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# EDITED TRANSCRIPT

PSXP - Q3 2015 Phillips 66 Partners LP Earnings Call

EVENT DATE/TIME: OCTOBER 30, 2015 / 6:00PM GMT



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## CORPORATE PARTICIPANTS

**Kevin Mitchell** *Phillips 66 Partners LP - VP of IR*

**Tim Taylor** *Phillips 66 Partners LP - President*

**Bob Herman** *Phillips 66 Partners LP - SVP of Operations*

**Greg Maxwell** *Phillips 66 Partners LP - VP and CFO*

**Tom Liberti** *Phillips 66 Partners LP - VP and COO*

## CONFERENCE CALL PARTICIPANTS

**Kristina Kazarian** *Deutsche Bank - Analyst*

**Andy Burd** *JPMorgan - Analyst*

**Brian Zarahn** *Barclays Capital - Analyst*

**Bhavesh Lodaya** *Credit Suisse - Analyst*

**Tim Schneider** *Evercore ISI - Analyst*

## PRESENTATION

**Operator**

Welcome to the third-quarter 2015 Phillips 66 Partners earnings conference call. My name is Mike, and I will be your operator for today's call.

(Operator Instructions)

Please note this conference is being recorded. I will now turn the call up to Kevin Mitchell, Vice President, Investor Relations. Kevin, you may begin.

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**Kevin Mitchell** - *Phillips 66 Partners LP - VP of IR*

Thank you, Mike. Good afternoon and welcome to the Phillips 66 Partners third-quarter earnings call. With me today are Tim Taylor, President of Phillips 66 Partners; Greg Maxwell, Vice President and CFO; Bob Herman, Senior Vice President Operations; and Tom Liberti, Vice President and Chief Operating Officer. The presentation materials we'll be using during the call 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 today. Factors that could cause actual results to differ are included here, as well as in our filings with the SEC. With that, I will turn call over to Tim Taylor for some opening remarks.

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**Tim Taylor** - *Phillips 66 Partners LP - President*

Thank you Kevin, and good afternoon, everyone. As you can see from the graph on slide 3, Phillips 66 Partners continues to deliver strong quarter-over-quarter distribution growth, while maintaining a sound coverage ratio. We'recommitted to achieving a 30% compound annual growth rate on distributions from fourth-quarter 2013 through 2018. Growth in our distributions will be supported by drop-down acquisitions, from our parent, Phillips 66, organic projects constructed at Phillips 66 Partners, and strategic acquisitions that benefit both the LP unit holders and the general partner.



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We had a strong third quarter, which highlights the consistent earnings of our fee-based portfolio. Distributable cash flow was higher, driven by increased pipeline and terminal volumes, and higher distributions from Explorer pipeline and Sand Hills pipeline. This supported the recently-declared third-quarter distribution of $0.428 per unit, that's 7% higher than the second quarter, and represents a 35% increase over the third quarter of 2014. Since our IPO, we've increased distributions at a compound annual growth rate of 42%.

Turning to operations, total pipeline throughput volumes for the quarter, excluding volumes from equity affiliates, were 744,000 barrels per day, up 2% from the last quarter. Total terminaling throughput volumes were 977,000 barrels per day, 4% higher than in the second quarter. These increases were primarily driven by higher volumes in the Sweeny to Pasadena Products System, the Clifton Ridge Crude System, and the Eagle Ford Gathering System, slightly offset by lower volumes on the Gold Line Products System.

Average pipeline revenue per barrel increased to $0.45 in the third quarter, up from $0.44 last quarter. Average terminal revenue remained flat at $0.39. Both of these rates exclude equity affiliates.

This morning, we announced PSXP's capital budget for 2016 will be $314 million. This includes $300 million for growth capital. We also announced that Phillips 66 Partners has agreed to acquire Phillips 66's 40% interest in the Bayou Bridge pipeline joint venture at Phillips 66's investment cost, which is approximately $70 million. This project is a great fit for Partners as it will provide fee-based earnings, underwritten by committed volumes from strong counterparties. Now, I'll turn the call over to Bob Herman to discuss our organic growth projects.

