TRANSCRIPT
2Q 2020 EARNINGS CALL

PHILLIPS 66 PARTNERS (NYSE: PSXP)
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PHILLIPS 66 PARTNERS PARTICIPANTS

Jeff Dietert, *Vice President, Investor Relations*

Kevin 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

Gabe Moreen, *Mizuho*

Spiro Dounis, *Credit Suisse*

Elvira Scotto, *RBC Capital Markets*

Theresa Chen, *Barclays*

Jeremy Tonet, *JPMorgan*

Chris Sighinolfi, *Jeffries*

TRANSCRIPT

Operator:

Welcome to the Second Quarter 2020 Phillips 66 Partners Earnings Conference Call.

My name is David, and I will be your 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 the Phillips 66 Partners Second 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 materials can be found on the Events section of the Phillips 66 Partners website, along with supplemental financial and operating information.

Slide 2 contains our Safe Harbor statement. We will be making forward-looking statements during the presentation and our Q&A session. Actual results may differ materially from today's comments. Factors that could cause actual 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 Mitchell:

Thank you, Jeff, and good afternoon, everyone.

During the second quarter, Phillips 66 Partners operated reliably and safely under chief key milestones on its growth projects. The Gray Oak Pipeline began full service and supplied the first crude oil into the South Texas Gateway Terminal which recently saw it's first cargo loading. The board of directors approved a second-quarter distribution of $0.875 per common unit, a 2% increase over second-quarter 2019 and unchanged from the first quarter of 2020.

Philips 66 Partners is well-positioned to navigate the current business environment with our investment-grade credit rating and strong liquidity. We remain focused on operating excellence, maintaining our strong balance sheet and disciplined capital allocation.

Moving on to Slide 4 to discuss financial results. The Partnership reported second-quarter earnings of $255 million. This includes recognition of an $84 million gain related to the Partnership's prior-year sale of an interest in the Gray Oak Pipeline. Adjusted EBITDA and distributable cash flow were both down about $50 million. The decreases from the first quarter reflect reduced volumes on wholly owned and joint venture assets, driven by lower domestic oil production, refinery utilization and product demand.

Slide 5 highlights our financial flexibility and liquidity. We ended the second quarter with $7 million of cash and $532 million available under our revolving credit facility. The Partnership funded $311 million of growth capital during the quarter. This includes investments in the Gray Oak Pipeline and South Texas Gateway Terminal, as well as spend on the C2G Pipeline and the Sweeny to Pasadena Pipeline.

In addition, the Partnership continues to fund its share of commitments for the deferred Liberty Pipeline project. The debt-to-EBITDA ratio on a revolver covenant basis was 3.1, which remains below our targeted long-term leverage ratio of 3.5. Our distribution coverage ratio was 1.09. We recognize the uncertainty associated with the Dakota Access Pipeline litigation. The economic implications of a temporary shutdown extend beyond the pipeline owners, the customers, state and local governments, consumers, and workers throughout the energy value chain. Dakota Access Pipeline has a history of safe operations, and we believe it should be allowed to operate while this matter continues through the judicial process. Dakota Access Pipeline has appealed the district court ruling as a District of Columbia (D.C.) Circuit Court. We believe the merits of the appeal are well-founded.

For the year, distribution coverage for Phillips 66 Partners could be negatively impacted by an adverse ruling on the Dakota Access Pipeline. However; we will continue to target long-term coverage in excess of 1.2 and take actions as necessary to achieve this. Maintaining a strong balance sheet remains a top priority.

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

Rosy Zuklic:

Thanks, Kevin, and hello, everyone.

Moving on to Slide 6, I'll talk about our growth projects. We recently completed the storage capacity expansion at Clemens Cavern from 9 million barrels to 16.5 million barrels, which supports the C2G Pipeline and the Phillips 66 Sweeny fracs 2 and 3. The project was done ahead of schedule and on budget. We expect the new caverns to contribute to third-quarter results.

The Gray Oak Pipeline commenced full operations from West Texas and the Eagle Ford to the Texas Gulf Coast, marking completion of the project. The Partnership has a 42.25% ownership interest in the Gray Oak Pipeline. Gray Oak connects to multiple refineries and export facilities in the Corpus Christi area, including the South Texas Gateway Terminal. The first dock and eight tanks totaling 3.4 million barrels of storage capacity have been commissioned, and the terminal began crude oil export operations in July.

