

Phillips 66
Form 10-Q
November 01, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **September 30, 2012**
or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: **001-35349**

Phillips 66

(Exact name of registrant as specified in its charter)

Delaware **45-3779385**
(State or other jurisdiction of *(I.R.S. Employer*
incorporation or organization) *Identification No.)*

3010 Briarpark Drive, Houston, Texas 77042
(Address of principal executive offices) (Zip Code)

281-293-6600
(Registrant's telephone number, including area code)

600 North Dairy Ashford, Houston, Texas 77079
(Former address, if changed since last report)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The registrant had 625,806,484 shares of common stock, \$.01 par value, outstanding as of September 30, 2012.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****Consolidated Statement of Income****Phillips 66**

	Millions of Dollars			
	Three Months Ended		Nine Months Ended	
	September 30 2012	2011	September 30 2012	2011
Revenues and Other Income				
Sales and other operating revenues*	\$ 42,945	50,610	135,475	147,983
Equity in earnings of affiliates	959	856	2,508	2,330
Net gain (loss) on dispositions	(1)	(221)	189	(175)
Other income	4	18	82	28
Total Revenues and Other Income	43,907	51,263	138,254	150,166
Costs and Expenses				
Purchased crude oil and products	36,189	43,905	116,915	129,853
Operating expenses	884	1,027	2,960	3,087
Selling, general and administrative expenses	432	372	1,261	1,042
Depreciation and amortization	229	222	669	667
Impairments	248	486	566	488
Taxes other than income taxes*	3,410	3,674	10,305	10,785
Accretion on discounted liabilities	7	5	18	16
Interest and debt expense	74	4	170	11
Foreign currency transaction (gains) losses	(15)	18	(22)	(56)
Total Costs and Expenses	41,458	49,713	132,842	145,893
Income before income taxes	2,449	1,550	5,412	4,273
Provision for income taxes	848	499	1,991	1,505
Net income	1,601	1,051	3,421	2,768
Less: net income attributable to noncontrolling interests	2	2	5	4
Net Income Attributable to Phillips 66	\$ 1,599	1,049	3,416	2,764
Net Income Attributable to Phillips 66 Per Share of Common Stock (dollars)**				
Basic	\$ 2.53	1.67	5.43	4.40
Diluted	2.51	1.65	5.37	4.36
Dividends Paid Per Share of Common Stock (dollars)	\$ 0.20		0.20	

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Average Common Shares Outstanding (in thousands)**

Basic	630,672	627,628	628,940	627,628
Diluted	637,913	634,645	636,585	634,645

* Includes excise taxes on petroleum products sales:

\$ 3,312 3,596 10,022 10,533

** See Note 10 Earnings Per Share.

See Notes to Consolidated Financial Statements.

Table of Contents**Consolidated Statement of Comprehensive Income****Phillips 66**

	Millions of Dollars			
	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2012	2011	2012	2011
Net Income	\$ 1,601	1,051	3,421	2,768
Other comprehensive income (loss)				
Defined benefit plans				
Prior service cost:				
Amortization to net income of prior service cost			1	
Actuarial gain/loss:				
Amortization to net income of net actuarial loss	22		37	2
Actuarial gain arising during the period			90	
Plans sponsored by equity affiliates	6	6	14	16
Income taxes on defined benefit plans	(10)	(2)	(52)	(7)
Defined benefit plans, net of tax	18	4	90	11
Foreign currency translation adjustments	210	(15)	151	2
Income taxes on foreign currency translation adjustments		(21)	48	(81)
Foreign currency translation adjustments, net of tax	210	(36)	199	(79)
Hedging activities	1		1	2
Income taxes on hedging activities				(1)
Hedging activities, net of tax	1		1	1
Other Comprehensive Income (Loss), Net of Tax	229	(32)	290	(67)
Comprehensive Income	1,830	1,019	3,711	2,701
Less: comprehensive income attributable to noncontrolling interests	2	2	5	4
Comprehensive Income Attributable to Phillips 66	\$ 1,828	1,017	3,706	2,697

See Notes to Consolidated Financial Statements.

Table of Contents**Consolidated Balance Sheet****Phillips 66**

	Millions of Dollars	
	September 30 2012	December 31 2011
Assets		
Cash and cash equivalents	\$ 4,430	
Accounts and notes receivable (net of allowance of \$52 million in 2012 and \$13 million in 2011)	9,136	8,354
Accounts and notes receivable related parties	1,657	1,671
Inventories	5,743	3,466
Prepaid expenses and other current assets	907	457
Total Current Assets	21,873	13,948
Investments and long-term receivables	10,800	10,306
Net properties, plants and equipment	15,311	14,771
Goodwill	3,344	3,332
Intangibles	726	732
Other assets	176	122
Total Assets	\$ 52,230	43,211
Liabilities		
Accounts payable	\$ 12,267	10,007
Accounts payable related parties	1,185	785
Short-term debt	585	30
Accrued income and other taxes	1,392	1,087
Employee benefit obligations	350	64
Other accruals	607	411
Total Current Liabilities	16,386	12,384
Long-term debt	7,393	361
Asset retirement obligations and accrued environmental costs	766	787
Deferred income taxes	5,436	5,803
Employee benefit obligations	1,081	117
Other liabilities and deferred credits	562	466
Total Liabilities	31,624	19,918
Equity		
Common stock (2,500,000,000 shares authorized at \$.01 par value)		
Issued (2012 628,400,884 shares)		
Par value	6	
Capital in excess of par	18,643	
Treasury stock (at cost: 2012 2,594,400 shares)	(111)	
Retained earnings	2,164	
Net parent company investment		23,142
Accumulated other comprehensive income (loss)	(129)	122
Total Stockholders' Equity	20,573	23,264

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Noncontrolling interests	33	29
Total Equity	20,606	23,293
Total Liabilities and Equity	\$ 52,230	43,211

See Notes to Consolidated Financial Statements.

Table of Contents**Consolidated Statement of Cash Flows****Phillips 66**

	Millions of Dollars	
	Nine Months Ended	
	September 30	
	2012	2011
Cash Flows From Operating Activities		
Net income	\$ 3,421	2,768
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	669	667
Impairments	566	488
Accretion on discounted liabilities	18	16
Deferred taxes	111	573
Undistributed equity earnings	(928)	(1,100)
Net loss (gain) on dispositions	(189)	175
Other	81	17
Working capital adjustments		
Decrease (increase) in accounts and notes receivable	(677)	(897)
Decrease (increase) in inventories	(2,253)	(2,042)
Decrease (increase) in prepaid expenses and other current assets	(266)	(332)
Increase (decrease) in accounts payable	1,912	1,863
Increase (decrease) in taxes and other accruals	526	79
Net Cash Provided by Operating Activities	2,991	2,275
Cash Flows From Investing Activities		
Capital expenditures and investments	(827)	(653)
Proceeds from asset dispositions	259	204
Advances/loans related parties	(100)	
Collection of advances/loans related parties		550
Other		56
Net Cash Provided by (Used in) Investing Activities	(668)	157
Cash Flows From Financing Activities		
Distributions to ConocoPhillips	(5,255)	(2,411)
Issuance of debt	7,794	
Repayment of debt	(206)	(20)
Issuance of common stock	23	
Repurchase of common stock	(111)	
Dividends paid on common stock	(125)	
Other	(40)	(1)
Net Cash Provided by (Used in) Financing Activities	2,080	(2,432)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	27	

Net Change in Cash and Cash Equivalents	4,430
Cash and cash equivalents at beginning of period	
Cash and Cash Equivalents at End of Period	\$ 4,430

See Notes to Consolidated Financial Statements.

Table of Contents**Consolidated Statement of Changes in Equity****Phillips 66**

	Millions of Dollars							
	Attributable to Phillips 66							Total
	Common Stock			Retained Earnings	Net Parent Company Investment	Accum. Other Comprehensive Income (Loss)	Non-controlling Interests	
Par Value	Capital in Excess of Par	Treasury Stock						
December 31, 2010	\$				25,787	214	25	26,026
Net income					2,764		4	2,768
Net transfers to ConocoPhillips					(2,354)			(2,354)
Other comprehensive loss						(67)		(67)
Distributions to noncontrolling interests and other							(1)	(1)
September 30, 2011	\$				26,197	147	28	26,372
December 31, 2011	\$				23,142	122	29	23,293
Net income				2,291	1,125		5	3,421
Net transfers to/from ConocoPhillips					(5,707)	(541)		(6,248)
Other comprehensive income						290		290
Reclassification of net parent company investment to capital in excess of par		18,560			(18,560)			
Issuance of common stock at the separation	6	(6)						
Cash dividends paid on common stock				(125)				(125)
Repurchase of common stock			(111)					(111)
Benefit plan activity		89		(2)				87
Distributions to noncontrolling interests and other							(1)	(1)
September 30, 2012	\$	6	18,643	(111)	2,164	(129)	33	20,606

	Shares in Thousands	
	Common	Treasury
December 31, 2011		
Issuance of common stock at the separation	625,272	
Repurchase of common stock		2,594
Shares issued stock-based compensation	3,129	

September 30, 2012

628,401

2,594

See Notes to Consolidated Financial Statements.

Table of Contents**Notes to Consolidated Financial Statements**
Note 1 Separation and Basis of Presentation**Phillips 66****The Separation**

On April 4, 2012, the ConocoPhillips Board of Directors approved the separation of its downstream businesses into an independent, publicly traded company named Phillips 66. In accordance with a separation and distribution agreement, the two companies were separated by ConocoPhillips distributing to its stockholders all 625,272,302 shares of common stock of Phillips 66 after the market closed on April 30, 2012. Each ConocoPhillips shareholder received one share of Phillips 66 stock for every two shares of ConocoPhillips stock held at the close of business on the record date of April 16, 2012. Fractional shares of Phillips 66 common stock were not distributed and any fractional shares of Phillips 66 common stock otherwise issuable to a ConocoPhillips shareholder were sold in the open market on such shareholder's behalf, and such shareholder received a cash payment with respect to that fractional share. In conjunction with the separation, ConocoPhillips received a private letter ruling from the Internal Revenue Service to the effect that, based on certain facts, assumptions, representations and undertakings set forth in the ruling, for U.S. federal income tax purposes, the distribution of Phillips 66 stock was not taxable to ConocoPhillips or U.S. holders of ConocoPhillips common stock, except in respect to cash received in lieu of fractional share interests. Following the separation, ConocoPhillips retained no ownership interest in Phillips 66, and each company now has separate public ownership, boards of directors and management. A registration statement on Form 10, as amended through the time of its effectiveness, describing the separation was filed by Phillips 66 with the U.S. Securities and Exchange Commission (SEC) and was declared effective on April 12, 2012 (the Form 10).

