Phillips 66
Form 10-Q
July 31, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended June 30, 2014

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 incorporation or organization)	(I.R.S. Employer 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)

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 [X] 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 [X] 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 [X] 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 [X]

The registrant had 558,888,518 shares of common stock, $.01 par value, outstanding as of June 30, 2014.

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PART I. FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS

Consolidated Statement of Income — Phillips 66

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Revenues and Other Income				
Sales and other operating revenues*	$45,549	43,190	85,832	84,401
Equity in earnings of affiliates	764	618	1,542	1,657
Net gain on dispositions	9	41	16	42
Other income	17	49	48	72
Total Revenues and Other Income	46,339	43,898	87,438	86,172
Costs and Expenses				
Purchased crude oil and products	39,316	37,257	73,697	72,500
Operating expenses	1,077	1,032	2,167	2,010
Selling, general and administrative expenses	412	368	814	695
Depreciation and amortization	239	229	473	471
Impairments	3	1	4	25
Taxes other than income taxes*	3,832	3,501	7,470	6,825
Accretion on discounted liabilities	6	6	12	12
Interest and debt expense	66	69	134	139
Foreign currency transaction (gains) losses	29	(18)	10	(16)
Total Costs and Expenses	44,980	42,445	84,781	82,661
Income from continuing operations before income taxes	1,359	1,453	2,657	3,511
Provision for income taxes	487	507	913	1,170
Income From Continuing Operations	872	946	1,744	2,341
Income from discontinued operations**	—	14	706	29
Net Income	872	960	2,450	2,370
Less: net income attributable to noncontrolling interests	9	2	15	5
Net Income Attributable to Phillips 66	$863	958	2,435	2,365
Amounts Attributable to Phillips 66 Common Stockholders:				
Income from continuing operations	$863	944	1,729	2,336
Income from discontinued operations	—	14	706	29
Net Income Attributable to Phillips 66	$863	958	2,435	2,365
Net Income Attributable to Phillips 66 Per Share of Common Stock (dollars)				
Basic				
Continuing operations	$1.52	1.53	3.00	3.75
Discontinued operations	—	0.02	1.23	0.05
Net Income Attributable to Phillips 66 Per Share of Common Stock	$1.52	1.55	4.23	3.80
Diluted				
Continuing operations	$1.51	1.51	2.98	3.72
Discontinued operations	—	0.02	1.21	0.04
Net Income Attributable to Phillips 66 Per Share of Common Stock	$1.51	1.53	4.19	3.76

Dividends Paid Per Share of Common Stock (dollars)	$0.5000	0.3125	0.8900	0.6250
Average Common Shares Outstanding (in thousands)				
Basic	565,799	619,143	574,876	622,086
Diluted	571,285	624,907	580,795	628,377
* Includes excise taxes on petroleum products sales:	$3,743	3,428	7,265	6,686
** Net of provision for income taxes on discontinued operations:	$—	7	5	15

Prior period amounts have been recast to reflect discontinued operations.
See Notes to Consolidated Financial Statements.

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Consolidated Statement of Comprehensive Income Phillips 66

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Net Income	$872	960	2,450	2,370
Other comprehensive income (loss)				
Defined benefit plans				
Actuarial gain/loss:				
Amortization to net income of net actuarial loss	14	24	26	50
Plans sponsored by equity affiliates	3	5	6	(8)
Income taxes on defined benefit plans	(6)	(11)	(11)	(14)
Defined benefit plans, net of tax	11	18	21	28
Foreign currency translation adjustments	96	38	127	(284)
Income taxes on foreign currency translation adjustments	2	(1)	1	3
Foreign currency translation adjustments, net of tax	98	37	128	(281)
Hedging activities by equity affiliates	—	1	—	1
Income taxes on hedging activities by equity affiliates	—	—	—	—
Hedging activities by equity affiliates, net of tax	—	1	—	1
Other Comprehensive Income (Loss), Net of Tax	109	56	149	(252)
Comprehensive Income	981	1,016	2,599	2,118
Less: comprehensive income attributable to noncontrolling interests	9	2	15	5
Comprehensive Income Attributable to Phillips 66	$972	1,014	2,584	2,113

See Notes to Consolidated Financial Statements.

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Consolidated Balance Sheet Phillips 66

	Millions of Dollars	
	June 30 2014	December 31 2013
Assets		
Cash and cash equivalents	$4,956	5,400
Accounts and notes receivable (net of allowances of $42 million in 2014 and $47 million in 2013)	7,925	7,900
Accounts and notes receivable—related parties	2,185	1,732
Inventories	4,928	3,354
Prepaid expenses and other current assets	611	851
Total Current Assets	20,605	19,237
Investments and long-term receivables	10,038	11,220
Net properties, plants and equipment	16,092	15,398
Goodwill	3,140	3,096
Intangibles	735	698
Other assets	212	149
Total Assets	$50,822	49,798
Liabilities		
Accounts payable	$11,529	9,948
Accounts payable—related parties	1,320	1,142
Short-term debt	38	24
Accrued income and other taxes	1,085	872
Employee benefit obligations	304	476
Other accruals	844	469
Total Current Liabilities	15,120	12,931
Long-term debt	6,174	6,131
Asset retirement obligations and accrued environmental costs	713	700
Deferred income taxes	5,686	6,125
Employee benefit obligations	825	921
Other liabilities and deferred credits	349	598
Total Liabilities	28,867	27,406
Equity		
Common stock (2,500,000,000 shares authorized at $.01 par value)		
Issued (2014—636,345,141 shares; 2013—634,285,955 shares)		
Par value	6	6
Capital in excess of par	18,986	18,887
Treasury stock (at cost: 2014—77,456,623 shares; 2013—44,106,380 shares)	(5,208)	(2,602)
Retained earnings	7,541	5,622
Accumulated other comprehensive income	186	37
Total Stockholders' Equity	21,511	21,950
Noncontrolling interests	444	442
Total Equity	21,955	22,392
Total Liabilities and Equity	$50,822	49,798

See Notes to Consolidated Financial Statements.

