TRANSCRIPT
Q1 2016 EARNINGS CALL

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

Rosy Zuklic, Manager, Investor Relations

Tim Taylor, President and Chief Executive Officer

Kevin Mitchell, Vice President and Chief Financial Officer

Robert Herman, Senior Vice President, Operations

Tom Liberti, Vice President and Chief Operating Officer

CALL PARTICIPANTS

Jeremy Tonet, *JP Morgan*

Elvira Scotto, *RBC Capital Markets*

Kristina Kazarian, *Deutsche Bank*

Justin Jenkins, *Raymond James*

Ryan Levine, *Citigroup*

TRANSCRIPT

Operator

Welcome to the First 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 First Quarter Earnings Conference Call. With me today are Tim Taylor, President of Phillips 66 Partners; Kevin Mitchell, Vice President and Chief Financial Officer; 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 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'll turn the call over to Tim Taylor for some opening remarks. Tim.

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

Thanks Rosy and good afternoon, everyone. As shown on our Distribution slide, we're on track to achieve a 30% compound annual growth rate from fourth quarter 2013 through 2018. We have now increased unitholder distributions in 10 consecutive quarters since our 2013 IPO. Despite lower refinery runs at some of the facilities connected to PSXP's assets, we delivered solid performance in the first quarter. Our Board of Directors approved a first quarter distribution increase to $0.481 per unit, 5% more than the fourth quarter and 30% higher than the first quarter of 2015. Distribution coverage this quarter was 1.15 times while leverage was 3.8 times EBITDA. Longer term, we continue to target leverage of 3.5 times EBITDA.

In support of our growth targets, in March, we added NGL fractionation to PSXP's portfolio by acquiring a 25% controlling interest in the recently constructed Sweeny Fractionator One and associated Clemens Storage Caverns. The assets are supported by 10-year contracts with minimum volume commitments. The $236 million dropdown acquisition was funded through a sponsor loan and units issued to Phillips 66.

Organically, we hit a milestone by recently completing the first segment of the Bayou Bridge Pipeline. This line runs from Southeast Texas to Louisiana and will ultimately deliver crude to several refineries.

We continue to make good progress on our other projects and as the partnership grows, we expect to take on larger organic projects in the future.

I'll now turn the call over to Bob Herman to discuss our operations and growth opportunities.

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

Thanks Tim. Starting on Slide 4, total pipeline throughput volumes for the quarter, excluding volumes from equity affiliates, were 801,000 barrels per day, in line with the fourth quarter. Both crude and product volumes were flat with the previous quarter.

Total terminal throughput volumes were 929,000 barrels per day, 2% higher than in the fourth quarter. The terminal volume increase was mostly attributable to higher volumes at Clifton Ridge. Average pipeline revenue per barrel decreased to $0.46 in the first quarter, down from $0.51in the previous quarter. The decrease was largely due to lower long haul product pipeline volumes on the Gold Line. Average Terminal revenue decreased to $0.40 per barrel from $0.42 in the prior quarter, primarily as a result of lower seasonal butane blending. Both of these rates exclude equity affiliates.

Turning to Slide 5, we continue to execute on our growth plans. We acquired a 25% controlling interest in the Sweeny Fractionator One and Clemens NGL Storage Caverns on March 1st. This is a 100,000 barrel per day fractionator with an associated multi-million barrel storage facility with ongoing expansion activities. We expect approximately $25 million in annual EBITDA from this investment.

We continue to make good progress on our organic growth projects. We started commercial operations on the first leg of the Bayou Bridge Pipeline, which is a 30-inch line that delivers crude oil from Nederland, Texas, to our Clifton Ridge Terminal in Lake Charles, Louisiana. The second leg is expected to start up in the second half of 2017 and will connect Lake Charles to St. James, Louisiana. The project is part of a joint venture with Energy Transfer Partners and the operator Sunoco Logistic Partners. We have a 40% interest in the joint venture.

In the Bakken, the Sacagawea Pipeline Project continues to progress and should be in operation in the third quarter of 2016. The pipeline will feed the recently completed Palermo Rail Terminal, which is currently receiving crude by truck to load rail cars. The Sand Hills Pipeline continues to increase capacity through investment in additional lateral lines and pumps. The pipeline currently has capacity of 250,000 barrels per day, which is expected to increase to 350,000 barrels per day over time. Volumes on this pipeline remain strong despite current low commodity prices.

Now I will turn the call over to Kevin Mitchell to provide a more detailed update on the financial results for the quarter.