On May 1, 2012, Phillips 66 stock began trading the regular-way on the New York Stock Exchange under the PSX stock symbol. Pursuant to the separation and distribution agreement with ConocoPhillips, on April 30, 2012, we made a special cash distribution to ConocoPhillips of \$5.95 billion. After subsequent working capital and inventory determinations, an additional cash distribution of \$1.87 billion was made to ConocoPhillips in June 2012. After consideration of the cash retained by Phillips 66 at separation, as well as cash flow impacts of the four months ended April 30, 2012, the net distribution to ConocoPhillips was \$5.3 billion.

Basis of Presentation

Prior to the separation on April 30, 2012, our results of operations, financial position and cash flows consisted of ConocoPhillips refining, marketing and transportation operations; its natural gas gathering, processing, transmission and marketing operations, primarily conducted through its equity investment in DCP Midstream, LLC (DCP Midstream); its petrochemical operations, conducted through its equity investment in Chevron Phillips Chemical Company LLC (CPChem); its power generation operations; and an allocable portion of its corporate costs (together, the downstream businesses). These financial statements have been presented as if the downstream businesses had been combined for all periods presented. All intercompany transactions and accounts within the downstream businesses were eliminated. The assets and liabilities have been reflected on a historical cost basis, as all of the assets and liabilities presented were wholly owned by ConocoPhillips and were transferred within the ConocoPhillips consolidated group. The statement of income for periods prior to the separation includes expense allocations for certain corporate functions historically performed by ConocoPhillips and not allocated to its operating segments, including allocations of general corporate expenses related to executive oversight, accounting, treasury, tax, legal, procurement and information technology. These allocations were based primarily on specific identification of time and/or activities associated with the downstream businesses, employee headcount or capital expenditures, and our management believes the assumptions underlying the allocations were reasonable. The combined financial statements may not necessarily reflect all of the actual expenses that would have been incurred had we been a stand-alone company during the periods presented prior to the separation.

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All financial information presented after the separation represents the consolidated results of operations, financial position and cash flows of Phillips 66. Accordingly:

Our consolidated statements of income and comprehensive income for the three months ended September 30, 2012, consist entirely of the consolidated results of Phillips 66. Our consolidated statements of income and comprehensive income for the nine months ended September 30, 2012, consist of the consolidated results of Phillips 66 for the five months ended September 30, 2012, and of the combined results of the downstream businesses for the four months ended April 30, 2012. Our consolidated statements of income and comprehensive income for the three and nine months ended September 30, 2011, consist entirely of the combined results of the downstream businesses.

Our consolidated balance sheet at September 30, 2012, consists of the consolidated balances of Phillips 66, while at December 31, 2011, it consists of the combined balances of the downstream businesses.

Our consolidated statement of cash flows for the nine months ended September 30, 2012, consists of the consolidated results of Phillips 66 for the five months ended September 30, 2012, and the combined results of the downstream businesses for the four months ended April 30, 2012. Our consolidated statement of cash flows for the nine months ended September 30, 2011, consists entirely of the combined results of the downstream businesses.

Our consolidated statement of changes in equity for the nine months ended September 30, 2012, consists of both the combined activity for the downstream businesses prior to April 30, 2012, and the consolidated activity for Phillips 66 completed at and subsequent to the separation on April 30, 2012. Our consolidated statement of changes in equity for the nine months ended September 30, 2011, consists entirely of the combined activity of the downstream businesses.

Note 2 Interim Financial Information

The interim-period financial information presented in the financial statements included in this report is unaudited and includes all known accruals and adjustments necessary, in the opinion of management, for a fair presentation of the consolidated financial position of Phillips 66 and its results of operations and cash flows for the periods presented. Unless otherwise specified, all such adjustments are of a normal and recurring nature. Certain notes and other information have been condensed or omitted from the interim financial statements included in this report. Therefore, these interim financial statements should be read in conjunction with the audited combined financial statements and notes thereto for the year ended December 31, 2011, included in our Form 10, as well as in conjunction with the interim financial information in our reports on Form 10-Q for the quarterly periods ended March 31, 2012, and June 30, 2012. The results of operations for the three and nine months ended September 30, 2012, are not necessarily indicative of the results to be expected for the full year.

Note 3 Variable Interest Entities (VIEs)

We hold significant variable interests in VIEs that have not been consolidated because we are not considered the primary beneficiary. Information on these VIEs follows:

Merey Sweeny, L.P. (MSLP) is a limited partnership that owns a delayed coker and related facilities at the Sweeny Refinery. As discussed more fully in Note 6 Investments, Loans and Long-Term Receivables, in August 2009 we exercised our call right to acquire the 50 percent ownership interest in MSLP of our co-venturer, Petróleos de Venezuela S.A. (PDVSA). That exercise has been challenged, and the dispute is being arbitrated. Because our exercise has been challenged by PDVSA, we continue to use the equity method of accounting for MSLP, and the VIE analysis below is based on the ownership and governance structure in place prior to the exercise of our call right. MSLP is a VIE because, in securing lender consents in connection with the separation, we provided a 100 percent debt guarantee to the lender of the 8.85% senior notes issued by

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MSLP. PDVSA did not participate in the debt guarantee. In our VIE assessment, this disproportionate debt guarantee, plus other liquidity support provided jointly by us and PDVSA independently of equity ownership, results in MSLP not being exposed to all potential losses. We have determined we are not the primary beneficiary while our call exercise is in dispute because under the partnership agreement the co-venturers jointly direct the activities of MSLP that most significantly impact economic performance. At September 30, 2012, our maximum exposure represented the outstanding principal debt balance of \$242 million. Our book value in MSLP at September 30, 2012, was \$92 million.

We have a 50 percent ownership interest with a 50 percent governance interest in Excel Paralubes, L.P. (Excel). Excel is a VIE because, in securing lender consents in connection with the separation, ConocoPhillips provided a 50 percent debt guarantee to the lender of the 7.43% senior secured bonds issued by Excel. We provided a full indemnity to ConocoPhillips for this debt guarantee. Our co-venturer did not participate in the debt guarantee. In our assessment of the VIE, this debt guarantee, plus other liquidity support up to \$60 million provided jointly by us and our co-venturer independently of equity ownership, results in Excel not being exposed to all potential losses. We have determined we are not the primary beneficiary because we and our co-venturer jointly direct the activities of Excel that most significantly impact economic performance. We continue to use equity method accounting for this investment. At September 30, 2012, our maximum exposure represented 50 percent of the outstanding principal debt balance of \$187 million, or \$94 million, plus half of the \$60 million liquidity support, or \$30 million. Our book value in Excel at September 30, 2012, was \$159 million.

Note 4 Inventories

Inventories consisted of the following:

	Millions of Dollars	
	September 30	December 31
	2012	2011
Crude oil and petroleum products	\$ 5,454	3,193
Materials and supplies	289	273
	\$ 5,743	3,466

Inventories valued on the last-in, first-out (LIFO) basis totaled \$5,303 million and \$3,046 million at September 30, 2012, and December 31, 2011, respectively. The estimated excess of current replacement cost over LIFO cost of inventories amounted to approximately \$7,900 million and \$8,600 million at September 30, 2012, and December 31, 2011, respectively. Planned year-to-date inventory LIFO liquidations increased net income in the nine-month period ended September 30, 2012, by \$86 million, all of which was attributable to the Refining and Marketing (R&M) segment.

Note 5 Assets Held for Sale or Sold

On June 22, 2012, we sold our refinery located on the Delaware River in Trainer, Pennsylvania, for \$229 million. The refinery and associated terminal and pipeline assets were included in our R&M segment and at the time of the disposition had a net carrying value of \$38 million, which included \$37 million of properties, plants and equipment (PP&E), \$25 million of allocated goodwill and a \$53 million asset retirement obligation. The \$189 million before-tax gain on this disposition was included in the Net gain (loss) on dispositions line in the consolidated income statement.

In the first quarter of 2012, equipment formerly associated with the cancelled Wilhelmshaven Refinery upgrade project was classified as held for sale. At September 30, 2012, the equipment had a net carrying value of \$30 million, primarily PP&E. See Note 8 Impairments, for additional information.

Table of Contents**Note 6 Investments, Loans and Long-Term Receivables****Equity Investments**

Summarized 100 percent financial information for WRB Refining LP (WRB) was as follows:

	Millions of Dollars			
	Three Months Ended		Nine Months Ended	
	September 30 2012	2011	September 30 2012	2011
Revenues	\$ 4,996	4,615	14,904	13,109
Income before income taxes	980	640	2,287	1,481
Net income	976	638	2,279	1,476

Loans and Long-Term Receivables

In July 2012, we entered into a market-based shareholder financing agreement for up to \$100 million with the Malaysian Refining Company Sdn. Bhd. (MRC). During the third quarter of 2012, MRC drew down \$100 million against the facility. The advance was recorded as a short-term related party advance with interest income recorded in equity earnings to offset the corresponding interest expense by MRC.

Other

MSLP is a limited partnership that owns a delayed coker and related facilities at the Sweeny Refinery. Prior to August 28, 2009, MSLP was owned 50/50 by ConocoPhillips and PDVSA. Under the agreements that govern the relationships between the partners, certain defaults by PDVSA with respect to supply of crude oil to the Sweeny Refinery gave ConocoPhillips the right to acquire PDVSA's 50 percent ownership interest in MSLP, which was exercised on August 28, 2009. PDVSA has initiated arbitration with the International Chamber of Commerce challenging the exercise of the call right and claiming it was invalid. The arbitral tribunal is scheduled to hold hearings on the merits of the dispute in December 2012. We continue to use the equity method of accounting for our investment in MSLP.

Note 7 Properties, Plants and Equipment

Our investment in PP&E, with the associated accumulated depreciation and amortization (Accum. D&A), was:

	Millions of Dollars					
	September 30, 2012			December 31, 2011*		
	Gross	Accum.	Net	Gross	Accum.	Net
	PP&E	D&A	PP&E	PP&E	D&A	PP&E
R&M						
Refining	\$ 18,751	5,988	12,763	19,333	6,630	12,703
Transportation	2,458	1,015	1,443	2,359	931	1,428
Marketing and other	1,418	813	605	1,386	766	620
Total R&M	22,627	7,816	14,811	23,078	8,327	14,751
Midstream	63	49	14	64	51	13

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Chemicals						
Corporate and Other	877	391	486	14	7	7
	\$ 23,567	8,256	15,311	23,156	8,385	14,771

* Certain PP&E within the R&M segment have been reclassified between Refining and Marketing and other.