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Consolidated Statement of Cash Flows Phillips 66

	Millions of Dollars	
	Six Months Ended June 30	
	2014	2013
Cash Flows From Operating Activities		
Net income	$2,450	2,370
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	473	471
Impairments	4	25
Accretion on discounted liabilities	12	12
Deferred taxes	(455)	162
Undistributed equity earnings	379	(21)
Net gain on dispositions	(16)	(42)
Income from discontinued operations	(706)	(29)
Other	69	1
Working capital adjustments		
Decrease (increase) in accounts and notes receivable	(291)	411
Decrease (increase) in inventories	(1,564)	(1,668)
Decrease (increase) in prepaid expenses and other current assets	(34)	(154)
Increase (decrease) in accounts payable	1,668	1,634
Increase (decrease) in taxes and other accruals	237	(27)
Net cash provided by continuing operating activities	2,226	3,145
Net cash provided by discontinued operations	2	36
Net Cash Provided by Operating Activities	2,228	3,181
Cash Flows From Investing Activities		
Capital expenditures and investments	(1,133)	(748)
Proceeds from asset dispositions*	657	69
Advances/loans—related parties	(3)	—
Collection of advances/loans—related parties	—	100
Other	34	—
Net cash used in continuing investing activities	(445)	(579)
Net cash used in discontinued operations	(2)	(10)
Net Cash Used in Investing Activities	(447)	(589)
Cash Flows From Financing Activities		
Repayment of debt	(17)	(505)
Issuance of common stock	(12)	(3)
Repurchase of common stock	(1,256)	(928)
Share exchange—PSPI transaction	(450)	—
Dividends paid on common stock	(510)	(386)
Distributions to noncontrolling interests	(13)	(1)
Other	25	(3)
Net cash used in continuing financing activities	(2,233)	(1,826)
Net cash provided by (used in) discontinued operations	—	—
Net Cash Used in Financing Activities	(2,233)	(1,826)

Effect of Exchange Rate Changes on Cash and Cash Equivalents	8	(20)
Net Change in Cash and Cash Equivalents	(444)	746
Cash and cash equivalents at beginning of period	5,400	3,474
Cash and Cash Equivalents at End of Period	$4,956	4,220

* Includes return of investments in equity affiliates.
Prior period amounts have been recast to reflect discontinued operations.
See Notes to Consolidated Financial Statements.

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Consolidated Statement of Changes in Equity Phillips 66

	Millions of Dollars						
	Attributable to Phillips 66						
	Common Stock						
	Par Value	Capital in Excess of Par	Treasury Stock	Retained Earnings	Accum. Other Comprehensive Income (Loss)	Noncontrolling Interests	Total
December 31, 2012	$6	18,726	(356)	2,713	(314)	31	20,806
Net income	—	—	—	2,365	—	5	2,370
Other comprehensive loss	—	—	—	—	(252)	—	(252)
Cash dividends paid on common stock	—	—	—	(386)	—	—	(386)
Repurchase of common stock	—	—	(928)	—	—	—	(928)
Benefit plan activity	—	89	—	(5)	—	—	84
Distributions to noncontrolling interests and other	—	(3)	—	—	—	(1)	(4)
June 30, 2013	$6	18,812	(1,284)	4,687	(566)	35	21,690
December 31, 2013	$6	18,887	(2,602)	5,622	37	442	22,392
Net income	—	—	—	2,435	—	15	2,450
Other comprehensive income	—	—	—	—	149	—	149
Cash dividends paid on common stock	—	—	—	(510)	—	—	(510)
Repurchase of common stock	—	—	(1,256)	—	—	—	(1,256)
Share exchange—PSPI transaction	—	—	(1,350)	—	—	—	(1,350)
Benefit plan activity	—	99	—	(6)	—	—	93
Distributions to noncontrolling interests and other	—	—	—	—	—	(13)	(13)
June 30, 2014	$6	18,986	(5,208)	7,541	186	444	21,955

	Shares in Thousands	
	Common Stock Issued	Treasury Stock
December 31, 2012	631,150	7,604
Repurchase of common stock	—	15,025
Shares issued—share-based compensation	2,509	—
June 30, 2013	633,659	22,629
December 31, 2013	634,286	44,106
Repurchase of common stock	—	15,928
Share exchange—PSPI transaction	—	17,423
Shares issued—share-based compensation	2,059	—
June 30, 2014	636,345	77,457

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements Phillips 66

Note 1—Interim Financial Information

The interim 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 consolidated financial statements and notes included in our 2013 Annual Report on Form 10-K. The results of operations for the three and six months ended June 30, 2014, are not necessarily indicative of the results to be expected for the full year.

Certain prior period financial information has been recast to reflect the change in the composition of our operating segments. See Note 20—Segment Disclosures and Related Information for additional information.

Note 2—Variable Interest Entities (VIEs)

In 2013, we formed Phillips 66 Partners LP, a master limited partnership, to own, operate, develop and acquire primarily fee-based crude oil, refined petroleum product and natural gas liquids pipelines and terminals, as well as other transportation and midstream assets. We consolidate Phillips 66 Partners as we determined that Phillips 66 Partners is a VIE and we are the primary beneficiary. As general partner, we have the ability to control its financial interests, as well as the ability to direct the activities of Phillip 66 Partners that most significantly impact its economic performance. See Note 22—Phillips 66 Partners LP for additional information.

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, a call right was exercised to acquire the 50 percent ownership interest in MSLP of the co-venturer, Petróleos de Venezuela S.A. (PDVSA). That exercise was challenged, and the dispute has been arbitrated. In April 2014, the arbitral tribunal upheld the exercise of the call right and the acquisition of the 50 percent ownership interest. In July 2014, PDVSA filed a petition to vacate the tribunal's award. Until this matter is settled, we will 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 the call right. MSLP is a VIE because, in securing lender consents in connection with our separation from ConocoPhillips in 2012 (the Separation), we provided a 100 percent debt guarantee to the lender of the 8.85% senior notes issued by 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 award is subject to vacatur because under the partnership agreement the co-venturers jointly direct the activities of MSLP that most significantly impact economic performance. At June 30, 2014, our maximum exposure to loss represented the outstanding debt principal balance of $203 million and our investment of $131 million.

