TRANSCRIPT
Q4 2016 EARNINGS CALL

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PHILLIPS 66 PARTNERS PARTICIPANTS

Rosy Zuklic, General Manager, Investor Relations

Tim Taylor, Director and President

Kevin Mitchell, Director, Vice President and Chief Financial Officer

Robert Herman, Senior Vice President, Operations

Tom Liberti, Vice President and Chief Operating Officer

CALL PARTICIPANTS

Kristina Kazarian, *Deutsche Bank*

Jeremy Tonet, *JP Morgan*

Brian Zarahn, *Mizuho Americas*

Selman Akyol, *Stifel Nicolaus*

Timm Schneider, *Evercore ISI*

TRANSCRIPT

Operator

Welcome to the Fourth Quarter 2016 Phillips 66 Partners Earnings Conference Call. My name is Saly 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 Rosy Zuklic, General Manager, Investor Relations. Rosy, you may begin.

Rosy Zuklic – Phillips 66 Partners – General Manager, Investor Relations

Thank you, Saly. Good afternoon and welcome to the Phillips 66 Partners Fourth Quarter Earnings Conference Call. With me today are:

- Tim Taylor, President of Phillips 66 Partners,
- Kevin Mitchell, Vice President and CFO,
- Bob Herman, Senior Vice President, Operations, and
- Tom Liberti, Vice President and Chief Operating Officer.

The presentation materials we will 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.

Slide 2 contains our Safe Harbor statement. It is a reminder that we will be making forward-looking statements during this 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'll turn the call over to Tim Taylor for some opening remarks. Tim.

Tim Taylor – Phillips 66 Partners – Director and President

Thank you, Rosy, and good afternoon, everyone.

Phillips 66 Partners had a strong fourth quarter. Adjusted earnings were $98 million, up 18% from the third quarter and 53% from a year ago. Adjusted EBITDA was $161 million, up 45% from the third quarter. This growth was fueled in large part by the October acquisition of logistics assets from Phillips 66.

Our Board of Directors recently approved a fourth quarter distribution at 55.8 cents per unit, a 5% increase over the third quarter. Distribution coverage this quarter was 1.48x. Since our 2013 IPO we've increased distributions for 13 consecutive quarters at a compound annual growth rate of 35%.

We remain on track to achieve a 30% distribution compound annual growth rate from fourth quarter 2013 through 2018.

Turning to Slide 4, 2016 was a very active year for us. We executed well on our organic growth projects and made three acquisitions from third parties. We also completed three acquisitions from Phillips 66 for a combined $2.3 billion and raised over $2 billion in a debt and equity capital markets.

During the fourth quarter, we acquired crude, refined product, and NGL logistics assets from Phillips 66 for $1.3 billion, reflecting an 8.7x multiple of forecasted 2017 EBITDA for these assets. We funded the transaction with $1.1 billion in cash raised from a debt offering and LP units issued to Phillips 66 valued at $196 million.

The Partnership acquired the River Parish NGL system in November. River Parish includes a 300-mile bi-directional NGL pipeline system and storage caverns located in southeast Louisiana. The system is connected to third-party fractionators, a petrochemical plant, and several refineries, including the Phillips 66 Alliance Refinery.

Development continues on the second leg of the Bayou Bridge pipeline from Lake Charles to St. James, Louisiana, with commercial operations for this segment expected to begin in the fourth quarter of 2017. We own a 40% interest in this joint venture project.

In the Bakken, the joint venture Sacagawea Pipeline was placed into service in November. The pipeline connects Bakken crude production to our joint venture Palermo Rail Terminal.

Phillips 66 Partners previously announced its 2017 organic capital budget of $437 million, reflecting $381 million of growth capital and $56 million of maintenance capital. The growth capital will be directed towards completion of the Bayou Bridge project, expansion activities in the STACK JV, continued expansion of the Sand Hills NGL Pipeline, and other organic opportunities.

Now I'll turn the call over to Kevin Mitchell to provide both operational and financial updates for the quarter.

Kevin Mitchell – Phillips 66 Partners – Director, Vice President and Chief Financial Officer

Thank you, Tim. Good afternoon, everyone.

Looking at operations on Slide 5, volumes across the system were significantly higher than the third quarter, mainly due to the October acquisition. Total pipeline throughput for the quarter, excluding volumes from equity affiliates was 1.8 million barrels per day, up from 900,000 barrels per day in the third quarter.

