TRANSCRIPT
1Q 2018 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

Brian Zarahn, *Mizuho Americas*

Justin Jenkins, *Raymond James*

Barrett Blaschke, *MUFG Securities*

Jeremy Tonet, *JP Morgan*

Dennis Coleman, *Bank of America Merrill Lynch*

Corey Goldman, *Jefferies*

Ryan Levine, *Citigroup*

Craig Shere, *Tuohy Brothers*

TRANSCRIPT

Operator:

Welcome to the First Quarter 2018 Phillips 66 Partners Earnings Conference Call. My name is Sharon 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 the Phillips 66 Partners' First Quarter Earnings conference 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 the 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 our 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 J. Mitchell:

Thank you, Jeff. Good afternoon everyone. We had a strong start to the year. The Partnership had net income of $172 million, a $10 million increase from the previous quarter. First quarter Adjusted EBITDA was $247 million. Our current asset base has demonstrated a $1 billion run rate Adjusted EBITDA, near our $1.1 billion year-end target. In addition, we recently announced our largest single, organic project to date, the Gray Oak Pipeline. This joint venture project expands our footprint in the high-growth Permian basin. We are making good strides advancing our strategic initiatives. The Partnership is well-positioned to fund the 2018 organic projects with cash on hand, debt capacity, and selective use of the ATM program.

Moving on to Slide 4, distributable cash flow increased 13% in the first quarter to $194 million. Our Board of Directors approved a first quarter distribution of $0.714 per common unit, a 5.3% increase from last quarter. This results in a distribution coverage ratio of 1.4 times. Since the 2013 IPO, we've increased distributions 18 consecutive quarters at a compound annual growth rate of 31%. We are well on our way to meet our five-year target of 30%.

Slide 5 captures the change in Adjusted EBITDA. First quarter was $247 million compared with $254 million in the fourth quarter. Our joint ventures contributed higher results compared to last quarter, largely driven by increased pipeline volumes. This increase was more than offset by lower earnings from wholly-owned assets, largely due to turnaround activity at the Phillips 66 operated Borger and Sweeny refineries.

Slide 6 highlights our financial flexibility and liquidity. We ended the first quarter with $167 million of cash and no outstanding borrowings under our $750 million revolving credit facility. Our debt-to-EBITDA ratio on the revolver covenant basis was 3.1 times. Long term, we expect leverage to be around 3.5 times.

One final topic that I would like to address is the recent FERC ruling that MLPs can no longer include an income tax allowance in their cost of service calculation. Phillips 66 Partners expects little to no impact from this decision due to our limited exposure to cost of service rates. Most of our pipelines fall into three categories: pipelines that are not FERC regulated, FERC-regulated pipelines where Phillips 66 is the sole shipper; and pipelines that have negotiated rates.

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

Tom Liberti:

Thanks, Kevin, and hello everyone. As Kevin mentioned, our strong financial position allows us to fund our entire 2018 organic program with cash on hand, debt capacity, and selected use of the ATM program. We have a strong and synergistic portfolio of projects to drive our future growth.

We've received sufficient binding commitments to proceed with construction of the Gray Oak Pipeline. This joint venture project will provide crude oil transportation from the Permian basin to locations along the Gulf Coast, including Corpus Christi, Sweeny, and Freeport.

A second binding open season is underway and will determine the final scope and capacity of the pipeline, which could be up to 700,000 barrels per day or more. Assuming the pipeline is fully subscribed, the capacity could be expanded to about 1 million barrels per day. The pipeline is expected to be completed in the fourth quarter of 2019. The Partnership will be the largest equity owner in the project.

In Corpus Christi, the Gray Oak Pipeline will connect to the new South Texas Gateway Terminal under development by Buckeye Partners. This deep water marine terminal will have export capability and an initial storage capacity of 3.4 million barrels. The terminal is expected to begin operations by the end of 2019 and we will have a 25% interest in this JV.

The Sand Hills Pipeline capacity was close to 400,000 barrels per day at the end of the first quarter. Further expansion of the line to over 450,000 barrels per day is anticipated to be completed in the second half of 2018. We are a one-third owner of this joint venture.

Construction continues on the Bayou Bridge Pipeline extension from Lake Charles to St. James, Louisiana, with commercial operations expected in the fourth quarter of 2018. The pipeline currently operates from Nederland, Texas, to Lake Charles, Louisiana, and the Partnership has a 40% ownership in Bayou Bridge.

