Phillips 66 Partners
Third Quarter 2014 Earnings Conference Call
October 29, 2014

Operator

Good afternoon. My name is Mike and I will be your conference operator today. At this time I would like to welcome everyone to the Third Quarter 2014 Phillips 66 Partners Earnings call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question and answer session. If you would like to ask a question during this time, press star, then the number one, on your telephone keypad. If you would like to withdraw your question, press the pound key.

I will now turn the call over to Rosy Zuklic, Manager of Investor Relations; you may begin your conference.

Rosy Zuklic:

Thank you. Good afternoon and welcome to the Phillips 66 Partners earnings conference call. With me today are Tim Taylor, President of Phillips 66 Partners; Greg Maxwell, Vice President and CFO; and Tom Liberti, Vice President and Chief Operating Officer.

The presentation materials we'll be using this afternoon can be found on the Events section of the Phillips 66 Partners website, along with supplemental financial and operating information. We'll have time for questions at the end of the presentation.

Slide 2 contains our Safe Harbor statement. It is a reminder that we will be making forward-looking statements during the presentation and the question and answer session. Actual results may differ materially from what we present here today and factors that could cause actual results to differ are included here as well in our filings with the SEC.

With that, I'll turn the call over to Tim Taylor for some opening remarks. Tim?

Tim Taylor:

Thank you, Rosy, and good afternoon everyone.

Slide 3 is a picture of the Bayway rail unloading facility which is part of our recently announced acquisition. This asset along with the Ferndale rail unloading facility and the Cross-Channel Connector pipeline assets will increase the breadth of our portfolio and provide PSXP unitholders with increased fee-based cash flows. Total transaction

costs is $340 million, of which $330 million was for the rail facilities, and $10 million was for the pipeline assets. We expect to close in December.

On Slide 4, we've outlined several key points of the acquisition. The 75,000 barrel per day Bayway rack commenced operations in August of 2014 and the 30,000 barrel per day rail rack at Ferndale is scheduled to begin commercial operations next month. These facilities are expected to generate $30 to $35 million of annual fee-based EBITDA for the Partnership. They'll add a new class of service to PSXP's asset base and expand its portfolio with east and west coast locations.

The Cross-Channel Connector pipeline assets consist of refined products pipelines crossing the Houston ship channel. After the transaction closes, we'll undertake a $12 million organic capital project to provide shippers access from our Pasadena terminal to third party pipelines and docks located north of the ship channel. The project is targeted to be complete by the second quarter of 2015. The pipeline is anticipated to have a capacity of up to 180,000 barrels per day and generate $6 to $8 million of annual EBITDA.

On Slide 5, we provided a look at distribution since inception. Last week, our Board of Directors approved a 5% distribution increase to 31.68 cents per unit for the third quarter. Since the third quarter of 2013, we've increased our distributions by 49%, demonstrating our commitment to growth. We expect that the recently announced transaction will allow us to continue to provide strong growth opportunities for our unitholders.

Operationally, we delivered on our commitment to safety and operating excellence. We had no major incidents or injuries during the quarter and this continues our trend since the IPO last July.

Now I'll turn the call over to Greg Maxwell to provide a more detailed update on the financial results for the quarter.

Greg Maxwell:

Thank you, Tim. Good afternoon everyone. Beginning on Slide 6, Phillips 66 Partners had third quarter revenues of $53.4 million. This is down $3.5 million from the second quarter. This decrease is primarily the result of maintenance activities performed at Phillips 66's Borger and their Sweeny refineries. These reductions were partially offset by higher volumes on the Clifton Ridge crude system.

Total cost and expenses were $23.9 million, down from the prior quarter, mainly due to lower operating costs and also lower general and administrative expenses. The Partners—the General Partner's Board recently declared a [third] quarter cash

distribution of 31.68 cents per limited partner unit and this is payable on November 13th to unitholders of record as of November 4th. This represents a 5% increase compared with our previous quarter's distribution of 30.17 cents per unit.

Turning to Slide 7, EBITDA for the quarter was $35 million and distributable cash flow was $33.4 million. During the quarter, we had adjustments related to minimum volume commitments of $1.4 million. These adjustments were triggered on both the Gold Line and the Sweeny to Pasadena products systems due to maintenance activities at the Borger and Sweeny refineries.

