TRANSCRIPT
4Q 2020 EARNINGS CALL

Phillips 66 Partners

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*

Casey Gorder, *General Manager, Operations*

Tim Roberts, *Director and Vice President, Operations*

MEETING PARTICIPANTS

Spiro Dounis, *Credit Suisse*

Theresa Chen, *Barclays*

Jeremy Tonet, *JPMorgan*

John Mackay, *Goldman Sachs*

TRANSCRIPT

Operator:

Welcome to the Fourth 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 Phillips 66 Partners Fourth Quarter Earnings Conference Call. Participants on today's call will include Kevin Mitchell, Vice President, CFO and Director; Tim Roberts, Vice President, COO and Director; and Casey Gorder, General Manager, Operations.

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 it over to Kevin Mitchell.

Kevin Mitchell:

Thank you, Jeff, and good afternoon, everyone. In the fourth quarter, Phillips 66 Partners delivered strong operating performance and solid results in a challenging market environment. We achieved a major milestone at the South Texas Gateway Terminal with the completion of the second dock and the loading of its first VLCC. The board of directors approved a fourth-quarter distribution of $0.875 per common unit, unchanged from the fourth quarter 2019.

Moving on to slide 4 to discuss full-year highlights. The Partnership demonstrated the strength of its fee-based portfolio. Despite the unprecedented challenges of 2020, adjusted EBITDA and distributable cash flow only declined modestly from our strong 2019 performance. We continue to operate safely and reliably. Phillips 66 Partners reported earnings of $791 million. Adjusted EBITDA for the year was $1.2 billion.

We continued to execute our growth program. The Gray Oak Pipeline, our largest project to date, reached full operations in the second quarter, and the expanded capacity at Clemens Caverns was placed into service in July.
In addition, we advanced the South Texas Gateway Terminal and continued construction of the C2G Pipeline. These assets, all supported by long-term customer commitments, will further integrate our portfolio.

Moving on to slide 5 to discuss financial results for the quarter. The Partnership reported fourth-quarter earnings of $104 million compared with $206 million in the third quarter. The decrease was due to $96 million of impairments related to investments in two crude oil logistics joint ventures.

Fourth-quarter adjusted EBITDA was $318 million. This was an increase of $5 million from the third quarter due to higher Bakken Pipeline volumes, partially offset by lower volumes on the Sand Hills Pipeline. Fourth-quarter distributable cash flow was $240 million, down $3 million from the prior quarter. The decrease reflects higher maintenance CapEx in the fourth quarter.

Slide 6 highlights our financial flexibility and liquidity. We ended the fourth quarter with $7 million of cash and $334 million available under our revolving credit facility. The Partnership funded $90 million of growth capital during the quarter. This included spend on the C2G Pipeline and investment in South Texas Gateway Terminal.

The debt-to-EBITDA ratio on a revolver covenant basis was 2.9, which is consistent with our target to remain below 3.5. Our distribution coverage ratio was 1.2.

We recognize the ongoing uncertainty associated with the Dakota Access Pipeline litigation. Earlier this week, the appellate court affirmed that the Corps must prepare an environmental impact study, which is already underway and is expected to be completed by the end of the year. The court also affirmed the vacating of the easement under Lake Oahe.

While the court did not mandate a shutdown of the pipeline while the EIS is being prepared, it recognized there is a pending motion for injunction on that issue in the lower court. The economic implications of a temporary shutdown extend beyond the pipeline owners to 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 process. We will continue to consider options as the legal process plays out.
Phillips 66 Partners remains focused on those areas within our control, including safe, reliable operations and disciplined capital allocation to maintain financial flexibility.

Now Casey will provide an update on our growth projects.

Casey Gorder:

Thank you, Kevin, and hello, everyone. Moving to slide 7, I'll provide an update on our major projects, which continue to progress during the quarter.

At the South Texas Gateway Terminal, the second dock commenced crude oil export operations in the fourth quarter. This enables the berthing and loading of two vessels at the same time with up to 800,000 barrels per day of throughput capacity. We expect construction to be completed in the first quarter of 2021 with total storage capacity of 8.6 million barrels. Phillips 66 Partners owns a 25% interest in the terminal.