We have a 50 percent ownership interest with a 50 percent governance interest in Excel Paralubes (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 June 30, 2014, our maximum exposure to loss represented 50 percent of the outstanding debt principal balance of $86 million, or

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$43 million, plus half of the $60 million liquidity support, or $30 million. The book value of our investment in Excel at June 30, 2014, was $127 million.

In 2013, we entered into a multi-year consignment fuels agreement with a marketer who we currently support with debt guarantees. Pursuant to the consignment fuels agreement, we own the fuels inventory, control the fuel marketing at each site and pay a fixed monthly fee to the marketer. We determined the consignment fuels agreement and the debt guarantees together create a variable interest in the marketer, with the marketer not being exposed to all potential losses. We determined we are not the primary beneficiary because we do not have the power to direct the activities that most significantly impact the economic performance of the marketer or its service stations. We have no ownership interest in the marketer. At June 30, 2014, our maximum exposure to loss represented the outstanding debt balance of $190 million and the fixed annual contractual payments under the consignment fuels agreement of approximately $80 million.

Note 3—Inventories

Inventories consisted of the following:

	Millions of Dollars	
	June 30 2014	December 31 2013
Crude oil and petroleum products	$4,666	3,093
Materials and supplies	262	261
	$4,928	3,354

Inventories valued on the last-in, first-out (LIFO) basis totaled $4,529 million and $2,945 million at June 30, 2014, and December 31, 2013, respectively. The estimated excess of current replacement cost over LIFO cost of inventories amounted to approximately $8,000 million and $7,600 million at June 30, 2014, and December 31, 2013, respectively.

Note 4—Business Combinations

In March 2014, we paid approximately $70 million, net of acquired cash, to acquire our co-venturer's interest in an entity that operates a power and steam generation plant located in Texas. This acquisition provided us with full operational control over a key facility providing utilities and other services to one of our refineries. We provisionally recorded $141 million of net properties, plants and equipment (PP&E), $40 million of intangible assets, $39 million of goodwill and $68 million of debt. The goodwill is the result of synergies this acquisition created with the refinery to which it provides utilities and other services.

In July 2014, we acquired Spectrum Corporation, a private label and specialty lubricants business headquartered in Memphis, Tennessee. The acquisition supports our plans to selectively grow stable-return businesses in our Marketing and Specialties (M&S) segment. We funded this acquisition with cash on hand.

The completion of our acquisition accounting for these transactions is subject to the finalization of valuations of the assets acquired and liabilities assumed.

Note 5—Assets Held for Sale or Sold

In December 2013, we entered into an agreement to exchange the stock of Phillips Specialty Products Inc. (PSPI), a flow improver business, which was included in our M&S segment, for shares of Phillips 66 common stock owned by the other party. Accordingly, as of December 31, 2013, the net assets of PSPI were classified as held for sale and the results of operations of PSPI were reported as discontinued operations. At December 31, 2013, PSPI had a net carrying value of

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$193 million, which primarily included $58 million of net PP&E and $117 million of allocated goodwill. The carrying amounts of PSPI's assets and liabilities at December 31, 2013, were reported in the "Prepaid expenses and other current assets" and "Other accruals" lines of our consolidated balance sheet, respectively.

On February 25, 2014, we completed the PSPI share exchange, resulting in the receipt of approximately 17.4 million shares of Phillips 66 common stock, which are held as treasury shares, and the recognition of a before-tax gain of $696 million. At the time of the disposition, PSPI had a net carrying value of $685 million, which primarily included $481 million of cash and cash equivalents, $60 million of net PP&E and $117 million of allocated goodwill. Cash and cash equivalents of $450 million included in PSPI's net carrying value is reflected as a financing cash outflow in the "Share exchange—PSPI transaction" line of our consolidated statement of cash flows. Revenues, income before-tax and net income from discontinued operations, excluding the recognized before-tax gain of $696 million, were not material for the six-month periods ended June 30, 2014 and 2013.

In May 2013, we sold our E-Gas™ Technology business. The business was included in our M&S segment and at the time of disposition had a net carrying value of approximately $13 million, including a goodwill allocation. The $40 million before-tax gain is included in the "Net gain on dispositions" line of our consolidated income statement.

Note 6—Investments, Loans and Long-Term Receivables

Equity Investments

Summarized 100 percent financial information for WRB Refining LP (WRB) and Chevron Phillips Chemical Company LLC (CPChem) were as follows:

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Revenues	$8,685	8,080	16,683	16,220
Income before income taxes	1,186	997	2,310	2,765
Net income	1,162	975	2,263	2,725

WRB

WRB is a 50-percent-owned business venture with Cenovus Energy Inc. (Cenovus). Cenovus was obligated to contribute $7.5 billion, plus accrued interest, to WRB over a 10-year period that began in 2007. In the first quarter of 2014, Cenovus prepaid its remaining balance under this obligation. As a result, WRB declared a special dividend, which was distributed to the co-venturers in March 2014. Of the $1,232 million that we received, $760 million was considered a return on our investment in WRB (an operating cash inflow), and $472 million was considered a return of our investment in WRB (an investing cash inflow). At June 30, 2014, the book value of our investment in WRB was $1,889 million and our basis difference was $3,465 million.

