NGL chain major crude line with DAPL-ETCOP related to kind of new production, good counterparty, solid volumes on that on the T&D side. But as we go forward and as we look at our portfolio, I think that we're shifting our attention to things that support our Refining business logistically, that touch existing Midstream assets or add value perhaps as the Chemicals value chain. So we're shifting more to the downstream, the demand side, as we think about the Midstream options versus a heavy focus initially on that upstream part of that.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Yes. So, less on production growth and more around liberating higher returns in our existing assets.

Edward Westlake – Credit Suisse

Okay. Fair. Then just a smaller point, your Refining turnaround expense, I mean I thought it would maybe come down a bit this year. I mean it's still a healthy chunk. Maybe just talk through what the key plans are on the Refinery turnaround side for this year.

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

From an expense side, Ed, we actually spent quite a bit less in '15 than we originally planned and so the outlook for '16 is somewhat higher than we'd previously talked about. So that reflects just the timing of some of the activity that ended up moving from '15 into '16. As you know, we don't give specific guidance on exactly what we're doing and when. We give cost guidance for the upcoming quarter and the full-year outlook on that.

Edward Westlake – Credit Suisse

Right. But it's a shifting, so we can look into that?

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

Yes.

Edward Westlake – Credit Suisse

Okay. Thank you.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Yes. That's right.

Operator

Paul Sankey from Wolfe Research is on line with a question.

Paul Sankey – Wolfe Research

Morning all. Can you just update us on how the changes in oil price and the effects of the US E&P industry are coming through from your point of view? I'm particularly interested—the toughest one for us is always the NGL market. Could you talk about the dynamics there and if there're shifts in where supply is coming from, shifts in the oversupply? Then update us on how you're getting on with the exports, which I think you've partly done but it would just be interesting if you could give it from a more macro perspective. Thank you.

Tim G. Taylor – Phillips 66 – President

Yes, Paul. On the NGL side we continue to see growth in the NGL supply, but there's no question that it's going to be at a slower pace as we look out. The other interesting thing is that there's a lot of ethane rejection today as the values don't pull it forward, so I think as the crackers startup there's going to be an influx of ethane so to speak into the NGL piece. But I think that certainly causes us some pause and we think about how large and how much increase beyond today we see in the NGL. Still see it, but probably not to the extent that we had seen a couple of years ago with all the E&P activity.

On the export side, a lot of interest still in LPG cargoes for both petrochemical operations and heating markets: Asia, Latin America, and even Europe. So I think we're still seeing a lot of interest around the world as people look at alternate supply so to speak on both the fuels and petrochemical sides. So, as Greg mentioned earlier, a lot of good progress on the contract sides and just a lot of interest there that we're working to continue to load.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

But we look at the balances and we're good to be long propane. So we think we're going to have to export propane to make everything work for the next few years in this country.

Paul Sankey – Wolfe Research

Got it. Forgive me if you've given these numbers, but did you say how much gasoline and distillate you exported and how much, in fact, maybe crude? I don't know. Thanks

C. Clayton Reasor – Executive Vice President, Investor Relations, Strategy, Corporate and Government Affairs

We have in the past. I don't know if we did for the quarter.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

In a quarter it's like 122 for the quarter and it's the typical 80% distillate, 20% gasoline.

Paul Sankey – Wolfe Research

Okay. Again, I guess what you—I assume the demand there is robust, yes?

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Yes. I would say demands robust, but we've actually exported fewer barrels this year than we did last year and it's because we've had better placement opportunities in the domestic markets.

Paul Sankey – Wolfe Research

Understood. Yes, sorry. The crude export thing, does that make any difference? I'll leave it there. Thanks guys.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

We'll see if Taylor wants to answer your question. You know, I'm going to reckon I don't think it really matters. I don't think you're going to see a lot of crude exports out of the US. I don't think the numbers work all that much. I think it probably caps the differential and you're not going to see the big blowouts that we saw in '13 and '14. But I think '16 is going to be a really volatile year and there's going to be times that it's just going to be hard to call what that differential is going to be.