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The three- and nine-month periods ended September 30, 2012 and 2011, included the following before-tax impairment charges:

	Millions of Dollars			
	Three Months Ended		Nine Months Ended	
	September 30 2012	2011	September 30 2012	2011
R&M				
United States	\$ 43	486	44	487
International			42	1
	43	486	86	488
Midstream	205		480	
	\$ 248	486	566	488

We have a 25 percent interest in Rockies Express Pipeline LLC (REX), which is included in our Midstream segment. During the second quarter of 2012, our co-venturer recognized a fair value adjustment of a disposal group that included its investment in REX, based on information gathered from its marketing process. After identifying this impairment indicator, we performed our own assessment of the carrying amount of our investment in REX, considering expected future cash flows and the discount rate. Based on this updated information, our internal assessment concluded our investment in REX was impaired, and the decline in fair value was other than temporary. Accordingly, our investment was written down to its fair value, and we recognized a \$275 million impairment in the second quarter of 2012. During the third quarter, we were notified of a right of first refusal purchase price from the co-venturer as part of its disposal process that indicated a fair value substantially lower than our second-quarter estimate. After considering this additional impairment indicator, we updated our internal assessment of REX's carrying amount. As a result, we recorded an impairment of \$205 million in the third quarter of 2012.

During the third quarter of 2012, we recorded an impairment of \$43 million on the Riverhead Terminal in our R&M segment. In addition, the nine-month period of 2012 included a held-for-sale impairment of \$42 million in our R&M segment related to equipment formerly associated with the cancelled Wilhelmshaven Refinery upgrade project. See Note 5 Assets Held for Sale or Sold, for additional information.

During the third quarter and nine-month period of 2011, we recorded a \$484 million impairment of Trainer Refinery and associated terminal and pipeline assets, due to the idling of the facility.

Note 9 Debt

During March 2012, we issued, through a private placement, \$5.8 billion of Senior Notes. The notes are guaranteed by Phillips 66 Company, a wholly owned subsidiary. In connection with the private placement, we and Phillips 66 Company granted the holders of the notes certain registration rights under a Registration Rights Agreement. We have agreed for the benefit of the holders of the notes to use our commercially reasonable efforts to file and cause to be effective a registration statement with the SEC on an appropriate form with respect to a registered offer to exchange each series of notes for new notes that are guaranteed by Phillips 66 Company with terms substantially identical in all material respects to such series of notes. Generally, we have one year from the issuance of the Senior Notes to complete the exchange offer.

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In the second quarter of 2012, we retired approximately \$185 million of previously existing debt and closed the financing of \$2.0 billion of new debt as a three-year amortizing term loan. The term loan incurs interest at a variable rate based on referenced rates plus a margin dependent upon the credit rating of our senior unsecured long-term debt as determined from time to time by Standard & Poor's Ratings Services (S&P) and Moody's Investors Service (Moody's).

Credit Facilities

In February 2012, we entered into a five-year revolving credit agreement with a syndicate of financial institutions. Under the terms of the revolving credit agreement, we have a borrowing capacity of up to \$4.0 billion. No amount has been drawn under this facility. However, as of September 30, 2012, \$51 million in letters of credit had been issued that were supported by this facility.

The revolving credit agreement contains covenants that we consider usual and customary for an agreement of this type for comparable commercial borrowers, including a maximum consolidated net debt-to-capitalization ratio of 60 percent. The agreement has customary events of default, such as nonpayment of principal when due; nonpayment of interest, fees or other amounts; violation of covenants; cross-payment default and cross-acceleration (in each case, to indebtedness in excess of a threshold amount); and a change of control.

Borrowings under the credit agreement will incur interest at London Interbank Offered Rate (LIBOR) plus a margin based on the credit rating of our senior unsecured long-term debt as determined from time to time by S&P and Moody's. The revolving credit agreement also provides for customary fees, including administrative agent fees and commitment fees.

Trade Receivables Securitization Facility

In the second quarter of 2012, we established a wholly owned subsidiary to hold trade receivables that will be used as collateral for the subsidiary's new borrowing facility with an aggregate capacity of \$1.2 billion, which has a term of three years. As of September 30, 2012, no cash had been borrowed under the facility, but we had obtained \$166 million in letters of credit under the facility that were collateralized by \$166 million of the trade receivables held by the subsidiary.

Note 10 Earnings Per Share

Basic earnings per share (EPS) is based on net income attributable to Phillips 66, reduced by dividends paid on unvested share-based employee awards that receive non-cancellable dividends during the vesting period, divided by the sum of the daily weighted-average number of common shares outstanding during the periods presented and fully vested stock and unit awards that have not yet been issued as common stock. Diluted EPS is also based on net income attributable to Phillips 66, which is reduced only by dividend equivalents paid on unvested share-based awards for which the dividends are more dilutive than the participation of the awards in the earnings of the periods presented; otherwise, net income attributable to Phillips 66 is not reduced by the dividends. To the extent unvested stock, unit or option awards and vested unexercised stock options are dilutive, they are included with the weighted-average common shares.

On April 30, 2012, 625,272,302 shares of our common stock were distributed to ConocoPhillips stockholders in conjunction with the separation. For comparative purposes, and to provide a more meaningful calculation of weighted-average shares outstanding, we have assumed this amount to be outstanding as of the beginning of each period prior to the separation presented in the calculation of weighted-average shares. In addition, we have assumed the dilutive securities outstanding at April 30, 2012, were also outstanding for each of the periods presented prior to the separation.

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	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Basic EPS Calculation				
Allocation of earnings:				
Net income attributable to Phillips 66 (<i>millions</i>)	\$ 1,599	1,049	3,416	2,764
Income allocated to participating securities (<i>millions</i>)	(1)		(1)	
Income available to common stockholders (<i>millions</i>)	\$ 1,598	1,049	3,415	2,764
Weighted-average common shares outstanding basic (<i>thousands</i>)	630,672	627,628	628,940	627,628
Earnings per share basic	\$ 2.53	1.67	5.43	4.40
Diluted EPS Calculation				
Allocation of earnings:				
Net income attributable to Phillips 66 (<i>millions</i>)	\$ 1,599	1,049	3,416	2,764
Income allocated to participating securities (<i>millions</i>)				
Income available to common stockholders (<i>millions</i>)	\$ 1,599	1,049	3,416	2,764
Weighted-average common shares outstanding basic (<i>thousands</i>)	630,672	627,628	628,940	627,628
Dilutive effect of stock-based compensation (<i>thousands</i>)	7,241	7,017	7,645	7,017
Weighted-average common shares outstanding diluted (<i>thousands</i>)	637,913	634,645	636,585	634,645
Earnings per share diluted	\$ 2.51	1.65	5.37	4.36

Note 11 Guarantees

At September 30, 2012, we were liable for certain contingent obligations under various contractual arrangements as described below. We recognize a liability, at inception, for the fair value of our obligation as a guarantor for newly issued or modified guarantees. Unless the carrying amount of the liability is noted below, we have not recognized a liability either because the guarantees were issued prior to December 31, 2002, or because the fair value of the obligation is immaterial. In addition, unless otherwise stated, we are not currently performing with any significance under the guarantee and expect future performance to be either immaterial or have only a remote chance of occurrence.

Guarantees of Joint Venture Debt

In April 2012, in connection with the separation, we issued a guarantee for 100 percent of the 8.85% senior notes issued by MSLP in July 1999. At September 30, 2012, the maximum potential amount of future payments to third parties under the guarantee is estimated to be \$242 million, which could become payable if MSLP fails to meet its obligations under the senior note agreement.

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At September 30, 2012, we had other guarantees outstanding for our portion of certain joint venture debt obligations, which have remaining terms of up to 14 years. The maximum potential amount of future payments under these other guarantees is approximately \$115 million. Payment would be required if a joint venture defaults on its debt obligations.

Other Guarantees

We have other guarantees with maximum future potential payment amounts totaling \$167 million, which consist primarily of guarantees to fund the short-term cash liquidity deficits of certain joint ventures and guarantees of the lease payment obligations of a joint venture. These guarantees generally have remaining terms of up to 13 years or life of the venture.

Indemnifications

Over the years, we have entered into various agreements to sell ownership interests in certain corporations, joint ventures and assets that gave rise to qualifying indemnifications. Agreements associated with these sales include indemnifications for taxes, environmental liabilities, permits and licenses, employee claims, real estate indemnity against tenant defaults, and litigation. The terms of these indemnifications vary greatly. The majority of these indemnifications are related to environmental issues, relative to which the term is generally indefinite and the maximum amount of future payments is generally unlimited. The carrying amount recorded for indemnifications at September 30, 2012, was \$356 million. We amortize the indemnification liability over the relevant time period, if one exists, based on the facts and circumstances surrounding each type of indemnity. In cases where the indemnification term is indefinite, we will reverse the liability when we have information the liability is essentially relieved or amortize the liability over an appropriate time period as the fair value of our indemnification exposure declines. Although it is reasonably possible future payments may exceed amounts recorded, due to the nature of the indemnifications, it is not possible to make a reasonable estimate of the maximum potential amount of future payments. Included in the recorded carrying amount were \$143 million of environmental accruals for known contamination that are included in asset retirement obligations and accrued environmental costs at September 30, 2012. For additional information about environmental liabilities, see Note 12 Contingencies and Commitments.

Indemnification and Release Agreement

In conjunction with, and effective as of, the separation, we entered into an Indemnification and Release Agreement with ConocoPhillips. This agreement governs the treatment between ConocoPhillips and us of all aspects relating to indemnification, insurance, litigation responsibility and management, and litigation document sharing and cooperation arising in connection with the separation. Generally, the agreement provides for cross-indemnities principally designed to place financial responsibility for the obligations and liabilities of our business with us and financial responsibility for the obligations and liabilities of ConocoPhillips' business with ConocoPhillips. The agreement also establishes procedures for handling claims subject to indemnification and related matters.

Note 12 Contingencies and Commitments

A number of lawsuits involving a variety of claims have been made against Phillips 66 that arose in the ordinary course of business. We also may be required to remove or mitigate the effects on the environment of the placement, storage, disposal or release of certain chemical, mineral and petroleum substances at various active and inactive sites. We regularly assess the need for accounting recognition or disclosure of these contingencies. In the case of all known contingencies (other than those related to income taxes), we accrue a liability when the loss is probable and the amount is reasonably estimable. If a range of amounts can be reasonably estimated and no amount within the range is a better estimate than any other amount, then the minimum of the range is accrued. We do not reduce these liabilities for potential insurance or third-party recoveries. If applicable, we record receivables for probable insurance or other third-party recoveries. In the case of income-tax-related contingencies, we use a cumulative probability-weighted loss accrual in cases where sustaining a tax position is less than certain.

Based on currently available information, we believe it is remote that future costs related to known contingent liability exposures will exceed current accruals by an amount that would have a material adverse impact on our consolidated financial statements. As we learn new facts concerning contingencies, we reassess our position.