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

Thanks Bob. Good afternoon, everyone. Beginning on Slide 6, I'll walk through our financials, which exclude predecessor results. I also want to point out that because PSXP acquired a controlling interest in the fractionator and storage caverns, we fully consolidate the financial results. Phillips 66's 75% ownership is removed through non-controlling interest.

First quarter revenues and other income were $103.3 million, up $0.5 million from the fourth quarter. This increase was driven primarily by the acquisition of the dropdown in assets. This was partially offset by the absence of a fourth quarter make-whole payment from a joint venture and the effects of refinery downtime on PXSP's assets.

Total cost and expenses were $47.8 million in the first quarter, up $9.6 million from the prior quarter, mainly due to higher operating costs, G&A expenses and DD&A related to the first quarter acquisition. After deducting non-controlling interest, net income attributable to PSXP was $52.3 million. The recently approved first quarter cash distribution was $0.481 per limited partner unit will be payable on May 12.

The next slide shows our Adjusted EBITDA and distributable cash flow growth since the first quarter of 2015. Adjusted EBITDA increased 51% from the first quarter of 2015 to the first quarter of 2016. Over this same time period, distributable cash flow was up 53%. The reduction in EBITDA this quarter reflects the impact of the fourth quarter make-whole payment as well as lower volumes due to refinery downtime. We continue to deliver on our plan for a five-year, 30% compound annual distribution growth rate for our unitholders through 2018.

Turning to Slide 8, Adjusted EBITDA for the first quarter was $73.8 million and distributable cash flow was $64.1 million. During the quarter, we had deferred revenue impacts related to minimum volume deficiencies and the Clemens Storage Caverns, which increased distributable cash flow by $1.4 million. Net interest expense was $9.9 million and maintenance capital expenditures were $1.2 million. Total cash distributions will be $55.5 million, resulting in a distribution coverage ratio of 1.15 times.

Slide 9 shows our financial position at the end of the first quarter. We ended the quarter with $20 million of cash and no expanding borrowings under our $500 million revolving credit facility. Our debt to EBITDA ratio at the end of the quarter was 3.8 times on a revolver covenant basis. Long term, we expect leverage to be at our targeted level of 3.5 times as organic growth projects continue to come online.

This concludes our prepared remarks. We will 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 touch-tone 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 touch-tone phone.

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

Jeremy Tonet – JP Morgan

Good afternoon.

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

Hi, Jeremy.

Jeremy Tonet – JP Morgan

I was just wondering if you might be able to expand a little bit more on some of the comments you made with regards to refinery maintenance during the quarter and how that could have affected kind of mix shift of volumes and is there any way to quantify what type of EBITDA impact that had for 1Q '16 versus 4Q '15, if I kind of think about the different buckets that drove the delta quarter-over-quarter?

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

Yes. Jeremy, this is Bob. We had some planned downtimes at some of the facilities associated with the PSXP assets and then we also moved some refinery maintenance forward into February to take advantage of the low margin period. So I think quarter-on-quarter we would say that that impact was somewhere in the $7 million to $9 million range on a volume basis for us.

Jeremy Tonet – JP Morgan

Got you. So, kind of a cleaner run rate for the quarter might have been $82 million or $83 million of EBITDA. Is that a fair way to think about it?

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

Yes. Jeremy, this is Tom. If you look at run rate just compared to where we were in the first quarter, you'd add about $3 million in for a typical Gold Line and a couple of million dollars for some Bakken timing that we would have. It would get you from the $74 [million] to about $79 [million], $80 [million] and $80 [million] would be the quarterly kind of run rate. If you then looked at the fact that the frac and the caverns were in for one month instead of three, you'd get more into towards the $84 [million], $85 [million] kind of run rate number on a typical quarter.

Jeremy Tonet – JP Morgan

That's very helpful. Thank you.

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

I think it's important to remember, Jeremy, when you go from fourth quarter to first quarter, we really had a strong fourth quarter volume for PSXP assets, so that contributes to the delta.

Jeremy Tonet – JP Morgan

Got you. Makes sense. Just thinking about Bayou Bridge and how that's going to ramp up, could you help us just think through how quickly that cadence might be over the next few quarters?

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

I think the way to look at it is the first leg of it will ramp up very quickly as it feeds the refinery base in Lake Charles and that line is up and running and capable of doing as much volume as they would like to take over there now. The second leg of that pipe then finishes out next year, so sometime in the second

half of the year we would expect to be able to start that line up. With the contracts that are in place on take-or-pay volumes on that, we should move to full rates very quickly sometime in that second half.

