TRANSCRIPT
Q1 2015 EARNINGS CALL

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

Rosy Zuklic, Manager, Investor Relations

Tim Taylor, President

Robert Herman, Senior Vice President, Operations

Greg Maxwell, Vice President and Chief Financial Officer

Tom Liberti, Vice President and Chief Operating Officer

CALL PARTICIPANTS

Brian Zarahn, *Barclays*

Richard Roberts, *Howard Weil*

Jeremy Tonet, *JPMorgan*

Timm Schneider, *Evercore ISI*

TRANSCRIPT

Operator

Good afternoon and welcome to the First Quarter 2015 Phillips 66 Partners' Earnings Conference Call. My name is Sally and I'll 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 your host, Rosy Zuklic, Manager of Investor Relations. Rosy, you may begin.

Rosy Zuklic – Phillips 66 Partners – Manager, Investor Relations

Thank you, Sally. Good afternoon and welcome to the Phillips 66 Partners First Quarter Earnings conference 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 here today. Factors that could cause actual results to differ are included here, as well as in our filings with the SEC. References in this presentation to operational and financial results for the fourth quarter of 2014 exclude amounts from predecessors. These are non-GAAP financial measures and the reconciliations to their GAAP counterparts, which include predecessor results, are included in the supplemental information accompanying our earnings release and posted on our website.

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

Tim Taylor – Phillips 66 Partners – President

Thanks, Rosy, and good afternoon, everyone. During the quarter, we continued to deliver on our growth plans. We completed our first billion dollar acquisition from Phillips 66. Over the last five quarters, we've executed over $2 billion in acquisitions, demonstrating our continuing commitment to top tier growth. Our recently announced first quarter distribution of $0.37 per unit is 9% higher than the fourth quarter distribution and keeps us on track to achieve our goal of a 30% compound annual distribution growth rate through 2018. Since the IPO, we have increased the distribution at a compound annual rate of 45%.

Slide 4 is a summary of our March acquisition. PSXP acquired one third equity interest in the Sand Hills and Southern Hills natural gas liquids pipelines, as well as a 19.5% interest in the Explorer refined products pipeline. We financed the $1.1 billion transaction with a combination of public equity, senior notes and units to Phillips 66. Our first debt offering was investment grade rated. This provides a solid foundation for efficient borrowing to fund our growth program. The acquisition provides increased

connectivity with Phillips 66's growing midstream business, adds natural gas liquids transportation service to our portfolio and gives us interest in one of the largest refined products pipelines in the country.

Let's move on and talk about the operational highlights from the first quarter. We operated well during the quarter. Total pipeline throughput volumes were 745,000 barrels per day, up 2% over the fourth quarter, largely driven by the full quarter operation of the Cross-Channel Connector Pipeline. The increase was tempered by lower volumes on the long-haul Gold Line products system due to the planned turnaround at the Borger Refinery. Volumes from our equity affiliates are not included in these results. Average pipeline revenue per barrel was $0.44, down $0.08 from the fourth quarter, mainly due to lower volumes on the Gold Line system. Total terminaling throughput volumes were 989,000 barrels per day, an increase of 10% over the prior quarter. Crude oil terminaling throughput was up 16% over the fourth quarter as a result of the Bayway and Ferndale rail racks operating for the full quarter after the December 2014 acquisition.

Now, I'll turn the call over to Bob Herman.

Robert Herman – Phillips 66 Partners – Senior Vice President, Operations

Thanks, Tim. On April 17th, our pipeline that transports refined products from the Hartford Terminal to a dock on the Mississippi River experienced a diesel fuel release. The release was discovered and halted on the same day. The current spill volume estimate is between 900 and 1,200 barrels. Our response teams began working with the appropriate authorities that day to ensure safe and effective remediation of the incident. Since this event occurred in April, first-quarter 2015 results were not affected. We expect costs associated with the cleanup and remediation to be $3 to $5 million, most of which are expected to be recognized in the second quarter of 2015. Phillip 66 Partners carries property and third-party liability insurance, each in excess of $5 million self-insured retentions.

Turning to Slide 7, we're making good progress on our organic growth projects. The Eagle Ford crude gathering and Bakken joint ventures remain on track for scheduled completion in the third and fourth quarters of 2015, respectively. The Cross-Channel Connector expansion project is progressing and we expect third-party connections to be completed in the third quarter of this year. For 2015, including additional growth capital for the recently acquired equity interest, we expect to spend about $235 million. The majority of this additional capital is for our lateral expansions on the Sand Hills pipeline. Going forward, as PSXP executes its plan for top tier growth, we expect to see the partnership take on larger organic projects to supplement acquisitions from Phillips 66.