Total terminal throughput was 1.4 million barrels per day, up from 1 million barrels per day in the prior quarter. Most of the terminal volume increase was in refined products.

Average pipeline revenue increased 13 cents per barrel in the fourth quarter to 59 cents. Average terminal revenue was slightly higher at 40 cents per barrel. Both of these rates exclude equity affiliates. The primary driver of the change in rates was the addition of assets acquired from Phillips 66 in October.

Slide 6 shows the change in adjusted EBITDA from the previous quarter.

Fourth quarter adjusted EBITDA was $161 million, up $50 million from the third quarter. The majority of the increase was due to the assets acquired in the fourth quarter.

Our existing asset base also performed well, with increased EBITDA of approximately $6 million for the quarter.

Slide 7 walks through the DCF calculation. Again, adjusted EBITDA for the fourth quarter was $161 million and distributable cash flow was $130 million.

During the quarter, we had deferred revenue impacts related to several assets, including our Gold Line system, Eagle Ford crude gathering system, and the Cross Channel Connector. These impacts increased distributable cash flow by $4 million. Net interest expense was $21 million and maintenance capital expenditures were $14 million.

Total cash distributions of $88 million will result in a distribution coverage ratio of 1.48x, up from 1.24x in the third quarter.

The recently approved fourth quarter cash distribution of 55.8 cents per limited partner unit will be payable on February 13.

Slide 8 highlights the growth that we achieved in 2016. Our fourth quarter distribution represents a 22% increase over fourth quarter 2015. Adjusted EBITDA increased by 85% and distributable cash flow by 76% year-over-year.

We continue to progress towards our goal of $1.1 billion of run-rate EBITDA by 2018. At year-end, run-rate EBITDA for the Partnership was approximately $600 million.

Slide 9 shows our financial position at the end of the fourth quarter. We ended the quarter with $2 million of cash and $210 million of outstanding borrowings under our revolving credit facility.

Our debt-to-EBITDA ratio at the end of the quarter was 3.8x on a revolver covenant basis. Long-term, we expect leverage to be at our targeted level of 3.5x.

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. If you have a question, please press star, then the number 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 Kristina Kazarian with Deutsche Bank. Your line is open.

Kristina Kazarian – Deutsche Bank

Afternoon, guys.

Tim Taylor – Phillips 66 Partners – Director and President

Hi, Kristina.

Kevin Mitchell – Phillips 66 Partners – Director, Vice President and Chief Financial Officer

Hi, Kristina.

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

Hi.

Kristina Kazarian – Deutsche Bank

So on the PSX call, I think Management quantified what the LPG export system could generate. Just in the context of this being a potential PSXP asset, can you just help me; did I hear $230 million of potential EBITDA? Does that sound right and does that include the caverns? Can you just help me understand the economics behind that and timeframe/run rate?

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

Yes. Kristina, this is Bob. I think you heard on the PSX call some quantification around those numbers and in kind of the current market conditions we're kind of on the low-end of those estimates. With quite a bit of market, hopefully to recover between now and '18. When we look at that system down there— and I think Greg alluded to this, right—we really look at it from the fractionator, which is the PSXP asset, all the way through to the water through the LPG. So the caverns and the pipes and interconnector are kind of all wrapped up into that EBITDA that was kind of laid out earlier.

So, I think for your purposes, you can think we've given the fractionator EBITDA before. The remainder kind of really goes with the assets that we've just brought online.

Kristina Kazarian – Deutsche Bank

Perfect. That's helpful. Then it sounds like, Frac Two might be more back on the formal consideration list for '17. Can you just help remind me: is this still planned to be done at the parent level; any chance, because it sounds like it could be cheaper than Frac One, that it could be done at PSXP level? Just thoughts around that?

Tim Taylor – Phillips 66 Partners – Director and President

Again, this is from a PSX perspective. I'll shift gears in that. So it could still be a large project, so I think you could conceivably do it either place, and so I think at the time we'll just have to decide what's the capability. But as we talked about at the PSX call, doing more organic projects at PSXP for Midstream is where we'd like to go ultimately.

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

Yes. Certainly, from PSXP's standpoint, we stay on kind of our three-legged stool, right, of organic growth, very, very attractive to the partnership, sponsor dropdown projects, and then third-party M&A, right, we'll continue to kind of flex between all three of those to the greatest benefit for both us and our partnership.