We're also developing a new pipeline that will connect clean product storage in Lake Charles, Louisiana, to our Clifton Ridge Marine Terminal. We expect initial product exports of up to 50,000 barrels per day from the terminal. This $25 million project is anticipated to be completed in mid-2019. We will have a long-term agreement with Phillips 66 that includes minimum volume commitments for the pipeline and marine dock.

In the quarter, we began construction of the new 25,000 barrel per day isomerization unit at the Phillips 66 Lake Charles Refinery. The unit will increase production of higher octane gasoline blend components. This project includes a long-term agreement with Phillips 66 for processing services, including a minimum volume commitment. Completion of this $200 million project is anticipated by the end of 2019.

This concludes our prepared remarks and 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 one on your touch-tone 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 touch-tone phone.

First question comes from Brian Zarahn with Mizuho. Please go ahead. Your line is open.

Brian Zarahn:

Good afternoon.

Tom Liberti:

Hi.

Kevin J. Mitchell:

Hi, Brian.

Brian Zarahn:

Just on Gray Oak, obviously an important project for PSXP's organic program. Maybe can you talk a little bit high level strategically about your expansion into the Permian and Corpus and some longer-term opportunities you see for your asset base?

Tom Liberti:

Sure. The Permian is obviously one of the hot beds and we had some presence there from a PSX standpoint. Obviously, it's nice to add that to the PSXP portfolio with this line. In Corpus, we really didn't have a presence in the Midstream in the Corpus Christi area, so this gives us a bit of a footprint and a start in that Corpus area.

Kevin J. Mitchell:

Yes. Brian, this is Kevin. I'd just supplement that with as you step back and look at this significant production of growth in the Permian—crude oil, NGLs, natural gas—infrastructure needs to move that to market. From a crude oil standpoint, a lot of the incremental production is ultimately going to be destined for exports, and so adding a Corpus position as well fits nicely into that. I think this is a really good fit to the overall Midstream portfolio.

Tom Liberti:

Brian, I'd also add, remember Sand Hills kind of starts in that Permian area also, so we got it from the NGL standpoint and now from a crude standpoint.

Brian Zarahn:

That's a good source of diversification. On the export angle, do you expect most of the exports to go to Corpus or do you see some going to Freeport?

Tom Liberti:

They can go to either location. As the line comes down and splits then, so Corpus and Freeport will give us the optionality then.

Kevin J. Mitchell:

But, ultimately, the shippers will be making that determination.

Brian Zarahn:

Okay. Then is the parent a shipper on the pipeline?

Kevin J. Mitchell:

We haven't given any information on shippers, for obvious reasons. Not unrealistic to assume that PSX would have a commitment, but this is not a pipeline that's being underwritten by PSX, if you look at it that way.

Brian Zarahn:

Then I know the other project is still under negotiation in terms of the scope, but in terms of economics, I mean right with the existing commitments now, are the economics attractive or it really it is baking in, which is needed, additional takeaway capacity in the basin as production continues to ramp?

Tom Liberti:

The economics, obviously with the commitments that we've got in the first open season, it obviously is attractive. Then going through the second expansion season, we'd just add to that.

Brian Zarahn:

Last one for me, given the addition of Gray Oak and some other smaller projects, what's the latest cap ex for 2018?

Tom Liberti:

We just increased the budget in the cap ex for PSXP to about $750 million, including our maintenance cap ex, and that's an increase from just under $600 million or just over $600 million to $750 million, so an increase of about $150 million.

Brian Zarahn:

Thanks, Tom.

Operator:

The next question comes from Justin Jenkins with Raymond James. Please go ahead. Your line is open.

Justin Jenkins:

Great. Thanks. Good afternoon again, guys. I think Brian just covered most of what I had, but I do want to talk about Gray Oak again. Just thinking about the longer-term optionality here, I know we're still in the scope stage of the project overall, but is there ultimately the optionality to get the barrels east of Sweeny and into the Beaumont area, given your footprint there on the PSX side, and then maybe even further east to Bayou Bridge and into Louisiana?

Kevin J. Mitchell:

I think it is a bit early to be speculating that far out. Clearly, if you're in Beaumont, then you can go east from there with Bayou Bridge, but I think it's too early for us to speculate on that at this point.