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**Bob Herman** - *Phillips 66 Partners LP - SVP of Operations*

Thanks, Tim. Turning to slide 4, we continue to make good progress on our organic growth projects. As Tim just mentioned, we will acquire Phillips 66's interest in the Bayou Bridge project, which will deliver crude oil from the Phillips 66 and Sunoco Logistics Partners terminals in the Nederland, Texas, to Lake Charles, Louisiana, and then on to St. James, Louisiana. Construction is underway on the 30-inch Nederland to Lake Charles segment of the pipeline, which is expected to begin commercial operations towards the end of the first quarter of 2016.

The second leg, from Lake Charles to St. James is in open season to determine the diameter of the pipe for that segment, which is scheduled to commence service in the second half of 2017. The pipeline project is part of a joint venture with Energy Transfer Partners and operator Sunoco Logistics Partners, with each owning 30%. The second phase of the Eagle Ford Crude Gathering System was completed in September, and should add additional EBITDA in the fourth quarter. The Cross Channel Connector Products System is currently operational, and is on track to finish the final third-party connection in the fourth quarter of this year.

The Palermo Rail Terminal in the Bakken remains on budget and on schedule. We have begun taking truck deliveries and will load the first railcars by year end. Once the Sacagawea Pipeline is complete the terminal will also take deliveries via pipeline. The Sacagawea Pipeline should be in operation in 2016, with completion timing dependent on permitting and weather.

Going forward, as PSXP executes its growth plans, we expect the partnership to continue to take on more and larger organic projects, to supplement acquisitions from Phillips 66. Highlights of our 2016 capital budget include completing the Sacagawea Pipeline, increasing capacity on the Sand Hills Pipeline, and continued funding of the Bayou Bridge crude pipeline project. Now, I will turn the call over to Greg Maxwell to provide a more detailed update on the financial results for the quarter.

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**Greg Maxwell** - *Phillips 66 Partners LP - VP and CFO*

Thanks, Bob. Good afternoon, everyone. Beginning on slide 5, third-quarter revenues and other income was $91.4 million. This is up $7.6 million from the second quarter. This was driven primarily by increased equity earnings from the Explorer pipeline, and higher pipeline and terminal volumes. Total cost and expenses were $39 million, down $2.9 million from the prior quarter, mainly driven by lower cost at Hartford and lower maintenance expense. The general partner's board recently declared a third-quarter cash distribution of $0.428 per limited partner unit, which will be payable on November 12.



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This represents a 7% increase over the $0.40 per unit distribution last quarter, and a 35% increase over the third quarter of 2014 distribution. This next slide shows our adjusted EBITDA and distributable cash flow growth since the third quarter of last year. We continue to execute our growth plan, which has resulted in an adjusted EBITDA increase of 104% year over year. Over the same time period, distributable cash flow is up over 90%, and we are continuing to deliver on our plans for a five-year 30% distribution CAGR for our unitholders.

Turning to slide 7, adjusted EBITDA for the third quarter was $73.4 million, and distributable cash flow was $64.5 million. During the quarter, PSXP received net minimum volume deficiency payments of $2.4 million from Phillips 66. These payments were primarily triggered at the Gold Line Products System. We have maintenance capital expenditures of $2.2 million during the quarter, and total cash distributions will be $46.2 million, resulting in a coverage ratio of 1.4 times.

Slide 8 shows our current financial position. We ended the quarter with $73 million of cash and no outstanding borrowings under our $500 million revolving credit facility. On a revolver covenant basis, our debt to EBITDA ratio at the end of the quarter was under 4 times, and long term, we expect this ratio to decrease to our targeted level of 3.5 times as organic growth projects come online. This concludes our prepared remarks. We will now open the line for questions.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions)

Kristina Kazarian, Deutsche Bank.

**Kristina Kazarian** - *Deutsche Bank - Analyst*

Hey guys. First, Greg, congratulations, again. I've really appreciated all your work over the past few years, and Kevin, very exciting for you as well.

**Greg Maxwell** - *Phillips 66 Partners LP - VP and CFO*

Thank you.

**Kristina Kazarian** - *Deutsche Bank - Analyst*

So great announcement on Bayou Bridge today. Can you guys talk a bit about the rationale behind PSX stocking it at cost, and parent taking back units?