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both with respect to accrued liabilities and other potential exposures. Estimates particularly sensitive to future changes include contingent liabilities recorded for environmental remediation, tax and legal matters. Estimated future environmental remediation costs are subject to change due to such factors as the uncertain magnitude of cleanup costs, the unknown time and extent of such remedial actions that may be required, and the determination of our liability in proportion to that of other responsible parties. Estimated future costs related to tax and legal matters are subject to change as events evolve and as additional information becomes available during the administrative and litigation processes.

Environmental

We are subject to international, federal, state and local environmental laws and regulations. When we prepare our consolidated financial statements, we record accruals for environmental liabilities based on management's best estimates, using all information available at the time. We measure estimates and base liabilities on currently available facts, existing technology, and presently enacted laws and regulations, taking into account stakeholder and business considerations. When measuring environmental liabilities, we also consider our prior experience in remediation of contaminated sites, other companies' cleanup experience, and data released by the U.S. Environmental Protection Agency (EPA) or other organizations. We consider unasserted claims in our determination of environmental liabilities, and we accrue them in the period they are both probable and reasonably estimable.

Although liability of those potentially responsible for environmental remediation costs is generally joint and several for federal sites and frequently so for state sites, we are usually only one of many companies cited at a particular site. Due to the joint and several liabilities, we could be responsible for all cleanup costs related to any site at which we have been designated as a potentially responsible party. We have been successful to date in sharing cleanup costs with other financially sound companies. Many of the sites at which we are potentially responsible are still under investigation by the EPA or the state agencies concerned. Prior to actual cleanup, those potentially responsible normally assess the site conditions, apportion responsibility and determine the appropriate remediation. In some instances, we may have no liability or may attain a settlement of liability. Where it appears that other potentially responsible parties may be financially unable to bear their proportional share, we consider this inability in estimating our potential liability, and we adjust our accruals accordingly. As a result of various acquisitions in the past, we assumed certain environmental obligations. Some of these environmental obligations are mitigated by indemnifications made by others for our benefit and some of the indemnifications are subject to dollar and time limits.

We are currently participating in environmental assessments and cleanups at numerous federal Superfund and comparable state sites. After an assessment of environmental exposures for cleanup and other costs, we make accruals on an undiscounted basis (except those acquired in a purchase business combination, which we record on a discounted basis) for planned investigation and remediation activities for sites where it is probable future costs will be incurred and these costs can be reasonably estimated. At September 30, 2012, our consolidated balance sheet included a total environmental accrual of \$533 million, compared with \$542 million at December 31, 2011. We expect to incur a substantial amount of these expenditures within the next 30 years. We have not reduced these accruals for possible insurance recoveries. In the future, we may be involved in additional environmental assessments, cleanups and proceedings.

Legal Proceedings

Our legal organization applies its knowledge, experience and professional judgment to the specific characteristics of our cases, employing a litigation management process to manage and monitor the legal proceedings against us. Our process facilitates the early evaluation and quantification of potential exposures in individual cases. This process also enables us to track those cases that have been scheduled for trial and/or mediation. Based on professional judgment and experience in using these litigation management tools and available information about current developments in all our cases, our legal organization regularly assesses the adequacy of current accruals and determines if adjustment of existing accruals, or establishment of new accruals, are required.

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Other Contingencies

We have contingent liabilities resulting from throughput agreements with pipeline and processing companies not associated with financing arrangements. Under these agreements, we may be required to provide any such company with additional funds through advances and penalties for fees related to throughput capacity not utilized.

At September 30, 2012, we had performance obligations secured by letters of credit of \$1,482 million (of which \$166 million were issued under the trade receivables securitization facility, \$51 million were issued under the provisions of our revolving credit facility, and the remainder were issued as direct bank letters of credit) related to various purchase and other commitments incident to the ordinary conduct of business.

Note 13 Derivatives and Financial Instruments

Derivative Instruments

We use financial and commodity-based derivative contracts to manage exposures to fluctuations in foreign currency exchange rates and commodity prices or to capture market opportunities. Since we are not currently using cash-flow hedge accounting, all gains and losses, realized or unrealized, from commodity derivative contracts have been recognized in the consolidated statement of income. Gains and losses from derivative contracts held for trading not directly related to our physical business, whether realized or unrealized, have been reported net in Other income on our consolidated statement of income. Cash flows from all our derivative activity for the periods presented appear in the operating section of the consolidated statement of cash flows.

Purchase and sales contracts with fixed minimum notional volumes for commodities that are readily convertible to cash (e.g., crude oil and gasoline) are recorded on the balance sheet as derivatives unless the contracts are eligible for, and we elect, the normal purchases and normal sales exception (i.e., contracts to purchase or sell quantities we expect to use or sell over a reasonable period in the normal course of business). We generally apply this normal purchases and normal sales exception to eligible crude oil, refined product, natural gas and power commodity purchase and sales contracts; however, we may elect not to apply this exception (e.g., when another derivative instrument will be used to mitigate the risk of the purchase or sales contract but hedge accounting will not be applied, in which case both the purchase or sales contract and the derivative contract mitigating the resulting risk will be recorded on the balance sheet at fair value).

Our derivative instruments are held at fair value on our consolidated balance sheet. For further information on the fair value of derivatives, see Note 14 Fair Value Measurements.

Commodity Derivative Contracts We operate in the worldwide crude oil, refined products, natural gas liquids, natural gas and electric power markets and are exposed to fluctuations in the prices for these commodities. These fluctuations can affect our revenues, as well as the cost of operating, investing and financing activities. Generally, our policy is to remain exposed to the market prices of commodities; however, we use futures, forwards, swaps and options in various markets to balance physical systems, meet customer needs, manage price exposures on specific transactions, and do a limited, immaterial amount of trading not directly related to our physical business. We also use the market knowledge gained from these activities to capture market opportunities such as moving physical commodities to more profitable locations, storing commodities to capture seasonal or time premiums, and blending commodities to capture quality upgrades. Derivatives may be used to optimize these activities, which may move our risk profile away from market average prices.

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The following table indicates the balance sheet line items that include the fair values of commodity derivative assets and liabilities presented net (i.e., commodity derivative assets and liabilities with the same counterparty are netted where the right of setoff exists); however, the balances in the following table are presented gross:

	Millions of Dollars	
	September 30 2012	December 31 2011
Assets		
Prepaid expenses and other current assets	\$ 1,691	665
Other assets	20	5
Liabilities		
Other accruals	1,696	703
Other liabilities and deferred credits	33	1

Hedge accounting has not been used for any items in the table.

The gains (losses) from commodity derivatives incurred, and the line items where they appear on our consolidated statement of income, were:

	Millions of Dollars			
	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Sales and other operating revenue	\$ (232)	162	(48)	(484)
Equity in earnings of affiliates	5		5	
Other income	(9)	7	44	(6)
Purchased crude oil and products	(86)	178	7	339

Hedge accounting has not been used for any item in the table.

The table below summarizes our material net exposures resulting from outstanding commodity derivative contracts. These financial and physical derivative contracts are primarily used to manage price exposure on our underlying operations. The underlying exposures may be from non-derivative positions such as inventory volumes. Financial derivative contracts may also offset physical derivative contracts, such as forward sales contracts. As of September 30, 2012, and December 31, 2011, the percentage of our derivative contract volume expiring within the next 12 months was 99 percent for both periods.

	Open Position Long/(Short)	
	September 30 2012	December 31 2011

Commodity

Crude oil, refined products and natural gas liquids (<i>millions of barrels</i>)	(27)	(13)
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Credit Risk

Financial instruments potentially exposed to concentrations of credit risk consist primarily of over-the-counter (OTC) derivative contracts and trade receivables.

The credit risk from our OTC derivative contracts, such as forwards and swaps, derives from the counterparty to the transaction. Individual counterparty exposure is managed within predetermined credit limits and includes the use of cash-call margins when appropriate, thereby reducing the risk of significant nonperformance. We also use futures, swaps and option contracts that have a negligible credit risk because these trades are cleared with an exchange clearinghouse and subject to mandatory margin requirements until settled; however, we are exposed to the credit risk of those exchange brokers for receivables arising from daily margin cash calls, as well as for cash deposited to meet initial margin requirements.

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Our trade receivables result primarily from the sale of products from, or related to, our refinery operations and reflect a broad national and international customer base, which limits our exposure to concentrations of credit risk. The majority of these receivables have payment terms of 30 days or less. We continually monitor this exposure and the creditworthiness of the counterparties and recognize bad debt expense based on historical write-off experience or specific counterparty collectability. Generally, we do not require collateral to limit the exposure to loss; however, we will sometimes use letters of credit, prepayments, and master netting arrangements to mitigate credit risk with counterparties that both buy from and sell to us, as these agreements permit the amounts owed by us or owed to others to be offset against amounts due us.

Certain of our derivative instruments contain provisions that require us to post collateral if the derivative exposure exceeds a threshold amount. We have contracts with fixed threshold amounts and other contracts with variable threshold amounts that are contingent on our credit rating. The variable threshold amounts typically decline for lower credit ratings, while both the variable and fixed threshold amounts typically revert to zero if our credit ratings fall below investment grade. Cash is the primary collateral in all contracts; however, many contracts also permit us to post letters of credit as collateral.

The aggregate fair values of all derivative instruments with such credit-risk-related contingent features that were in a liability position were not material at September 30, 2012, or at December 31, 2011.

Note 14 Fair Value Measurements

We carry a portion of our assets and liabilities at fair value that are measured at the reporting date using an exit price (i.e., the price that would be received to sell an asset or paid to transfer a liability) and disclosed according to the quality of valuation inputs under the following hierarchy:

Level 1: Quoted prices (unadjusted) in an active market for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are directly or indirectly observable.

Level 3: Unobservable inputs that are significant to the fair value of assets or liabilities.

The classification of an asset or liability is based on the lowest level of input significant to its fair value. Those that are initially classified as Level 3 are subsequently reported as Level 2 when the fair value derived from unobservable inputs is inconsequential to the overall fair value, or if corroborated market data becomes available. Assets and liabilities that are initially reported as Level 2 are subsequently reported as Level 3 if corroborated market data is no longer available. There were no material transfers in or out of Level 1.

