ELLIOTT

Elliott Investment Management L.P.
360 S Rosemary Ave, 18th Floor, West Palm Beach, FL 33401

November 29, 2023

The Board of Directors
Phillips 66
2331 CityWest Blvd.
Houston, Texas 77042

Dear Members of the Board:

We are writing to you on behalf of Elliott Associates, L.P. and Elliott International, L.P. (collectively, "Elliott" or "we"), which together have an approximately $1 billion investment in Phillips 66 ("Phillips 66" or the "Company"), making us one of your largest investors.

As we have explained in our discussions with CEO Mark Lashier and the executive leadership team over the past several weeks, we are investors in Phillips 66 today because of our strong confidence in the path to realizing significant value-creation at the Company. While we have appreciated our dialogue to date, we are sharing our thoughts publicly to facilitate an open discussion of views on the best path forward for Phillips 66.

In the balance of this letter, we outline the drivers of Phillips 66's underperformance, the magnitude of the value-creation opportunity at hand – which we believe could be **approximately 75% of upside** from today's stock price (or greater than $200 per share) – and the steps that Phillips 66 needs to take to deliver on that opportunity.

Drivers of Phillips 66's Underperformance

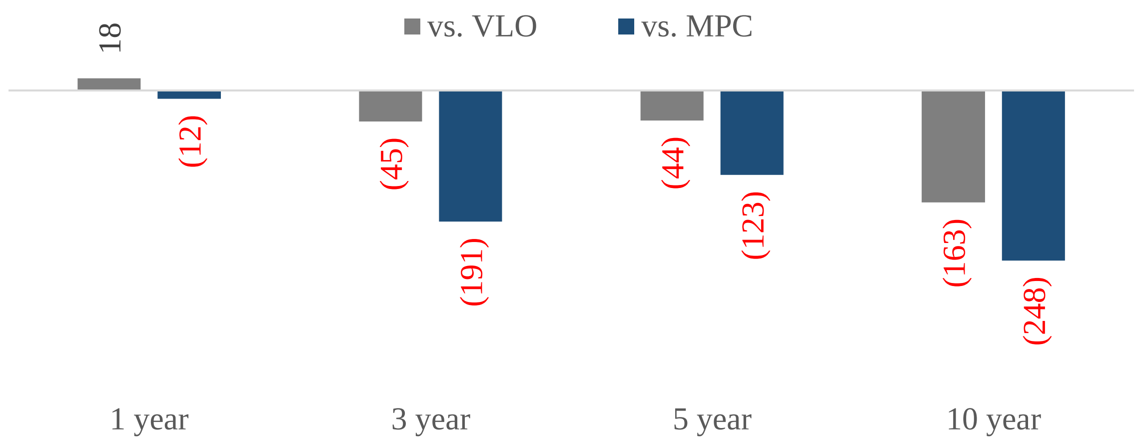
Following its 2012 spin from ConocoPhillips, most investors regarded Phillips 66 as a well-run and high-performing company. The Company continues to play a critical role across the domestic energy value chain.

In recent years, however, Phillips 66's performance has declined as it has shifted its focus away from its Refining segment. (Mr. Lashier admitted as much in January, when he said, "We have taken our eye off the ball a little bit with respect to refining.")[1] As a result, operational execution has suffered, and the Company was poorly positioned to take advantage of the refining super-cycle in 2022 and 2023. During this transformative period, peers such as Marathon Petroleum ("Marathon") and Valero Energy ("Valero") were far better prepared.

Over the past three years, as Phillips 66 has fallen further and further behind, its stock has meaningfully underperformed these peers:

[1] Mark Lashier (CEO), January 2023, GS Energy Conference

Phillips 66 Total Shareholder Return vs. Peers[2]:

