TRANSCRIPT
4Q 2019 EARNINGS CALL

PHILLIPS 66 PARTNERS (NYSE: PSXP)
January 31, 2020 at 2:00 pm ET

PHILLIPS 66 PARTNERS PARTICIPANTS

Jeff Dietert, *Vice President, Investor Relations*

Kevin J. Mitchell, *Director, Vice President and Chief Financial Officer*

Rosy Zuklic, *Vice President and Chief Operating Officer*

Tim Roberts, *Director and Vice President, Operations*

MEETING PARTICIPANTS

Theresa Chen, *Barclays*

Phil Stuart, *Scotiabank*

Chris Sighinolfi, *Jefferies*

Elvira Scotto, *RBC Capital Markets*

TRANSCRIPT

Operator:

Welcome to the Fourth Quarter 2019 Phillips 66 Partners Earnings Conference Call.

My name is Kensey and I will be your conference Operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. Please note that this conference is being recorded.

I will now turn the call over to Jeff Dietert, Vice President, Investor Relations. Jeff, you may begin.

Jeff Dietert:

Good afternoon, and welcome to Phillips 66 Partners' Fourth Quarter Earnings Conference Call.

Participants on today's call will include Kevin Mitchell, Vice President and CFO, Tim Roberts, Vice President, Operations, and Rosy Zuklic, Vice President and Chief Operating Officer.

Today's presentation material can be found on the Events section of the Phillips 66 Partners website, along with supplemental financial and operating information.

Slide 2 includes our Safe Harbor statement. We are going to be making forward-looking statements today. Actual results will likely be different. Factors that could cause results to differ are included here, as well as in our SEC filings.

With that, I'll turn the call over to Kevin Mitchell.

Kevin J. Mitchell:

Thank you, Jeff, and good afternoon, everyone.

During the fourth quarter, Phillips 66 Partners delivered strong operating performance, advanced major growth projects and maintained its strong financial position. Board of directors approved a fourth-quarter distribution of $0.875 per common unit, an increase of $0.01 per common unit from the previous quarter. Year over year, we have increased the per unit cash distribution 11%. We continue to maintain our record of quarterly distribution increases since the July 2013 IPO.

Moving on to Slide 4, 2019 was another successful year for the Partnership. We continued to operate safely and reliably and delivered record earnings and adjusted EBITDA. We ended the year at a run rate EBITDA of $1.4 billion.

During 2019, we completed a transaction to eliminate our general partner's incentive distribution rights.

With a simplified structure, strong balance sheet, attractive organic growth opportunities and sponsor alignment, Phillips 66 Partners is a sector-leading MLP.

In 2019, PSXP delivered a 56% total unitholder return.

We made good progress on our growth program this year. In November, we started initial operations on our largest project to date, the Gray Oak Pipeline. In addition, the Bayou Bridge pipeline extension, the Lake Charles products pipeline and the Lake Charles isomerization unit were completed. These assets are running well, meeting our expectations and contributing to EBITDA growth.

Moving on to Slide 5 to discuss the financial results. The Partnership reported record fourth-quarter earnings of $255 million and adjusted EBITDA of $345 million. EBITDA increased $22 million from the third quarter. The improvement reflects increased volumes on our wholly owned assets and a full quarter contribution from the Lake Charles isomerization unit. Our wholly owned pipelines and terminals also achieved record volumes for the year.

Fourth-quarter distributable cash flow was $254 million, a decrease of $1 million from the prior quarter, driven by the timing of distributions from our joint ventures.

Slide 6 highlights our financial flexibility and liquidity. We ended the fourth quarter with $286 million of cash and $749 million available under our revolving credit facility. In October, we paid off $300 million of senior notes due February 2020. The debt-to-EBITDA ratio on a revolver covenant basis was 2.9. Our distribution coverage ratio was 1.27. We continue to target a long-term leverage ratio of up to 3.5 and distribution coverage ratio over 1.2.