We had maintenance capital expenditures of $2.2 million during the quarter and total cash distributions will be $25.3 million, resulting in a 1.32 coverage ratio.

Slide 8 shows that we ended the quarter with $43 million of cash and cash equivalents. We currently have outstanding debt of $160 million in the form of a note payable to Phillips 66. Additionally, we have access to a $250 million revolving credit facility that also has a $250 million accordion feature. This facility remained undrawn during the third quarter.

As of September 30th, our debt to EBITDA ratio was approximately 1.1.

As we announced last week, we intend to fund our second acquisition with $28 million in borrowings under the revolving credit facility. The assumption of a five-year $244 million note payable to a Phillips 66 subsidiary and $68 million in additional units to Phillips 66.

Looking forward, we intend to position PSXP to achieve an investment grade credit rating to enhance its financial flexibility and also to facilitate low-cost financings that will efficiently fund our future growth plans.

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

Operator:

At this time I would like to remind everyone in order to ask a question, press star, one, on your telephone keypad. We will pause for a few moments to compile the Q&A roster.

Your first question is from Jeremy Tonet with JPMorgan.

Rosy Zuklic:

Hi Jeremy.

Jeremy Tonet:

Hi. I just wanted to make sure I was there. So, the Cross-Channel Connector pipeline acquisition and expansion project appears to be nicely accretive on the numbers we're looking at and we're just wondering, would you say this type of project represents an area where PSXP is more focused on maximizing commercial opportunities for logistics assets versus what PSX had done historically? And do you think there's more low-hanging fruit like this project?

Tom Liberti:

Well I think it's—Jeremy, this is Tom. The connection for the PSXP Pasadena Terminal first makes it very attractive. The pipe that we currently have, there is some volume on that pipe. The commercial aspect of going across the channel on to third party terminals and giving water access plus the terminal access certainly is attractive.

More out there? You know, we don't have a lot that are like this that are connected to some of the other terminals that we currently have in the portfolio for PSXP, but you look down more to Gulf Coast terminals you'd see those kind of opportunities a little bit more.

Tim Taylor:

Jeremy, I think that as PSXP grows and you get more assets into the MLP, you should expect to see more of these types of organic projects as they grow and scale in scope.

Jeremy Tonet:

That makes sense. I think on the PSX call there was mention of dropdowns reaching $1 to $2 billion a year. Would you say that's a good run rate going forward, or is that more of a later-dated target?

Tim Taylor:

You know, we don't—we just said the top quartile distribution growth. The question was really centered around how much could you drop funding? How do you go about it? So I think there's a lot of options but I think we've got a great pool of assets in the midstream at PSX and so the sponsor has got a great pipeline of projects and I would anticipate that that'll help be a key part of the growth story for PSXP.

Jeremy Tonet:

Got you. I was just wondering, it seems like that the first couple of dropdowns that these are projects that just recently come online, and I'm wondering how much that factor comes into play when deciding what to drop down next. Within that context, how does the Southern and Sand Hills look like as far as reaching maybe half that level of maturity where it would be a fit for the MLP?

Tom Liberti:

Yes, we've always said that we'll look at each asset individually and see when—see things for timing and how things have matured. When a new asset comes online obviously there's some efficiencies to dropping them early, from an accounting standpoint, from a tax standpoint, but that doesn't mean we'll necessarily do everything as soon as it would come online. Again, we'd look at each one of those individually.

Sand and Southern are ripening nicely. They're maturing about how we have it in the plan. We still about a 3.5 to 4-year ROFL on those assets so we still have some time in the future for those.

Jeremy Tonet:

Thanks for that. Then just one last one for me: I think PSX had discussed midstream EBITDA reaching $2.3 billion by 2018 and I'm just wondering if you could provide color? If you think—if all these assets would be built upstairs or do you think some would be built at the PSXP level? And kind of importantly, what do you see as the markers as whereas PSXP has reached big enough scale where it can really warehouse more of these projects itself?

Tim Taylor:

Many dimensions to that question, so first in terms of the size and scope, clearly great runway as the MLP increases in size. The ability to take on bigger projects or bigger chunks of that develops. As far as organic at PSXP or PSX, clearly scale and scope at the MLP is required to be able to tackle a $3, $3.5 billion LPG export fractionation project. So those look a little difficult, particularly given the size today. Over time, we'd expect that size to begin to increase beyond like the Connector project into more progressive sizes, and I think that just goes with maturation of the MLP in terms of its scale.