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 – Phillips 66 Partners –Vice President and Chief Financial Officer

Thanks, Bob. Good afternoon, everyone. Beginning on Slide 8, first quarter revenues were $70.1 million. This is up $7.4 million from the fourth quarter. The increase primarily reflects a month of equity earnings from the ownership interest that we acquired in the Sand Hills and the Southern Hills NGL pipelines and also the Explorer pipeline. This acquisition closed at the beginning of March. Also included

are a full quarter of revenues from the Bayway and Ferndale rail racks that were acquired in December of 2014.

Total costs and expenses were $34.5 million. This is up $8.2 million from the prior quarter, mainly driven by costs associated with the first quarter acquisitions, including additional interest expense on the new debt that we issued. We also had higher operating costs, general and administrative expenses and depreciation for the rail racks. The General Partner's Board recently declared a first quarter distribution of $0.37 per limited partner unit which will be payable on May 12th. This represents a 9% increase compared with the $0.34 per unit distribution for the previous quarter.

The next slide shows our Adjusted EBITDA and distributable cash flow growth over the last five quarters. During this time period, we have executed on our aggressive growth plans and the impact on PSXP's growth profile has been significant. Adjusted EBITDA has more than doubled, and distributable cash flow is up 80%. As shown, we are delivering on our objective to provide top tier growth for our unitholders.

Turn to Slide 10. EBITDA for the fourth quarter was $46.6 million, and distributable cash flow was $41.9 million. During the quarter, PSXP received minimum volume deficiency payments of $1.1 million from Phillips 66. These payments were primarily triggered at the Gold Line Products system due to turnaround activities at the Borger Refinery. We had maintenance capital expenditures of $1.7 million during the quarter, and total cash distributions will be $36.7 million, resulting in a coverage ratio of 1.14.

Slide 11 shows that we ended the quarter with $138 million of cash and cash equivalents and no outstanding borrowings on our revolving credit facility. As previously noted during the quarter, we issued $1.1 billion of senior notes with tenures of 5, 10 and 30 years, with a weighted average interest rate of 3.6%. The proceeds from the notes offering were used to partially fund our acquisition of the equity interests in the pipelines and to repay the $412 million in sponsor loans to Phillips 66. Our debt to EBITDA ratio on a debt covenant basis and also adjusted for JV depreciation was 4.2. We expect our leverage to decrease to at or below our target level of 3.5 as Sand Hills and Southern Hills continue to ramp up and as organic growth projects advance.

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

Operator

Thank you. We will now begin the question answer session. If you have a question, please press star, then one 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 one on your touchtone phone.

Your first question comes from the line of Brian Zarahn with Barclays. Your line is open.

Brian Zarahn – Barclays

Good afternoon.

Tim Taylor – Phillips 66 Partners – President

Hi, Brian.

Tom Liberti – Phillips 66 Partners – Vice President and Chief Operating Officer

Hi, Brian.

Brian Zarahn – Barclays

I know it's a small project, but what caused the delay of the Cross-Channel Connector from the second to the third quarter?

Robert Herman – Phillips 66 Partners – Senior Vice President, Operations

So, this is Bob. Mostly it's—we were depending on third parties to complete connection work there and they've been delayed on executing their parts of the projects. The part that's on Partners' assets is completed and up and running.

Brian Zarahn – Barclays

And then any color on additional organic projects that you're looking at that haven't been announced yet?

Tom Liberti – Phillips 66 Partners – Vice President and Chief Operating Officer

We don't have—this is Tom, Brian. We don't have anything to announce at this point in time, but you know, we haven't put our 2016 capital budget together yet, same as the parent. So—but , you know, you would expect us to look at and be in the same kind of range and grow, as we said in the past, as the Partnership's gotten larger, we're able to take on more and larger capital projects and organic growth, and we would expect to do that.

Brian Zarahn – Barclays

And then on the dropdown inventory, is the new number $2.2 billion of EBITDA incorporating the March transaction?

Tim Taylor – Phillips 66 Partners – President Yes, that $2.2 [billion] inventory, looking out in that 2018 timeframe, was existing assets with the base that we had in 2013 looking at the growth as well, so that was part of that number.