The Partnership advanced its major projects during the quarter, funding $146 million of growth capital. This included spend for the C2G Pipeline, Sweeny to Pasadena capacity expansion, Clemens Caverns and the South Texas Gateway Terminal. As we begin 2020, we remain committed to maintaining our strong financial position and disciplined capital allocation.

Now, Rosy will provide an update on our growth projects.

Rosy Zuklic:

Thanks, Kevin, and hello, everyone.

Slide 7 lists the projects we have ongoing. All of these projects are backed by long-term volume commitments and are expected to deliver typical midstream returns.

The Gray Oak Pipeline started initial operations in November. Gray Oak is currently moving crude from West Texas to Central Junction, Helena and Three Rivers. This section of the pipeline is operating in line with expectations, and we continue to progress towards full service in the second quarter of 2020. Gray Oak will connect to multiple terminals in the Corpus Christi area, including South Texas Gateway Terminal. The marine export terminal will have two deep water docks with storage capacity of 8.5 million barrels and up to 800,000 barrels per day of throughput capacity. Phillips 66 Partners owns a 25% interest in the terminal, which is expected to start up in the third quarter of 2020.

The remaining projects listed are progressing as planned.

Phillips 66 Partners' 2020 adjusted capital budget is $867 million. This includes $734 million for growth projects and $133 million of maintenance capital.

This concludes our prepared remarks. We will now open the line for questions.

Operator:

Thank you. We will now begin the question-and-answer session. If you have a question, please press star, then 1 on your touchtone phone. If you wish to be removed from the queue, please press the pound key. If you are using a speakerphone, you may need to pick up the handset first before pressing the numbers. Once again, if you have a question, please press star, then 1 on your touchtone phone.

Theresa Chen from Barclays, your line is open, please go ahead.

Theresa Chen:

Good afternoon, and thank you for taking my questions. Rosy, for the South Texas Gateway Terminal, I understand the facility is expected to start up in the third quarter with initial service, but can you provide some color on the timing and pace of the ramp up to full service there?

Rosy Zuklic:

Sure. I'll start off with a little bit of info, and of course, Tim's here and he can give us a little bit of color, as well.

Let me start—back up with—as you know, Buckeye had started initially with the facility at 3.4 million barrels of storage. And since then we've expanded the facility to now be 8.5 million barrels of storage and having capacity for two VLCC-capable docks. In the fall of 2019, Buckeye received the U.S. Army Corp of Engineers permit to be able to start the work on the dock, and since then they've been working on the dock. Everything's been moving in the right direction. So, everything looks good from that perspective.

With projects this size and scale, the way we see it, is that as tanks become available, as the dock becomes available, those are going to be made available to, obviously, our shippers. It's not all going to be available at the same time. It's going to be a phased approach.

I don't know if, Tim, there's any sort of color from the exact timing, when in the third quarter, or anything.

Tim Roberts:

Yes, third quarter. We would expect early in the third quarter, as far as getting one of the docks out. And then, potentially, around again midyear with terminals. There's a—not terminals, the tanks, excuse me—multiple tanks coming on, and as they are commissioned and we get filled, and then subsequently can actually utilize the first dock - which both docks don't have to come up at the same time. Then we'll start progressing barrels going through the facility.

Theresa Chen:

Got it, and when do you think all 8.5 and those docks will be in service?

Rosy Zuklic:

You know, at this point, it's probably too early to tell. I would speculate some time later in the year, but I honestly don't have an exact number. We'll just have to wait and see as things progress.

Theresa Chen:

Got it. Switching gears a bit. I wanted to touch on some of Greg's comments on the PSX call related to how the midstream inventory should ultimately end up at PSXP; and of that $800 million to $900 million qualifying income amount, how much of that consists of what we would call inside the refinery gate assets, versus the more attractive, large-scale assets that could be backed by more third-party cash flows, like the export infrastructure at Beaumont, Freeport and such?