**Tim Taylor** - *Phillips 66 Partners LP - President*

Kristina, this is Tim. I think we always want to continue to develop organic projects at PSXP. It's the right kind of project. We actually have that coming into service in the first half of 2016, and then with additional spend and organic build, and then EBITDA hitting later, when we complete the pipe to St. James. So for us it's a really good fit with PSXP. As far as cost, it's not in operation, and we'll take back units and cash at $70 million, a relatively small amount, but I think it shows how we see the relationship between the sponsor and the partnership to try to maximize the value, so I think it's a win-win for both the sponsor as well as the partnership.



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**Kristina Kazarian** - *Deutsche Bank - Analyst*

And I know the open season is still pending on the extension, but have you given even just a guide on the EBITDA generation or the potential of the pipes?

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**Tom Liberti** - *Phillips 66 Partners LP - VP and COO*

Yeah, we've talked about typical midstream EBITDA, Kristina, this is Tom, and we've got a baseload of EBITDA on the project as it is, and so anything that would we would add in the open season would be incremental to that.

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**Kristina Kazarian** - *Deutsche Bank - Analyst*

Sounds good, and then last one for me. I know PSX has put out its 2016 CapEx budget, and it looks like about $2 billion of that is going to be spent midstream. Can you maybe talk about what this means for the PSX opportunities from a drop-down perspective, and frame it relative to that $20 billion of midstream potential growth projects at PSX that they talk about?

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**Bob Herman** - *Phillips 66 Partners LP - SVP of Operations*

Yeah, Kristina, this is Bob. I think the $2 billion you see for PSX and the midstream for 2016 is really a completion of the LPG export terminal. It's our spending on DAPL and ETCOP lines. It's the completion of some of the smaller projects we've got going. We continue to build up the Beaumont terminal and adding tankage there, and really all those projects we finish next year, for the most part, that becomes MLP-able type EBITDA, fee-based assets for the most part.

And then we would also spend some money anticipating next year on the next tranche of projects that we would see coming on in 2019, 2020. Development work around Frac 2 and additional infrastructure projects around our existing refining base,that give us more access to advantage crudes or allow us better access for export of products. So we'll continue to work on those projects as part of that $2 billion next year.

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**Kristina Kazarian** - *Deutsche Bank - Analyst*

All right, that's it for me. Great job again today.

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**Greg Maxwell** - *Phillips 66 Partners LP - VP and CFO*

Thank you.

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**Operator**

Jeremy Tonet, JPMorgan.

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**Andy Burd** - *JPMorgan - Analyst*

Hi, good afternoon. It's actually Andy stepping in. In terms of the higher distribution from the joint venture pipelines, can you give incremental color in terms of the composition of the beat between either Explorer or Sand Hills?

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**Tom Liberti** - *Phillips 66 Partners LP - VP and COO*

Yes, this is Tom, Andy. Explorer had some record volumes in the third quarter so their contribution was much higher. So was Sand Hills, and the thing to remember to with Sand and Southern is in the second quarter, we received two months of the quarter's earnings, because of a working capital adjustment that we had. So we're really reflective in the third quarter, a full quarter, instead of two-thirds of the quarter.

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**Andy Burd** - *JPMorgan - Analyst*

Okay, so fair to say that the operational performance of Sand and Southern Hills is likely sustainable, given that it's a ramp up, whereas Explorer -- is this more to do with refining demand being up, or excuse me refined products demand being up than anything else, and this might not necessarily repeat in the future?

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**Tom Liberti** - *Phillips 66 Partners LP - VP and COO*

Explorer will still be in its typical historical volume levels, but there was some refinery upsets in the Midwest that added to their volumes in third quarter.

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**Andy Burd** - *JPMorgan - Analyst*

Okay, great. And then final question from us is on the M&A environment. I guess specifically focused on crude assets closer to the wellhead, similar to maybe the Bakken assets or Eagle Ford that you're developing, and whether or not that bid-ask spread has come in there may be more so than other assets? And any general update on that environment would be helpful.

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**Tim Taylor** - *Phillips 66 Partners LP - President*

Yeah, this is Tim. I'd just say that we continue to look at everything that's out there, gathering systems, other types of logistics assets. First and foremost, it's really nice and it ties to our systems where we can support that on the incremental basis, or provide some additional growth platform. I think that's always something of interest. We still like the organic projects that we have, that really add a lot of value, but I do sense that perhaps things are starting to become more available in the midstream space over time. So we'll keep an eye on that, but I always like to emphasize that needs to be a strategic fit with the scale and scope of our operations, so we get the maximum value for the partnership with that.