Marine operations, including the second dock, are expected to ramp up by the end of this year as additional phases of construction are finished. We expect the project to be completed in the first quarter of 2021, with total storage capacity of 8.6 million barrels and up to 800,000 barrels per day of export capacity. Phillips 66 Partners owns a 25% interest in the terminal.

The Sweeney to Pasadena capacity expansion reached mechanical completion in July and began operations this quarter. The project is supported by long-term pipeline and terminal volume commitments from Phillips 66.

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. As we open the call for questions, as a courtesy to all participants, please limit yourself to one question and a follow-up. If you have a question, please press star, then 1 on your touch-tone 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 touch-tone phone.

Gabe Moreen from Mizuho, please go ahead. Your line is open.

Gabe Moreen:

Hi. Good afternoon, everyone. I'm just wondering if I could start out with the DAPL, and if a stay is not achieved, I guess your current outlook in terms of maintaining the distribution as well as your investment-grade credit rating while the EIS is prepared. Just wanted to know what your thoughts are there, and any discussions you've had with ratings agencies and how much time they might give you to see the DAPL process through?

Kevin J. Mitchell:

Gabe, it's Kevin. I don't think we've said that in the event the pipeline has to shut down that, that means we will still hold the distribution at the same level. That's something we will evaluate. We will make a decision around that at that point in time, and the two main levers we've got available to ourselves are the distribution and the level of capital spend. Obviously, when you look at the capital spend in terms of this year, there's not that much flexibility. There's a lot more flexibility as you look into next year as a lot of these projects complete, but in the event of the pipeline having to shut down, that would be a reason for us to consider the distribution and where that needs to be.

Gabe Mourine

Understood. Then I also had a question as to I think you have other assets in the Bakken. There's a rail terminal there, I think there is, you have a partial interest in. Would there be any benefit to that asset, or could you get some customers' volumes over to that asset in the event of a DAPL shutdown?

Rosy Zuklic

Yes, no, this is Rosy, Gabe. Yes, you're thinking about it right. We would see benefit there at the Palermo Rail Terminal from an event like that.

Gabe Mourine

Rosy, can you just talk about how much volume you're doing there currently versus capacity?

Rosy Zuklic

It's probably at a 60% rate right now.

Gabe Mourine

Okay, understood. Thank you.

Operator

Spiro Dounis from Credit Suisse, please go ahead. Your line is open.

Spiro Dounis

Hey, afternoon, guys.

First question just follow up on DAPL briefly. I know it's been covered a lot in the last few calls, but just in the event of an extended or more permanent shutdown, just curious where Liberty would stand in that scenario. Just trying to understand how quickly it could sort of mobilize and get that project back up on foreground, and is that a realistic alternative for you?

Tim Roberts

This is Tim Roberts, Spiro. Thanks for the question.

I would say, right now with Liberty, that Liberty is going to really be dependent, we've deferred it, it's really going to be dependent on our ability to get long-term commitments. So, if there are long-term investment-grade commitments that people are willing to make, producers, shippers, or anybody else who wants to get on that line, obviously that would help into achieving acceptable returns. Obviously, those are interesting for us.

I would say that I wouldn't, with the timing between the two, it's hard to say that what happens on Bakken is going to impact what's going to happen on Liberty. It could very well, but I think it's too much uncertainty right now, to be honest with you. Plus, when we put Liberty in place, Liberty was really meant to be also Powder River Basin, coupled with some parts of the Bakken, coupled with barrels up in the Rockies, DJ, and so forth. So, it really wasn't a Bakken play as much. I think that complemented it, but it wasn't that specific play. I think at this point, still too early to call, and we still look at Liberty on its own merits. We have enough interest that makes sense to possibly advance that project, we'll do it.

Spiro Dounis

Got it. Thanks, Tim. That makes sense. Switching gears to MVCs, I believe the accounting here means that we'll see some of those MVCs realized in revenue on a forward basis as the credits are used up. Do you have any sense for what the total deficiency amount was this quarter, for both wholly owned and JV assets, and maybe over how many quarters going forward we could see that start to get realized through EBITDA?

Rosy Zuklic

I don't have a number for you, and it's hard to say, but just simply because so many of the JVs have different ways − when it comes to their distributions, in some cases, some of them pay out like March, April and May, as opposed to actually paying out the actual quarter month. But you are thinking about it right. As the next quarter moves forward, and we are actually seeing the volumes go closer to the MVC levels, we should actually start seeing benefits there from a cash flow perspective and earnings perspective.

Operator

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

Elvira Scotto

Hey, good afternoon, everyone.