Recurring Fair Value Measurements

Financial assets and liabilities reported at fair value on a recurring basis primarily include derivative instruments and certain investments to support nonqualified deferred compensation plans. The deferred compensation investments are measured at fair value using unadjusted prices available from national securities exchanges; therefore, these assets are categorized as Level 1 in the fair value hierarchy. We value our exchange-traded derivatives using closing prices provided by the exchange as of the balance sheet date, and these are classified as Level 1 in the fair value hierarchy. Where exchange-provided prices are adjusted, non-exchange quotes are used or when the instrument lacks sufficient liquidity, we generally classify those exchange-cleared contracts as Level 2. OTC financial swaps and physical commodity forward purchase and sales contracts are generally valued using quotations provided by brokers and price index developers such as Platts and Oil Price Information Service. These quotes are corroborated with market data and are classified as Level 2. In certain less liquid markets or for longer-term contracts, forward prices are not as readily available. In these circumstances, OTC swaps and physical commodity purchase and sales contracts are valued using internally developed methodologies that consider historical relationships among various commodities that result in management's best estimate of fair value. These contracts are classified as Level 3. Financial OTC and physical commodity options are valued using industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and contractual prices for the underlying instruments, as well as other relevant economic measures. The degree to which these inputs are

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observable in the forward markets determines whether the options are classified as Level 2 or 3. We use a mid-market pricing convention (the mid-point between bid and ask prices). When appropriate, valuations are adjusted to reflect credit considerations, generally based on available market evidence.

The fair value hierarchy for our derivative assets and liabilities accounted for at fair value on a recurring basis was:

	Millions of Dollars							
	September 30, 2012			Total	December 31, 2011			Total
Level 1	Level 2	Level 3	Level 1		Level 2	Level 3		
Assets								
Commodity derivatives	\$ 1,165	535	3	1,703	389	270	6	665
Rabbi trust assets	48			48				
Total assets	1,213	535	3	1,751	389	270	6	665
Liabilities								
Commodity derivatives	1,178	542	1	1,721	428	267	4	699
Total liabilities	1,178	542	1	1,721	428	267	4	699
Net assets (liabilities)	\$ 35	(7)	2	30	(39)	3	2	(34)

The derivative values above are based on analysis of each contract as the fundamental unit of account; therefore, derivative assets and liabilities with the same counterparty are not reflected net where the legal right of setoff exists. Gains or losses from contracts in one level may be offset by gains or losses on contracts in another level or by changes in values of physical contracts or positions that are not reflected in the table above.

As reflected in the table above, Level 3 activity is not material.

Nonrecurring Fair Value Remeasurements

There were no material fair value impairments for the nine-month period ended September 30, 2011. The following table shows the values of assets, by major category, measured at fair value on a nonrecurring basis in periods subsequent to their initial recognition during the nine-month period ended September 30, 2012:

	Millions of Dollars			
	Fair Value*	Fair Value Measurements Using Level 1 Inputs	Fair Value Measurements Using Level 3 Inputs	Before-Tax Loss
September 30, 2012				
Net properties, plants and equipment (held for use)	\$ 33	33		43
Net properties, plants and equipment (held for sale)	32	32		42
Equity method investment	283		283	480

* Represents the fair value at the time of the impairment.

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During the nine-month period ended September 30, 2012, net PP&E held for use related to a terminal and storage facility with a carrying amount of \$76 million, was written down to its fair value of \$33 million, resulting in a before-tax loss of \$43 million. Net PP&E held for sale related to equipment formerly associated with a cancelled refinery upgrade project with a carrying amount of \$74 million, was written down to its fair value of \$32 million, resulting in a before-tax loss of \$42 million. The fair values in each case were primarily determined by negotiated selling prices with third parties. During this same period, our investment in a natural gas transmission pipeline was written down to a fair value of \$283 million, resulting in a before-tax loss of \$480 million. Fair value was based on an internal assessment of expected discounted future cash flows.

Fair Values of Financial Instruments

We used the following methods and assumptions to estimate the fair value of financial instruments:

Cash and cash equivalents: The carrying amount reported on the balance sheet approximates fair value.

Accounts and notes receivable: The carrying amount reported on the balance sheet approximates fair value.

Debt: The carrying amount of our floating-rate debt approximates fair value. The fair value of our fixed-rate debt is estimated based on quoted market prices as a Level 2 fair value.

Commodity swaps: Fair value is estimated based on forward market prices and approximates the exit price at period end. When forward market prices are not available, fair value is estimated using the forward prices of a similar commodity with adjustments for differences in quality or location.

Futures: Fair values are based on quoted market prices obtained from the New York Mercantile Exchange, the InterContinental Exchange Futures, or other traded exchanges.

Forward-exchange contracts: Fair values are estimated by comparing the contract rate to the forward rate in effect at the end of the respective reporting periods and approximating the exit price at those dates.

Our commodity derivative and financial instruments were:

	Millions of Dollars			
	Carrying Amount		Fair Value	
	September 30	December 31	September 30	December 31
	2012	2011	2012	2011
Financial Assets				
Commodity derivatives	\$ 133	73	133	73
Rabbi trust assets	48		48	
Financial Liabilities				
Commodity derivatives	88	52	88	52
Total debt, excluding capital leases	7,970	377	8,551	406

The amounts shown for derivatives in the preceding table are presented net (i.e., assets and liabilities with the same counterparty are netted where the right of setoff exists). In addition, the September 30, 2012, commodity derivative assets and liabilities appear net of \$33 million of obligations to return cash collateral and \$96 million of rights to reclaim cash collateral, respectively. The December 31, 2011, commodity

derivative liabilities appear net of \$55 million of rights to reclaim cash collateral.

Table of Contents**Note 15 Accumulated Other Comprehensive Income (Loss)**

Accumulated other comprehensive income (loss) in the equity section of the balance sheet included:

	Millions of Dollars			Accumulated
	Defined	Foreign		Other
	Benefit	Currency		Comprehensive
	Plans	Translation	Hedging	Income
				(Loss)
December 31, 2011	\$ (145)	270	(3)	122
Other comprehensive income	90	199	1	290
Net transfer from ConocoPhillips*	(541)			(541)
September 30, 2012	\$ (596)	469	(2)	(129)

* See Consolidated Statement of Changes in Equity.

Note 16 Employee Benefit Plans**Pension Plans**

Prior to the separation, certain of our U.S. and U.K. employees participated in defined benefit pension plans and postretirement health and life insurance plans (Shared Plans) sponsored by ConocoPhillips, which included participants of other ConocoPhillips subsidiaries. Through the separation date, we accounted for such Shared Plans as multiemployer benefit plans. Accordingly, we did not record an asset or liability to recognize the funded status of the Shared Plans on our consolidated balance sheet until the separation date. At the separation date, the assets and liabilities of certain defined benefit plans and postretirement benefit plans, allocable to Phillips 66 employees, were transferred to Phillips 66. Plan assets of \$2,092 million, benefit obligations of \$3,072 million and \$870 million of accumulated other comprehensive loss (\$541 million net of tax) were recorded for the plans transferred to us. The amount of plan assets transferred was adjusted during the third quarter of 2012 based on the final actuarial analyses. As a result, \$2,063 million of plan assets was ultimately received from ConocoPhillips.

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The table below presents the allocated benefit cost from Shared Plans, as well as the net periodic benefit cost associated with plans sponsored by us, for the three and nine months ended September 30, 2012 and 2011:

	Millions of Dollars					
	Pension Benefits				Other Benefits	
	2012		2011		2012	2011
	U.S.	Int l.	U.S.	Int l.		
Components of Net Periodic Benefit Cost						
Three Months Ended September 30						
Service cost	\$ 30	7		1	1	
Interest cost	25	8		4	2	
Expected return on plan assets	(30)	(7)		(2)		
Amortization of prior service cost						
Recognized net actuarial loss	19	2			(1)	
Subtotal net periodic benefit cost	44	10		3	2	
Allocated benefit cost from ConocoPhillips				54	10	5
Total net periodic benefit cost	\$ 44	10		54	13	5
Nine Months Ended September 30						
Service cost	\$ 51	14		4	2	
Interest cost	41	17		10	3	
Expected return on plan assets	(50)	(14)		(6)		
Amortization of prior service cost	1					
Recognized net actuarial loss	31	5		2	(1)	
Subtotal net periodic benefit cost	74	22		10	4	
Allocated benefit cost from ConocoPhillips	71	13	160	30	7	15
Total net periodic benefit cost	\$ 145	35	160	40	11	15

During the first nine months of 2012, we contributed \$37 million to our U.S. plans and \$24 million to our international plans. Total contributions for the remainder of the year are currently estimated to be \$13 million for our international plans. No further contributions are expected this year for our U.S. plans due to new funding relief rules enacted during the third quarter of 2012.

Table of Contents**Note 17 Related Party Transactions**

Significant transactions with related parties were:

	Millions of Dollars			
	Three Months Ended		Nine Months Ended	
	September 30 2012	2011	September 30 2012	2011
Operating revenues and other income (a)	\$ 1,883	2,107	6,119	6,515
Purchases (b)	4,176	8,938	18,984	25,354
Operating expenses and selling, general and administrative expenses (c)	32	97	175	288
Interest expense (d)	2	3	6	7

- (a) We sold crude oil to MRC. Natural gas liquids, solvents and petrochemical feedstocks were sold to CPChem, and gas oil and hydrogen feedstocks were sold to Excel. Crude oil, blendstock and other intermediate products were sold to WRB. In addition, we charged several of our affiliates, including CPChem and MSLP, for the use of common facilities, such as steam generators, waste and water treaters, and warehouse facilities.
- (b) We purchased refined products from WRB. We purchased natural gas and natural gas liquids from DCP Midstream and CPChem for use in our refinery processes and other feedstocks from various affiliates. We purchased refined products from MRC. We also paid fees to various pipeline equity companies for transporting finished refined products. In addition, we paid a price upgrade to MSLP for heavy crude processing. We purchased base oils and fuel products from Excel for use in our refining and marketing businesses.
- (c) We paid utility and processing fees to various affiliates.
- (d) We incurred interest expense on a note payable to MSLP. See Note 6 Investments, Loans and Long-Term Receivables, for additional information on loans to affiliated companies.

Also included in the table above are transactions with ConocoPhillips through April 30, 2012, the effective date of the separation. These transactions include crude oil purchased from ConocoPhillips as feedstock for our refineries and power sold to ConocoPhillips from our power generation facilities. Sales to ConocoPhillips prior to the separation were \$381 million in 2012 and \$869 million for the nine months ended September 30, 2011. For the three months ended September 30, 2011, sales to ConocoPhillips were \$305 million. Purchases from ConocoPhillips prior to the separation were \$5,328 million in 2012 and \$11,592 million for the nine months ended September 30, 2011. For the three months ended September 30, 2011, purchases from ConocoPhillips were \$4,005 million.

For periods prior to the separation, the consolidated statement of income includes expense allocations for certain corporate functions historically performed by ConocoPhillips and not allocated to its operating segments, including allocations of general corporate expenses related to executive oversight, accounting, treasury, tax, legal, procurement and information technology. Net charges from ConocoPhillips for these services, reflected in selling, general and administrative expenses, were \$70 million in 2012 and \$144 million for the nine months ended September 30, 2011, and \$46 million for the three months ended September 30, 2011.