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**Andy Burd** - *JPMorgan - Analyst*

Great, thanks very much.

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**Operator**

Brian Zarahn, Barclays.

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**Brian Zarahn** - *Barclays Capital - Analyst*

Good afternoon, everybody, I just want to echo the prior comments to both Greg and Kevin. On the $300 million of growth CapEx for next year, is Bayou Bridge the largest portion of the budget?

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**Tom Liberti** - *Phillips 66 Partners LP - VP and COO*

Yes, Brian, this is Tom. It is the biggest portion in 2016. Sand Hills has a pretty good spend in there also. Then we've got a number of smaller projects around the assets, also.

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**Brian Zarahn** - *Barclays Capital - Analyst*

And then staying on Bayou Bridge, and understanding it's coming in, in phases and typically there's a ramp period, how should we think about the contribution to PSXP next year, and then going forward?

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**Tom Liberti** - *Phillips 66 Partners LP - VP and COO*

Next year, somewhat towards the first quarter, we should begin to be getting some EBITDA from the Nederland to Lake Charles portion, but it will be small, so that will ramp up over time because we'll still have costs associated with the rest of the spend. So full income should be coming in towards the end of 2017.

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**Brian Zarahn** - *Barclays Capital - Analyst*

And then looking at the competitive environment, any impact from a proposed expansion into St. James on your project?

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**Bob Herman** - *Phillips 66 Partners LP - SVP of Operations*

Yes I think that's why we went out to open season,this is Bob, given we had the base pipe underwritten, and then there seems to be more and more interest for Texas crude to find its way to Louisiana, so that's why we've gone back out to open season, before we size that second leg.

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**Brian Zarahn** - *Barclays Capital - Analyst*

And then moving upstream from Bayou Bridge, any change in the cost or in-service date for DAPL ETCOP?

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**Tom Liberti** - *Phillips 66 Partners LP - VP and COO*

I think we see that project continues to be on time and on budget, and right away acquisition and permitting efforts, particularly for the DAPL leg of that project kind of continue on pace. We've got some time to go yet to complete all that. But we feel the end of 2016, early 2017 start up DAPL ETCOP is still the schedule.

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**Brian Zarahn** - *Barclays Capital - Analyst*

And then last one

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**Tom Liberti** - *Phillips 66 Partners LP - VP and COO*

I'm just going to add that's volume underwritten by some real good counterparties, also.

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**Brian Zarahn** - *Barclays Capital - Analyst*

Understood. Last one for me, looking at financing, and the market changes every day, it's gotten a little bit better the past few days, but if we are in a choppy equity market environment next year, does that impact your drop-down plans and your financing plans for PSXP?

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**Tim Taylor** - *Phillips 66 Partners LP - President*

Yes, Brian, I think we look at it and certainly, we'd like to have a stable market with really high prices, but I think we look at very competitive sourced cost of capital for us. It does not change our plan to access both debt and equity markets to continue to grow the partnership.

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**Greg Maxwell** - *Phillips 66 Partners LP - VP and CFO*

Brian, this is Greg. The only other thing I would add to that is we've had discussions with the bankers and everything. We think that being a strong sponsored MLP, that we would still have the ability to do the financing.

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**Brian Zarahn** - *Barclays Capital - Analyst*

Thanks for the color, everybody.

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**Operator**

[Bhavesh Lodaya], Credit Suisse.

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**Bhavesh Lodaya** - *Credit Suisse - Analyst*

Glad to see the organic projects move to PSXP. As we look ahead into the next couple of years, would you see the smaller more developmental projects really move over PSXP or would be PSXP rather take some level of interest in the larger projects that PSX is doing?

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**Bob Herman** - *Phillips 66 Partners LP - SVP of Operations*

Yes I think what you'll see is us do over time is PSXP continues to grow, they'll take on more and more organic projects. And we'll continue to look at every project individually and balance the capital carry load that PSXP could handle, versus the timing of that project. And as Tim alluded to earlier, this one that we just did the Bayou Bridge fits perfectly because we get some incremental EBITDA coming in very quickly on this project, helps support the capital spend going forward. So I think all options are on the table going forward, whether we continue to develop projects up top and drop them as appropriate, or co-invest with our sponsor on some of the bigger projects. But it will be really just a function of scale of the project and the size of PSXP.