Other

MSLP owns a delayed coker and related facilities at the Sweeny Refinery. MSLP processes long residue, which is produced from heavy sour crude oil, for a processing fee. Fuel-grade petroleum coke is produced as a by-product and becomes the property of MSLP. 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 triggered the right to acquire PDVSA's 50 percent ownership interest in

MSLP, which was exercised on August 28, 2009. PDVSA initiated arbitration with the International Chamber of Commerce challenging the exercise of the call right and claiming it was invalid. The arbitral tribunal held hearings on the merits of the dispute in December 2012, and post-hearing briefs were exchanged in March 2013. The arbitral tribunal issued its ruling in April 2014, which upheld the exercise of the call right and the acquisition of the 50 percent ownership interest. In July 2014, PDVSA filed a petition in U.S. district court to vacate the tribunal's ruling. Following the

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Separation, Phillips 66 generally indemnifies ConocoPhillips for liabilities, if any, arising out of the exercise of the call right or otherwise with respect to the joint venture or the refinery. Until this matter is settled, we will 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					
	June 30, 2014			December 31, 2013		
	Gross PP&E	Accum. D&A	Net PP&E	Gross PP&E	Accum. D&A	Net PP&E
Midstream	$3,381	1,141	2,240	2,865	1,104	1,761
Chemicals	—	—	—	—	—	—
Refining	19,644	7,053	12,591	19,191	6,718	12,473
Marketing and Specialties	1,499	765	734	1,395	749	646
Corporate and Other	1,026	499	527	975	457	518
Discontinued Operations*	—	—	—	—	—	—
	$25,550	9,458	16,092	24,426	9,028	15,398

* At December 31, 2013, net PP&E of $58 million associated with discontinued operations was classified as current assets.

Note 8—Goodwill

Effective January 1, 2014, we reallocated $52 million of goodwill from the Refining segment to the M&S segment based upon the realignment of certain assets between the reporting units. Goodwill was reassigned to the reporting units using a relative fair value approach. Goodwill impairment testing was completed and no impairment recognition was required. See Note 20—Segment Disclosures and Related Information for additional information on this segment realignment.

In March 2014, we acquired our co-venturer’s interest in an entity that operates a power and steam generation plant, and provisionally recorded $39 million of goodwill related to this transaction. The completion of our acquisition accounting is subject to the finalization of valuations of the assets acquired and liabilities assumed. See Note 4—Business Combinations, for additional information on this acquisition.

See Note 5—Assets Held for Sale or Sold for additional information on goodwill allocated to assets held for sale or sold.

The carrying amount of goodwill was as follows:

	Millions of Dollars	
	June 30 2014	December 31 2013
Midstream	$518	518
Refining	1,872	1,867
Marketing and Specialties	750	711

	$3,140	3,096

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Note 9—Impairments

The three- and six-month periods ended June 30, 2014 and 2013, included the following before-tax impairment charges:

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Refining	$1	1	2	1
Marketing and Specialties	2	—	2	15
Corporate and Other	—	—	—	9
	$3	1	4	25

During the six-month period of 2013, we recorded a $15 million held-for-use impairment in our M&S segment, primarily related to PP&E associated with our planned exit from the composite graphite business.

Note 10—Earnings Per Share

The numerator of basic earnings per share (EPS) is net income attributable to Phillips 66, reduced by noncancelable dividends paid on unvested share-based employee awards during the vesting period (participating securities). The denominator of basic EPS is 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. The numerator of diluted EPS is also based on net income attributable to Phillips 66, which is reduced only by dividend equivalents paid on participating securities for which the dividends are more dilutive than the participation of the awards in the earnings of the periods presented. 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 outstanding in the denominator. Treasury stock is excluded from the denominator in both basic and diluted EPS.

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	Three Months Ended June 30				Six Months Ended June 30			
	2014		2013		2014		2013	
	Basic	Diluted	Basic	Diluted	Basic	Diluted	Basic	Diluted
Amounts attributed to Phillips 66 Common Stockholders (millions):								
Income from continuing operations attributable to Phillips 66	$863	863	944	944	1,729	1,729	2,336	2,336
Income allocated to participating securities	(2)	—	(1)	—	(3)	—	(2)	—
Income from continuing operations available to common stockholders	861	863	943	944	1,726	1,729	2,334	2,336
Discontinued operations	—	—	14	14	706	706	29	29
Net Income available to common stockholders	$861	863	957	958	2,432	2,435	2,363	2,365
Weighted-average common shares outstanding (thousands):	562,056	565,799	615,380	619,143	570,992	574,876	618,328	622,086
Effect of stock-based compensation	3,743	5,486	3,763	5,764	3,884	5,919	3,758	6,291
Weighted-average common shares outstanding—EPS	565,799	571,285	619,143	624,907	574,876	580,795	622,086	628,377
Earnings Per Share of Common Stock (dollars):								
Income from continuing operations attributable to Phillips 66	$1.52	1.51	1.53	1.51	3.00	2.98	3.75	3.72
Discontinued operations	—	—	0.02	0.02	1.23	1.21	0.05	0.04
Earnings Per Share	$1.52	1.51	1.55	1.53	4.23	4.19	3.80	3.76

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Note 11—Debt

At both June 30, 2014, and December 31, 2013, we had no direct outstanding borrowings under our $4.5 billion revolving credit agreement or our $696 million trade receivables securitization facility. However, as of both June 30, 2014, and December 31, 2013, $51 million in letters of credit had been issued that were supported by our revolving credit agreement. As of June 30, 2014, no letters of credit were outstanding under our trade receivables securitization facility. As of December 31, 2013, $26 million in letters of credit had been issued that were collateralized by trade receivables held by a subsidiary under our trade receivables securitization facility. At June 30, 2014, and December 31, 2013, no amount had been drawn on the $250 million revolving credit agreement of Phillips 66 Partners. Accordingly, as of June 30, 2014, an aggregate $5.4 billion of total capacity was available under these facilities.

At June 30, 2014, we classified $800 million of long-term debt due within a year as long-term debt, based on our intent to refinance the obligation on a long-term basis and our ability to do so under our revolving credit facility.

Note 12—Guarantees

At June 30, 2014, 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 June 30, 2014, the maximum potential amount of future payments to third parties under the guarantee is estimated to be $203 million, which could become payable if MSLP fails to meet its obligations under the senior notes agreement. The senior notes mature in 2019.

Other Guarantees
We have residual value guarantees associated with leases with maximum future potential payments totaling $228 million. We have other guarantees with maximum future potential payment amounts totaling $311 million, which consist primarily of guarantees to fund the short-term cash liquidity deficits of certain joint ventures, guarantees of third parties related to prior asset dispositions, and guarantees of the lease payment obligations of a joint venture. These guarantees generally extend up to 10 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, litigation, environmental liabilities, permits and licenses, supply arrangements, and employee claims; and real estate indemnity against tenant defaults. The terms of these indemnifications vary greatly. The majority of these indemnifications are related to environmental issues, the term is generally indefinite, and the maximum amount of future payments is generally unlimited. The carrying amount recorded for indemnifications at June 30, 2014, was $243 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 $113 million of environmental accruals for known contamination that were included in asset retirement obligations and accrued environmental costs at June 30, 2014. For additional information about environmental liabilities, see Note 13—Contingencies and Commitments.

