TRANSCRIPT
Q4 2017 EARNINGS CALL

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

Jeff Dietert, *Vice President, Investor Relations*

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

Tom Liberti, *Vice President and Chief Operating Officer*

CALL PARTICIPANTS

Justin Jenkins, *Raymond James*

Barrett Blaschke, *MUFG Securities*

Brian Zarahn, *Mizuho Americas*

Jeremy Tonet, *JP Morgan*

Kristina Kazarian, *Credit Suisse*

Tim Howard, *Stifel Nicolaus & Company*

Tom Abrams, *Morgan Stanley*

Corey Goldman, *Jefferies*

TRANSCRIPT

Operator:

Welcome to the Fourth 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' Fourth Quarter Earnings Call. Participants on today's call will include Kevin Mitchell, Vice President and CFO, and Tom Liberti, Vice President and Chief Operating Officer. The presentation materials we will be using during the call can be found on our Events section of our 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 Kevin Mitchell.

Kevin Mitchell:

Thank you, Jeff. Good afternoon, everyone. The Partnership operated very well during the quarter and we completed our largest transaction to date with the acquisition of the Merey Sweeney coker and the 25% interest in the Bakken Pipeline from Phillips 66. With this latest addition we are near our $1.1 billion 2018 year-end run rate EBITDA target and we remain on track to deliver our 30% five-year distribution CAGR.

Our Board of Directors approved a fourth quarter distribution of $0.678 per common unit, which is 5% higher than last quarter. Our distribution coverage was 1.33 times this quarter. Since our 2013 IPO, we've increased distributions 17 consecutive quarters at a compound annual growth rate of 31%.

Slide 4 highlights our financial growth. As you can see from this slide, we have achieved substantial growth in earnings, Adjusted EBITDA, and DCF each year since IPO. In 2017, we increased earnings and DCF by over 50% and Adjusted EBITDA by 60% from 2016. Our run rate Adjusted EBITDA has grown to approximately $950 million.

Concurrent with the fourth quarter acquisition, we modified our disclosures to include joint ventures on a look through basis when reporting Adjusted EBITDA. This change was made retrospectively and reports our actual results on a consistent basis with our $1.1 billion 2018 run rate target. Distributable cash flow is not impacted by this change.

Moving on to Slide 5, fourth quarter earnings were $162 million, Adjusted EBITDA was $254 million, and distributable cash flow was $172 million. Adjusted EBITDA increased $83 million from the third quarter, primarily driven by the acquisition of Merey Sweeney and the 25% interest in the Bakkan Pipeline, which had strong fourth quarter volumes.

In addition, we had higher pipeline and terminal volumes during the quarter mainly due to improved operations after the hurricane and higher Phillips 66 refinery utilization.

Slide 6 shows our financial position at the end of the year. We ended 2017 with $185 million of cash and no outstanding borrowings under our $750 million revolving credit facility. Our debt-to-EBITDA ratio on a revolver covenant basis was 3.2 times. Long term, we expect leverage to be around 3.5 times.

We continue to run our business from a strong financial position and we are confident in our ability to fund our 2018 growth plans without accessing the equity markets other than through selective use of our ATM program.

With that, I'll turn the call over to Tom Liberti for an update on our growth projects.

Tom Liberti:

Thanks, Kevin, and good afternoon, everyone. As Kevin indicated, with our strong balance sheet and a healthy distribution coverage ratio at 1.33 times, we are well-positioned to fund our 2018 growth opportunities. Our capital budget is $595 million, which includes $510 million for growth projects and $85 million for maintenance capital.

During the fourth quarter, the Sand Hills Pipeline exceeded 300,000 barrels per day of throughput, and we expect to complete the capacity expansion to 365,000 barrels per day by the end of the quarter. Further expansion of the Sand Hills Pipeline capacity to 450,000 barrels per day is anticipated in the second half of 2018. Phillips 66 Partners is a one-third owner of this joint venture with DCP Midstream.