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Supplemental Cash Flow Information

In accordance with the separation and distribution agreement with ConocoPhillips, certain assets and liabilities were transferred to us at separation that were not included in the historical financial statements for periods prior to the separation. These noncash capital contributions included:

\$374 million of PP&E; primarily office buildings and facilities.

\$1,230 million of employee benefit liabilities; primarily related to U.S. and U.K. pension plans.

\$340 million of deferred taxes associated with the employee benefit liabilities.

Note 18 Segment Disclosures and Related Information

We have organized our reporting structure based on the grouping of similar products and services, resulting in three operating segments:

- 1) **R&M** This segment purchases, refines, markets and transports crude oil and petroleum products, mainly in the United States, Europe and Asia. This segment also includes power generation operations. The R&M segment's United States and international operations are disclosed separately for reporting purposes.
- 2) **Midstream** This segment gathers, processes, transports and markets natural gas and fractionates and markets natural gas liquids in the United States. The Midstream segment primarily consists of our 50 percent equity investment in DCP Midstream.
- 3) **Chemicals** This segment manufactures and markets petrochemicals and plastics on a worldwide basis. The Chemicals segment consists of our 50 percent equity investment in CPChem.

Corporate and Other includes general corporate overhead, interest expense, our investments in new technologies and various other corporate activities. Corporate assets include all cash and cash equivalents.

We evaluate performance and allocate resources based on net income attributable to Phillips 66. Intersegment sales are at prices that approximate market.

Table of Contents**Analysis of Results by Operating Segment**

	Millions of Dollars			
	Three Months Ended		Nine Months Ended	
	September 30 2012	2011	September 30 2012	2011
Sales and Other Operating Revenues				
R&M				
United States	\$ 27,618	32,216	87,064	96,991
International	14,018	16,315	44,011	45,249
Intersegment eliminations	(53)	(87)	(217)	(400)
R&M	41,583	48,444	130,858	141,840
Midstream				
Total sales	1,390	2,259	4,795	6,512
Intersegment eliminations	(36)	(95)	(195)	(380)
Midstream	1,354	2,164	4,600	6,132
Chemicals	2	2	8	8
Corporate and Other	6		9	3
Consolidated sales and other operating revenues	\$ 42,945	50,610	135,475	147,983
Net Income (Loss) Attributable to Phillips 66				
R&M				
United States	\$ 1,401	795	2,932	1,913
International	247	(10)	300	134
Total R&M	1,648	785	3,232	2,047
Midstream	(77)	118	(79)	290
Chemicals	153	193	577	568
Corporate and Other	(125)	(47)	(314)	(141)
Consolidated net income attributable to Phillips 66	\$ 1,599	1,049	3,416	2,764

	Millions of Dollars	
	September 30	December 31
	2012	2011
Total Assets		
R&M		
United States	\$ 26,098	25,056
International	11,511	8,902
Goodwill	3,344	3,332

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Total R&M	40,953	37,290
Midstream	2,144	2,900
Chemicals	3,858	2,999
Corporate and Other	5,275	22
Consolidated total assets	\$ 52,230	43,211

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Note 19 Income Taxes

Our effective tax rate for the third quarter and first nine months of 2012 was 35 percent and 37 percent, respectively, compared with 32 percent and 35 percent for the corresponding periods of 2011. The effective tax rate for the nine-month period of 2012 differs from the federal statutory rate of 35 percent primarily due to state income taxes (net of federal benefit), partially offset by the domestic manufacturing deduction. The provision for income taxes for periods prior to the separation has been computed as if we were a stand-alone company.

Note 20 Condensed Consolidating Financial Information

Our \$5.8 billion of Senior Notes were issued by Phillips 66, and are guaranteed by Phillips 66 Company, a 100-percent-owned subsidiary. Phillips 66 Company has fully and unconditionally guaranteed the payment obligations of Phillips 66 with respect to these debt securities. The following condensed consolidating financial information presents the results of operations, financial position and cash flows for:

Phillips 66 and Phillips 66 Company (in each case, reflecting investments in subsidiaries utilizing the equity method of accounting).

All other nonguarantor subsidiaries.

The consolidating adjustments necessary to present Phillips 66's results on a consolidated basis. This condensed consolidating financial information should be read in conjunction with the accompanying consolidated financial statements and notes.

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Income Statement	Millions of Dollars					
	Phillips 66	Phillips 66 Company	All Other Subsidiaries	Consolidating Adjustments	Total Consolidated	
Revenues and Other Income						
Sales and other operating revenues	\$	89,075	46,400		135,475	
Equity in earnings of affiliates		3,514	2,786	346	(4,138)	2,508
Net gain (loss) on dispositions			190	(1)		189
Other income (loss)			(40)	122		82
Intercompany revenues		1	2,047	18,474	(20,522)	
Total Revenues and Other Income		3,515	94,058	65,341	(24,660)	138,254
Costs and Expenses						
Purchased crude oil and products			80,833	56,541	(20,459)	116,915
Operating expenses			2,448	555	(43)	2,960
Selling, general and administrative expenses		3	963	318	(23)	1,261
Depreciation and amortization			490	179		669
Impairments			45	521		566
Taxes other than income taxes			3,922	6,384	(1)	10,305
Accretion on discounted liabilities			13	5		18
Interest and debt expense		140	24	2	4	170
Foreign currency transaction gains				(22)		(22)
Total Costs and Expenses		143	88,738	64,483	(20,522)	132,842
Income before income taxes		3,372	5,320	858	(4,138)	5,412
Provision (benefit) for income taxes		(44)	1,806	229		1,991
Net income		3,416	3,514	629	(4,138)	3,421
Less: net income attributable to noncontrolling interests				5		5
Net Income Attributable to Phillips 66	\$	3,416	3,514	624	(4,138)	3,416
Comprehensive Income	\$	3,026	3,632	617	(3,564)	3,711

Income Statement	Millions of Dollars					
	Phillips 66	Phillips 66 Company	All Other Subsidiaries	Consolidating Adjustments	Total Consolidated	
Revenues and Other Income						
Sales and other operating revenues	\$	100,428	47,555		147,983	
Equity in earnings of affiliates		2,764	2,261	572	(3,267)	2,330
Net gain (loss) on dispositions			48	(223)		(175)
Other income (loss)			(1)	29		28
Intercompany revenues			3,430	21,314	(24,744)	
Total Revenues and Other Income		2,764	106,166	69,247	(28,011)	150,166

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Costs and Expenses					
Purchased crude oil and products		94,382	60,184	(24,713)	129,853
Operating expenses		2,467	651	(31)	3,087
Selling, general and administrative expenses		740	302		1,042
Depreciation and amortization		480	187		667
Impairments		486	2		488
Taxes other than income taxes		3,610	7,175		10,785
Accretion on discounted liabilities		10	6		16
Interest and debt expense		10	1		11
Foreign currency transaction gains		(1)	(55)		(56)
Total Costs and Expenses		102,184	68,453	(24,744)	145,893
Income before income taxes	2,764	3,982	794	(3,267)	4,273
Provision for income taxes		1,218	287		1,505
Net income	2,764	2,764	507	(3,267)	2,768
Less: net income attributable to noncontrolling interests			4		4
Net Income Attributable to Phillips 66	\$ 2,764	2,764	503	(3,267)	2,764
Comprehensive Income	\$ 2,697	2,697	497	(3,190)	2,701

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Balance Sheet	Millions of Dollars				Total Consolidated	
	Phillips 66	Phillips 66 Company	All Other Subsidiaries	Consolidating Adjustments		
Assets						
Cash and cash equivalents	\$	2,891	1,539		4,430	
Accounts and notes receivable		11	2,423	9,784	(1,425)	10,793
Inventories			3,290	2,453		5,743
Prepaid expenses and other current assets		13	483	411		907
Total Current Assets		24	9,087	14,187	(1,425)	21,873
Investments and long-term receivables		28,302	19,429	4,370	(41,301)	10,800
Net properties, plants and equipment			11,640	3,671		15,311
Goodwill			3,344			3,344
Intangibles			710	16		726
Other assets		47	112	17		176
Total Assets	\$	28,373	44,322	22,261	(42,726)	52,230
Liabilities and Equity						
Accounts payable	\$	2	7,276	7,599	(1,425)	13,452
Short-term debt		571	14			585
Accrued income and other taxes			628	764		1,392
Employee benefit obligations			306	44		350
Other accruals		137	297	173		607
Total Current Liabilities		710	8,521	8,580	(1,425)	16,386
Long-term debt		7,224	168	1		7,393
Asset retirement obligations and accrued environmental costs			577	189		766
Deferred income taxes		(72)	4,535	973		5,436
Employee benefit obligations			924	157		1,081
Other liabilities and deferred credits		77	1,637	3,551	(4,703)	562
Total Liabilities		7,939	16,362	13,451	(6,128)	31,624
Common stock		18,538	25,853	8,286	(34,139)	18,538
Retained earnings		2,164	2,375	244	(2,619)	2,164
Accumulated other comprehensive income (loss)		(268)	(268)	247	160	(129)
Noncontrolling interests				33		33
Total Liabilities and Equity	\$	28,373	44,322	22,261	(42,726)	52,230

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Balance Sheet	Millions of Dollars				Total Consolidated
	December 31, 2011	Phillips 66 Company	All Other Subsidiaries	Consolidating Adjustments	
Assets					
Cash and cash equivalents	\$				
Accounts and notes receivable		6,497	4,307	(779)	10,025
Inventories		2,048	1,418		3,466
Prepaid expenses and other current assets		110	347		457
Total Current Assets		8,655	6,072	(779)	13,948
Investments and long-term receivables	23,264	12,810	3,623	(29,391)	10,306
Net properties, plants and equipment		11,304	3,467		14,771
Goodwill		3,332			3,332
Intangibles		713	19		732
Other assets		105	17		122
Total Assets	\$ 23,264	36,919	13,198	(30,170)	43,211
Liabilities and Net Investment					
Accounts payable	\$	6,845	4,726	(779)	10,792
Short-term debt		23	7		30
Accrued income and other taxes		427	660		1,087
Employee benefit obligations		13	51		64
Other accruals		332	79		411
Total Current Liabilities		7,640	5,523	(779)	12,384
Long-term debt		361			361
Asset retirement obligations and accrued environmental costs		606	181		787
Deferred income taxes		4,814	989		5,803
Employee benefit obligations			117		117
Other liabilities and deferred credits		234	2,631	(2,399)	466
Total Liabilities		13,655	9,441	(3,178)	19,918
Net ConocoPhillips investment	23,142	23,142	3,436	(26,578)	23,142
Accumulated other comprehensive income	122	122	292	(414)	122
Noncontrolling interests			29		29
Total Liabilities and Net Investment	\$ 23,264	36,919	13,198	(30,170)	43,211