Tom Liberti:

And I would just add too, Jeremy, the time that the EBITDA comes online too, so the time of construction also a factor when we're looking at the size of the MLP today.

Jeremy Tonet:

That's all very helpful. Thank you.

Operator:

Again, if you would like to ask a question, press star, one. The next question is from Brian Zarahn with Barclays.

Brian Zarahn:

Good afternoon.

Tom Liberti:

Hi Brian.

Brian Zarahn:

Regarding the $2.3 billion of midstream EBITDA by 2018, I'm just confirming that includes PSXP's EBITDA currently.

Tim Taylor:

That would include PSXP's EBITDA, yes.

Brian Zarahn:

Okay, so if we look at—sort of dropdown inventory prior to the second dropdown and then the Energy Transfer JV was about $2.2 billion, so net-net that inventory grew by whatever assumption we have on netting out the $35 million or so of EBITDA from the second dropdown and the contribution from the Energy Transfer JV. So all else equal the inventory got bigger including the Energy Transfer JV…

Tim Taylor:

Yes, the Dakota Access pipeline and the Energy transfer crude oil pipeline joint ventures that we're forming with Energy Transfer were not included in that $2.3 billion. The capital costs, our share is roughly estimated to be $1.2 billion and you put typical midstream multiple on it, that's the increment of EBITDA that would be added to that

$2.3 billion, so just to kind of walk through that, so that's in addition to what we talked about, net $2.3.

Tom Liberti:

You're absolutely correct that the recent dropdown that we just announced, that was in the 2.3 million, that EBITDA was correct.

Brian Zarahn:

Okay, so ballparking that number is now $2.3, $2.35 billion of available EBITDA in the future by 2018 for PSXP.

Tim Taylor:

Roughly correct, given what's already in the MLP and what would be left. You have to take the debt out of the $2.3.

Plus the DAPL, so you're kind of in the right ballpark.

Brian Zarahn:

Then on the—staying on those projects, how do you think about—which is the future dropdown for PSXP—the Beaumont terminal, expansion opportunities there related to the Bakken-Gulf Coast pipelines?

Tim Taylor:

You know, the midstream growth key piece for element at the sponsor with PSX and that's it. The MLP is a great way to help realize the value from that. So we don't give specifics around which assets, when, whatever, but it's—I think you should expect the MLP to grow as the sponsor really grows that midstream plus its organic. So that—my comment is back about the great pool of assets of EBITDA that can drop. So I think that's really the right way to look at that, and timing and flexibility and how that develops is really still some flexibility into the future.

Brian Zarahn:

In the terms of the—it sounds like you're planning on expanding Beaumont's capacity. I didn't know if that was related more to export opportunities or related more to now you have a major long-haul pipeline ending at that terminal.

Tim Taylor:

I'll speak as the PSX sponsor on that one. It's really around developing the Beaumont asset, that really is. It's about water access on the exports, products. It's about crude movements along the Gulf Coast. It's about the inbound pipelines and it will also have a nice supply dimension to our refining system. So it's really—we see that as a key asset to develop to help us on the midstream side really develop a lot of logistics capability around the Gulf Coast. So it's a key asset, as Greg said earlier on our call.

Brian Zarahn:

Given all your dropdowns so far have been, you know, fully backed by PSX, as the counter party, obviously the Bakken-Gulf Coast pipeline is a little bit different. But does PSX anticipate being a shipper on the pipeline system?

Tim Taylor:

Yes, on the Bakken-DAPL-ETCO system we anticipate being a shipper.

Brian Zarahn:

Okay. Then lastly on the second dropdown, how should we think about maintenance capex?

Tom Liberti:

Maintenance capex, since those are—the two rail racks are brand new. We really don't have maintenance capex in for the first few years. The Cross-Channel, we're actually doing most of the enhancement capex now so again it'll be light on that too.

Brian Zarahn:

That's all I had. Thank you.

Operator:

There are no further questions at this time. I will turn the call back over to Rosy Zuklic for closing remarks.

Rosy Zuklic:

Okay. Well, thank you very much. Thank you for everyone who listened in and if you have any further questions, Tom or I are available for your calls. Thank you.

Operator:

This concludes today's conference. You may now disconnect.