The $200 million isomerization project at the Phillips 66 Lake Charles refinery has received final approval. This 25,000 barrel per day unit will increase production of higher octane gasoline blending components. When completed, we will enter into a long-term agreement with Phillips 66 for processing services, including a minimum volume commitment. Startup is expected by the end of 2019.

The STACK joint venture expansion to loop the existing pipeline and extend further into the STACK play was completed in the fourth quarter. The loop increased capacity by 150,000 barrels per day. As a reminder, we own a 50% interest in this JV. All permits have been received and construction has begun on the Bayou Bridge Pipeline extension from Lake Charles to St. James, Louisiana. Commercial operations on the extension are expected to begin in the second half of 2018. Phillips 66 Partners owns a 40% interest in this joint venture, and remember the initial phase of this line from Nederland, Texas, to Lake Charles began operations last year.

Our Sacagawea Pipeline joint venture is constructing a 24-mile raw natural gas pipeline system linking North Dakota production in Mountrail County and gathering and processing capacity in McKenzie County. Project completion is expected in the second half of 2018 and we are a 49.5% owner in this venture.

This concludes our prepared remarks. We will 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 touchtone phone. If you wish to be removed from the queue, please press the pound key. If you're 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.

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

Justin Jenkins:

Great. Thanks. Hi again, everybody. I guess I'd to start maybe with the capital budget. It looks like PSXP has just over half of the growth capital in Midstream for the whole PSX family. How should we think about that evolving over the next couple of years? Does that kind of mix stay near the half mark, does it grow to three-fourths or does it even become all of Phillips Midstream growth at PSXP?

Kevin Mitchell:

Justin, this is Kevin. I think as you look at the PSXP capital spend, it's increased each year, year-over-year and the ability of the MLP to continue to increase its capital spend has really grown with the growth in the MLP. So, I don't think it's unreasonable to assume that as the MLP continues to grow, its ability to take on a larger share of the overall Midstream capital to grow with that. As we look back, it was always our objective that over time the MLP will be directly funding the majority of the CAPEX that we're conducting in the Midstream segment.

Justin Jenkins:

Right. Perfect. That's helpful, Kevin. Then maybe on the capital market side, as a follow-up, is the reference to selective ATM issuance just conservatism in case another bolt-on project comes up or should we think of 3.5 times debt to EBITDA as maybe the limiting factor there?

Kevin Mitchell:

No. I think what we're saying is—so we have a lot of capacity today. Well, there's a couple of things. Let me step back. We're not too off our $1.1 billion run rate EBITDA target anyway, and then you look at the organic projects that are underway—and Tom just described most of those—a fair amount of organic EBITDA that will come on over the course of 2018, so to the extent that there's some capital needs that won't be funded by—if you look at coverage, we've got already, we're sitting on reasonable healthy cash balance at the MLP; we've got debt capacity, 3.2 times at the end of 2017, potential to increase that. So, to the extent that we feel there's a little bit of equity needs, we can easily accommodate that within the ATM program.

We've never done a lot of activity on the ATM. So, I think in the 18 months we've had the program, I think we've done somewhere around about $200 million in total over that time period. So, we were just referencing the fact that we don't anticipate much equity needs at all; and what we may need, we would just do through the program.

Justin Jenkins:

Perfect. Appreciate that color, Kevin. Last one if I can squeeze in a modeling question. Thinking about the difference between cash distribution from JVs and the proportional EBITDA, I think the change in presentation, is that $22 million reported for 4Q a good run rate or was particularly high in 4Q?

Tom Liberti:

That's probably just about typical, Justin.

Justin Jenkins:

Perfect. Leave it there. Have a good weekend, guys.

Kevin Mitchell:

Thanks.

Tom Liberti:

Thanks.

Operator:

Barrett Blaschke from MUFG Securities, please go ahead, your line is open.