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Indemnification and Release Agreement
In 2012, we entered into the Indemnification and Release Agreement with ConocoPhillips. This agreement governs the treatment between ConocoPhillips and us of matters 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 13—Contingencies and Commitments

A number of lawsuits involving a variety of claims that arose in the ordinary course of business have been filed against us or are subject to indemnifications provided by us. 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 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 potentially 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 alleged to have liability 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.

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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 pertaining to sites 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 June 30, 2014, our consolidated balance sheet included a total environmental accrual of $504 million, compared with $492 million at December 31, 2013. 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, is required.

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 June 30, 2014, we had performance obligations secured by letters of credit of $1,148 million ($51 million of which 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 14—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 15—Fair Value Measurements.

Commodity Derivative Contracts—We operate in the worldwide crude oil, refined products, natural gas liquids (NGL), 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

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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.

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. For information on the impact of counterparty netting and collateral netting, see Note 15—Fair Value Measurements.

	Millions of Dollars	
	June 30 2014	December 31 2013
Assets		
Accounts and notes receivable	$—	2
Prepaid expenses and other current assets	781	592
Other assets	2	2
Liabilities		
Other accruals	831	633
Other liabilities and deferred credits	1	1

Hedge accounting has not been used for any item 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 June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Sales and other operating revenues	$(28)	124	29	118
Equity in earnings of affiliates	(2)	2	(2)	(1)
Other income	1	24	15	27
Purchased crude oil and products	(45)	74	(43)	163

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

The following table 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 June 30, 2014, and December 31, 2013, the percentage of our derivative contract volume expiring within the next 12 months was over 99 percent for both periods.

Open Position

	Long/(Short)	
	June 30 2014	December 31 2013
Commodity		
Crude oil, refined products and NGL (millions of barrels)	(26)	(9)

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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.

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 June 30, 2014, or December 31, 2013.

Note 15—Fair Value Measurements

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

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We carry certain assets and liabilities at fair value, which we measure 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 disclose the quality of these fair values based on the valuation inputs used in these measurements under the following hierarchy:

- Level 1: Fair value measured with unadjusted quoted prices from an active market for identical assets or liabilities.
- Level 2: Fair value measured with: 1) adjusted quoted prices from an active market for similar assets; or 2) other valuation inputs that are directly or indirectly observable.
- Level 3: Fair value measured with unobservable inputs that are significant to the measurement.

We classify the fair value of an asset or liability based on the lowest level of input significant to its measurement; however, the fair value of an asset or liability initially reported as Level 3 will be subsequently reported as Level 2 if the unobservable inputs become inconsequential to its measurement or corroborating market data becomes available. Conversely, an asset or liability initially reported as Level 2 will be subsequently reported as Level 3 if corroborating market data becomes unavailable. We made no material transfers in or out of Level 1 during the six-month periods ended June 30, 2014 and 2013.

Recurring Fair Value Measurements
Financial assets and liabilities recorded at fair value on a recurring basis consist primarily of investments to support nonqualified deferred compensation plans and derivative instruments. 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 commodity derivatives using closing prices provided by the exchange as of the balance sheet date, and these are also classified as Level 1 in the fair value hierarchy. When exchange-cleared contracts lack sufficient liquidity or are valued using either adjusted exchange-provided prices or non-exchange quotes, we classify those 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. We corroborate these quotes with market data and classify the resulting fair values 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. We classify these contracts 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 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 following tables display the fair value hierarchy for our material financial assets and liabilities either accounted for or disclosed at fair value on a recurring basis. These values are determined by treating each contract as the fundamental unit of account; therefore, derivative assets and liabilities with the same counterparty are shown gross (i.e., without the effect of netting where the legal right of setoff exists) in the hierarchy sections of these tables. These tables also show that our Level 3 activity was not material.

We have master netting arrangements for all of our exchange-cleared derivative instruments, the majority of our OTC derivative instruments, and certain physical commodity forward contracts (primarily pipeline crude oil deliveries). The following tables show these contracts on a net basis in the column "Effect of Counterparty Netting." We have no contracts that are subject to master netting arrangements that are reflected gross on the consolidated balance sheet.

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The carrying values and fair values by hierarchy of our material financial instruments, either carried or disclosed at fair value, and derivative assets and liabilities, including any effects of master netting agreements or collateral, were:

	Millions of Dollars								
	June 30, 2014								
	Fair Value Hierarchy								
	Level 1	Level 2	Level 3	Total Fair Value of Gross Assets & Liabilities	Effect of Counterparty Netting	Effect of Collateral Netting	Difference in Carrying Value and Fair Value	Net Carrying Value Presented on the Balance Sheet	Cash Collateral Received or Paid, Not Offset on Balance Sheet
Commodity Derivative Assets									
Exchange-cleared instruments	$563	152	—	715	(703)	—	—	12	—
OTC instruments	—	38	—	38	(13)	—	—	25	—
Physical forward contracts*	—	24	6	30	(1)	—	—	29	—
Rabbi trust assets	76	—	—	76	N/A	N/A	—	76	N/A
	$639	214	6	859	(717)	—	—	142	
Commodity Derivative Liabilities									
Exchange-cleared instruments	$631	161	—	792	(703)	(89)	—	—	—
OTC instruments	—	28	—	28	(13)	—	—	15	—
Physical forward contracts*	—	11	1	12	(1)	—	—	11	—
Floating-rate debt	52	—	—	52	N/A	N/A	—	52	N/A
Fixed-rate debt, excluding capital leases**	—	6,482	—	6,482	N/A	N/A	(523)	5,959	N/A
	$683	6,682	1	7,366	(717)	(89)	(523)	6,037	

* Physical forward contracts may have a larger value on the balance sheet than disclosed in the fair value hierarchy when the remaining contract term at the reporting date is greater than 12 months and the short-term portion is an asset while the long-term portion is a liability, or vice versa.
** We carry fixed-rate debt on the balance sheet at amortized cost.