Kevin J. Mitchell:

Yes, Theresa, this is Kevin. So, yes, Greg talked about the $800 million or so of existing EBITDA that's available to drop, and of course he also clarified that there's a significant amount of investment underway at the PSX level that will continue to grow that EBITDA number. That $800 million is all what we would consider sort of the true midstream assets. It's not refinery, inside the refinery fence, type of infrastructure

that if you sort of contractually arrange—you know, put the appropriate arrangements around it, you could make it midstream-qualifying. So, it's all what we would consider true midstream EBITDA.

Theresa Chen:

Got it. In terms of financing—again, echoing Greg's words that secondary equity markets are currently closed—any thoughts on other avenues of financing? Would you consider doing another pref, or a PIPE, for example?

Kevin J. Mitchell:

I wouldn't really speculate around what our future financing would be. As we look at any of those kind of transactions, we're always triangulating around the balance sheet, leverage ratios, maintaining coverage, and funding the transaction. I mean, to me, a PIPE is just a form of an equity issuance. And so I think of just common equity in the sort of broadest sense. Whether you go about that through a sort of public offering or you go about it through a PIPE-type mechanism, that's all a variation. You end up in the same place, from that standpoint. The preferred is certainly another option to consider. Obviously, we've done that in the past and that's proven to be very successful for us. But, I'm not going to speculate too far on exactly what that might look like.

Theresa Chen:

Thank you.

Operator:

Phil Stuart from Scotiabank, please go ahead, your line is open.

Phil Stuart:

Good morning everyone, and congrats on another solid quarter. I was hoping that maybe we could talk about the EBITDA ramp kind of throughout 2020. Obviously, you guys did a great job of growing EBITDA in 2019, and kind of hitting that $1.4 billion kind of annualized run rate in 4Q, a little bit ahead of schedule. As we look out, you know, on a quarterly basis, it seems like 1Q '20 is probably going to be the low point, given just seasonal turnaround and the fact that you're not going to have a full contribution from Gray Oak. I was wondering if you guys could maybe walk us through kind of how EBITDA growth stair steps throughout the year, and if that $1.5 billion kind of annualized run rate exit 4Q '20 is still a good figure.

Rosy Zuklic:

Yes, you're right, Phil, the first quarter is normally a seasonally weaker quarter for the MLP, and there's two main reasons. One, we're coming off of butane blending. The fourth-quarter benefits from butane blending and the first quarter ends up having about 10% of volumes coming off, and so that ends up always being a headwind for the first quarter. Then, additionally, just in general, refinery turnarounds tend to be a little bit higher in the first quarter. You may have heard that in the PSX earnings call, they guided to about a 90% utilization rate. If you think about the fourth-quarter that ran at about 97% utilization. Then, you think about specifically the assets that are tied to the PSX refining system—or, excuse me, the PSX assets. They ran very, very well, whether it was Ponca or Borger. If you think just overall 90% utilization rate, so that's going to be an additional headwind. Then, as part of Gray Oak—Gray Oak is really, you know, with second quarter being when we expect full ramp up, it's really not going to be of anything substantial to offset those two headwinds.

So, first quarter will be, certainly, the weakest quarter, and then the way it naturally progresses, if you just look at history, the second quarter is a little bit stronger than the first, the third quarter is stronger than the

second, and then the fourth quarter always ends up being the strongest quarter. And we still believe that the $1.5 billion run rate EBITDA is what we'll exit 2020 with.

Kevin J. Mitchell:

If you look at the table of organic growth projects that come online this year. So you go from Gray Oak, is really the first one that's making a contribution. Sweeny to Pasadena is a 2Q. 3Q you've got South Texas Gateway. And then 4Q, Clemens Caverns expansion. So, there's a nice ramp up through the year as the projects come up. Of those, Gray Oak is by far the most significant in terms of as an individual project.

Phil Stuart:

Great, I really appreciate the color there. Then, just as far as Gray Oak goes, understanding that initial service has begun, and I appreciate the kind of updated commentary on kind of the 2Q '20 being the first quarter of kind of full service, just wondering if there are any material milestones that really need to be hit between now and then, you know, that could push that back or maybe bring it forward a little bit.