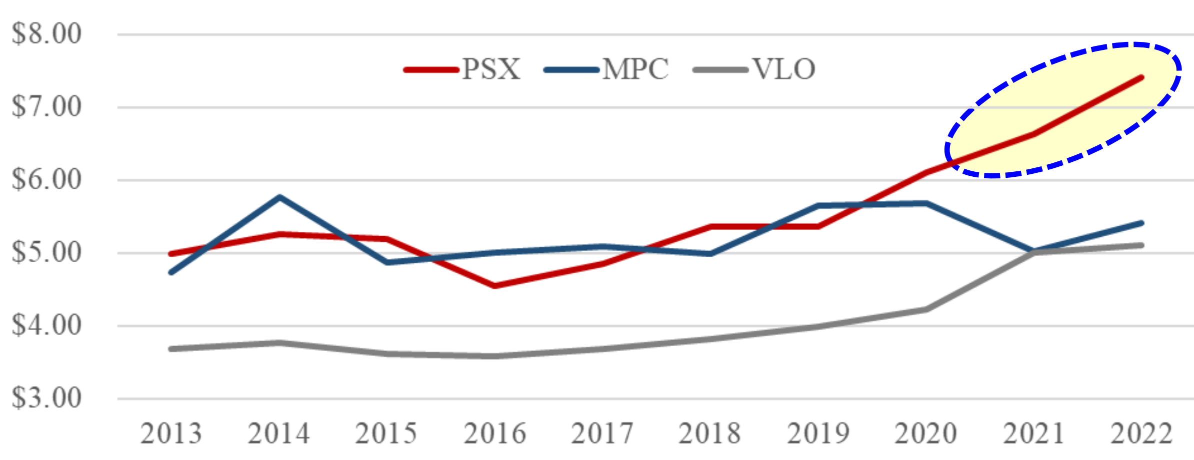


We believe the loss of investor confidence illustrated by the chart above derives from the Company's underperformance in Refining, as well as poor execution on its cost-reduction efforts.

Underperformance in Refining

The consequences of management taking its "eye off the ball" in Refining (some of which predates Mr. Lashier's tenure) have proven costly for shareholders. The chart below shows how Phillips 66's Refining operating expenses per barrel ("opex/bbl") – the metric by which industry participants compare operating efficiency on a like-for-like basis – have soared in recent years, shaking investor confidence in the Company's ability to run its refining operations efficiently.

Opex per Barrel excluding Turnarounds[3]:



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[2] As of November 27, 2023, Bloomberg

[3] Phillips 66 figures include proportional share of affiliate opex and throughput. Marathon figures in 2013 assume turnarounds represent 50% of "Planned Turnaround and Major Maintenance", consistent with 2014-18 revisions.

The magnitude of this inefficiency has ballooned in recent years.[4] By 2022, Phillips 66's opex/bbl "gap" to Valero had grown to ~$2.30/bbl, representing an *increase of ~$0.95/bbl* versus its average gap from 2013-2019 of ~$1.35/bbl.

At the same time, and in stark contrast to Phillips 66, Marathon's opex/bbl gap to Valero shrank dramatically. By 2022, under the leadership of CEO Mike Hennigan, Marathon had reduced its opex/bbl to within ~$0.30/bbl of Valero, representing a *reduction of ~$1.10/bbl* versus its average gap from 2013-2019 of ~$1.40/bbl.

We believe this lack of opex discipline has been a key driver of the Company's stock-price underperformance, particularly in the context of the substantial improvements made by its similarly situated peer Marathon. Achieving safe, reliable and efficient refining operations is paramount to reversing Phillips 66's underperformance.

Lack of trust in cost-reduction programs

In 2019, the Company embarked on the AdvantEdge66 program, aimed at reducing costs. What followed was disappointing to investors: Phillips 66 actually saw costs *increase* relative to peers following implementation. These results have rightfully led investors to dismiss the Company's subsequent targets – not based on their estimation of the opportunity, but on their estimation of the management team's ability to achieve its stated goals.

For example, despite recognizing the quality of the Company's assets, market participants have voiced a lack of confidence in Phillips 66's 2022 Investor Day targets, pointing to a lack of certainty in execution. At the 2022 Investor Day, one analyst questioned:

> "…in 2019, you laid out a similar cost-cutting program, and it actually looks like costs increased over that period on an absolute basis, stripping out energy and maintenance costs on a per unit – on a per barrel basis and relative to peers. So to instill some confidence maybe in this program that you're about to embark on, can you discuss maybe what went wrong in that 2019 to 2022 program and how you expect to maybe not incur those same issues?" – *Cowen, November 2022*

As the analyst quote above shows, a lack of trust stemming from the Company's failure to cut costs as part of its AdvantEdge66 program persists to this day. Today, one of the Company's most important tasks is to remedy this lack of trust and thereby get the proper credit for its 2025 targets.