But we think four to six long-term, it ought to be in that. It's what it's going to take to export barrels of crude out of the U.S.

C. Clayton Reasor – Executive Vice President, Investor Relations, Strategy, Corporate and Government Affairs

It could create opportunities for us at Beaumont.

Tim G. Taylor – Phillips 66 – President

Yes. You know, I think the other way to look at that is we're—with Beaumont and even with Sweeny and Freeport, we have options to capitalize on should they develop, but I think generally our view is there's just kind of a balancing point today where excess crude in the world is trying to push in and then we've got local productions here. So I think it just narrows that diff at the coast, and I think that's going to continue and I think that's a significant change from over the last two years.

Paul Sankey – Wolfe Research

Great. Thank you very much.

Tim G. Taylor – Phillips 66 – President

Thanks, Paul.

Paul Sankey – Wolfe Research

Yes, bye.

Operator

Jeff Dietert with Simmons & Company is on line with a question.

Jeff Dietert – Simmons & Co. International

Good afternoon.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Hey, Jeff.

Jeff Dietert – Simmons & Co. International

Hey, you talked a little bit about shifting your organic growth away from meeting production needs towards maybe better integrating existing assets. What about M&A, asset M&A, corporate M&A, where does that fall in the pecking order?

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Well, certainly I think we look at everything that's out there and we think about a build multiple versus a buy multiple, and as long as the build multiples are better, I think you'll see us do that. But we'll certainly take a look at what comes across and everything out there, Jeff.

Jeff Dietert – Simmons & Co. International

Mm-hm. I saw—I had read that Whitegate may be back on the market. Can you talk about the process there if there is one, and perhaps some of your assets you may consider divesting?

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

So here's what I can tell you that, yes, we are in a process and in Whitegate and we're kind of well into that process so we obviously can't talk about the specifics. But we have people that are interested and so there's a list of people that we're going through with that asset. You know, I think that on balance that's the only process we have going on right now in terms of assets. We get asked a lot about the West Coast in the U.S. and, you know, West Coast is, as we've said, it's an option on the future, but we have no current programs or there's nothing underway today in terms of the West Coast. You know, margins have been pretty good there the last year or two and we've got good assets out there. We've got great people running those assets and so it's an option on the future is the way I look at the West Coast.

Jeff Dietert – Simmons & Co. International

Got you. Finally, as far as Sweeny Frac Two is concerned, should we think about that project just being on hold until drilling activity reaccelerates?

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Well, as you know, we push Frac 2 FID from last year into this year, so we're still doing engineering work on that and we'll make a decision on that later this year, midyear, third quarter, but we won't proceed unless we get it fully contracted and we're long NGL today but it's not fully contracted. So we're not going to build a speculative frac.

Jeff Dietert – Simmons & Co. International

Got you. Thanks for your comments.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

You bet.

Operator

Phil Gresh from JP Morgan is on line with a question.

Phil Gresh – JP Morgan

Hey, good afternoon.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Good afternoon, Phil.

Phil Gresh – JP Morgan

First question is just on Chemicals. Given the compression of the gas to oil price ratio, as you look ahead, are you still considering a second cracker at this point with economics work at this stage, if we were just to indeed stay at these types of levels?

Tim G. Taylor – Phillips 66 – President

So, Phil, it's Tim. We continue to do engineering work—and again I'll reiterate this is a global view with a global business. North America still looks attractive long-term and today's margins do work. It's obviously not the same return that we would have if it was $0.10 a pound better. So I think that for us it's really about continuing to meet the customer demand, the opportunity, and then structurally, our view of the long-term advantage on U.S. or Middle East based ethane cracking in the case of the ethylene chain still to us has the greatest appeal and we think long-term a competitive advantage. Although it's less than it was, it's still quite good by historical standards.

Phil Gresh – JP Morgan

Okay. So is there a period of time in which you're trying to make a decision on the second FID or is it really just kind of open-ended at this point?