You talked about the two levers in the event of a DAPL shutdown that PSXP itself could pull, which would be capex and distributions. Let's just start a minute with capex. You said that with most of your growth projects essentially finished or close to being complete this year, you still have some capex spend. What would be a reasonable run rate for growth capex in 2021 and beyond?

Kevin Mitchell

Hey, Elvira. It's Kevin. If you just look at the major projects that we've got going, the only one that has a decent amount of spend in 2021 is the C2G ethane pipeline, and then the rest will be small projects on top of that. I'm not in a position to give capital guidance for 2021 at this point. That's something we do later in the year, but I think the point is we're highlighting that there's the potential for it to be quite a bit lower than where we were this year. So, this year, in aggregate, it's something close to $900 million, and so it could come down by a reasonable order of magnitude from that, but not in a position to give a specific number at this point.

Elvira Scotto

Okay, thanks. My second question is just around the distribution as a lever that you said you would look at the distribution. So is DAPL, just trying to understand, if DAPL were shut down, is the distribution − should we think about it as, okay, that is − automatically, we should think about the distribution going down, or are you going to see what happens in terms of either a timeline, or what the rating agencies say, or, look, it's your leverage, or leverage forecast?

Kevin Mitchell

We'll be looking holistically across the entire financial profile of the MLP as we give consideration to those things, and so the loss of EBITDA, the loss of cash flow from the pipeline being shut down, if that's what happens, that impacts a certain element of our metrics. The distribution can help offset that, if we make a decision on the distribution, but we're also looking at the leverage metrics as well because they get impacted. So, we're sort of triangulating around all those different elements. Then also it depends on what's the economic outlook, the broader economic position at that point in time. The distribution is an easy one to do, but that doesn't mean to say that a shutdown automatically means a reduction of whatever percent. That's something that we won't be definitive around that until we're at that point where we're ready to go there.

Elvira Scotto

Thank you.

Operator

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

Theresa Chen

Just to clarify expectations around the DAPL process. What are you expecting in terms of the timeline itself of the appeal process?

Tim Roberts

From the process that stands right now, we're expecting some sort of response from the Court of Appeals any time. Any time can be hours, days or weeks. We do think all the briefings have been submitted, so that's been done. They are now going through that process, so we'll hear what they come back with. Regardless, whatever that outcome may be, there still is another avenue to appeal, which would then, the appellate process would send you up to the Supreme Court, which I would suspect either party, depending on what side of the decision you're on, is probably going to take that course.

So, that in itself, you can get an emergency process through there, and that again turns into − if you look at the Nationwide Permit, for example, that was just recently went up through on an emergency process, I believe that took around six weeks before they came back with response on that. That's not a given, but it just gives us another data point on what that could potentially look like.

Theresa Chen

Okay, so, from the time that permit landed, or the appeal for the permit landed on the Supreme Court's desk to the time that a decision was rendered, it was six weeks?

Tim Roberts

Yes, I think by the time the appeal process was started with the Supreme Court it was six weeks. Yes, we may be saying the same thing, Theresa. I look at it from the time you get an answer from this Court of Appeals, I think we look at it six weeks from that point on getting another answer if it goes through that process.

Theresa Chen

Got it. In relation to the gap between the MVCs and throughput which you were made whole on in terms of DCF and coverage, I believe, and please correct me if I'm wrong, but I believe that will be recognized in earnings once the makeup period for the shipper or your affiliate is over. When you look at the timing of when each contract started within the year, and assuming that makeup period is around a year, do you see any lumpiness in the recognition of earnings as we go on?

Rosy Zuklic

There could be, but you're right. I think that every JV pipeline has a slightly different agreement with their shippers, so it's not going to be all the same, and in some cases, like I was describing earlier to Spiro, the way the distributions of their cash is also a little bit off, so that causes a little bit of lumpiness too, but you are thinking about it right.

Operator

Jeremy Tonet from JPMorgan, please go ahead. Your line is open.

Jeremy Tonet

Good afternoon. Just wanted to touch base with your expectations for refined product volumes and crude oil volumes, if you will, over your system for the balance of the year. If you could just give us a live snapshot of what you're seeing now, and how recovery, you think, will progress across your areas, and how those volumes could recover over the balance of the year. That would be helpful.

Jeff Dietert

Yes, Jeremy, we average 75% utilization in the second quarter, and on the PSX call we talked about averaging in the low 80% range during the month of July. As we look forward into the rest of the third quarter and the back half of the year, it's really going to depend on how rapidly demand recovers, and the economy recovers, and what the demand for refined products, how that evolves in the back half of the year. We expect to increase utilization as demand continues to recover.