The Phillips 66 Value-Creation Opportunity

Since his elevation to CEO in 2022, Mr. Lashier, along with the Phillips 66 management team, has set a strategic outlook that includes i) targeting $14 billion of mid-cycle EBITDA by 2025, with more than $1 billion in improvement generated from Refining-segment operations via both opex and commercial improvements; ii) selling $3 billion of non-core assets; and iii) increasing the Company's long-term capital-return policy.

[4] Ibid

These are certainly the correct goals. If achieved, the $14 billion 2025E mid-cycle EBITDA target translates to $9 billion of free cash flow, which at a 10% free cash flow yield implies a >$205 share price.[5] By contrast, we estimate that Valero trades at a ~7% free cash flow yield using comparable commodity assumptions to those underpinning Phillips 66's target.[6]

The table below lays out a breakdown of this potential upside:

Phillips 66 Upside if 2025 Mid-Cycle EBITDA Target is Achieved

$ in millions, except per share amounts		**Upside to 2025E Target Mid-Cycle FCF**
<u>Free Cash Flow at 2025E Mid-Cycle Target</u>		
Operating Cash Flow at 2025E Mid-Cycle EBITDA Target	**$**	**11,000**
(−) Capex	$	(2,000)
Free Cash Flow at 2025E Mid-Cycle EBITDA Target	**$**	**9,000**
<u>Upside to Current Price</u>		
Free Cash Flow at 2025E Mid-Cycle EBITDA Target	$	9,000
Illustrative Mid-Cycle Free Cash Flow Yield		10.0%
Market Capitalization	**$**	**90,000**
Estimated Diluted Shares at Year-End 2023		437
Share Price	**$**	**205.89**
% Upside vs. Current Share Price		**74%**

But while the Company's announced plan is admirable, investor skepticism about Phillips 66's ability to achieve these goals remains a weight on its stock price. According to analysts, Phillips 66 "remains an execution story" (BofA, October 2023) and "[F]eedback from investors following [our] upgrade suggested they wanted to see PSX execute before giving them credit" (Cowen, August 2023).

At present, we believe Mr. Lashier and the rest of the management team deserve investor support so long as they demonstrate meaningful progress against these targets. At the same time, we find the market's skepticism to be understandable, and we believe the Board must take several steps to reassure investors that Phillips 66 is in the best possible position to achieve its value-creation potential.

Achieving the Phillips 66 Value-Creation Opportunity

We are convinced that the fulfilment and sustainability of the Company's success will in large part depend on its oversight capabilities. To that end, we believe that Board enhancements are necessary to ensure the Company meets its targets and delivers the upside potential outlined above.

[5] As of November 27, 2023: Capex based on Company guidance; Estimated Diluted Shares at Year-End 2023 assumes $1 billion of share repurchases in Q4 2023, in-line with the quarterly buyback cadence implied by management's latest capital-return policy.
[6] Based on Elliott's estimate of Valero's free cash flow assuming average 2012 through 2019 RVO (Renewable Volume Obligation) adjusted refining crack spread, the same assumption that underpins Phillips 66's 2025 mid-cycle EBITDA target.

And should the Company fail to meet its targets, we believe there is an alternative path available that would lead to significant value creation.

Board enhancements

Given the Company's history of failed execution, we believe shareholders would welcome the appointment to the Board of two new directors with refining-operating experience. We have identified multiple highly qualified directors who we believe would provide relevant experience and expertise as the Board implements the necessary operational improvements at Phillips 66. Furthermore, we believe these directors will help enhance a Phillips 66 Board that has limited refining-operations expertise, which is particularly noteworthy given the Company's poor execution in this segment.