Millions of Dollars								
December 31, 2013								
Fair Value Hierarchy								
Level 1	Level 2	Level 3	Total Fair Value of Gross Assets & Liabilities	Effect of Counterparty Netting	Effect of Collateral Netting	Difference in Carrying Value and Fair Value	Net Carrying Value Presented on the Balance	Cash Collateral Received or Paid, Not Offset on

								Sheet	Balance Sheet
Commodity Derivative Assets									
Exchange-cleared instruments	$227	332	—	559	(538)	—	—	21	—
OTC instruments	—	10	—	10	(8)	—	—	2	—
Physical forward contracts*	—	25	2	27	—	—	—	27	—
Rabbi trust assets	64	—	—	64	N/A	N/A	—	64	N/A
	$291	367	2	660	(546)	—	—	114	
Commodity Derivative Liabilities									
Exchange-cleared instruments	$253	326	—	579	(538)	(41)	—	—	—
OTC instruments	—	11	—	11	(8)	—	—	3	—
Physical forward contracts*	—	43	1	44	—	—	—	44	—
Floating-rate debt	50	—	—	50	N/A	N/A	—	50	N/A
Fixed-rate debt, excluding capital leases**	—	6,168	—	6,168	N/A	N/A	(262)	5,906	N/A
	$303	6,548	1	6,852	(546)	(41)	(262)	6,003	

* Physical forward contracts may have a larger value on the balance sheet than disclosed in the fair value hierarchy when the remaining contract term at the reporting date is greater than 12 months and the short-term portion is an asset while the long-term portion is a liability, or vice versa.
** We carry fixed-rate debt on the balance sheet at amortized cost.

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The values presented in the preceding tables appear on our balance sheet as follows: for commodity derivative assets and liabilities, see the first table in Note 14—Derivatives and Financial Instruments; rabbi trust assets appear in the "Investments and long-term receivables" line; and floating-rate and fixed-rate debt appear in the "Short-term debt" and "Long-term debt" lines.

Nonrecurring Fair Value Remeasurements
During the six-month period ended June 30, 2014, there were no significant nonrecurring fair value remeasurements of assets subsequent to their initial recognition.

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 six-month period ended June 30, 2013:

	Millions of Dollars				
		Fair Value Measurements Using			
	Fair Value*	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Before-Tax Loss
June 30, 2013					
Net properties, plants and equipment (held for use)	$22	22	—	—	27

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

During the six-month period ended June 30, 2013, net PP&E held for use related to the composite graphite business in our M&S segment, with a carrying amount of $18 million, was written down to its fair value, resulting in a before-tax loss of $18 million. The fair value was based on an internal assessment of expected discounted future cash flows. During this same period, corporate net PP&E held for use, with a carrying amount of $31 million, was written down to its fair value of $22 million, resulting in a before-tax loss of $9 million. The fair value was primarily determined by a third-party valuation.

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Note 16—Employee Benefit Plans

Pension and Postretirement Plans
The components of net periodic benefit cost for the three and six months ended June 30, 2014 and 2013, were as follows:

	Millions of Dollars					
	Pension Benefits				Other Benefits	
	2014		2013		2014	2013
	U.S.	Int’l.	U.S.	Int’l.		
Components of Net Periodic Benefit Cost						
Three Months Ended June 30						
Service cost	$31	10	31	9	2	2
Interest cost	27	9	23	8	2	1
Expected return on plan assets	(35)	(10)	(30)	(8)	—	—
Amortization of prior service cost (credit)	—	—	1	(1)	(1)	(1)
Recognized net actuarial loss	10	3	21	3	—	—
Total net periodic benefit cost	$33	12	46	11	3	2
Six Months Ended June 30						
Service cost	$61	20	62	18	4	4
Interest cost	54	18	46	16	4	3
Expected return on plan assets	(71)	(19)	(60)	(15)	—	—
Amortization of prior service cost (credit)	1	(1)	1	(1)	(1)	(1)
Recognized net actuarial loss (gain)	20	6	42	8	(1)	—
Total net periodic benefit cost	$65	24	91	26	6	6

During the first half of 2014, we contributed $163 million to our U.S. plans and $31 million to our international plans. We currently expect to make additional contributions of approximately $50 million in 2014, primarily to our international plans.

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Note 17—Accumulated Other Comprehensive Income (Loss)

The following table depicts changes in accumulated other comprehensive income (loss) by component, as well as detail on reclassifications out of accumulated other comprehensive income (loss):

	Millions of Dollars			
	Defined Benefit Plans	Foreign Currency Translation	Hedging	Accumulated Other Comprehensive Income (Loss)
December 31, 2012	$(778)	466	(2)	(314)
Other comprehensive loss before reclassifications	(5)	(281)	1	(285)
Amounts reclassified from accumulated other comprehensive income (loss)*				
Amortization of defined benefit plan items**				
Actuarial losses	33	—	—	33
Net current period other comprehensive income (loss)	28	(281)	1	(252)
June 30, 2013	$(750)	185	(1)	(566)
December 31, 2013	$(404)	443	(2)	37
Other comprehensive income before reclassifications	4	128	—	132
Amounts reclassified from accumulated other comprehensive income (loss)*				
Amortization of defined benefit plan items**				
Actuarial losses	17	—	—	17
Net current period other comprehensive income	21	128	—	149
June 30, 2014	$(383)	571	(2)	186

* There were no significant reclassifications related to foreign currency translation or hedging.
** These accumulated other comprehensive income (loss) components are included in the computation of net periodic benefit cost (see Note 16—Employee Benefit Plans, for additional information).