Tim G. Taylor – Phillips 66 – President

So, doing engineering work, anything you start now puts it out post 2020 and I think we just continue to evaluate the options, siding, permits, all those kinds of things, to look at it here and then look at options that we might have available in other parts of the world as well.

Phil Gresh – JP Morgan

Okay. Got it. Second question is just on the Specialties business. You know, you mentioned lower margins in a step down sequentially. Would you say that a component of that is seasonal or do you think that that's more of a structural step down from increased competition in that business that we should think about as more of a new run rate, or maybe some combination of the two? How would you think about that?

Tim G. Taylor – Phillips 66 – President

Okay, a couple of things. You know, you have a lag effect in that business on prices, so as prices come down, you tend to hold it and then it catches up. So I think this quarter there was a piece of that, but if you think about finished lubricants prices versus VGO feedstock into the base oil business, the one segment that we see in the U.S. that's weaker is oil and gas, as you might expect, but generally strong automotive business that when you're looking at what's going on in Detroit and so our view is volumes are still pretty good this year versus last. Not a lot of growth inherently in that business by the nature of it, but we see nothing fundamental there and I think we would say next year to us probably looks a lot like—for this year it looks a lot like last year in terms of how we look at the lubricants.

But it's a business we like. Good returns. I think this quarter just had some noise around it. I would also say that you can imagine customers don't particularly like to buy a lot when they see the price falling, so we don't see a lot of inventory building the chain, but they don't want to get caught with higher cost inventory, so there's always some effect when you see that in any quarter in which that occurs.

Phil Gresh – JP Morgan

Okay. Understood. Last question is just on the global gasoline supply demand outlook for 2016. You know, where do you guys stand on that because if we have global demand growth in the 400,00 to 500,000 barrel a day range, is there enough global supply to keep up with that and what's your view on gasoline cracks for this year?

Tim G. Taylor – Phillips 66 – President

Well, I think we are fairly well supplied today, but basically if I just break the components, we would expect stronger gasoline growth globally than distillate. You know, we're thinking it's less than this year, but in total, the two, probably in the million barrel a day range or so with two-thirds or so of that being on the gasoline side and a third really coming from the distillate. So clearly distillate has more headwind, I think, because of the general economic conditions and less capital spend as you think about industrial activity whereas we still see a pretty strong consumer market around the world that pulls along gasoline and to some extent the Chemicals business as well.

Phil Gresh – JP Morgan

Okay. Thanks.

Operator

Ryan Todd from Deutsche Bank is on line with a question.

Ryan Todd – Deutsche Bank

Great. Thanks. Good afternoon, everybody. Maybe a couple—if I could ask one on—you gave a little bit of color on Bayou Bridge and DAPL. Could you maybe give a little bit more granularity in terms of the timing of the ramp on each and maybe what the impact that you're looking for, both to the slates in your Refining business or potential impact on differentials?

Tim G. Taylor – Phillips 66 – President

Yes. So let's start with the Bayou Bridge because it's closest to being in service. So there are two segments, one is Nederland, to Beaumont area over to our Lake Charles Refinery, and then from Lake Charles to St. James. That first leg to Lake Charles will be in service at the end of this quarter and that will have some initial impact in terms of the Midstream earnings. Then later this year we'll complete the leg into St. James. So those are both underway. I think it clearly connects the West, the Texas market with Louisiana. There's still a drive for that. That line is underwritten on the commitment side with T&D, so there's been interest in that on the Refining side to get a new source of supply and I think that's still a piece of what needs to happen. So I think that just continues to make crude options more available now to the Eastern Gulf versus what we've seen just really in the Western Gulf.