Tim Roberts:

No, really, it's—the milestone at this point is the finish line. We're at a point now where we've got multiple spreads working with regard to terminals, finishing up connections. The pipe's in the ground. It's really just finishing up the terminals. Power connections, I&E work, hydro testing, any kind of terminals—I mean, we are completely in the weeds on many different fronts, but this is typical as you're getting ready to finish the project. I've seen this in, you know, previous experience with petrochemical facilities. Nothing big, but a lot of little things and they've all got to get done. So, that's where we're at in this home stretch.

Phil Stuart:

All right, thanks so much. That's it for me.

Operator:

Chris Sighinolfi from Jefferies, please go ahead, your line is open.

Chris Sighinolfi:

Hi, everyone, good afternoon. Rosy, I just wanted to follow-up on Theresa's discussion about the capital growth projects. Obviously, there was a scope change, you guys talked about it, and had been earlier talked about by PSX, with regard to the South Texas Gateway Terminal. On the third quarter to the fourth quarter, just comparing these slides, right, costs came up, it came up on Sweeny to Pasadena. I'm assuming, given that the original budget was given in December, if that's already been contemplated in what you gave, because it's consistent with what you gave today, is that right, or were there offsets elsewhere?

Rosy Zuklic:

That's right.

Chris Sighinolfi:

Okay.

Rosy Zuklic:

Right. The $867 million of cap ex is not changing at this point, that's right.

Chris Sighinolfi:

Okay. Then, you had mentioned—I'm always just curious when slide decks change with new data, what comes out. You guys had been featuring sort of an anticipated six- to eight-multiple on the organic backlog, and you've noted as such on that same slide. I don't see it this time. You had a made a comment in your prepared remarks about a consistent midstream multiple, and I'm just curious if you're hinting that it's changing.

Rosy Zuklic:

No, and it's funny, because we actually, in preparing these slides, thought that someone would bring it up. I don't know if you noticed that we actually changed the look of the slides, and it's a much more cleaner look, and the new slide layout does not have kicker boxes. So, that's why I made a point of saying it in my script.

Chris Sighinolfi:

Okay, fair enough, and then a final question for me, and I noticed this when you guys gave the original budget. The significant step up in maintenance budget from last year to this year, is there a particular item that's driving that, or I guess what is driving that change, and what's the cadence, I guess, if we look at the future?

Rosy Zuklic:

No, there isn't any one particular item. Just in general, we have an integrity and reliability program that we have throughout the Company, whether it's PSX or PSXP. And it just so happened that for 2020, a lot of the pipelines that we've identified—we have a lot of 40-year or 50-year and 60-year vintage pipelines throughout both the PSX and PSXP system- that we want to increase just the reliability and integrity of the pipeline system. The good news is that a lot of the work that we're doing is really more on identifying things before they happen. So, what you're seeing, really, in 2020, is we're actually increasing. So the spend that we have is more like 9% of EBITDA. But, obviously, what we'll see is that going forward it'll be more like 6% of EBITDA, which is what historically our spend has been. So, 2020 is an anomaly, in that it's a bump up, compared to where it's been, but I would say that it's simply because we are growing. The level of the maintenance expense is probably more in that $130 million, where we're finding 2020 to be, but it'll end up being more like 6% of EBITDA, which again has been more the historical level.

Chris Sighinolfi:

Okay. So, driven there maybe more acutely because of some particular programs, but in general, as the business grows, you just think that's probably the new ballpark. Is that a fair representation?

Rosy Zuklic:

That's right. The business will obviously get bigger, but the amount as a percentage will be smaller.

Tim Roberts:

You'll find our maintenance, when you look at it across, whether it's the PSX level for midstream or with PSXP, we have a number for the year, but it really is not ratable per quarter, and, again, based on specific size, complexity of a project in a region. So it really does—like we said, it's not a big number, which is good, but the other side of it is it just isn't really ratable, and it's not predictable year over year with regard to

always the fourth quarter will be the highest, or such and such. It really does move depending on the project and what needs to get done, and when, based on our priority list.

