Phillips 66

4Q23 First look: EPS bear solid progress report, led by consistent reliability

Maintain Rating: NEUTRAL | PO: 150.00 USD | Price: 142.41 USD

Solid progress report; 85% of cost savings achieved

Adjusted EPS of $3.09 beat consensus and BofAe of $2.35 / $2.36 which like all refiners so far had dropped ahead of the quarter on late Dec margin weakness. Vs our estimate crude spreads offset headline margin weakness in a beat that was two-parts refining, and one-part midstream. Strong refining earnings were paced by the Mid Cont ($23.45 vs $15.71 est) and the Gulf Coast ($13.96 vs $10.79 est) where PSX benefited from discounted Canadian crude, following the trend set by Valero and MPC. Cash flow of $1.98bn (pre working cap benefit of $207mm) also beat Street consensus of $1.56bn, consistent with the margin strength. Free cashflow of $1.35bn after capex ($634mm). funded the majority of cash returns ($1.6bn), including $1.14bn in share buy backs bringing the total since 3Q22 to $5.56bn or ~10% of outstanding shares. PSX captured $1.2bn o/o $1.4bn total cost savings targeted by y/end 2024 and ahead of the $1.0bn targeted by y/end 2023 (which itself was raised from $900mn at 3Q).

Refining strength looks driven by discounted WCS

Refining pre-tax earnings of $797mm beat our estimate of $476mm with a tailwind from butane blending and Canadian crude discounts which looks mainly responsible for strong Gulf Coast & Mid Continent margins. Total company gross margin of $14.41 beat our estimate of $12.49. Crude unit utilization of 92% matched 'low 90's guidance,' and now marks four consecutive quarters of solid operating performance, addressing one prior criticism of PSX management. Opex was modestly above our estimate: $1,135mm vs $1,072mm. Weakness in the West Coast margins is worth calling out – with a realized margin of $9.89/bbl, half our estimate of $17.72 but driven by Rodeo where secondary units were down ahead of the full conversion to RD, that is still on pace for 1Q24 (received necessary permit in January).

Record earnings from a new NGL segment inc DCP

Midstream pre-tax earnings of $776mm was a record ($661mm est) highlighted by strong results in the NGL segment ($423mm) on strong margins and volumes at Sweeny and lower opex, and contribution from DCP Midstream. benchmark margins have started to recover (16c vs 12.7c q/q), CP Chem earnings are still bottoming out as $106mm looks flat versus 3Q at $104mm. Marketing & Specialties pre-tax earnings of $432mm were roughly in line with our est. of $471mn, with stronger volumes partially offsetting weak gross margins (4c/gal vs 7c/gal q/q).

Execution story: PSX has pressure to deliver in 2024

With more than 85% of planned cost savings secured the early stages of PSX plan to lift mid cycle EBITDA to $14bn by 2025 looks on track. Recall 2024 guidance released in December was an early indication of delivery with a $300mn reduction baked into sustaining capital of $923mn. Worth noting is that mgmt. still sees itself in execution mode – suggesting the $1.4bn target by year-end 2024 has upside. While PSX has lagged more refining levered peers in recent weeks, this followed a strong rebound on the Elliot news; however we expect PSX to still participate in a summer margin trajectory we expect to lift 2024 refining earnings above mid cycle.

31 January 2024

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Stock Data

Price	142.41 USD
Price Objective	150.00 USD
Date Established	5-Jan-2024
Investment Opinion	B-2-7
52-Week Range	89.74 USD - 142.58 USD
Mrkt Val (mn) / Shares Out (mn)	62,654 USD / 440.0
Free Float	99.6%
Average Daily Value (mn)	429.32 USD
BofA Ticker / Exchange	PSX / NYS
Bloomberg / Reuters	PSX US / PSX.N
ROE (2023E)	22.9%
Net Dbt to Eqty (Dec-2022A)	32.4%
ESGMeter™	High

WCS – western Canadian select

MPC – Marathon Petroleum

RD – renewable diesel

NGL – natural gas liquids

CP Chem – Chevron Phillips Chemical Co.

Refer to important disclosures on page 4 to 6. Analyst Certification on page 2. Price Objective Basis/Risk on page 2.

4Q23 earnings variance

The table below compares actual 4Q23 results to our estimate and prior periods results.