We continue construction of the C2G Pipeline connecting Clemens Storage Caverns to petrochemical facilities in the Corpus Christi area. The project is backed by long-term commitments. Pipeline construction is about 85% complete and is expected to startup in mid-2021.

We continue to execute projects that optimize our existing asset base, including the Zena Lateral associated with the Gray Oak Pipeline. Our integrated portfolio has created a number of opportunities for capital efficient, high-return optimization projects.

We will continue to identify and evaluate these quick-win projects to meet customer demand while maintaining capital discipline. The 2021 capital budget of $300 million includes $165 million for growth and $135 million for maintenance capital. Growth capital will be directed toward in-flight and optimization projects.

This concludes our prepared remarks. We'll 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.

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

Spiro Dounis:

Hey, afternoon, guys. A question for you, Kevin, first maybe. In the past you talked about achieving a $1.5 billion EBITDA run rate. Realize we're not there yet. But barring the Bakken Pipeline for a second, is that still a good way to think about your earnings power, I guess, as the market normalizes this current asset base or is it going to take incremental investment to get there at some point?

Kevin J. Mitchell:

Yeah. I think to get to the $1.5 billion of EBITDA, you probably don't quite get there with the current asset base; in part, if I remember right and Tim may need to confirm this for me, I think we included Liberty in that.

Tim Roberts:

Yeah

Kevin Mitchell:

And so that's the big difference between what we had at the time we made that statement versus where we are today. So that's really the primary differentiator versus those previous projections.

Spiro Dounis:

Okay. That's helpful. And then next question, perhaps not surprisingly, just on Dakota Access. I realize a fair amount is out of your control, and I appreciate your update on that, Kevin. But I guess if we could just focus on what is in your control, and I guess that's how you would react to a potential closure. I think this is probably what's on most people's minds, but I guess what tools are at your disposal, not from a legal perspective, but just in terms of the balance sheet and how you react? To the extent that closure is actually just a temporary measure, to the extent it only extends inside of a year, if that's really all an EIS is going to take, do you feel compelled to react to that or is that a wait-it-out type of strategy?

Kevin Mitchell:

Well, I think if we're in a situation where there's a shutdown, even if temporary, there's going to be a fair amount of uncertainty as to how long that's going to last. And so, we do think about all of the options available to us. And from a financial standpoint, there are really two main levers, and that's growth capital and the distribution. The growth capital has already come down significantly.

So, Casey mentioned $165 million in the budget this year. That's significantly lower than where we've been the last couple of years. So, there's a little bit of room there, but not a lot. And so, I'd just say, all options are on the table. We're not going to give any specific guidance at this point of time other than to reinforce that any decisions we make are going to be focused on preserving the balance sheet at Phillips 66 Partners and protecting the best interests of all the unitholders.

Spiro Dounis:

Understood. That's it from me. Thanks, guys, and have a good weekend.

Operator:

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

Theresa Chen:

Hi. So, I wanted to follow up on the DAPL topic. I mean, where the units currently sit, it looks like about 80% to 90% probability of a shutdown is priced into Phillips 66 Partners stock. And I wanted to hear from your own words, what are your expectations for the Feb. 10 hearing? What do you think the potential outcomes are and their respective likelihood?

Tim Roberts:

Theresa, this is Tim. I think Kevin actually summarized it, it feels fairly binary with regard to, it's either going to keep running or it's not. And then at that point, we have options that we would want to look at. And we're going to deal with Energy Transfer. They have their earnings call. They'll probably want to deal with – take the point on this. But we're in discussions with them as far as what legal options we have. Obviously, it's in our interest to continue to pursue keeping the pipeline running.

Jeff Dietert:

Yeah. Energy Transfer is leading the legal effort on that project.

Theresa Chen:

Okay. And, Kevin, to your earlier comment about the distribution as a potential lever to preserve the balance sheet and protect unitholders. So if the pipeline does shut and you pull that lever, what kind of coverage do you think that the base business should target? Given that you do have long-term plans for the midstream business and equity markets remain closed, would you target something higher than what you have historically?

Kevin Mitchell:

Well, I'm not going to get into a path of trying to speculate where we might go on the distribution specifically. But we're triangulating around the balance sheet metrics, thinking about debt metrics, as well as coverage metrics from a distribution standpoint. So, it's not just about having the cash generation, and the distributable cash flow to be able to cover the distribution. It's the broader picture of the balance sheet and the leverage metrics around that as well. And so, we're just thinking through all of those elements.

