TRANSCRIPT
Q3 2017 EARNINGS CALL

Phillips 66 Partners

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PHILLIPS 66 PARTNERS PARTICIPANTS

Jeff Dietert, *Vice President, Investor Relations*

Tim Taylor, *Director and President*

Kevin Mitchell, *Director, Vice President and Chief Financial Officer*

Tom Liberti, *Vice President and Chief Operating Officer*

CALL PARTICIPANTS

Justin Jenkins, *Raymond James*

Brian Zarahn, *Mizuho Americas*

Jeremy Tonet, *JP Morgan*

Theresa Chen, *Barclays*

Elvira Scotto, *RBC Capital Markets*

Ryan Levine, *Citigroup Global Markets*

Michael Bloom, *Wells Fargo*

Corey Goldman, *Jefferies*

TRANSCRIPT

Operator:

Welcome to the Third Quarter 2017 Phillips 66 Partners Earnings Conference Call. My name is Julie 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 Jeff Dietert, Vice President, Investor Relations. Jeff, you may begin.

Jeff Dietert:

Good afternoon and welcome to Phillips 66 Partners Third Quarter Earnings Conference Call. Participants on today's call will include Tim Taylor, President; Kevin Mitchell, Vice President and CFO; 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 Q&A 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 SEC filings.

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

Tim Taylor:

Thank you, Jeff. The Partnership's third quarter earnings were $99 million and Adjusted EBITDA was $168 million. We operated our assets well with minimal disruptions and financial impacts from Hurricane Harvey. Our Board of Directors approved a third quarter distribution of $0.646 per common unit, which is 5% higher than last quarter. Our distribution coverage was 1.12 times this quarter. Since our 2013 IPO, we've increased distribution 16 consecutive quarters at a compound annual growth rate of 32%.

Moving to Slide 4, we recently completed our largest acquisition to date and secured attractive financing. The acquired assets include Merey Sweeny and a 25% interest in the Bakken Pipeline. That pipeline complements our strategy to expand current systems integrated with Phillips 66 assets. Merey Sweeny provides a reliable source of cash flow generation backed by a 15-year tolling agreement that includes a base throughput fee and a minimum volume commitment from Phillips 66. The assets are expected to add about $270 million of annual run-rate adjusted EBITDA for the Partnership.

The $1.7 billion consideration for the transaction was funded through the issuance of common and general partner units to Phillips 66, proceeds from the private placement of preferred and common equity units, and a public debt issuance. The acquisition keeps us on track to deliver our 30% five-year distribution CAGR target. We're well positioned to achieve our $1.1 billion run-rate EBITDA goal by the end of 2018, and we expect to do so without further access to the equity market other than through selective use of our ATM program.

Let's now move to Slide 5 and talk about the execution of our organic growth portfolio. The Sand Hills Pipeline is increasing capacity from 280,000 barrels per day to 365,000 barrels per day. This project is expected to be complete by the end of this year. DCP Midstream, the operator, has announced plans to further expand capacity to approximately 450,000 barrels per day with completion expected in the second half of 2018. We own a one-third interest in this joint venture.

The STACK joint venture project to loop the existing pipeline is now complete and increases capacity by 150,000 barrels per day. An extension further into the STACK play is expected to be completed in the fourth quarter of 2017. We own a 50% interest in this JV.

The Bayou Bridge Pipeline in which we have a 40% interest currently operates from the Phillips 66 Beaumont Terminal to Lake Charles, Louisiana. A new segment from Lake Charles to St. James, Louisiana is expected to begin commercial operations in the second half of 2018.

We continue development of a new 25,000 barrel per day isomerization unit at the Phillips 66 Lake Charles Refinery. The project will include a long-term agreement with Phillips 66 for processing services including a minimum volume commitment. Final project approval is expected in the first quarter of 2018.

The Sacagawea Pipeline joint venture is investing in growth projects to develop additional services in the Bakken region. The venture is constructing a 24-mile raw natural gas pipeline system in North Dakota. The system will link production in Mountrail County to gathering and processing capacity in McKenzie County. Total capital cost of the project is expected to be about $60 million. Completion is expected by the end of 2018. PSXP owns a 49.5% interest in this JV.