Exhibit 1: PSX Earnings Variance

Q/Q and Y/Y Comparison (all figures in $ millions, except per share)

	4Q23A	4Q23E	3Q23A	Q/Q	4Q22A	Y/Y
Refining (Corp + Equity Affiliates)	754	476	1,740	-73%	1,626	-71%
Marketing + Specialties (Corp)	432	471	633	-26%	539	-13%
Midstream (PSXP + DCP Equity)	797	625	569	10%	675	-7%
Chemicals (CPChem Equity)	106	135	104	30%	52	160%
Total Segment EBT	2,089	1,707	3,046	-44%	2,892	-41%
Items not allocated to segments	-	-				
Corporate & other unallocated items	(82)	(90)	(80)	-12%	(87)	-3%
Other	n/a	n/a	n/a		n/a	
Income from Operations	2,007	1,617	2,966	-45%	2,805	-42%
Net Interest Expense	(215)	(215)	(215)	0%	(193)	-11%
Other Non-Op Expenses	-	-	-		-	
Earnings Before Tax	1,792	1,403	2,751	-49%	2,612	-46%
Income Tax Expense	405	337	660	-49%	574	-41%
Tax rate	24%	24%	24%	0%	22%	9%
Income (loss) from continuing ops.	1,387	1,066	2,091	-49%	2,038	-48%
Add Income (loss) from discontinued ops.	-	-	-		-	
Net Income (loss)	1,387	1,066	2,091	-49%	2,038	-48%
Less income attributable to Redeemable NCI	-	-	-		-	
Less income attributable to NCI	25	35	21	67%	138	-75%
Net Income to PSX	1,362	1,031	2,070	-50%	1,900	-46%
Adjusted EPS	$3.09	$2.36	$4.63	-49%	$4.01	-41%

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Price objective basis & risk

Phillips 66 (PSX)

Our price objective of $150/share is based on a sum of the parts valuation of PSX's four main businesses with refining assets assessed by a discounted cash flow (DCF) value that treats the assets as annuities after deducting maintenance capital. This valuation is also supported by a dividend discount model. We use a long term Gulf Coast 321 crack spread in our benchmark assumptions of $11.5/bbl, a long-term crude differential of $3.5 and a weighted-average cost of capital (WACC) of 8.0%, and a 22% corporate tax rate.

The risks to our price objective are (1) the company is weighted toward heavy crude. As light-heavy crude differentials narrow, the benefits of a more complex refinery will diminish, which may delay return on investment, (2) the company is vulnerable to refining margin correction. If demand for refined products or chemicals is weaker than expected, or if oil prices remain robust, this could pressure margins, (3) the inability to capture the price environment due to cost pressures (opex, capex, and taxation).

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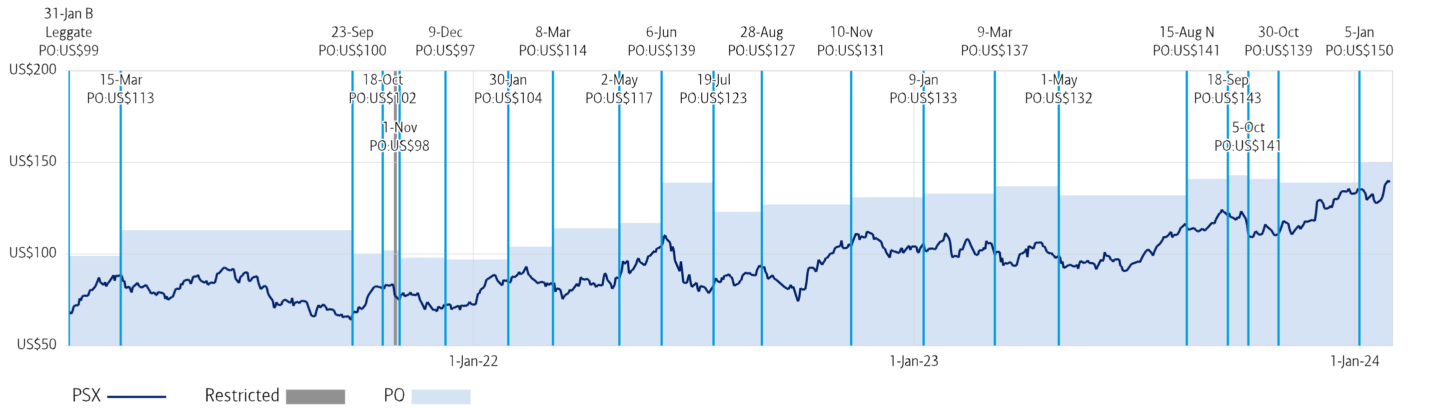
Phillips 66 (PSX) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	83	61.48%	Buy	64	77.11%
Hold	28	20.74%	Hold	21	75.00%
Sell	24	17.78%	Sell	18	75.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

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Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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