Barrett Blaschke:

Hey, guys. Just kind of a quick question thinking a little more long-term here; as we watch you guys kind of rise quickly through the splits and operating under the assumption that all GPs and IDR structures eventually have a lifespan, do you start to look at coverage now and say this is really the right level as a protective measure to, if you ever did want to eliminate the GP and the IDRs, that you want to keep it a little higher just to soften the blow of big block of units coming out?

Kevin Mitchell:

Yes. I mean, you certainly could do that. As we look at this structure—we have a reasonable percent of distributions are coming back to the GP by way of IDRs, so we see that, but at the same time we have a yield that's sitting right around 5%. In overall terms, the cost of equity is still competitive and—as we step back and look at that. However, as you say, over time you get to a point where this needs to be addressed and so we know we'll get there. I'm not sure we're quite there yet.

I also think that relative to how we probably thought about this three, four years ago, it probably comes sooner than we would have previously anticipated. But we just need to be thoughtful about how we go about that, how we structure it, what works from the standpoint of the General Partner and also the LP Unitholders such that this doesn't end up in a way that's dilutive to the LPs. It's got to work in overall terms.

Tom Liberti:

You know, Barrett, I would just point out that we've always had a fairly high and strong coverage ratio, but we've also had, for a fairly young MLP, we've had a pretty aggressive organic growth program, too and an overall growth program. So, we've kept those, we've kept the balance sheet pretty strong from the beginning and the plan would be to always keep that balance sheet strong.

Barrett Blaschke:

Right. I guess it comes down in my mind too—we seem to be in an environment where investors are—we're willing to see a lower rate of distribution growth if you can have a healthier balance sheet and healthier coverage, and they just don't want to see anybody else paint themselves into a corner because of high distribution growth and then suddenly go, well, we need to do an elimination and we're going to be very dilutive when we do it, and you end up with a distribution cut in the mix. I guess that's always the concern, so just I like to know that people are thinking along those lines.

Kevin Mitchell:

Yes. No. We certainly understand that.

Tom Liberti:

Yes. I think along that lifecycle that you were talking about, if we were going to do something and make some adjustment, we obviously would want to be on the front end rather than the back end of that.

Barrett Blaschke:

Right. Okay. Thanks, guys.

Operator:

Brian Zarahn with Mizuho Securities, please go ahead, your line is open.

Brian Zarahn:

Good afternoon.

Tom Liberti:

Hey, Brian.

Kevin Mitchell:

Hey, Brian.

Brian Zarahn:

In the quarter, could you elaborate a bit on the $33 million increase in equity earnings? I'm assuming most of it's from the Bakken Pipeline, but maybe a little bit about the breakdown from the Bakken and Sand Hills?

Tom Liberti:

Yes. Actually, volumes, Brian, in the fourth quarter, the Bakken volumes were healthy, even from our initial projection, obviously just the first quarter from that acquisition. Sand Hills and Southern Hills NGL line both had increased volumes. Sand Hills, as the capacities increased, the volume has ramped to meet that capacity every quarter and Southern Hills actually had increased volume also this quarter.

Brian Zarahn:

So, the $33 million increase from the third quarter, most of it from the Bakken, Sand Hills, and some from Southern Hills; is that the right way to think about it?

Tom Liberti:

Yes. I mean, most of it is the acquisition obviously in the Bakken.

Brian Zarahn:

Okay. On the Parent's proposed premium crude pipeline project, obviously there's a great deal competition, but if it moves forward or some other form of participation moves forward, how do you think about PSXP participating? Could it be a partner at the outset or this could be something longer-term as a drop-down?

Tom Liberti:

We've said all along on any project that we'd be looking at we always look at what's the right kind of split. PSXP could participate with PSX; we could look at it in the future as a drop-down. It would just be the situation that both PSX and PSXP are in at the time of the project.

Brian Zarahn:

Okay. Then last one for me on the isomerization unit, how do the projects' expected returns, given the contract compare with historical drop-downs?

Tom Liberti:

It's attractive. We talked about it being in the typical Midstream kind of returns, and I think from organic project it's going to be on the good end of those typical Midstream returns.