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

Kevin Mitchell:

Thank you, Tim. Good afternoon everyone. Looking at operations on Slide 6, overall volumes across the system were up from the second quarter. Total pipeline throughput excluding volumes from equity affiliates was 1.9 million barrels per day, while terminal throughput was 1.4 million barrels per day. Both pipeline and terminal crude volumes increased during the quarter, mainly due to higher utilization at the Phillips 66 refineries which completed turnarounds during the second quarter.

Our pipeline and terminal product and NGL volumes declined during the quarter, primarily due to hurricane-related downtime at the Sweeny to Pasadena Pipeline, Cross Channel Connector and the Pasadena Terminal. Average pipeline revenue increased $0.02 per barrel in the third quarter to $0.63, while average terminal revenue was slightly lower at $0.41 per barrel. Both of these rates exclude equity affiliates.

Slide 7 shows the change in Adjusted EBITDA from the previous quarter. Third quarter Adjusted EBITDA was $168 million, down $2 million from the second quarter. Operations increased EBITDA by $5 million during the quarter. This was primarily driven by higher throughput volumes partially offset by planned maintenance expense. Hurricane-related impacts decreased our EBITDA $5 million through lower volumes and higher maintenance costs.

Slide 8 walks through the DCF calculation. During the quarter, we had deferred revenue impact of $1 million, net interest expense was $23 million, and maintenance capital expenditures were $10 million. Distributable cash flow for the quarter was $136 million. The total cash distribution of $121 million will result in a distribution coverage ratio of 1.12 times.

The coverage ratio reflects the impact of the common units issued in connection with the recent acquisition. These units will receive third quarter cash distributions, however, earnings from the acquired assets will not be recognized until the fourth quarter.

The recently approved third quarter cash distribution of $0.646 per limited partner unit will be payable on November 13th to unitholders of record as of October 31.

Slide 9 highlights the growth that we have achieved over the last year. Third quarter adjusted EBITDA increased by 51% and distributable cash flow increased by 33% year-over-year. Prior to the completion of the recent acquisition, annualized run-rate adjusted EBITDA for the Partnership was $675 million. Post acquisition, our run-rate adjusted EBITDA is approximately $950 million.

Slide 10 shows our financial position at the end of the third quarter. We ended the quarter with $2 million of cash and $87 million of outstanding borrowings under our $750 million revolving credit facility. We finished the quarter with a debt-to-EBITDA ratio of 3.4 times on a revolver covenant basis. Long term, we expect leverage to be around 3.5 times.

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 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.

Justin Jenkins from Raymond James, please go ahead. Your line is open.

Justin Jenkins:

Great. Thanks. Good afternoon again everybody. I guess maybe starting on the capital side of things, budget at PSX taken down a bit here today. Looks like we're trending below the full-year guidance at PSXP as well. Is there a bit of back-end loaded spend at the MLP level, or has maybe some spend shifted? I guess I'm thinking Bayou Bridge here into 2018.

Tom Liberti:

Justin, this is Tom. You're exactly right. Some of the Bayou Bridge shifted into 2018, but with the increase that we have on the Sand Hills Pipeline, we still plan on ending on our guidance that we had for CAPEX.

Justin Jenkins:

Perfect. Then I guess I'll stick on CAPEX here, maybe on 2018 again. With the PSX budget set at $2 billion to $3 billion, is it reasonable to think that maybe PSXP's share of that continues to grow like we've seen in past years? I know you don't want to front run the December announcement but maybe just directionally if that's how we're viewing the outlook.

Tim Taylor:

Jeff, I think as we think about it, it's accretive, those organic projects, at PSXP, so over time we've grown that and as we get bigger in size and better coverage on an absolute level, that's the direction we're going to continue to trend, so it'll be in line with this last year depending on the opportunity set, but we have more capability this next year than we've had this last year, and that's directionally how we want to continue to go. Tom, do you-

Justin Jenkins:

Perfect.

Tom Liberti:

I was just going to say we've increased that expansion CAPEX budget every year and certainly have guided to plan to do that in the years in the future.