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**Bhavesh Lodaya** - *Credit Suisse - Analyst*

And just on Bayou Bridge, is the cost still $700 million to $900 million overall?

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**Tom Liberti** - *Phillips 66 Partners LP - VP and COO*

Yes, the total cost, this is Tom, Bhavesh. The total cost of the entire project is in the $700 million to $800 million range, and we're of course 40% of that.



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**Bhavesh Lodaya** - *Credit Suisse - Analyst*

Most of that would be in the 1Q 2016 region, right?

**Tom Liberti** - *Phillips 66 Partners LP - VP and COO*

No. Actually the spend next year, the remaining spend, our remaining spend of about $220 million, in that kind of range will be split over 2016 and 2017.

**Bhavesh Lodaya** - *Credit Suisse - Analyst*

Okay. That helps, thank you so much.

**Operator**

Michael Sheen with Evercore ISI

**Tim Schneider** - *Evercore ISI - Analyst*

It's actually Tim Schneider. I had a macro question for you on the LPG exports, actually. First of all, can you remind us how much of your facility is going to be contract versus spot?

**Tim Taylor** - *Phillips 66 Partners LP - President*

Yes, this is Tim. Tim, and so this is really a PSX question on our Midstream, so we have said that, you should think about it as 150,000 barrels a day, eight cargoes. I think our objective would be to have six of those with, say, with outside third parties, and then two of those would then be a P66 commitment or opportunity to market those. And whether or not that's spot or term, our preference certainly is term, although spot can certainly serve a role as well. We're really trying to structure toward term agreements, but there are certainly opportunities in the spot market, too. But we want this to be underwritten with those term agreements.

**Tim Schneider** - *Evercore ISI - Analyst*

Okay, got it. And then to follow up, who, of counterparties that you're signing up on term, are these actual end-users or are you trading houses to move the volumes around, where they see the biggest arb opportunity?

**Bob Herman** - *Phillips 66 Partners LP - SVP of Operations*

Tim, this is Bob. To date the counterparties that we have signed up to take cargoes are all end-users, and for the most part for petro-chem type uses in either in the Far East and some domestic use in Mexico and Latin America. I would say the interest by other parties for the remaining cargoes that we're going to contract are in that same vein.

**Tim Schneider** - *Evercore ISI - Analyst*

Okay, got it, and then appreciate you answering these, because I know it's more a PSX focus, but one last follow-up, and then this is just an opinion question. Do you think there's ever a scenario where even if a counterparty has term contracts, that those cargoes actually won't get lifted because



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naphtha prices in Asia, for example, render it not economic to import US LPG? I know it doesn't really matter for you guys, because the stuff is contracted. Just more of a US/NGL balance.

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**Bob Herman** - *Phillips 66 Partners LP - SVP of Operations*

I think when we look at the counterparties we have to date, the fact that they want it for pet-chem processing, and they're talking about the PDH units, so you can't feed naphtha to PDH, and particularly, the PDH units that are integrated with polypropylene derivative units, those make sense in most scenarios. So we would think that those would continue to lift. The Mexico/Latin America type barrels are going into domestic demand, isn't likely to be traded off in the naphtha market either. So I think we would see most of those cargoes getting lifted.

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**Tim Taylor** - *Phillips 66 Partners LP - President*

One comment on that. I'd think about it in terms of what's the sunk cost and the variable cost versus the alternative, and that is what would have to take place. You want to make sure that you cover that incrementally versus your commitment, and that would be where I would -- it would have to be discounted to be able to cover that extra cost, that they consider.

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**Tim Schneider** - *Evercore ISI - Analyst*

Got it. I don't remember if you have put it out or not, the terminal fee for the LPG terminal?

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**Tim Taylor** - *Phillips 66 Partners LP - President*

No, we have not published that, but it's very competitive.

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**Tim Schneider** - *Evercore ISI - Analyst*

Okay, got it. Thank you.

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**Operator**

There are no further questions at this time. I will turn the call back over to the presenters.

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**Kevin Mitchell** - *Phillips 66 Partners LP - VP of IR*

Thank you very much for participating in the call today. We appreciate your interest in Phillips 66 Partners. You'll be able to find a transcript of the call posted on the website shortly, and if you have any additional questions, please feel free to contact Clayton or CW. Thank you.

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**Operator**

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

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