Kristina Kazarian – Deutsche Bank

All right. Then, last one for me; it feels like we're seeing a simplification almost every other week or sometimes every week in the Midstream space right now. Can you guys just give me your thoughts on PSXP level cost of capital and how you see the entity evolving over the longer-term?

Tim Taylor – Phillips 66 Partners – Director and President

Yes. This is Tim, Kristina. I think specifically around equity, we'll talk about that. I think our debt is obviously very competitive and it has to be a component as we think longer-term on the capital structure. The equity side, we have a very attractive cost of capital today, even considering the IDR structure, so we're pretty early. I think that as long as we're very competitive we can do—successfully compete for projects and develop accretive organic projects that's good for the GP and the LP. I think we're going to continue down that path. So, it's something we can always address if we need to, but the real key for us is making sure that we have the best cost of capital possible on the equity side.

Kristina Kazarian – Deutsche Bank

Perfect. Thanks for the update today, guys.

Tim Taylor – Phillips 66 Partners – Director and President

You bet.

Operator

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

Jeremy Tonet – JP Morgan

Good afternoon.

Tim Taylor – Phillips 66 Partners – Director and President

Hi.

Kevin Mitchell – Phillips 66 Partners – Director, Vice President and Chief Financial Officer

Hi.

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

Good morning, Jeremy.

Jeremy Tonet – JP Morgan

I just wanted to follow up on the quarter a little bit. It looked like the equity in earnings on affiliates stepped down a bit quarter-over-quarter. I was wondering if you could provide a little bit more detail? I think you touched on it a bit, as far as what some of the drivers were there and where you expect that to kind of trend in the coming year?

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

Yes. Jeremy, it's Tom. Most of that reduction was in Sand Hills and a little bit in Southern Hills, and that was mostly December. You've got to remember, from an equity earnings standpoint we get all of the quarters, so December gets included in the fourth quarter. It comes back a little bit on the EBITDA side because we get cash on a one-month lag. So we've got cash from September, October, November for those equity assets, but we got actually the earnings from October through December, and December is typically a down month.

We would expect still in the first quarter we might be down a little bit from Sand Hills, but we would expect that volume to ramp on the NGL side throughout the year.

Jeremy Tonet – JP Morgan

Got you. So that explains the delta between the distribution and the equity earnings there as far as that lag goes?

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

That is correct.

Jeremy Tonet – JP Morgan

Great. Then, when you're thinking about equity needs for the upcoming year, you've seen some of your dropdown peers use other forms of equity, such as preferred equity issuance and common equity issuance, and doing it in a size combined where it kind of took them out of equity markets for some time. I'm just wondering if you could provide any thoughts to us as far as how you approach getting the equity component for your funding needs this year?

Kevin Mitchell – Phillips 66 Partners – Director, Vice President and Chief Financial Officer

Yes. Jeremy, this is Kevin. I mean, so we've still got a lot of growth ahead of us. The growth has to be funded. We've got access to debt and we'll be doing equity in the form of third-party equity and, to some extent, take-back equity. As we look at that, we will look at different alternatives around potential ways of accessing the equity markets. But, to date, we've been able to adequately fund what we've needed to fund just through this other conventional equity issuances, which doesn't mean to say that's exactly what we're going to do again going forward, but we'll continue to look at the alternatives. So, not really any specific guidance on how we approach that. We certainly look at the different structures that are out there and give that consideration and evaluation as we look at the funding needs.

Jeremy Tonet – JP Morgan

That makes sense. Then I was just wondering, as far as the inventory of EBITDA upstairs, if you could just give us an update there, where that sits and what the buckets are as far as what's on-stream now and kind of what are growth projects that will bring EBITDA in the future?

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

Yes. So I think if you looked at where we were on PSX's last update, then from the sponsor's view, right about $1 billion of EBITDA out there between the two, we've now got, well, we've got about $600 million of that down below. Then we've got our growth projects beyond that that are in flight.

So we've got—we as we talked about, we've just finished the LPG Terminal. We're very confident in the DAPL Pipeline System, the ETCOP Pipeline System, will be completed and up and running first part of this year. We've got Bayou Bridge at the PSXP level being extended and started up in the fourth quarter of this year. So you've got a pretty good chunk of EBITDA coming on in the not-too-distant future between PSX and PSXP. We just talked a minute ago about FID'ing another fractionator at some point in time. So, we've got a fair amount in that kind of backlog bucket.