Note 18—Cash Flow Information

	Millions of Dollars Six Months Ended June 30	
	2014	2013
Cash Payments		
Interest	$123	132
Income taxes	1,093	896

Noncash Investing and Financing Activities
As discussed more fully in Note 5—Assets Held for Sale or Sold, on February 25, 2014, we completed the exchange of our flow improvers business for shares of Phillips 66 common stock owned by the other party to the transaction. The noncash portion of the net assets surrendered by us in the exchange was $204 million, and we received approximately 17.4 million shares of our common stock, with a fair value at the time of the exchange of $1.35 billion.

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Note 19—Related Party Transactions

Significant transactions with related parties were:

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Operating revenues and other income (a)	$1,586	2,050	3,653	3,799
Purchases (b)	4,535	4,474	8,526	8,761
Operating expenses and selling, general and administrative expenses (c)	41	28	76	52
Interest expense (d)	2	2	4	4

(a) We sold crude oil to the Malaysian Refining Company Sdn. Bdh. (MRC). NGL and other petrochemical feedstocks, along with solvents, were sold to CPChem, and gas oil and hydrogen feedstocks were sold to Excel. Certain feedstocks and intermediate products were sold to WRB. We also acted as agent for WRB in supplying other crude oil and feedstocks, wherein the transactional amounts did not impact operating revenues. 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 also acted as agent for WRB in distributing asphalt and solvents, wherein the transactional amounts did not impact purchases. We purchased natural gas and NGL from DCP Midstream, LLC (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 specialty businesses.

(c) We paid utility, commission and processing fees to various affiliates.

(d) We incurred interest expense on a note payable to MSLP.

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Note 20—Segment Disclosures and Related Information

Our operating segments are:

1) Midstream—Gathers, processes, transports and markets natural gas; and transports, fractionates and markets NGL in the United States. In addition, this segment transports crude oil and other feedstocks to our refineries and other locations, and delivers refined and specialty products to market. The Midstream segment includes, among other businesses, our 50 percent equity investment in DCP Midstream and our investment in Phillips 66 Partners LP.

2) Chemicals—Manufactures and markets petrochemicals and plastics on a worldwide basis. The Chemicals segment consists of our 50 percent equity investment in CPChem.

3) Refining—Buys, sells and refines crude oil and other feedstocks at 15 refineries, mainly in the United States, Europe and Asia.

4) Marketing and Specialties—Purchases for resale and markets refined products, mainly in the United States and Europe. In addition, this segment includes the manufacturing and marketing of specialty products (such as base oils and lubricants), as well as power generation operations.

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.

Effective January 1, 2014, we changed the organizational structure of the internal financial information reviewed by our chief executive officer, and determined this resulted in a change in the composition of our operating segments. The primary effects of this reporting reorganization were as follows:

- We moved two of our equity investments, Excel and Jupiter Sulphur, LLC, as well as the commission revenues related to needle and anode coke, polypropylene and solvents, from the Refining segment to the M&S segment.

- We moved several refining logistics projects from the Refining segment to the Midstream segment.

The new segment alignment is presented for the three- and six-month periods ended June 30, 2014, with the prior periods recast for comparability.

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Analysis of Results by Operating Segment

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Sales and Other Operating Revenues				
Midstream				
Total sales	$1,155	1,481	3,310	3,109
Intersegment eliminations	(274)	(210)	(566)	(442)
Total Midstream	881	1,271	2,744	2,667
Chemicals	2	2	4	4
Refining				
Total sales	33,628	30,994	62,843	60,756
Intersegment eliminations	(18,793)	(18,510)	(36,351)	(36,367)
Total Refining	14,835	12,484	26,492	24,389
Marketing and Specialties				
Total sales	30,489	29,729	57,535	57,909
Intersegment eliminations	(666)	(305)	(958)	(583)
Total Marketing and Specialties	29,823	29,424	56,577	57,326
Corporate and Other	8	9	15	15
Consolidated sales and other operating revenues	$45,549	43,190	85,832	84,401
Net Income (Loss) Attributable to Phillips 66				
Midstream	$108	90	296	201
Chemicals	324	181	640	463
Refining	390	455	696	1,359
Marketing and Specialties	162	344	299	534
Corporate and Other	(121)	(126)	(202)	(221)
Discontinued operations	—	14	706	29
Consolidated net income attributable to Phillips 66	$863	958	2,435	2,365

	Millions of Dollars	
	June 30 2014	December 31 2013
Total Assets		
Midstream	$5,803	5,485
Chemicals	4,930	4,377
Refining	26,946	26,046
Marketing and Specialties	7,380	7,331
Corporate and Other	5,763	6,348
Discontinued operations	—	211
Consolidated total assets	$50,822	49,798

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Note 21—Income Taxes

Our effective tax rate for the second quarter and the first six months of 2014 was 36 percent and 34 percent, respectively, compared with 35 percent and 33 percent for the corresponding periods of 2013. The effective tax rate varies from the federal statutory tax rate of 35 percent primarily as a result of state tax expense, offset by the manufacturing deduction and foreign operations.

Note 22—Phillips 66 Partners LP

In 2013, we formed Phillips 66 Partners, a master limited partnership, to own, operate, develop and acquire primarily fee-based crude oil, refined petroleum product and NGL pipelines and terminals, as well as other transportation and midstream assets.
On March 1, 2014, we contributed to Phillips 66 Partners certain transportation, terminaling and storage assets for total consideration of $700 million, which consisted of $400 million in cash, the receipt of 3,530,595 common units and 72,053 general partner units of Phillips 66 Partners and a 5-year, $160 million note receivable. These assets consisted of our Gold Line products system and the Medford spheres, two newly constructed refinery-grade propylene storage spheres. Since we consolidate Phillips 66 Partners for financial reporting purposes, this transaction was eliminated upon consolidation and did not impact our financial position or cash flow.

At June 30, 2014, we owned a 73 percent limited partner interest and a 2 percent general partner interest in Phillips 66 Partners, while the public owned a 25 percent limited partner interest. We consolidate Phillips 66 Partners because we control the partnership through our general partner interest (see Note 2—Variable Interest Entities (VIEs) for additional information). The public's ownership interest in Phillips 66 Partners was $412 million at June 30, 2014, and is reflected as a noncontrolling interest in our financial statements. The most significant asset of Phillips 66 Partners that can only be used to settle its obligations was net PP&E of $275 million at June 30, 2014.