Tom Liberti:

Remember, Justin, DAPL, the Bakken pipeline, comes down from Dakota down in, and will go into Nederland, and then from Nederland connects into Bayou Bridge, and then that takes those barrels east into Louisiana.

Justin Jenkins:

Understood. Thanks, guys. Maybe separately here, the Rodeo project that was previously talked about on the gathering side, is this kind of coordinated with Gray Oak or is that completely separate from this announcement?

Tom Liberti:

A little bit of a precursor. What that did was allow PSX to see what interest would be in the line, and the interest was to bring barrels all the way down to the Gulf Coast.

Justin Jenkins:

Perfect. Thanks again, guys. I'll leave it there.

Operator:

Next question comes from Barrett Blaschke with MUFG. Please go ahead. Your line is open.

Barrett Blaschke:

Hey, guys. Could you give us just a little more detail around anymore turnarounds kind of on the books for this year planned?

Kevin J. Mitchell:

That's a PSX question?

Barrett Blaschke:

Yes.

Kevin J. Mitchell:

The Company does not give specific turnaround plans. The only guidance that is out there on the fourth quarter call, PSX gave guidance of full-year turnaround expense of …

Jeff Dietert:

$520 to $570 million

Kevin J. Mitchell:

$570, that's right; $520 to $570 for the year, and first quarter actuals was $245 million.

Barrett Blaschke:

Okay. Thank you.

Operator:

Next question comes from Jeremy Tonet with JP Morgan. Please go ahead. Your line is open.

Jeremy Tonet:

Good afternoon. Just wanted to come back to Gray Oak real quickly if I could. There's a lot of competing projects out there to service this Permian takeaway. I was just wondering if you could expand a bit more as far as how you guys were able to win the day here and what advantages did you guys bring? Were you able to get the project and get the returns you were looking for?

Tom Liberti:

Well, I think first of all, some of our Midstream folks, our legal folks and our tax folks, a lot of our people worked long and hard on this project to bring it in. We've been talking about expanding the Midstream for a long time now in PSX and with the development of PSXP. I think our folks have been there. We've had that commercial area for a long time and we were able to bring some other people to the table and get some of the shippers down on our line. You know, it follows the line, it kind of follows the path too of Sand Hills, so we've got a little bit of experience with that. I think it's a start, our reputation and the ability to put everything together the Midstream area.

Jeremy Tonet:

Great. Thanks for that. Then just wanted to touch base on operations a bit here. It seems like your joint ventures kind of exceed our expectations here. I was wondering if you could expand a bit more on some of the drivers. It seems like there was a little bit of some one-time issues there, but nonetheless, still kind of a step up quarter-over-quarter. Any thoughts you might have as far as the cadence of growth for joint ventures over the balance of the year here?

Tom Liberti:

Yes. I would tell you Bayou Bridge, the volume was up a bit on Bayou Bridge. STACK volume was up a bit and we would expect STACK volume to come up because you had the first full quarter of the loop coming in off of STACK. Explorer volume was up a little bit because it was down a little bit in the fourth quarter, and Sand Hills continues to ramp up. What we've seen with Sand Hills is every time we add to the capacity, we tended to migrate to fulfilling that capacity, so we would expect those to kind of continue that way.

Jeremy Tonet:

Great. Thanks for that. Actually, just one last one on Gray Oak here; as far as the equity options third parties have to acquire more interest, when is the expiration date of those options?

Tom Liberti:

We haven't announced that yet, Jeremy.

Jeremy Tonet:

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

Tom Liberti:

Thank you.

Operator:

Next question comes from Dennis Coleman with Bank of America Merrill Lynch. Please go ahead. Your line is open.

Dennis Coleman:

Great. Good afternoon. Thanks for taking my questions. I wonder if I might step back a little bit in reference to the earlier call with PSX. Just wondering about the dropdown strategy. There have been some pretty steady dropdowns and, I guess maybe to get to the $1.1 billion run rate target, we had been thinking that there would likely be more in 2018, but there seems to be just a slight change of tone or perhaps interest at the PSX level and I wonder if you can maybe tell me if I'm misreading that or did I get that right?