Justin Jenkins:

Perfect. Appreciate the responses, guys. I'll leave it at two, and have a good weekend.

Tim Taylor:

Thank you.

Operator:

Brian Zarahn from Mizuho Securities, please go ahead. Your line is open.

Brian Zarahn:

Good afternoon.

Tim Taylor:

Hi.

Brian Zarahn:

Bayou Bridge, what's causing the change in service date to the second half of the year from the first quarter?

Tim Taylor:

Well, basically the project is still sound. We're currently in the permitting process and I think the Corps is just doing their own due diligence and we think that's a good thing. I think that's just what we expect to see going forward, that it's going to take longer in the permitting as they make sure they cover their bases very thoroughly. So, it truly is just a matter of getting the final permits from the Corps before we can proceed with construction.

Brian Zarahn:

Then sticking with Bayou Bridge, can you elaborate a bit more on performance in the third quarter?

Tom Liberti:

I can, Brian. Third quarter, actually volumes were much higher and a lot of that has to do with DAPL coming online; so I think what we're beginning to see is a bit of that synergy that Tim was talking about in his presentation, the connections into other facilities that we own. DAPL comes into the Beaumont, into the PSX terminal there, and then there's a connection in Beaumont into Bayou Bridge and that volume into Lake Charles. We saw much higher volumes in the third quarter than in the second or first quarter.

Brian Zarahn:

Appreciate the color. Shifting to the recent dropdown, the financing was obviously well received by the market. I guess on the inclusion of the processing unit, can you talk a little bit more about the addition of that asset. I know it's contracted but it's a little less traditional than your other Midstream assets.

Tim Taylor:

We look at this as it's really set up as a partnership. It was already carved out separately, so it was a nice fit that way as it came totally into our portfolio, and then I think about it much like I think about a fractionator. We're doing a toll and a processing operation, and so it really fits with the service and the processing piece of the business, very much like a fractionator does in terms of what you get and the product you get out.

I think, A- it was a unique opportunity in terms of that refining asset, and B- like the isomer unit that we're looking at building as well, those are both processing units that lend themselves to that kind of structure.

Brian Zarahn:

Just to confirm on CAPEX and expansion CAPEX, you maintain your outlook for the year. Maintenance CAPEX, any changes to that expectation for the year?

Tom Liberti:

No, we think we'll be close to the yearly guidance we've given of around $55 million, $56 million, and that kind of falls in line when you look at it with EBITDA. We've talked about as we've put more mature assets in, getting into that 8 to9 to 10% of EBITDA kind of number for the year. There'll be some quarters where we're down and that's just kind on timing things, and then a little bit more of a make up in the next quarter. So, we still think on a yearly basis we'll hit that guidance.

Brian Zarahn:

Okay, and last one for me. Understanding third quarter distribution coverage was impacted a little by the hurricane but more so by the financing for the dropdown and the cash flows are coming in the fourth quarter, but now that you have much higher visibility on achieving your target for 2018, I guess after 2018, given your larger size, how are you thinking about the balance of a sustainable distribution growth rate, distribution coverage, financing needs and as well as the IDR structure?

Tim Taylor:

There were a lot of questions in that. This is Tim.

Brian Zarahn:

One question with many parts.

Tim Taylor:

Yeah, I like that. I think fundamentally as you go forward, if we look at our backlog, look at the inventory of assets that we have there, we have the ability to really drive continued distribution growth. And we talk about top quartile distribution growth post 2018, and yet I say the market is one of those that we're sensitive to what creates maximum value. I think we're looking at that, thinking about the combination of distribution growth, of organic project development, M&A, IDR structures, to make sure we have that optimal capital structure to really deliver the best accretion and drive the best value.

I think that we'd like to just leave it by saying that we're looking at—we're flexible. We look at a number of options, and I think we also try to pick through as what—make sure it's a sustaining, enduring trend, but position ourselves to have good cost of capital, good distribution growth, and yet be in tune with what the market expectations are on coverage and what the expectations are.