Jeremy Tonet – JP Morgan

Great. Thanks for that, and just one last one if I could? Access to the capital markets has been something of a point of concern for the space as a whole for a little bit but it seems like the tide might have turned a bit there and I'm just wondering if you could provide us any updated thoughts on how you guys think about capital market access at this point? Thanks.

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

Hey Jeremy, this is Tim. I think we look at it and say that the equity markets, particularly for high quality MLPs that are fee-based like ours backed by a strong sponsor, the access is there and it's encouraging to see the entire space recover. So, I think that we feel like that access is there and that's an important part of how we think about funding as we go forward.

Jeremy Tonet – JP Morgan

Great. That's it for me. Thank you.

Operator

Your next question comes from the line of Elvira Scotto with RBC Capital Markets. Your line is open.

Elvira Scotto – RBC Capital Markets

Hi. Good afternoon. Just to follow up on that last question, if the capital markets or if the equity markets kind of remain challenged, what's the appetite for PSX to continue to take PSXP units in order to allow PSXP to do the dropdowns that are going to allow PSXP to hit this distribution growth?

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

Well Elvira, first of all, we're committed to our target of $1.1 million [billion] of EBITDA in PSXP in 2018 and the 30% CAGR on the distribution growth, so I think we'll find a way. I think longer term if there was an issue there, that's a different proposition but I think anything we see is much more temporary. So, I think we're going to continue down the path and I think that our preference is certainly to keep the conventional, if you will, MLP model where we issue debt and equity to finance acquisitions for the Partnership.

Elvira Scotto – RBC Capital Markets

Okay. Thanks for that. Then just kind of bigger picture, over the next couple of years demand for ethane should increase as new petchem facilities come online. Can you talk a little bit about how PSXP can participate? I mean, you know, my guess is it should drive some incremental volumes through Sand and Southern Hills and greater demands on fractionation capacity, but can you provide any more detail there?

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

You know, there's approximately—if I just look at the demand side and look at the industry, there's probably somewhere between 400,000 and 500,000 barrels a day of incremental Gulf Coast ethane

demand and that's either going to come from the existing basins in the central part of the country and the southwest and then perhaps from the Marcellus and we have two key pipes in Sand Hills and Southern Hills that are in the right basins that have the capacity to handle additional volumes. So, if you think about 400,000 or 500,000 barrels a day that has to come down the pipe, gathered and processed, right, and then you've got to fractionate it and then send it to the petchems; that's kind of the industry picture. Specifically for PSXP, obviously we're connected to those systems and the fractionator is a key piece of what we can do with that, and actually getting more ethane in the mix actually increases our throughput capability, increases our turns in the caverns and just kind of fills out the whole system.

Elvira Scotto – RBC Capital Markets

Great and just the last one for me, and it's really just trying to get your view on propane exports. Now, if we do have these new ethane crackers coming online, consuming ethane, you may see some of the flexi crackers switch more to propane, you have PDH facilities come online if you start getting more normal weather. How much propane do you think is available for export, or I guess the bigger question is do you think we're too long propane export capacity, like when we go out into 2017 and 2018?

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

Yes, Elvira, this is Bob. I think when we start out in 2017, it may be a little bit more of a balanced market but certainly as you watch oil prices recover, and we're in the camp of believing that they will, you will see both NGL production and therefore propane production continue to rise. We really haven't seen a fall-off in propane production, even at the current price set and that's a combination of NGLs continuing to come out of the basins where we operate and also strong LPG production from the refining base in the U.S. that's running at high utilization rates. So, we would think that as the crackers come on and there's the pull on ethane that Tim just talked about, it's going to raise the overall price for natural gas liquids. It will incent more NGLs back into the market and I think we'll see propane volumes continue to be there, continue to rise and we're going to start from a base of—I would expect when we get to the other side of the summer, propane inventories will be at an all-time high in the U.S.

Elvira Scotto – RBC Capital Markets

Okay great. Thank you. That's all I had.

Operator

Your next question comes from the line of Kristina Kazarian with Deutsche Bank. Your line is open.

Kristina Kazarian - Deutsche Bank

Hi guys. Can you help me put together your comments earlier about sticking to the $1 billion for PSXP and continuing the process on drops if the capital markets open and jive that with the comments from earlier in the call about taking on larger scale organic growth projects? So, when I'm thinking organic growth projects, what should I be thinking like max size here and how do I balance those two concepts together?