Kevin J. Mitchell:

Yes. This is Kevin. I don't think there's any real change in tone around any of that. I think those comments earlier reflect the fact that we're at $1 billion of run rate EBITDA currently. We have organic projects underway at PSXP that we'll complete before the end of the year, so we're already going to come in north of $1 billion. Now, whether the organic projects alone get us all the way to $1.1 billion, we'll see on that. So, I think what that means is if the organic projects are not going to quite generate enough to hit the $1.1 billion, then maybe that means there's a small dropdown, but it may not be required, depending on exactly how everything else goes over the course of the year.

I would interpret that more as just maintaining sufficient flexibility to decide whether there is or is not another dropdown take place over the course of this year.

Tom Liberti:

Dennis, our strategy has always been kind of three-pronged. We talked about dropdowns; we talked about strategic acquisitions and we've made some of those; and we talked about the organic program that we would always have. One of the reasons we talked about we did the dropdowns early on in the history of the MLP, is to get it to the size where it could take on those larger organic projects. Now that we're at that size with $1 billion of EBITDA, we're able to take on the larger organic projects that we've talked about all the time.

Dennis Coleman:

Sure. Sure. That makes sense. But, no—I guess just a slightly different angle—no concerns or questions about the MLP structure? It seems that we have seen increasingly management sort of stepping back from the structure, whether that means withholding dropdowns or just sort of the term loan in the capital markets have increased concerns from sponsors.

Kevin J. Mitchell:

No. No, not at all. If we were concerned about the ongoing structure, we may not be talking about Gray Oak in this call.

Dennis Coleman:

Okay. Very good. Separately, distribution growth obviously has been quite strong and you mentioned you're poised to hit your five-year target of 30% plus growth. Anything that you might talk about beyond that? Obviously you have quite a bit of runway with the 1.4 times coverage, but I mean should we expect another five-year commitment to a growth target at some point? How do you think about that?

Kevin J. Mitchell:

No. I mean, as you step back and look at this, we've got strong coverage, we have a good internal portfolio of growth projects, so more EBITDA in DCF growth to come after this year, and we've said we intend to be top quartile from a distribution growth standpoint. But, unlikely we will tie ourselves into a numeric target in the way that we gave the 30% guidance; probably won't be as specific in terms of future guidance. It'll be certainly the sort of top quartile over the next year or so. I think we said that and we'll probably continue to say that, but I don't think we'll go out and give a firm five-year guidance this time around.

Dennis Coleman:

Sure.

Tom Liberti:

I think the key is that we'll have the flexibility to really kind of adjust what the market is going to reward. If the market is rewarding a high growth, I think we'll have the ability to do that. We'll see what the market rewards in the future.

Dennis Coleman:

Okay. Thank you for that. One last one for me; in terms of the third-party option that Jeremy just mentioned, I guess my first read from the press release the other day was that that was the Enbridge option, but it seems that maybe it's a more expanded group than that. Can you comment on it?

Kevin J. Mitchell:

Only so far as to as to say it is more than Enbridge, but really no more to say than that.

Dennis Coleman:

Okay. Thanks for that. Thank you for the answers.

Kevin J. Mitchell:

Thank you.

Operator:

Your next question comes from Corey Goldman with Jefferies. Please go ahead. Your line is open.

Corey Goldman:

Hey, guys. Another one on Gray Oak; was the project always envisioned to be at PSXP? I just know the original release came from the PSX side, so not sure if there was a change there.

Kevin J. Mitchell:

This is Kevin. Just speaking from a sort of parent company perspective, it was always, I wouldn't say envisioned as a PSXP project, but always with the potential that it could be a PSXP project. Then as it comes closer to reality, the decision is made on where does this need to be and obviously we'd consider PSXP's ability to do the project, to bear the capital lift while it's under construction, until there's actual cash generation from the project. So, we look at a multitude of factors as we consider that. Our objective—and I think this was stated this morning on the call as well—ultimately, our objective is PSXP is a Midstream growth vehicle and the significant portion of the overall growth capital, we'd like to see at the MLP, so totally consistent with that.

Corey Goldman:

Understood. Actually, a pretty good segue into just the second question there. Obviously, there's still more to go in the open season, and to your earlier point about Enbridge and potentially other parties to exercise an option, just wondering if the funding for this project at PSXP, given that it does have some liquidity to do something, would that be the same funding strategy as what you've currently outlined in terms of cash on hand, debt capacity, and some opportunistic ATM usage?