Then, we've got our existing organic projects that we're spending. Those are usually done at a fairly attractive capital-to-EBITDA multiple, so the spend this year. So we'll continue to grow that. We're always on the lookout for an accretive third-party asset that fits into our system and either enhances the liquid side of our business or the NGL part of our business. River Parish in the fourth quarter is probably a great example of a system that gives us an anchor point now in Louisiana for NGLs and LPGs. So, you'll continue to see us, I think, add to that backlog, if you want to look at it that way.

Jeremy Tonet – JP Morgan

Was that acquisition you just spoke of, was that kind of a one-off or do you see many more opportunities like that? How would you describe the bid-ask spread in the market now; do you think things are approaching areas where it makes it easier for you to transact?

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

I think I'd probably characterize that, it's never easy on the bid ask, right; everybody—is proud of their assets. But you're seeing more transactions getting done, so I think that's a pretty healthy sign that the market is equilibrating around values that can get done by either C-corps or MLPs. We've obviously got a competitive cost of capital, so we're able to do that. You'll see us continue to play in areas where we think we have a competitive advantage and we already have the strength. So, the M&A activity seems to be heating up if you just kind of look at the deal flow for the last couple of months out there, and I think with the optimism with the rig counts up and with the need to do more, particularly in the Permian, you'll see people continuing to do transactions.

Tim Taylor – Phillips 66 Partners – Director and President

Yes. I'd just like to add to that. I think on the macro level, clearly the North American production environment is more encouraging than it has been for a couple of years. So, I think opportunity is going to emerge, both organic, as well as inorganic, and so I think that's really where we want to focus, just how

do we find those new opportunities that build around our system, that then accomplish accretion for the LP, and we think the opportunity set is only going to grow.

Jeremy Tonet – JP Morgan

That's all helpful. Thank you very much.

Operator

Again, as a reminder, if you would like to ask a question, please press star, one on your touchtone phone.

You next question comes from the line of Brian Zarahn with Mizuho Securities. Your line is open.

Brian Zarahn – Mizuho Americas

Good afternoon.

Tim Taylor – Phillips 66 Partners – Director and President

Hi, Brian.

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

Hi.

Brian Zarahn – Mizuho Americas

On the STACK, can you elaborate a bit on the growth opportunities you see from that joint venture?

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

Yes. Brian, this is Tom. We think there may be an opportunity as volumes start increasing in that region, to loop that line, and that would be what we're looking at now. We're doing some engineering work now. We'll see where volumes keep going, but we think there's going to be enough demand there that we'd loop that and then double the volume on that line.

Brian Zarahn – Mizuho Americas

Do you see any opportunities to diversify the product mix in the STACK outside of crude?

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

If you look at that system, it's really kind of a dedicated system from truck stations or well-head into Cushing, and then allows our sponsor to pick that crude up in Cushing and take it to one of their refineries. So, I think you'll see that continue to be a dedicated crude gathering system.

Tim Taylor – Phillips 66 Partners – Director and President

But more broadly, I think that perhaps with the STACK there's opportunities in NGLs, as well as that system and condensate as that field develops. But this particular joint venture is pretty focused.

Brian Zarahn – Mizuho Americas

Understood. I was asking about NGL opportunities, whether inside or outside this joint venture.

Tim Taylor – Phillips 66 Partners – Director and President

Yup. Okay.

Brian Zarahn – Mizuho Americas

Then on the Bakken, can you give us your latest thoughts on your outlook for your assets for crude infrastructure? Has anything changed over the past couple of months?

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

Yes. I think if you step back and look at the Bakken in general, Tim just commented about the overall macro picture is looking better, and I think that includes the Bakken. Also, we currently see—production's been kind of flat in North Dakota over the last couple of months. Differentials have started to widen out a little bit here; that's nothing but good for our rail infrastructure and the ability to move crude east and west. There'll probably be some temporary disruptions in the market as we go into line fill period for DAPL here at some point in the first half of the year. But, overall, I think we still see the drill bit turning again in the Bakken, production recovering over the period of 2017, 2018, and continuing to utilize our rail assets to go east and west.