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Statement of Cash Flows	Millions of Dollars				Total Consolidated
	Phillips 66	Phillips 66 Company	All Other Subsidiaries	Consolidating Adjustments	
Cash Flows From Operating Activities					
Net Cash Provided by (Used in) Operating Activities	\$ (44)	7,300	(4,265)		2,991
Cash Flows From Investing Activities					
Capital expenditures and investments		(606)	(231)	10	(827)
Proceeds from asset dispositions		210	49		259
Advances/loans related parties			(100)		(100)
Collection of advances/loans related parties			7	(7)	
Other					
Net Cash Used in Investing Activities		(396)	(275)	3	(668)
Cash Flows From Financing Activities					
Contributions from (distributions to) ConocoPhillips	(7,469)	(3,837)	6,051		(5,255)
Issuance of debt	7,794				7,794
Repayment of debt		(204)	(9)	7	(206)
Issuance of common stock	23				23
Repurchase of common stock	(111)				(111)
Dividends paid on common stock	(125)				(125)
Other	(68)	28	10	(10)	(40)
Net Cash Provided by (Used in) Financing Activities	44	(4,013)	6,052	(3)	2,080
Effect of Exchange Rate Changes on Cash and Cash Equivalents					
			27		27
Net Change in Cash and Cash Equivalents					
		2,891	1,539		4,430
Cash and cash equivalents at beginning of period					
Cash and Cash Equivalents at End of Period	\$	2,891	1,539		4,430

Statement of Cash Flows	Millions of Dollars				Total Consolidated
	Phillips 66	Phillips 66 Company	All Other Subsidiaries	Consolidating Adjustments	
Cash Flows From Operating Activities					
Net Cash Provided by Operating Activities	\$	643	1,632		2,275
Cash Flows From Investing Activities					
Capital expenditures and investments		(477)	(176)		(653)
Proceeds from asset dispositions		110	94		204
Collection of advances/loans related parties		550			550
Other		2	54		56

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Net Cash Provided by (Used in) Investing Activities	185	(28)	157
Cash Flows From Financing Activities			
Distributions to ConocoPhillips	(814)	(1,597)	(2,411)
Repayment of debt	(14)	(6)	(20)
Other		(1)	(1)
Net Cash Used in Financing Activities	(828)	(1,604)	(2,432)
Net Change in Cash and Cash Equivalents			
Cash and cash equivalents at beginning of period			
Cash and Cash Equivalents at End of Period			\$

Table of Contents**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Management's Discussion and Analysis is the company's analysis of its financial performance, financial condition, and of significant trends that may affect future performance. It should be read in conjunction with the consolidated financial statements and notes. It contains forward-looking statements including, without limitation, statements relating to the company's plans, strategies, objectives, expectations and intentions that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words anticipate, estimate, believe, budget, continue, could, intend, may, plan, potential, predict, seek, should, will, would, expect, goal, guidance, outlook, effort, target and similar expressions identify forward-looking statements. The company does not undertake to update, revise or correct any of the forward-looking information unless required to do so under the federal securities laws. Readers are cautioned that such forward-looking statements should be read in conjunction with the company's disclosures under the heading: CAUTIONARY STATEMENT FOR THE PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995, beginning on page 45.

The terms earnings and loss as used in Management's Discussion and Analysis refer to net income (loss) attributable to Phillips 66.

BUSINESS ENVIRONMENT AND EXECUTIVE OVERVIEW

Phillips 66 is an international downstream company with refining and marketing, midstream and chemicals businesses. At September 30, 2012, we had total assets of \$52 billion. Our common stock trades on the New York Stock Exchange under the symbol PSX.

The Separation

On April 4, 2012, the ConocoPhillips Board of Directors approved the separation of its downstream businesses into an independent, publicly traded company named Phillips 66. In accordance with a separation and distribution agreement, the two companies were separated by ConocoPhillips distributing to its stockholders all 625,272,302 shares of common stock of Phillips 66 after the market closed on April 30, 2012. Each ConocoPhillips shareholder received one share of Phillips 66 stock for every two shares of ConocoPhillips stock held at the close of business on the record date of April 16, 2012. Fractional shares of Phillips 66 common stock were not distributed and any fractional shares of Phillips 66 common stock otherwise issuable to a ConocoPhillips shareholder were sold in the open market on such shareholder's behalf, and such shareholder received a cash payment with respect to that fractional share. In conjunction with the separation, ConocoPhillips received a private letter ruling from the Internal Revenue Service to the effect that, based on certain facts, assumptions, representations and undertakings set forth in the ruling, for U.S. federal income tax purposes, the distribution of Phillips 66 stock was not taxable to ConocoPhillips or U.S. holders of ConocoPhillips common stock, except in respect to cash received in lieu of fractional share interests. Following the separation, ConocoPhillips retained no ownership interest in Phillips 66, and each company now has separate public ownership, boards of directors and management. A registration statement on Form 10, as amended through the time of its effectiveness, describing the separation was filed by Phillips 66 with the U.S. Securities and Exchange Commission (SEC) and was declared effective on April 12, 2012 (the Form 10). Pursuant to the separation and distribution agreement with ConocoPhillips, on April 30, 2012, we made a special cash distribution to ConocoPhillips of \$5.95 billion. After subsequent working capital and inventory determinations, an additional cash distribution of \$1.87 billion was made to ConocoPhillips in June 2012. After consideration of the cash retained by Phillips 66 at separation, as well as cash flow impacts of the four months ended April 30, 2012, the net distribution to ConocoPhillips was \$5.3 billion.

Basis of Presentation

Prior to the separation on April 30, 2012, our results of operations, financial position and cash flows consisted of ConocoPhillips refining, marketing and transportation operations; its natural gas gathering, processing, transmission and marketing operations, primarily conducted through its equity investment in DCP Midstream, LLC (DCP Midstream); its petrochemical operations, conducted through its equity investment in Chevron Phillips Chemical Company LLC (CPChem); its power generation operations; and an allocable portion of its corporate costs (together, the downstream businesses). These financial statements have been presented as if

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the downstream businesses had been combined for all periods presented. All intercompany transactions and accounts within the downstream businesses were eliminated. The assets and liabilities have been reflected on a historical cost basis, as all of the assets and liabilities presented were wholly owned by ConocoPhillips and were transferred within the ConocoPhillips consolidated group. The statement of income for periods prior to the separation includes expense allocations for certain corporate functions historically performed by ConocoPhillips and not allocated to its operating segments, including allocations of general corporate expenses related to executive oversight, accounting, treasury, tax, legal, procurement and information technology. These allocations were based primarily on specific identification of time and/or activities associated with the downstream businesses, employee headcount or capital expenditures, and our management believes the assumptions underlying the allocations were reasonable. The combined financial statements may not necessarily reflect all of the actual expenses that would have been incurred had we been a stand-alone company during the periods presented prior to the separation. All financial information presented after the separation represents the consolidated results of operations, financial position and cash flows of Phillips 66.

Business Environment

Results for our Refining and Marketing (R&M) segment depend largely on refining and marketing margins, cost control, refinery throughput, and product yields. The crack spread is a measure of the difference between market prices for refined petroleum products and crude oil, and it is used within our industry as an indicator for refining margins. Both domestic and international industry crack spreads improved in the third quarter of 2012. The U.S. 3:2:1 crack spread (three barrels of crude oil producing two barrels of gasoline and one barrel of diesel) increased in the third quarter of 2012, compared with both the third quarter of 2011 and the second quarter of 2012. The improvement in domestic industry crack spreads was primarily attributable to higher distillates and gasoline prices resulting from lower production from several domestic refineries due to refinery outages, seasonal maintenance and the weather disruptions during the third quarter of 2012.

In addition, U.S. crude production continued to increase, and limited infrastructure for takeaway options resulted in advantaged crude prices for U.S. refiners with Midcontinent and Gulf Coast refineries that run advantaged crudes. Seasonally high inventory levels in the Midcontinent continued to cause West Texas Intermediate (WTI) crude to trade at a deep discount relative to waterborne crudes such as Light Louisiana Sweet (LLS) and Brent. Refineries capable of processing WTI crude and crude oils that price relative to WTI, primarily the Midcontinent and Gulf Coast refineries, benefitted from these lower regional feedstock prices.

The Northwest Europe benchmark crack spread increased in the third quarter of 2012, compared with the third quarter of 2011 and the second quarter of 2012. The improvement over both periods was driven by higher distillates and gasoline prices due to tight supply caused by refinery closures, seasonal maintenance and outages. Decreased distillates supply from Russia and the United States also contributed to higher distillates prices. In addition, lower Brent crude oil prices in the third quarter of 2012, compared with the third quarter of 2011, contributed to the improved market crack spread.

The Midstream segment's results are closely linked to natural gas liquids prices and, to a lesser extent, natural gas prices. Natural gas liquids prices decreased in the third quarter of 2012, compared with the third quarter of 2011 and the second quarter of 2012, due to growing natural gas liquids production from liquids-rich shale plays with limited corresponding demand increase from the petrochemical industry.

The Chemicals segment consists of our 50 percent equity investment in CPChem. The chemicals and plastics industry is mainly a commodity-based industry where the margins for key products are based on market factors. The chemicals industry experienced improved ethylene margins in regions of the world where production is based upon natural gas liquids versus crude-derived feedstocks. In particular, North American ethane-based crackers benefitted from the lower-priced feedstocks.

Table of Contents**RESULTS OF OPERATIONS**

Unless otherwise indicated, discussion of results for the three- and nine-month periods ended September 30, 2012, is based on a comparison with the corresponding periods of 2011.

Consolidated Results

A summary of net income (loss) attributable to Phillips 66 by business segment follows:

	Millions of Dollars			
	Three Months Ended		Nine Months Ended	
	September 30	September 30	September 30	September 30
	2012	2011	2012	2011
R&M	\$ 1,648	785	3,232	2,047
Midstream	(77)	118	(79)	290
Chemicals	153	193	577	568
Corporate and Other	(125)	(47)	(314)	(141)
Net income attributable to Phillips 66	\$ 1,599	1,049	3,416	2,764

Earnings for Phillips 66 increased 52 percent in the third quarter of 2012 and 24 percent in the nine-month period ended September 30, 2012, compared with the corresponding periods of 2011. The increases in both periods were primarily due to the improved results from our R&M segment, mainly due to higher refining margins and increased utilization. The improved results were partially offset by lower earnings from our Midstream segment and higher interest expense and corporate repositioning expenses.