Jeremy Tonet

That's very helpful. Thanks. Just wondering if you could provide a bit more color on your JV EBITDA. Everything's kind of consolidated there, so wondering if you could give us a flavor on the year-over-year look by the individual assets, which ones had bigger changes than others.

Rosy Zuklic

I think, from what I saw this quarter, at least, is just simply no surprise the DAPL Pipeline came in lower from the first quarter, and that's just the result of the shut in of the wells that happened in the Bakken area.

Gray Oak was increased from the first quarter, and that's, again, to be expected as we saw additional ramp up in that pipeline. When it comes to the Sand Hills and Southern Hills NGL pipes have been doing well, and so we were pleasantly surprised from the contributions that were received from those pipes in this quarter.

Operator

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

Chris Sighinolfi

Hey. Good afternoon, everyone. Kevin, I just wanted to follow up on Gabe and Elvira's questions regarding DAPL. I appreciate that this process is uncertain. There's a lot of moving parts. Your response will be shaped by lots of different things depending on what the regulatory and legal outcomes are, but as I understand it, you and the other co-ventures in Dakota Access provided a contingent equity contribution agreement in association with the spring '19 Midwest Connector notes offering, and your securities filings have made reference to an equity contribution trigger event, I guess, as determined by Dakota Access, which would require essentially you to maybe put up your portion of the debt.

So, with regard to that, obviously questions around what the courts do, my question is more what constitutes the trigger event. Is it a timing related issue, is it if they stay fails in the D.C. Circuit, and at the Supreme Court, is that a trigger event? Can you just help us better understand that component as well?

Kevin Mitchell

The way to think about that is a temporary shutdown would not be a trigger event, but something that revoked the permit permanently would be a trigger event. The whole notion of the triggering event, it's really all around the permit, the availability of the permit, and therefore, the ability of the pipeline to continue operations. An interim period of shutdown while the Corps completes its work would not be a triggering event, but a permanent revoke of the permit would. That's how I think about it, but, Tim, any…

Tim Roberts

No, that's right. That's exactly right. I did want to clarify one comment. I just verified, about eight weeks was the Nationwide Permit 12, not six. That's still in the hands of the Supreme Court, so that can be less, they may not take it or it could be longer. So, it just was a guideline from that last ruling that they did make.

Chris Sighinolfi

And there can be significant variance around that time period?

Tim Roberts

Absolutely. That's just a data point. I wouldn't necessarily (audio interference) be set in stone.

Chris Sighinolfi

Okay. With regard to, let's just say that the efforts around securing a stay fail, and we have to go through a formal EIS process, and that might take a year or longer, that you and your partners would effectively service the DAPL debt, is that the way to think about it?

Kevin Mitchell

Yes, that's right, that's right.

Chris Sighinolfi

Then depending on the outcome of EIS, then that's at what point the trigger event determination is made? If the pipeline is back in service, everything's fine, if it's a challenge, then it's an issue.

Kevin Mitchell

Yes. In that event, there's a period of 12 months or so, whatever that period is, of the pipeline being shut down, then the co-ventures would probably have to put cash in to fund the debt service, the interest expense.

Chris Sighinolfi

Okay. Perfect. That's all I had. Thank you very much for the clarification.

Tim Roberts

Thanks, Chris.

Operator

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

Theresa Chen

Tim, to your follow up on the Nationwide Permit, do you expect that this process will need the full Supreme Court, or that it would just be adjudicated by Justice Roberts?

Tim Roberts

Yes, now you're out of my league. I would probably have to refer and just get back to you on what that is, Theresa, but I don't think it's a full Supreme Court, but that's a guess, so I'm going to pull back and say let me check.

Theresa Chen

Okay, and then if I could just squeeze one more, offline from one investor, how long would you be comfortable running sub-1 times coverage while DAPL plays out?

Kevin Mitchell

Well, we think about coverage, really, on an annual basis. So, you've got the quarter-by-quarter it can fluctuate, so we could certainly have a situation where in a given quarter you drop below 1, but you wouldn't expect that to continue over multiple quarters. It's an extended − a shutdown scenario is an event that would cause us to consider whether distribution needs to be, if we need to take action on that. But we wouldn't go for an extended period at sub-1 coverage.

Theresa Chen

Thank you very much.

Operator

We have reached the end of today's call. I will now turn the call back over to Jeff.

Jeff Dietert

Thank you, David, and thank all of 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.