Brian Zarahn:

Thanks, Tom.

Operator:

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

Jeremy Tonet:

Good afternoon. Maybe just picking up on that last question there, there's been kind of concerns with regards to Midstream entities being able to really hit the returns that they target on their organic growth side given how competition has turned out to be so fierce. If you kind of look across your portfolio slate here, I mean, do you see the major projects you have kind of hitting those mid-teen rate of returns or are you seeing any pressure out there, or anything else you can share with us on that kind of competitive landscape out there?

Kevin Mitchell:

Yes, Jeremy; it's Kevin. I think as we look across the projects we've done at PSXP, they're hitting the kind of return expectations that we had internally from the outset. I know we've not given a whole lot of project level specifics as we've talked about those externally other than saying they're sort of typical Midstream returns. But from the way we look at it, we're seeing the kind of returns that we would have wanted and expected as we laid out and went into those projects, and I don't see any reason why the isomerization unit will be any different. It's structured with a—it'll be on a sort of fee basis with minimum volume commitments, so as long as the capital spend comes in aligned with where we expect, it should deliver exactly as we expected to.

Tom Liberti:

Yes, Jeremy. I think Kevin hit it. I mean, we've been pretty selective with the projects and the organic spend that we've had and with it being fee-based, and with those minimum volume commitments, the projects have come in pretty nicely. Again, it's been a question of being selective, I think, with the projects. It hasn't been a question if we've growth for growth's sake. We've kind of grown selectively and we've grown profitably.

Jeremy Tonet:

Thanks for that. Then thinking about projects and turning to Gray Oak there and seeing how it's upstairs, but just wondering how you think about returns and risk on a project like that. You've seen different shapes for those type of proposed projects. One competitor out there is looking for a project with just acreage dedication as opposed to minimum volume commitments. I was just wondering if you could help us think through how you guys look at risk out there and returns for those type of projects, you know, how important MVCs would be or if acreage dedications could make sense.

Kevin Mitchell:

Well, when we look at projects from a MLP standpoint, and, really, that's from a sponsor perspective, that's all Midstream projects, because at that level we consider all the projects as ultimately being destined for the MLP. We're looking at that expectation around minimum commitments, fee-based revenues, such that you de-risk the cash flow stream and make it very much a fit for the MLP portfolio. So, when you start talking about acreage dedication type, you're kind of looking—it looks a little bit more like G&P business at that point in terms of the way that's structured, which is a different model. When you look at PSXP, very much pipelines, terminals, some processing assets, but they're also fee-based with minimum volume commitments. So, we kind of err on the side of less risk, not more, as we look at these Midstream projects.

Jeremy Tonet:

That's very good to hear. Thanks for that. Then just a housekeeping item here: with the leverage ratio, as it sits at 3.2 on the covenant basis, could you just let us know where that sits on an agency basis just if we're keeping track there?

Tom Liberti:

Well, the covenant basis is basically for the agency, but on a run rate standpoint, it's just a little bit, just a touch lower than the 3.2. It's more like on a 3.1 on a run rate basis.

Jeremy Tonet:

Okay. Thanks for that. That's all for me.

Kevin Mitchell:

Thanks, Jeremy.

Operator:

Kristina Kazarian from Credit Suisse, please go ahead, your line is open.

Kristina Kazarian:

Sounds great. Hey, guys, can you talk a little bit more about the longer-term organic growth opportunities set for PSXP, and maybe talk about what you're thinking are some of the most attractive regions for projects? Specifically, it looks like the NGL strategy is really working; is there work you can do there as well?

Tom Liberti:

Yes. I'll start that and then Kevin can probably come in a little bit more. As we're looking right now, Sand Hills Pipeline, the expansion for 365,000 [barrels per day] will be done by the end of this quarter completed and we're in the process of moving that to 450,000 barrels a day. That'll be completed by the end of the year. Then, we've talked about and DCP has talked about possibly looking at further expansion for another 100,000 barrels a day for 550,000 [barrels per day] with that. The Lake Charles isom project will be going on this year and into next year into 2019, so we've got the expansion there.