Kevin Mitchell:

The only thing I'd add there is that you're right that the distribution coverage will be very healthy as this drop is complete and you look at the fourth quarter. So into 2018 in growth, you've got the organic projects that are being completed within PSXP, you still have potential for other assets that currently reside at the PSX level, and then you've also got that distribution coverage itself as another means to help deliver some of that distribution growth. You factor all of that in as we look '18 and beyond into 2019.

Brian Zarahn:

Thank you, Kevin.

Operator:

Jeremy Tonet from JP Morgan, please go ahead. Your line is open.

Jeremy Tonet:

Good afternoon.

Tim Taylor:

Hi, Jeremy.

Jeremy Tonet:

Clearly the market is placing more emphasis on less common equity issuance and more internal self-funding. Granted, you guys have been very successful in finding deep pockets of alternative capital hybrids out there that work very nice with this last dropdown. I'm just wondering, as you think about the Partnership later dated 2018 and beyond, does your funding strategy start to evolve there? How do you think about that given what you've been seeing in the MLP market recently?

Tim Taylor:

I think as we indicated a minute ago, I think optimum cost of capital structure, maximum accretion, and if you look at the market today, you're right. I think if you have a large common equity offering you can actually end up not creating as much value as you go through that, so I think that's the part that as we look about our organic growth, our coverage ratio, our distribution growth, that we try to make sure that we hit all those factors to get the best value driver and try to be thoughtful about what the market really is telling us in terms of that. So, I think we have a lot of levers that we can push, a lot of inventory to try and drive that right optimal value creation.

Jeremy Tonet:

That's helpful, thanks. Then, just thinking about the $1.8 billion of EBITDA that could find its way into PSXP over time, are there any other buckets of refinery type assets such as the processing unit that's a little bit different than your traditional Midstream assets? Are there any other notable items to think about there?

Tim Taylor:

Putting on my PSX hat on that question, I think as we think about it, we would need to see I think primarily a processing for new projects similar to the way to structure that. There's not really a desire on our part to go deep into a refinery and convert all the processing units today. I think it has to depend upon a project by project basis or an opportunity. It's most likely out of refining, continues to be the logistics associate with refining; the storage, the connections, the docks, those kind of things that we've always had in there as possibilities to include in the MLP and that's going to be the primary focus versus saying that we're going to do a lot of processing type of things on existing assets.

Tom Liberti:

Jeremy, there's other assets that PSX has that are qualifying income assets and they could be set up as fee-based but we've not included that in any of the backlog to this point.

Operator:

Theresa Chen from Barclays, please go ahead. Your line is open.

Theresa Chen:

Hi. I'm going to ask you to put your PSX hat back on. I wanted to follow up on one of the comments made during the Parent's call about how multiples for assets in the Permian are very frothy and returns for midstream in general needs to increase, and one way of doing that might be partnering up with someone else. Is there any volition to team up with another entity for Rodeo?

Tim Taylor:

I think as we think, Theresa, about all the options, I think if you think about opportunities and maximum value, I think that across the portfolio we'd think about that. If you look at SCOOP/STACK, you look at all the NGL expansion on Sand Hills, we think that there's something there. That's a case by case basis but we're open to that as a way that the opportunities can deliver the maximum value.

Theresa Chen:

Okay. You're no stranger to JVs for midstream assets. In a very frothy environment would you still seek another midstream entity, or someone very similar to yourselves with a C-corp sponsor and a publicly traded MLP, or are you willing to go with a private partner as well?

Tim Taylor:

I think we're open to whatever makes the most sense. Clearly, we've done joint interest and joint venture projects with large MLP companies and other kinds of partners so I think we look at the whole suite of things to say, "What do we all bring to the table that makes the best solid project?" That's the best way to look at that.

Kevin Mitchell:

Theresa, this is Kevin. I would just add by saying that those frothy multiples, we don't view going into a JV arrangement as a way to justify overpaying for an opportunity. Just to be clear on how we view where some of these future growth prospects might come from, we see the potential to utilize some form of JV going in with somebody else, but it's not a way to justify paying too much.