Chris Sighinolfi:

Okay, and I guess, if I could, one more question for me, and it's just regarding the preferred equity position. I don't know, Rosy, if this is for you or for Kevin, but do you just contemplate that remaining in a preferred state or do you contemplate conversion of that at some point, or take out of that?

Kevin J. Mitchell:

The way things stand right now, the preferred equity holders have the right to convert that to common equity, at their election, and so that's really a question for them. I don't know that they—they haven't signaled anything around an interest to do that. Upon certain price thresholds being met of the common units, at a certain point in time, which I think is October of this year, we have the right—if those criteria are met, we have the right to force that conversion, but that's something for a point in the future. Our assumption, we just assume it stays where it is, as preferred equity, for the time being.

Chris Sighinolfi:

Okay. All right, I took a lot of time this morning, I appreciate you guys enabling me to do that, so thanks again.

Operator:

We have no further questions at this time. I will now turn the call back over to Jeff—oh, we do have another question that's come up.

Elvira Scotto from RBC Capital Markets, your line is open, please go ahead.

Elvira Scotto:

Hey, good afternoon. Sorry for kicking in late. The questions that I have are absent, like, a big project, is there a certain level of growth cap ex, maybe smaller projects, that PSXP can kind of find year in and year out, certain, you know, kind of sustainable level of growth cap ex longer term, that we can think about?

Kevin J. Mitchell:

I'm just thinking through that. I mean, there probably is. As you know, we've grown the MLP significantly through a combination of drop-downs, which was more in sort of the earlier stages of PSXP's lifecycle, and then in the last two or three years it's been a lot more organic opportunities, albeit it's still projects that originated at the PSX level. As we look at it, we still think that that's probably the path to continued growth at the MLP. What we do find with the infrastructure we have in place, we do continue to come upon relatively small investment opportunities that are nice return projects that give a good little boost to growth EBITDA generation, and so there probably is a level. I don't think we've really defined what that is. Obviously, it would be significantly lower than where we've been lately. Where we're sort of a $800 million total capital spend number, it'll be something significantly lower than that. But, with the size of the portfolio that we have at the MLP, and the fact that that is continuing to grow, it makes sense that there would be sort of continued, almost incremental-type opportunities to provide additional returns and growth.

Elvira Scotto:

Thanks for that, and then the last question that I have is—at the PSX level, and on the call, they talked about AdvantEdge and how that's going to provide about $1.2 billion of enhancements, I think, through the end of 2021. Does any of that flow through to the PSXP level, or how should we think about AdvantEdge as it relates to PSXP?

Kevin J. Mitchell:

I think that would manifest itself at the PSXP level. To the extent that there are capital projects being done at the MLP, which of course there are, that's an element of the benefits that we're seeing, in terms of more effective execution of our capital projects, and so you can expect to see it from that standpoint. There's a significant focus around how we look at our value chain from beginning to end. That's not going to show up the same in the MLP because that's really all around the hydrocarbons. The MLP model, which is more of a tolling arrangement type, volumes times a tariff or a fee, you're less likely—you're not going to see that same sort of value chain focus. But, the other area is that value chain focus identifies investment opportunities that we might not have done previously. So, to the extent those investment opportunities make sense to the MLP, you'll see some benefit there. Then, the other element is in terms of operations and using digital data, having the ability to do data analytics and drive better decisions around how we actually operate our assets. And the MLP will benefit from that just as much as at the PSX level, for those assets that sit at the MLP. So, there's certainly some elements of that will flow and be for the benefit of the MLP.

Elvira Scotto:

Great. Thank you very much.

Operator:

We have no further questions at this time. I will now turn the call back over to Jeff.

Jeff Dietert:

Thank you for your interest in Phillips 66 Partners. If you have additional questions, please call Brent or me. Thank you.

Operator:

Thank you. Ladies and gentlemen, this concludes today's conference. You may now disconnect.