We've got a number of smaller rural projects on the current assets that we currently have. A lot of those will add up. Bayou Bridge will be done again in the second half of the year, so that's a rather large project. We're looking at a couple of things that are kind of more extensions of the current assets that we have, and those things could come to fruition both in this year and through next year.

Kevin Mitchell:

Yes, and I would just supplement that with a sort of perspective from a sponsor level. You look at what's out there already but not in the MLP, so you've got the Beaumont Terminal, which PSX is continuing to invest in, and, of course, integrates with the Bakken Pipeline and also the Bayou Bridge Pipeline. You've got some additional transportation assets that still sit at the PSX level, as well as some refinery logistics assets that potentially could be destined for the MLP at some point.

Tom talked about the sort of NGL expansion, which, again, from a sponsor's standpoint could tie into future expansion down at the Sweeny hub, both from a frac capacity standpoint. Beyond that, I'd say you're looking at infrastructure opportunities in and around our existing assets that leverage those assets and provide the sort of double whammy benefit to enhance the underlying, say, refining assets, so that's where we're connected, and also provide good Midstream opportunities along with that.

Kristina Kazarian:

Great. My follow-on for you guys is one of your peers did a transaction in the market yesterday, and I know we've talked about not needing to do a drop this year and only selective equity issuances, but in the context of that, maybe how does that impact your thought process?

Kevin Mitchell:

Well, I think it just reinforces the position that we've taken and where we sit, that we're in very good stead for our 2018 targets, some good organic projects underway that will come online in 2018. We haven't said anything specific about whether we will or will not have a drop this year, but when you look at the investment that would be required to get to our $1.1 billion target, it's pretty nominal needs externally when you look at the ongoing cash generation and the cash balance on hand. The fact that we've got a really strong balance sheet—we're at the low end of the range on our debt metrics—and so to the extent we do need a little bit of equity, we can easily take care of that on the ATM program, so you shouldn't see us coming out with anything like the transaction you're referring to.

Tom Liberti:

Yes. We said last quarter the financing that we did last quarter, that transaction really put us in good shape for 2018 to see through all of our targets.

Kristina Kazarian:

Perfect. That's very good to hear. Thank you, guys.

Kevin Mitchell:

Thanks.

Tom Liberti:

Thanks.

Operator:

Selman Akyol from Stifel, please go ahead, your line is open.

Tim Howard:

Hi. This is Tim on for Selman. Thanks for taking our question. Just one quick one: how will turnarounds impact PSXP in 1Q?

Tom Liberti:

Well, we always talk about refinery maintenance, and that's really a PSX issue. We don't issue any direct numbers on that, but remember we have minimum volumes on almost all of our assets, and so those minimum volume commitments are really there to smooth out turnaround activity, maintenance activity from basically the refining systems, so you don't really see a big effect when we have those.

Tim Howard:

Got it. Thanks.

Operator:

Tom Abrams from Morgan Stanley, please go ahead, your line is open.

Tom Abrams:

Thanks. I just wanted to follow up on a couple of things. First on Jeremy's question with regard to gathering and processing assets, if someday in the future, distant future perhaps, you're offered Eagle Ford, DJ, Permian, and a few STACK gathering and processing, would that kind of categorically not be not of interest to you because of the likely contract structure?

Kevin Mitchell:

That would certainly be a significant deviation from the path that we've been down to date with PSXP and all of our stated intentions. I never want—you never want to say never on anything, but as we step back—and, again, I'll kind of put my PSX hat on—as we look at this, we've got PSXP that is in that Midstream infrastructure transportation, pipelines, terminals, all of those kind of assets, and then you've got DCP with all the G&P business, and so that's really how we think about it is in terms of our G&P exposure is through DCP and then the more traditional Midstream infrastructure transportation, terminaling assets are PSXP.