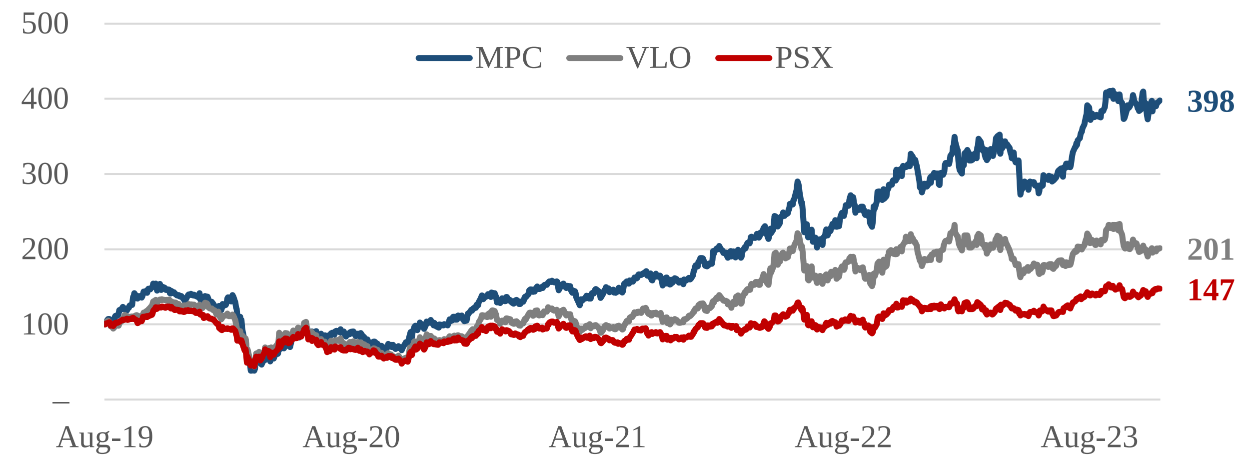
Broader strategic initiatives, if necessary

We are hopeful the current management team, supported by an enhanced Board, can deliver on its performance targets and achieve significant stock-price outperformance. However, should Phillips 66 fail to show material progress toward its 2025 targets over the next year, we believe that the Company should at that point pursue its best available option by making a strategic pivot and following a path that mirrors Marathon's recent transformation.

Following our engagement with Marathon in 2019, its management team and board dramatically improved the company's structure and operating performance, leading its stock price to outperform its U.S. refining peers by approximately 200%. Marathon's achievements over this period included:

- Enhancing governance with the addition of a new director;
- Transitioning to a new CEO;
- Improving refining operations under new leadership which, within two years, closed a $2 per barrel EBITDA gap between Marathon and best-in-class peer Valero (an EBITDA improvement of approximately $2 billion) by reducing operating costs and improving the company's commercial function; and
- Selling the company's Speedway retail operation, which generated $17 billion in after-tax cash proceeds and which has enabled a best-in-class capital-return program while sustaining an investment-grade balance sheet.

Marathon Total Shareholder Return vs. Peers Since Elliott's Engagement[7]:



If it becomes necessary, we are confident Phillips 66 could follow a similar path by:

- Making appropriate management changes;
- Closing the current $2-$3 per barrel refining EBITDA gap between Phillips 66 and Valero; and
- Generating $15 billion to $20 billion of after-tax cash proceeds from the sale of Phillips 66's CPChem stake, European convenience stores, and a portion of its non-operated midstream stakes – monetization events that would enable a best-in-class capital return program while sustaining an investment-grade balance sheet.

Next Steps

Phillips 66 has the ability to remedy its recent period of underperformance through strong execution and a restoration of trust with investors. We believe the key step we outline above – enhancing the Board with fresh perspectives – will ultimately help the Company deliver on its targets. We are committed to ensuring that Phillips 66 reaches its full potential.

Our desire is to work constructively with the Company to add highly qualified directors to its ranks. To that end, we will make ourselves available to meet with the Company to discuss our views in more detail.

Sincerely,

John Pike
Partner

Mike Tomkins
Portfolio Manager

[7] Represents indexed TSR from August 14, 2019 through November 27, 2023, Bloomberg.