If you look at DAPL-ETCOP, you know, Bakken to Patoka then Patoka to Beaumont, I think there's a pretty good call in the northern tier on the Bakken today. Again, that line is underwritten with T&Ds, both very good counterparties, and so I think you'll continue to see when it comes in service at the end of this year, early next year the ability to move those crudes then into the markets that want that; and then ultimately down into the Beaumont area as an option as well. Ultimately for us we think about DAPL-ETCOP as a potential way to supply Bayway, be it the pipe and then around with the Jones Act tanker in the Bayway to make it very competitive with the rail option that exists from the Bakken to Bayway today.

So I think it's all about creating more options on the Refining side for ourselves, as well as others and it does also, once you get to Beaumont, creates the opportunity to export should that develop. So I think just a lot of good options and that's a —you know, I think that project, we look at it, is going continue to be the lowest cost option to get Bakken to the markets that we're talking about serving.

Ryan Todd – Deutsche Bank

What's your expected cost from Bakken to the Gulf, via that route?

Tim G. Taylor – Phillips 66 – President

We've not disclosed that. We just simply say it's the most competitive, but it's substantially less than rail and we've looked at other piping systems, it's still a more effective way to move.

Ryan Todd – Deutsche Bank

Great. Thanks. Then maybe one final one. We've seen some of your peers talking to actually invest in various ways—you know, capital in various ways to address perceived octane shortages. What's your outlook on this regard and is there any interest or ability within the organization to invest to address the shortages?

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Yes. So we—I mean, we have some incremental opportunities that we're going to pursue. They're value creative, but they're small projects and they don't really add a lot. We're looking at standalone alky and trying to see if that makes sense. On the other hand, I don't want to be the last one. If everyone else builds alky, there'd probably be no reason for us to do it. So we'll have to assess that against our other opportunities. The small incremental things that we'll do this year or next year, they make a lot of sense and we'll do those.

Ryan Todd – Deutsche Bank

Great. Thanks a lot. I'll leave it there.

Operator

Brad Heffern from RBC Capital Markets is on line with a question.

Brad Heffern – RBC Capital Markets

Morning, everyone. Thanks for taking my questions. Greg, I just wanted to go back to an earlier question around DCP. I mean I think you explained it relatively well, but I was hoping you could put a finer point on it. If you just take strip pricing, do you think DCP just does not require any further equity injections?

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

If you take current pricing? No. We don't expect. They have a balance sheet they can work from. They're working to get their cash breakeven down in the mid-$0.30 this year, so I think DCP will be fine in 2016.

Brad Heffern – RBC Capital Markets

Okay. Thanks for the clarification. Then just talking about Santa Maria, I was curious if you had any update or timeline around crude sourcing there. Obviously it's been impacted by the plains' downtime.

Tim G. Taylor – Phillips 66 – President

So we've increased truck unloading at Santa Maria to mitigate that. We do run more processed inputs at San Francisco to supplement. The pipe is still something we'd like to see, so we continue to work on more trucks, other options. We'd like to get the pipe back, but I think that is out somewhat based on permits and public and government acceptance of that. So I think we're in this mode for a while and so we continue to look at new ways to get more options in there, but until we get that pipe back in service or an alternate, it's harder to get the full volume that we need.

Greg C. Garland – Phillips 66 – Chairman and Chief Executive Officer

Yes. The pipe is the preferred route but we don't control that. So I think the folks have done a great job of mitigating it but it's kind of 20, 25 today impact at Santa Maria. We've probably cut that in half with trucks, and then we made up the volumetrics on process inputs at Rodeo, but obviously the margin tells us not as good.

Brad Heffern – RBC Capital Markets

Great. I'll leave it there. Thanks.

Tim G. Taylor – Phillips 66 – President

Thank you.

Operator

Thank you. We have come to the end of the allotted time. I will now turn the call back over to Clayton Reasor.

C. Clayton Reasor – Phillips 66 – Executive Vice President, Investor Relations, Strategy, Corporate and Government Affairs

Well, thank you very much for your interest in Phillips and participating in the call today. You'll be able to find a transcript of the call posted on our website shortly, and if you've got additional questions, don't hesitate to reach out to either C.W. or me. We'd be happy to take your call. Thanks again.

Operator

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