Tom Abrams:

I just wanted to confirm. The other thing I wanted to ask about was the—it seems like you're going to a year ahead guidance type model. As we think about '19 and '20 and try to model it, it sounds like we could put on a little bit more debt. It sounds like your coverage is about where you want it. Are there any other parameters around corridors, if you will, that we should be thinking about triangulating your future?

Tom Liberti:

No. I don't think there's anything from a corridor standpoint. I mean, I think it's safe to say that first preference would be where we have current assets, where there's some synergy in the assets that we operate now. I think short of that, stepping out would have to be something very attractive for us to be someplace where we're or not. But if that asset would be extremely attractive and accretive for the MLP, we would look at it, obviously.

Tom Abrams:

No. I was saying absent—sorry I misspoke—the absent acquisitions, what the financial parameters are or the—coverage, for instance, 1.1 to 1.3 is kind of where you would like or be comfortable, or balance sheet between 3.2 and 3.8 or—that you'd be comfortable. Those kinds of corridors parameters that you'd like to operate in over the future.

Kevin Mitchell:

Yes. Okay. Okay. I mean, so you've gone through a couple of them. We say that leverage around about 3.5 and acknowledge that it can be both above that and below that depending on the timing of acquisitions and how those transactions are funded, so 3.5 times on a leverage basis. Coverage we historically have said 1.1 times. The market's kind of pushing that up, but the expectations are going higher and we would respond accordingly on that. We haven't given any specific guidance on distribution growth beyond 2018 other than to say we still have a strong growth pipeline so we expect to be sort of top-tier or top-quartile on distribution growth.

Tom Abrams:

All right. Thanks a lot.

Operator:

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

Corey Goldman:

Hey, yes, just a follow-up on Justin's question earlier about the new EBITDA methodology. Sorry if I misheard it in the beginning of the prepared remarks. That is apples-to-apples and how you're considering the $1.1 billion target now?

Kevin Mitchell:

That's correct.

Corey Goldman:

Okay. Just purely out of curiosity, what was the motivation of that change?

Kevin Mitchell:

When we did the drop in the fourth quarter, the Bakken Pipeline and MSLP, all the metrics that we showed with that, we really needed to talk about that on a look through basis to make the overall transaction make sense in terms of the asset value, the transaction value, the EBITDA multiple. We needed to talk to that on a look through basis and so we decided to—the easiest thing to do, the most straight-forward thing to do would be to carry that forward through with the way we report the MLP. It's also consistent with the way the Parent Company reports EBITDA at a total PSX level, and by segment level. We look at look through in part because there are significant joint ventures, as you probably know, within the overall Parent, and so that is the methodology we're typically using internally when we're looking at EBITDA.

Corey Goldman:

Got you. Okay. Then, sorry, just if you could just remind us: how much off-balance sheet debt is there on PSXP; is it just DAPL or Bakken?

Tom Liberti:

Explorer is a C-corp, and Explorer has outside debt.

Corey Goldman:

Got you. Okay. All right, and so maybe—and again, I apologize if you spoke to this—but if we just look at where you run rate now in 4Q, about a little over $1 billion or so and just given the growth projects you do have coming on stream in '18, you don't necessarily need a drop-down this year, do you?

Tom Liberti:

We don't give guidance on any of the drops that we have, but obviously when you look at the current run rate and you take on some of the organic projects, we're getting closer and closer to our $1.1 billion EBITDA target.

Corey Goldman:

Okay. Like PSX's target for—I'm going to butcher the number—I think 1.8 for the full slate, is it a year-end target also for PSXP or is that a full year we should be thinking of that $1.1 billion?

Kevin Mitchell:

It's a year-end run rate.

Corey Goldman:

Got you. Okay. Perfect. I really appreciate the help, guys. Thanks.

Kevin Mitchell:

Okay.

Operator:

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

Jeff Dietert:

Thank you, Julie. Appreciate your interest in Phillips 66 Partners. Please call Rosy or me if you need any follow-up. Thank you.

Operator:

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