Tom Liberti:

Teresa, I would just finally add, if you look at some of our portfolio and things, I think some of the JVs that work the best are where the partners have a base volume, maybe not enough to justify an entire line but can bring volumes and bring volumes together so you automatically have the demand, and then it makes it a little bit easier to do the CAPEX lift.

Theresa Chen:

Okay. That brings up an interesting point. Sticking with the Permian, in addition to the gathering system, any updated thoughts on taking a stake in a long-haul pipeline? Possibly to Corpus?

Tim Taylor:

Well, I'd say Permian is active. We see the volume growth and so the Rodeo project, kind of responding to the intra-basin, on the exit pipe there's a lot of things under consideration and I think that's an area that

we just look at and say, “What’s the opportunity and would it make sense?” So, it’s a possibility in terms of a way to do what Tom was talking about there, to leverage in, but I think that’s really all we need to say on that.

Theresa Chen:

Thank you very much.

Operator:

Elvira Scotto from RBC Capital Markets, please go ahead. Your line is open.

Elvira Scotto:

Hey, good afternoon everyone. I am going to butcher this name. The Sacagawea Pipeline JV, the newly announced raw gas pipeline, does that have contracts and should we expect a typical midstream return on that capital spend?

Tom Liberti:

Elvira, the answer is yes to both. We do have a baseload volume contract on that and should expect the typical kind of midstream organic returns.

Elvira Scotto:

Then are there more expansion opportunities around that JV?

Tom Liberti:

We’re always looking for different things and I think the answer to that would come as volume increases in the Bakken. There’s a good bit of infrastructure there. Sacagawea kind of gave us an opportunity to get into some places where there wasn’t good off-take, where people were trucking things and we could move the product by pipeline rather than by truck.

The gas line, the raw gas line really gives us—came as an opportunity to take advantage of the synergy we have. That line runs parallel for 24 miles of the Sacagawea crude pipeline, so we’ve just kind of taken the advantage there. I don’t if there will be some things in the future but we’re always looking for things.

Tim Taylor:

The DAPL system kind of circles the center where the Sacagawea operations are, so as the Bakken grows and there’s additional connections, I think we’ve got the footprint now on the gathering and intrabasin transmission to continue to connect with our DAPL pipeline as well.

Tom Liberti:

I’d give you one quick example of a small line, but we just made a connection in from some of the fields at New Town and that actually connects into the Sacagawea line on the crude side. And, we’ve made the Sacagawea bi-directional now, so you can get into DAPL going south on that line and get into the Dakota Pipeline going north in that line with the Palermo Rail Terminal.

Elvira Scotto:

Thanks for that. Then when you think about the Midstream organic growth opportunity for PSX, PSXP, where is it that you see the greatest opportunity? Is it around Beaumont and the export opportunity? Is it SCOOP/STACK? It seems like the Permian there's a lot of growth, but it's expensive. Any discussion around that would be helpful.

Tim Taylor:

I think from a theme standpoint, you continue to see the U.S. will be an exporter of clean products, of crude oil, of NGLs and natural gas. I think there's a natural thought on the midstream side around making sure that the needs for the export capacity is there, so that's of interest to us; Beaumont fits that.

Then, within that, if you think about our sponsor's system, there are opportunities to increase crude supply with different types of crude, different market centers, and that's the other theme I would look at because we still believe that North America liquids production and gas production will continue to grow over the long run. So, it's really finding which pieces of infrastructure are needed to get those to market, and then looking at our Phillips 66 sponsor is how can we work with them to integrate the network and provide better market connections or supply options around that system.

Elvira Scotto:

Great. Then just a last one for me. Do you foresee a time where PSXP will construct all of the sort of the Midstream for the Phillips entities?

Tim Taylor:

Well, you know, it depends on the size of the project, but clearly the capital budget now of where we are, as you get into bigger and bigger projects, but as you get bigger, that gets easier to do, and so I think our long-term vision would be this is the primary vehicle for midstream growth at the sponsor level of PSX. We would hope that's where we are, and we're getting to the size now where we're much more capable of handling bigger projects than we were just a couple of years ago.

Elvira Scotto:

Great. Thank you very much.

Operator:

Ryan Levine from Citi, please go ahead. Your line is open.