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

Brian, I'd add in…

Brian Zarahn – Mizuho Americas

Then I—yes?

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

I was just going to say I'd add in for the Palermo Terminal, with Sacagawea Pipeline now finished, that makes the economics a little bit better. Instead of trucking volume into Palermo, you can use the pipe in, so it helps the economics that way.

Brian Zarahn – Mizuho Americas

Okay. Then I guess turning to your longer-term outlook, you're getting closer to your end of 2018 guidance period. How do you think about the longer-term growth outlook for PSXP, understanding it's getting a larger entity, it'll be $1.1 billion of EBITDA, and as you make your way through the GP splits? How do you calibrate that with the opportunities of a better backdrop?

Tim Taylor – Phillips 66 Partners – Director and President

Well, I think clearly the $1.1 billion target is what we're focused on. We haven't given guidance beyond that, but I would say that we still see a lot of opportunity in Midstream. So, you think about as PSXP now has a fractionator at Sweeny, the Sand Hills/Southern Hills pipe, the expansion, the NGL chain still looks attractive to us in the future. We're doing smaller things around the crude systems and the gathering in the various basins, so I think our view is we're going to continue to develop those kinds of opportunities.

And I think it's still a growth area based on what we see happening in North America on the production side, and then just looking at other opportunities that kind of build around maybe our sponsors' backbone to help improve the value of that system as well.

Brian Zarahn – Mizuho Americas

Thanks for the color.

Tim Taylor – Phillips 66 Partners – Director and President

You're welcome.

Operator

Your next question comes from the line of Selman Akyol with Stifel. Your line is open.

Selman Akyol – Stifel Nicolaus

Thank you. Just one, and really just kind of a clarification from the PSX call. I think they referenced industry-wide turnarounds in the first quarter and I was wondering how that might impact your volume? Should we see anything showing up there beyond just seasonality for you guys?

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

Yes. Selman, this is Tom. Yes. I mean, we've indicated it's a heavy turnaround quarter in the first quarter and so that's going to have some effect. Now, we offset some of that with minimum volume commitments that we have, so it kind of smoothes out that a little bit. But it'll have some effect in the first quarter.

Selman Akyol – Stifel Nicolaus

All right. Thank you.

Operator

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

Timm Schneider – Evercore ISI

Hey, guys. Thanks.

Tim Taylor – Phillips 66 Partners – Director and President

Hey, Timm.

Timm Schneider – Evercore ISI

Just I guess more in PSX territory, but it's on the LPG side. I know you guys—I think it's four cargoes is for customers, four cargoes is for yourselves or for your marketing business. Are you utilizing those four for your own—or for your marketing company fully at this point?

Tim Taylor – Phillips 66 Partners – Director and President

You know, Timm, just let me preface and say this is certainly a PSX question, not a PSXP, so we'll talk from the sponsors' viewpoint from that perspective.

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

Yes. I would say that of the eight cargoes, about 6.5 of those cargoes are now contracted out to third parties and about 2.5 are available for PSX to use as part of their commercial LPG trading operations. So, that'll move around kind of quarter-to-quarter a little bit because some of the contracted volumes are, they're not exactly ratable. But we feel pretty good about where we are on kind of a term basis with the cargoes down there.

Timm Schneider – Evercore ISI

Okay. Got it. Then as far as the end markets go, I think the industry stuff that's been—the incremental demand driver was Asia, but where also are the cargoes going? Do you have anything going to South America or Europe as well?

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

Well, I think we've always said our PSX has always said publicly too that we're interested in and actually have contracts in Europe, Mexico, Latin America, and Asia. And so there's volumes flowing to all three. Some of that's a little seasonal, depending, but with the petchem use in Europe, basically kind of the heating market in Latin America, Mexico, and then mostly petchem in Asia. So, all three centers are showing demand.

Timm Schneider – Evercore ISI

Okay. Got it. That's it for me, guys. Thank you.

Tim Taylor – Phillips 66 Partners – Director and President

Thanks, Timm.

Operator

We have no further questions at this time. I will now turn the call back over to Rosy.

Rosy Zuklic – Phillips 66 Partners – General Manager, Investor Relations

Thank you, Saly, and thank you for your interest in Phillips 66 Partners. If you have additional questions, please feel free to give CW or me a call.

Operator

Thank you. This concludes today's conference call. You may now disconnect.