Brian Zarahn – Barclays

But the—(inaudible) a little variable, but in terms of the incremental inventory, what can be dropped to PSXP? Is $2.2 billion the right estimate, or is it—how would you think about that?

Tim Taylor – Phillips 66 Partners – President

$2.2 [billion] is the total, of which now run rate is about $300 million.

Brian Zarahn – Barclays

Okay, so the inventory is less than $2 [billion], about $1.9 [billion] you're saying?

Tim Taylor – Phillips 66 Partners – President

Correct. That's right.

Brian Zarahn – Barclays

Okay. Then on guidance, the $1.1 billion EBITDA that you provided, is that an exit rate for 2018, or is that more of an average for 2018?

Tom Liberti – Phillips 66 Partners – Vice President and Chief Operating Officer

Yeah, that's a run rate for 2018.

Brian Zarahn – Barclays

So more of a negative exit (inaudible) sort of an exit rate at some point in the…

Tom Liberti – Phillips 66 Partners – Vice President and Chief Operating Officer

Right.

Brian Zarahn – Barclays

Okay. And the last one, I know the answer to this question but I have to ask anyway, will PSXP have any role in the DCP restructuring?

Tim Taylor – Phillips 66 Partners – President

The DCP restructuring, our view is that that is really handled at the DCP level. We don't anticipate that PSXP would be involved in that.

Brian Zarahn – Barclays

Thank you.

Operator

Your next question comes from the line of Richard Roberts with Howard Weil. Your line is open.

Richard Roberts – Howard Weil

Hey, good afternoon, folks. A couple for me. So now we've got a distribution growth target out there in the 30% CAGR range. I'm just wondering what the thought around dropdowns is now. Is that going to be more of a balancing mechanism to sort of get you to those targets outside of what you do organically or through third-party acquisitions, or would you expect to still be more methodical in getting those PSX assets down into PSXP?

Robert Herman – Phillips 66 Partners – Senior Vice President, Operations

I think we continue to be very methodical about what we drop and when we drop it, and I think when we look at our inventory, the method, looking at it, would get us to that $1.1 billion run rate in 2018, so I don't really anticipate changing the way we approach that. I think we've caution people before not to

draw a straight line between today and 2018 because the projects are of varying size and they won't come at a ratable dropdown rate.

Richard Roberts – Howard Weil

Okay, got it.

Tom Liberti – Phillips 66 Partners – Vice President and Chief Operating Officer

(Cross talking)And to add to that, Richard. You know, as we said in the past, we'll look opportunistically at what happens, so if there's other things like acquisitions or more organic projects, then that would affect the dropdown rate also.

Richard Roberts – Howard Weil

Sure. Yeah, and then looking up at PSX, so there's still a fair amount of organic capital underway on the midstream side up there. You sort of alluded to this in the comments earlier, but as you're getting bigger at the MLP, I'm just wondering how you think about, you know, what sort of maybe size projects you can take on at the MLP level versus up at the parent, and then similarly on third-party acquisitions, should we expect anything of a certain size to be done at PSX versus PSXP? Just, how do we think about those sort of things?

Robert Herman – Phillips 66 Partners – Senior Vice President, Operations

So I think, you know, if you kind of look at what we've done already, we've gone from essentially no capital, organic capital last year to this year and we'll be in the $250 million range, and one of those projects, our Bakken project actually in and of itself being fairly sizable. So we'll look at every organic project that our sponsor has and we'll strike a balance between PSX and PSXP with trying to balance out unit, distributable cash flow growth over the period. We'll like projects that—not so much the absolute cost of those projects but more the duration of how long it takes those projects to get up and start generating EBITDA. So I can tell you, we look at every project that's coming through the portfolio and you'll just see us take on bigger and bigger projects as time goes on.

Tim Taylor – Phillips 66 Partners – President

Longer term, we would expect more of that capital spend to end up being conducted directly by PSXP from our long-term plan.

Richard Roberts – Howard Weil

Okay, thanks. Then maybe just one more. On the revenue for the quarter, a little bit lighter than what we were looking for in our model, and admittedly, we didn't have much impact from the Gold Line being down for bit, so I'm wondering if you can help us out on a couple of things. For one, if you are at the sort of run rate EBITDA numbers you'd given on the rail terminals in the quarter, and then also on the pipeline acquisitions you did in the first quarter, if you were at sort of the run rate pro rata there for the quarter and then if you can give us any order of magnitude on what the degradation from the Gold Line system being down partially, what kind of impact we had there on the revenue side? And that's it for me. Thanks.