Note 23—New Accounting Standards

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." This ASU amends the definition of discontinued operations so that only disposals of components of an entity representing major strategic shifts that have a major effect on an entity's operations and financial results will qualify for discontinued operations reporting. The ASU also requires additional disclosures about discontinued operations and individually material disposals that do not meet the definition of a discontinued operation. ASU 2014-08 is effective January 1, 2015, and earlier application is permitted, but only for disposals not previously reported in the financial statements. We adopted this ASU effective July 1, 2014, and the adoption of this ASU did not have an effect on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." The new standard converged guidance on recognizing revenues in contracts with customers under accounting principles generally accepted in the United States and International Financial Reporting Standards. This ASU is intended to improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. ASU 2014-09 is effective for annual and quarterly reporting periods of public entities beginning after December 15, 2016. Early application for public entities is not permitted. We are currently evaluating the provisions of ASU 2014-09 and assessing the impact, if any, it may have on our financial position and results of operations.

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Note 24—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.

Effective with fiscal year 2013, we revised the cash flow presentation of inter-column transactions associated with our centralized cash management program and intercompany loans, from operating cash flows to investing cash flows, in a new line item labeled “Intercompany lending activities.” Additionally, interest and debt expense in the statement of income was revised to eliminate intra-column lending transactions. All periods have been revised to conform to this presentation.

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Statement of Income	Millions of Dollars Three Months Ended June 30, 2014 Phillips 66	Phillips 66 Company	All Other Subsidiaries	Consolidating Adjustments	Total Consolidated
Revenues and Other Income					
Sales and other operating revenues	$—	30,145	15,404	—	45,549
Equity in earnings of affiliates	908	604	130	(878)	764
Net gain on dispositions	—	—	9	—	9
Other income (loss)	—	18	(1)	—	17
Intercompany revenues	—	1,057	5,700	(6,757)	—
Total Revenues and Other Income	908	31,824	21,242	(7,635)	46,339
Costs and Expenses					
Purchased crude oil and products	—	27,670	18,358	(6,712)	39,316
Operating expenses	—	862	226	(11)	1,077
Selling, general and administrative expenses	2	316	117	(23)	412
Depreciation and amortization	—	183	56	—	239
Impairments	—	1	2	—	3
Taxes other than income taxes	—	1,416	2,416	—	3,832
Accretion on discounted liabilities	—	4	2	—	6
Interest and debt expense	67	2	8	(11)	66
Foreign currency transaction losses	—	—	29	—	29
Total Costs and Expenses	69	30,454	21,214	(6,757)	44,980
Income from continuing operations before income taxes	839	1,370	28	(878)	1,359
Provision (benefit) for income taxes	(24)	462	49	—	487
Income (Loss) From Continuing Operations	863	908	(21)	(878)	872
Income from discontinued operations	—	—	—	—	—
Net income (loss)	863	908	(21)	(878)	872
Less: net income attributable to noncontrolling interests	—	—	9	—	9
Net Income (Loss) Attributable to Phillips 66	$863	908	(30)	(878)	863
Comprehensive Income	$972	1,017	81	(1,089)	981

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Statement of Income	Millions of Dollars Three Months Ended June 30, 2013 Phillips 66	Phillips 66 Company	All Other Subsidiaries	Consolidating Adjustments	Total Consolidated
Revenues and Other Income					
Sales and other operating revenues	$—	29,335	13,855	—	43,190
Equity in earnings of affiliates	1,003	637	78	(1,100)	618
Net gain on dispositions	—	40	1	—	41
Other income (loss)	(2)	34	17	—	49
Intercompany revenues	—	412	5,530	(5,942)	—
Total Revenues and Other Income	1,001	30,458	19,481	(7,042)	43,898
Costs and Expenses					
Purchased crude oil and products	—	26,420	16,747	(5,910)	37,257
Operating expenses	—	821	218	(7)	1,032
Selling, general and administrative expenses	1	264	126	(23)	368
Depreciation and amortization	—	177	52	—	229
Impairments	—	—	1	—	1
Taxes other than income taxes	—	1,295	2,206	—	3,501
Accretion on discounted liabilities	—	5	1	—	6
Interest and debt expense	67	3	1	(2)	69
Foreign currency transaction gains	—	(1)	(17)	—	(18)
Total Costs and Expenses	68	28,984	19,335	(5,942)	42,445
Income from continuing operations before income taxes	933	1,474	146	(1,100)	1,453
Provision (benefit) for income taxes	(25)	471	61	—	507
Income From Continuing Operations	958	1,003	85	(1,100)	946
Income from discontinued operations*	—	—	14	—	14
Net income	958	1,003	99	(1,100)	960
Less: net income attributable to noncontrolling interests	—	—	2	—	2
Net Income Attributable to Phillips 66	$958	1,003	97	(1,100)	958
Comprehensive Income	$1,013	1,059	141	(1,197)	1,016
* Net of provision for income taxes on discontinued operations:	$—	—	7	—	7

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Statement of Income	Millions of Dollars Six Months Ended June 30, 2014 Phillips 66	Phillips 66 Company	All Other Subsidiaries	Consolidating Adjustments	Total Consolidated
Revenues and Other Income					
Sales and other operating revenues	$—	57,384	28,448	—	85,832
Equity in earnings of affiliates	1,830	1,450	308	(2,046)	1,542
Net gain on dispositions	—	—	16	—	16
Other income	—	40	8	—	48
Intercompany revenues	—	1,335	10,401	(11,736)	—
Total Revenues and Other Income	1,830	60,209	39,181	(13,782)	87,438
Costs and Expenses					
Purchased crude oil and products	—	52,054	33,296	(11,653)	73,697
Operating expenses	2	1,765	417	(17)	2,167
Selling, general and administrative expenses	5	602	255	(48)	814
Depreciation and amortization	—	363	110	—	473
Impairments	—	2	2	—	4
Taxes other than income taxes	—	2,717	4,753	—	7,470
Accretion on discounted liabilities	—	9			