Operator:

Jeremy Tonet, JPMorgan. Please go ahead. Your line is open.

Kevin Mitchell:

Hi, Jeremy.

Jeremy Tonet:

I just wanted to start with, Phillips 66 has been talking about the renewable fuels business and potentially some expansions there. I'm just wondering if that could translate into opportunities for Phillips 66 Partners or how that might impact the Partnership overall.

Tim Roberts:

Yeah, it can. I would say right now that, for example, Rodeo. If you do Rodeo, you're still going to be moving the fuels. So, that really doesn't change; whether it's renewable fuel or not, you're still going to be using pipelines and terminals to go ahead and get the product to market. Now, good and bad side of that is really Phillips 66 Partners does not have much as far as any footprint out on the West Coast, which would benefit the Phillips 66 Midstream segment. But if our footprint were to expand into other locations for renewable, clearly, that may overlap with some Phillips 66 Partners assets.

Kevin Mitchell:

Yeah. And I would just say, Jeremy, so long as it generates its qualifying EBITDA from that standpoint for the MLP, then those types of assets would lend themselves to that structure. So there's no reason to think that if we had those types of assets within the broader portfolio, they couldn't be candidates to be in the MLP. So, I think that's certainly something that could be possible in the future.

Jeremy Tonet:

Got it. And maybe touching on a point you raised there, is there the potential for capacity rationalization on the refinery side in the U.S. going forward. And just wondering what's Phillips 66 Partners' view on that, how it could impact the Partnership. How do you see the refineries at Phillips 66 Partners stance on the cost curve there?

Tim Roberts:

I mean, Jeremy, I think to keep it fairly simple is that really where a lot of the Phillips 66 Partners assets are located around Mid-Con, and we feel we've got a highly integrated, highly competitive footprint. And so, we do feel like we're well-positioned, both now and into the future, with those assets and where Phillips 66 Partners is associated with those assets.

Jeremy Tonet:

Got it. That's very helpful. And just wanted to touch on terminal volumes a little bit there. I think they might have been a touch down quarter-over-quarter 3Q into 4Q, when we thought maybe they would have ticked up a little bit there. Just wondering if you could touch on drivers to that.

Casey Gorder:

Yeah. I think on the volume piece, it's really just a reflection of refinery utilization. I think it was consistent with what we saw on the pipeline assets, as well that you saw the terminal volumes decrease quarter-over-quarter.

Operator:

John Mackay, Goldman Sachs, your line is open.

John Mackay:

Just wanted to follow-up one more on DAPL. I understand comments you've made and how this is an ongoing process. Just looking for – maybe a more specific one you might be able to answer, just in terms of – could you talk about what the specific trigger for Phillips 66 Partners needing to fund its share of the DAPL debt would specifically look like? And if this was a temporary shutdown during an EIS, for instance, what would happen in that case?

Kevin Mitchell:

Yeah. John, this is Kevin. A temporary shutdown would be unlikely to trigger an action under the debt. Now, you probably get into how long is temporary, but the way we think about this sort of big picture is that it would take a permanent shutdown that would be sort of more conclusive in terms of that determination around it being a triggering event. And so, that's all laid out within the loan agreements around that in terms of that criteria. And so, the way we think about it, a temporary shutdown would not be a trigger. A permanent shutdown would be.

John Mackay:

Understood, that's helpful. Thank you. Maybe just turning to a slightly easier one. Could you just comment on the impairment this quarter and what drove that and what assets those were?

Kevin Mitchell:

Yeah. So we had two impairments, both of them were crude oil logistics related. One was a rail terminal in North Dakota. The other was a crude pipeline in the Mid-Continent. In both cases, through the normal process, we assess all of our assets and then investments for impairment periodically. And just when we look at the future projections around production and revenues, so it didn't pass the threshold to maintain the previous book value investment. And so, we took the appropriate impairment.

John Mackay:

Great. Thank you.

Operator:

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

Jeff Dietert:

Thank you. We appreciate your interest in Phillips 66 Partners. And please follow up with Shannon or me if you have any further questions. Thank you.

Operator:

Thank you, ladies and gentlemen. This concludes today's conference. You may now disconnect.