Lower earnings from the Midstream segment were driven by lower equity in earnings from DCP Midstream and impairments of our equity investment in Rockies Express Pipeline LLC (REX), which decreased our Midstream segment earnings by \$133 million in the current quarter and \$170 million in the second quarter of 2012.

See the Segment Results section for additional information on our segment results.

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Income Statement Analysis

Sales and other operating revenues for the third quarter and nine-month period of 2012 decreased 15 percent and 8 percent, respectively, and purchased crude oil and products decreased 18 percent and 10 percent, respectively. The decreases were mainly due to processing lower refining volumes at our wholly owned refineries, resulting from the shutdown of Trainer Refinery in September 2011, combined with lower natural gas liquids (NGL) prices.

Equity in earnings of affiliates for the third quarter and nine-month period of 2012 increased 12 percent and 8 percent, respectively. The increases in both periods primarily resulted from improved earnings from WRB Refining LP (WRB), mainly due to higher refining margins in the Central Corridor, combined with processing higher refining volumes associated with the start-up of the coker and refining expansion (CORE) project at the Wood River Refinery. This increase was partially offset by:

Lower earnings from DCP Midstream, mainly due to lower natural gas liquids prices.

Lower earnings from Excel Paralubes, mainly due to lower margins in the third quarter of 2012, and lower volumes and higher operating expenses in the nine-month period of 2012, resulting from a major turnaround in the first quarter of 2012.

Lower earnings from Merey Sweeny, L.P. (MSLP), mainly due to lower margins.

The absence of earnings from Colonial Pipeline Company, which was sold in December 2011.

In addition, earnings from CPChem decreased in the third quarter of 2012, mainly due to a loss on early extinguishment of debt and fixed assets impairments, while equity earnings from CPChem increased in the nine-month period of 2012, primarily resulting from higher ethylene and polyethylene margins. Earnings from Malaysian Refining Company Sdn. Bhd. (MRC) increased in the third quarter of 2012, mainly due to improved refining margins in the current quarter, while they decreased in the nine-month period of 2012, primarily resulting from lower refining margins in the nine-month period.

Net loss on dispositions for the third quarter of 2012 decreased \$220 million, primarily related to a before-tax loss of \$228 million on the sale of our refinery in Wilhelmshaven, Germany, in the third quarter of 2011. During the nine-month period of 2012, our net gain on dispositions was \$189 million, primarily reflecting the sale of Trainer Refinery and associated terminal and pipeline assets in the second quarter of 2012, compared with a net loss of \$175 million in the nine-month period of 2011, primarily related to the loss on the sale of Wilhelmshaven Refinery (WRG) as mentioned above.

Other income increased \$54 million in the nine-month period of 2012, compared with the corresponding period of 2011. The increase was primarily associated with gains from trading activities not directly related to our physical business.

Operating expenses for the third quarter and nine-month period of 2012 decreased 14 percent and 4 percent, respectively. The decreases in both periods were primarily driven by lower utility costs, reflecting lower natural gas prices, and the absence of operating expenses associated with Trainer Refinery, which was shut down in September 2011, and WRG, which was sold in August 2011.

Selling, general and administrative expenses for the third quarter and nine-month period of 2012 increased 16 percent and 21 percent, respectively, primarily resulting from costs associated with the separation of Phillips 66 from ConocoPhillips, and incremental costs relating to a prior retail disposition program.

Impairments in 2012 included an investment in a natural gas transmission pipeline, a marine terminal and associated assets, as well as equipment formerly associated with a cancelled refinery upgrade project. Impairments in 2011 included the Trainer Refinery and associated terminal and pipeline assets. For additional information on the impairments, see Note 8 Impairments, in the Notes to Consolidated Financial Statements.

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Interest and debt expense for the third quarter and nine-month period of 2012 increased \$70 million and \$159 million, respectively, primarily due to approximately \$7.8 billion of new debt issued in March and April of 2012. For additional information on the debt issuances, see Note 9 Debt, in the Notes to Consolidated Financial Statements.

Foreign currency transaction (gains) losses for the third quarter of 2012 were a \$15 million gain, compared with a loss of \$18 million for the third quarter of 2011. For the nine-month period of 2012, the gains decreased \$34 million compared with the same period of 2011. The favorable change in the current quarter was primarily due to the U.S. dollar weakening against both the British pound and the euro, compared with the U.S. dollar strengthening against both the British pound and the euro during the third quarter of 2011. The lower gain in the nine-month period of 2012 was driven by the U.S. dollar weakening less against both the British pound and the euro than in the nine-month period of 2011.

See Note 19 Income Taxes, in the Notes to Consolidated Financial Statements, for information regarding our provision for income taxes and effective tax rates.

Table of Contents**Segment Results****R&M**

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2012	2011	2012	2011
Millions of Dollars				
Net Income (Loss) Attributable to Phillips 66				
United States	\$ 1,401	795	2,932	1,913
International	247	(10)	300	134
	\$ 1,648	785	3,232	2,047

	Dollars Per Barrel			
Refining Margins				
Atlantic Basin/Europe	\$ 13.02	6.86	9.25	5.81
Gulf Coast	11.42	10.21	9.00	9.40
Central Corridor	31.83	26.30	25.14	21.23
Western/Pacific	13.30	10.72	10.71	10.17
Worldwide	17.05	12.53	13.34	10.62

	Dollars Per Gallon			
U.S. Average Wholesale Prices*				
Gasoline	\$ 3.09	3.04	3.05	2.99
Distillates	3.24	3.16	3.18	3.11

*Excludes excise taxes.

	Thousands of Barrels Daily			
Operating Statistics				
Refining operations*				
Atlantic Basin/Europe				
Crude oil capacity	588	773	588	773
Crude oil processed	587	719	574	718
Capacity utilization (percent)	100%	93	98	93
Refinery production	628	769	623	779
Gulf Coast				
Crude oil capacity	733	733	733	733
Crude oil processed	649	668	640	649
Capacity utilization (percent)	88%	91	87	89
Refinery production	736	761	726	741
Central Corridor				
Crude oil capacity	469	471	470	471
Crude oil processed	478	442	467	434
Capacity utilization (percent)	102%	94	99	92
Refinery production	495	453	485	449
Western/Pacific				
Crude oil capacity	439	435	439	435
Crude oil processed	424	394	397	387

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Capacity utilization (percent)	97%	91	90	89
Refinery production	437	415	417	411
Worldwide				
Crude oil capacity	2,229	2,412	2,230	2,412
Crude oil processed	2,138	2,223	2,078	2,188
Capacity utilization (percent)	96%	92	93	91
Refinery production	2,296	2,398	2,251	2,380

**Includes our share of equity affiliates.*

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	Three Months Ended		Nine Months Ended	
	September 30 2012	2011	September 30 2012	2011
	Thousands of Barrels Daily			
Petroleum products sales volumes				
Gasoline	1,211	1,300	1,208	1,326
Distillates	1,161	1,250	1,153	1,210
Other products	486	639	490	598
	2,858	3,189	2,851	3,134

The R&M segment refines crude oil and other feedstocks into petroleum products (such as gasoline, distillates and aviation fuels); buys, sells and transports crude oil; and buys, transports, distributes and markets petroleum products. This segment also includes power generation operations. R&M has operations mainly in the United States, Europe and Asia.

R&M reported earnings of \$1,648 million during the third quarter of 2012, an increase of \$863 million, or 110 percent, compared with the third quarter of 2011. Earnings for the nine-month period of 2012 were \$3,232 million, an increase of \$1,185 million, or 58 percent, compared with the same period of 2011. See the Business Environment and Executive Overview section for information on industry crack spreads and other market factors impacting this quarter's results.

Earnings for both periods of 2012 improved, primarily due to higher worldwide refining margins driven by improved market cracks. Also contributing to the improved 2012 results were lower operating expenses and favorable volume impacts. Lower operating expenses were primarily due to lower utility costs, reflecting lower natural gas prices, and the absence of operating expenses from Trainer Refinery, which was shut down in September 2011, and WRG, which was sold in August 2011.

While worldwide refining volumes decreased, refining volumes increased in the high-margin Central Corridor and decreased in the low-margin Atlantic Basin/Europe as a result of the shutdown of Trainer Refinery in September 2011. The improved volume mix favorably impacted our earnings in the 2012 periods.

The third quarter of 2012 included an after-tax impairment of \$27 million on the Riverhead Terminal, compared with an after-tax impairment of \$314 million on Trainer Refinery during the third quarter of 2011. In addition, the nine-month period of 2012 included a \$42 million after-tax impairment related to equipment formerly associated with the cancelled WRG upgrade project. For additional information on these impairments, see Note 8 Impairments, in the Notes to Consolidated Financial Statements.

Additionally, the nine-month period of 2012 included an after-tax gain of \$106 million from the sale of Trainer Refinery and associated terminal and pipeline assets, compared with an after-tax loss on the sale of our refinery in Wilhelmshaven, Germany, in the third quarter of 2011. For additional information on the sale of Trainer Refinery and associated assets, see Note 5 Assets Held for Sale or Sold, in the Notes to Consolidated Financial Statements.

Our worldwide refining capacity utilization rate was 96 percent in the third quarter of 2012, compared with 92 percent in the third quarter of 2011. The current year improvement was primarily due to improved market conditions.

Our Bayway Refinery in Linden, New Jersey, was shut down in advance of Hurricane Sandy, and currently remains shut down. We are assessing the impact of the hurricane on the refinery, including the extent of wind and water damage. We do not yet have a forecast on when Bayway will resume production.

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Industry refining margins can vary by region of the world, due to differing crude slates and refined product demand fundamentals. In conjunction with our long-range planning efforts, in the absence of any interim indicators, we perform an annual review for impairment indicators of property and equity investments in the fourth quarter. The review takes into account the company's outlook on economic factors that influence cash flows including commodity prices, industry refining margins, capital spending and other operating plan assumptions. As we finalize our plans and conduct our review, it is reasonably possible non-cash impairments of some of our properties and equity investments may be required.

Midstream

	Three Months Ended September 30 2012		Nine Months Ended September 30 2012	
	2011	2011	2011	2011
	Millions of Dollars			
Net Income (Loss) Attributable to Phillips 66*	\$ (77)	118	(79)	290
<i>*Includes DCP Midstream-related earnings:</i>	\$ 39	87	141	228

	Dollars Per Barrel			
Weighted Average Sales Prices				
U.S. natural gas liquids*				
Equity affiliates	\$ 30.21	52.09	34.93	50.66

* Based on index prices from the Mont Belvieu and Conway market hubs that are weighted by natural gas liquids component and location mix.

	Thousands of Barrels Daily			
Operating Statistics				
Natural gas liquids extracted*	199	196	200	188