Ryan Levine:

Good afternoon. Regarding Beaumont, what volumes did you see this quarter and can you provide an update in terms of what the outlook is for growth there and timing around next expansion projects?

Tim Taylor:

That's a PSX asset, first of all, and so I'll give you just kind of a quick update. I don't have the specific volumes because it's not a PSXP asset, but generally we're seeing increased demand for crude exports and product opportunities across the dock there, and then continuing to build out storage that connects the inbound crudes within the outbound, either water-borne or the Bayou Bridge pipe that's PSXP's that we just talked about, more crude selections for Lake Charles Refinery and of course as that's extended to St. James we'll continue to see that growth there. So, it really is the connectivity on the Gulf Coast within

the pipeline system and then the water-borne connection and what we're seeing on top of that is just really good demand and opportunity for storage at the PSX level. That's been a very strong performing asset from the opportunity standpoint.

Ryan Levine:

Are you still targeting 16 million barrels as ultimate capacity of the asset? Any color around when you may be able to ramp to that level of capacity?

Tim Taylor:

I think today with some recently sanctioned projects, we're in the 13 million to 14 million barrel of storage range. We're headed, we think, ultimately to a little bit over 16 million and we probably have the capacity to continue to refine that or develop that further if the opportunity develops. But again, that's a PSX asset, not a PSXP.

Ryan Levine:

Then, to that point, any color around when that may become a PSXP asset, or where that sits in the queue of potential dropdown candidates?

Tim Taylor:

It is in our potential dropdown inventories as—at PSX, when we talk about the inventory of assets, that's one of those that's in there, and, as you might appreciate, we don't give specific guidance on dropdown timing.

Ryan Levine:

Thank you.

Operator:

Michael Bloom from Wells Fargo, please go ahead. Your line is open.

Michael Bloom:

Thanks. My questions were addressed. Thank you.

Tim Taylor:

Thank you.

Operator:

Corey Goldman from Jefferies, please go ahead. Your line is open.

Corey Goldman:

Hey guys. I appreciated the color you provided Brian on Merey Sweeny. Can you guys give some color on a DCF for those assets? On both DAPL and Merey. Presumably there's more maintenance on Merey, and I think there's still some project-level debt on DAPL, so any color on guidance that you can give would be helpful.

Tom Liberti:

The EBITDA that we've given, the $270 million a year on both of those assets is asset level adjusted EBITDA. It's going to be pretty close in to the DCF level. There's some interest obviously on the DAPL loan.

Merey Sweeny, we've actually contracted with PSX that major maintenance, we have a way of actually getting a charge on it, an ongoing charge to take care of the major maintenance that would happen around turnaround, so that will be fairly steady income there.

Corey Goldman:

Okay, so we shouldn't expect to see any difference on the PSX side then, right? If they're taking the cost.

Tom Liberti:

They're taking the cost today on the Merey Sweeny side, yeah.

Corey Goldman:

Then the second question, in terms of IDRs, I know you guys discussed this a little bit on the PSX call, but just as a follow-up to corporate structure and some potential solutions, what are the options you guys are considering there? Assuming you don't raise equity at PSXP to any significant extent, and you were to swap the IDRs for LP units like some of your peers have been doing, even at no premium you guys would own a pretty good size of that float for PSXP. So, A, is that something that PSX would be comfortable with, and B, are there other options there that you guys are perhaps willing to share at this point?

Tim Taylor:

No, I mean I think the way that we think about—like to leave that pretty open. There's a lot of things to look at for IDRs in terms of restructuring. Total conversion is one, and so I come back to I think we want to maintain a really strong capital structure and an accretive capital structure for the MLP, so there are a whole host of things that you can look at should we need to address that.

Corey Goldman:

Are there any that you'd be willing to say is higher on the pecking order versus lower?

Tim Taylor:

No, not at this point.

Corey Goldman:

Okay. Thanks, guys.

Operator:

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

Jeff Dietert:

Thank you, Julie, and thank you for your interest in Phillips 66 Partners. If you have additional questions, please call Rosie, C.W. or me. Thank you.

Operator:

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