Tom Liberti – Phillips 66 Partners – Vice President and Chief Operating Officer

Yeah, this is Tom. From a rail rack standpoint, those ran exactly as we had planned and budgeted for a full quarter. They also ran exactly the same way in the last month of last year when we dropped them. Going forward, if we look at the lines that we dropped in the first quarter, those are actually ramping up. Most of that ramp up is at Sand Hills. We were at about 70% capacity at both Sand and Southern for the first quarter, and so that was reflected in the one month that PSXP owned it, and we expect that volume to ramp up over time, Sand getting closer to its initial capacity of 200,000 barrels in the third quarter kind of timeframe. Trying to think of the…

Rosy Zuklic – Phillips 66 Partners – Manager, Investor Relations

The Gold Line (cross talking).

Tom Liberti – Phillips 66 Partners – Vice President and Chief Operating Officer

The Gold Line impact was basically the bulk of the reduction in income that we had in the first quarter.

Richard Roberts – Howard Weil

Great. Thank you very much.

Operator

Your next question comes from the line of Jeremy Tonet with JPMorgan. Your line is open.

Jeremy Tonet – JPMorgan

Good afternoon.

Tom Liberti – Phillips 66 Partners – Vice President and Chief Operating Officer

Hi, Jeremy.

Robert Herman – Phillips 66 Partners – Senior Vice President, Operations

Hi.

Jeremy Tonet – JPMorgan

Hi. Thanks for the color today. Just wanted to follow up a bit more on Sand Hills and Southern Hills, if possible, and wanted to know if you guys could provide a little bit more color on the growth you see at these assets and what type of growth capex and expansion opportunities you see there, and has that slowed at all in the current environment with producers curtailing their activity a bit? Any color on that would be great.

Tom Liberti – Phillips 66 Partners – Vice President and Chief Operating Officer

Jeremy, I think that most of the growth will really come from the Sand Hills, and if you think about the areas that support the Sand Hills line, you can kind of understand that. We see that ramping up to its current capacity of 200,000 barrels a day, again as I said, somewhere in the third quarter. As we look forward, you know, we're putting anywhere from $40 to $45 million of capital to some other lines and

connections and things to ramp that capacity up to about 300,000 barrels a day, and we see that happening over the next couple of years kind of timeframe.

Jeremy Tonet – JPMorgan

Okay, great. So you could increase the capacity with—by 50% with just kind of a modest investment it looks like, so it looks like that'd be pretty accretive projects?

Tom Liberti – Phillips 66 Partners – Vice President and Chief Operating Officer

That's capital this year. There'll be more capital in the next year timeframe, in the 2016 timeframe. But a lot of it is pump capacity and connections that we have to different fields.

Jeremy Tonet – JPMorgan

So how much would that be in total for pump capex? Could you share that?

Tom Liberti – Phillips 66 Partners – Vice President and Chief Operating Officer

No, I don't have that number available right now.

Jeremy Tonet – JPMorgan

Okay, fair enough. Thank you. Thank you for the color.

Operator

Your next question comes from the line of Timm Schneider with Evercore ISI. Your line is open.

Timm Schneider – Evercore ISI

Hey, good afternoon, guys. A quick macro question for me. I think the theme coming out of some of these E&P earnings calls is how bad some of these NGL realizations have been, so I was just wondering if you could give us a little bit more color on how you see volumes on your NGL system—on your NGL pipelines kind of shake out over next couple of years here?

Tim Taylor – Phillips 66 Partners – President and Chief Executive Officer

Well, I—this is Tim. I think—I look at NGL and think about crude prices, and if you look at that, they're falling—or they've fallen in line with the crude price, and maybe the forward curves look a little bit different, so I think it really is related directly to the crude price and the activities. So to the extent that there's lower drilling activity, we would expect there to be lower growth in the future, yet some of these are pretty close to market and so it very much depends on the field. So I think it's—still growth is there. Our view is it's pushed that growth out a year or two in terms of what the ramp ups ultimately from an industry perspective that we would have expected.

Timm Schneider – Evercore ISI

Okay. Thank you.

Operator

We have no further questions at this time. Rosy, I'll turn the call back over to you.

Rosy Zuklic – Phillips 66 Partners – Manager, Investor Relations

Okay, well perfect. Well, thank you very much for joining us this afternoon and for your interest in Phillips 66 Partners. If you have any additional questions, please feel free to give me a call. Thank you once again. Bye.

Operator

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