Kevin J. Mitchell:

Yes. Yes. That's right.

Tom Liberti:

No matter where the percentage of ownership sits, that's how we'll fund the project, yes.

Corey Goldman:

Perfect. Okay. Then just last one for me, and it's kind of a follow-up from the PSX call. I think Greg was talking about the Sweeny Hub looking at 2018 EBITDA, somewhere in that $130 to $140 million range. Does that include the frac that currently sits at PSXP?

Kevin J. Mitchell:

It does, but it includes—it's an all-in look at the hub, so you have all aspects of it, including the commodity piece there. As we have talked about at PSXP, that's a challenged commodity environment right now for the export terminals. That's an all-in look at this point.

Corey Goldman:

Okay. Again, if this is a better question just for PSX, given that they still own that Freeport LPG hub—not the frac piece—but in terms of re-contracting on that asset, given that we have seen that the Asia LPG margins open up a little bit—again, understand that there's good to be some pressure in that business in the near term, but as you guys look at the NGL production coming out of the Permian, Sand Hills being a piece of that, feeding that Freeport hub to an extent, have you guys potentially looked at adding additional contracts that can help convert that commodity piece to a non-commodity piece?

Kevin J. Mitchell:

Yes. I think you have to take that to a PSX question.

Corey Goldman:

Okay. No worries. Thanks for the help, guys.

Operator:

Your next question comes from Ryan Levine with Citi. Please go ahead. Your line is open.

Ryan Levine:

Good afternoon. I guess a couple on Gray Oak. Have you secured all the right-of-ways for the project as of now, or where are you in that process?

Tom Liberti:

Currently in that process, Ryan.

Ryan Levine:

Okay. Is there any more color you can provide? I mean, is there any big hurdles that you envision in securing those?

Tom Liberti:

No. We wouldn't comment. I mean, we're in the process.

Ryan Levine:

Okay. Then in terms of expansion opportunities for Gray Oak, is it envisioned to be a platform for additional pipelines in the future, or is it more discrete in its current proposed design?

Tom Liberti:

Well, I think we have the flexibility, as we mentioned in the press release. If there's—depending on the interest of this expansion open season, we can expand up to 700,000 barrels a day, and if there's customer interest and commitment, it could go to as much as a million barrels a day.

Ryan Levine:

Okay. Thank you.

Operator:

Once again, if you'd like to ask a question, please press star, then one on your touch-tone phone. Next question comes from Craig Shere with Tuohy Brother. Please go ahead. Your line is open.

Craig Shere:

Good afternoon.

Tom Liberti:

Hi.

Craig Shere:

Do you see your plate pretty full with your organic growth and potential dropdowns over time, or do you remain open to third-party M&A? And to a degree you do, can you comment on the degree to which Midstream and MLP space is getting potentially more interesting?

Kevin J. Mitchell:

Craig, this is Kevin. I would just go back to what we've always said around growth of PSXP, which is we have dropdown opportunities from the parent, there's organic growth projects, and we'll look at acquisition type opportunities. As you point out, we have a pretty full plate right now as you look in the near term with the organic projects, and so I think that will consume a lot of our internal time, effort, and resources. But that wouldn't preclude us from at least being aware of and on top of what's going on in the rest of the MLP space, and if there were appropriate opportunities, we would look to capitalize on those. But I wouldn't anticipate that turns into anything immediate from an M&A standpoint.

Craig Shere:

Understood. Do you feel like at least from a public currency standpoint, that you're in a bit of a more competitive position today than before the latest broader MLP pullback?

Kevin J. Mitchell:

Yes. I think we are from that standpoint, but at the same time, while on the face of it, it might look like attractive valuations, when you factor in all things including what the balance sheets of some of these other entities look like, the debt load that they have, things don't look so cheap as you might initially think just looking at where the equities are trading.

Tom Liberti:

Yes. I would think we've got a good financial position so we can take advantage of an opportunity that would arise, but obviously it would have to be a good opportunity that would fit in our fairway that we would look at.

Craig Shere:

Very well. Appreciate the color.

Operator:

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

Jeff Dietert:

Thank you for your interest in Phillips 66 Partners. If you have any additional questions, please call Rosy or me. Thank you.

Operator:

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