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

Well, I think the $1.1 billion target that we continue to affirm, it requires both sponsor support from PSX and clearly as PSXP grows, its capability to do things under their own, either through coverage ratio, debt, equity issuance gets larger as well. Our capital program this year is several hundred million dollars and so I think that grows kind of progressively as we get bigger. But I think any really large scale project that is a billion dollars or those kinds of things would typically be done at a sponsor level and then we could just see if that was the appropriate project to drop into the MLP or something for PSXP to look to acquire. So, I think it's a scale question and as we get bigger that becomes more of that would be done at PSXP, and frankly, I would want PSXP to continue to do more and more organic projects within PSXP. And as we think about our system to help our sponsor continue to build out their system around the refineries and chem plants, NGL operations and so some of the smaller shorter-cycle type of projects really fit well with that.

Kristina Kazarian – Deutsche Bank

Perfect. Then on the rest of Sweeny frac and storage associated assets, do I think about those being the next assets that come down into here and how do I balance that with some of the other assets that PSX has coming online that are great Midstream assets that would fit as well?

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

Yes. I think probably the best way to look at that. We'll stay on our glide path to the $1.1 billion and the 30% CAGR by the end of '18. Obviously, we've demonstrated that we think the fractionator and the cavern assets have a home for us down in PSXP. Whether or not they're the next ones, we continue to always evaluate the assets and our long-range model and how to stay on fairly good growth glide pattern. So, I don't know that they'll be the next ones to go down but obviously they're a good candidate for finding their way down as part of that $1.1 billion.

Kristina Kazarian – Deutsche Bank

Perfect and then last clarification question for me. When I'm thinking about Palermo assets that came online in December and Sacagawea coming online in 3Q, I think my cap ex number I had for both of those of two combined, so could you just talk to me about when cash flows are fully ramped on both those projects and contributing?

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

Yes. Kristina, this is Tom. We've got some cash coming in now at the Palermo Rail Terminal. Obviously that's just being fed by truck volumes at the present time. When Sacagawea comes on and we expect that sometime in the third quarter of this year, then we'll have the pipeline revenues coming and it will be additional revenue that will feed the rail racks.

Kristina Kazarian – Deutsche Bank

That's perfect. All right, thank you guys.

Operator

Your next question comes from the line of Justin Jenkins with Raymond James. Your line is open.

Justin Jenkins – Raymond James

Hey guys, thanks. Most of mine have been asked and answered but I guess I'll just start on the NGL side of things. So, appreciate the volume breakdown on in the release on Sand and Southern Hills and in the commentary in, the prepared remarks on the Sand expansion but I guess as we see—and this was also talked about on the PSX call—but as we see NGL volumes kind of continue to hang in there and maybe even grow a bit despite commodity prices, is it fair to think that those volumes can keep ramping here in the near term?

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

Yes, I think, as you've heard on the PSX call, if crude prices remain flat we would expect NGLs to remain kind of flattish along with them, and then as prices recover and drilling moves back up, you will see NGL volumes come with it. You'll also see NGL volumes come with natural gas, so as some of these NGL export facilities start pulling on natural gas, we should see a call for more natural gas in the U.S. and the associated liquids that will come with them. So, we still think there is plenty of volumes of NGLs to come over the next few years.

Justin Jenkins – Raymond James

Perfect and just a quick clarification, one the Sweeny frac. So, since it's a fee-for-service type model, it shouldn't see anything in terms of major cash flow volatility as we continue to ramp utilization at the frac itself. Is that right?

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

That's correct.

Justin Jenkins – Raymond James

Okay. Appreciate the comments guys. Thanks.

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

Thank you.

Operator

Your next question comes from the line of Ryan Levine with Citi. Your line is open.

Ryan Levine – Citigroup

Hi guys. Just a follow up on one of the comments that were made in the press release on the PSX level around declining earnings at both REX and Explorer. What caused the decline in earnings contribution for Explorer, from the Explorer JV? Was there anything operational?

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

No, it wasn't operational. It was volume related, right, and if you think back to the fourth quarter of last year there were some operating issues with refiners up in the Chicago area that put a pull on volumes out of the Gulf Coast up to Chicago. So, volumes were very high on Explorer on a quarter-to-quarter basis.

Ryan Levine - Citigroup

Okay. Then regarding REX, given your partner's interest in dropping down that asset, does that change your timeline of dropping your interest into your MLP?

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

No, we continue to evaluate REX and one, the cash flows in that particular asset makes sense for us to have it move. Obviously, it's qualifying income and makes sense to be in an MLP at some point, but we'll continue to evaluate that.

Ryan Levine – Citigroup

Okay. Thank you.

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

Okay well thank you Saly and thank you everyone for your interest in Phillips 66 Partners. If you have additional questions, C.W. Mallon and I are available. A transcript of the call will be posted shortly on our website. Thank you.

Operator

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