

**TRANSCRIPT**

**3Q 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*

**MEETING PARTICIPANTS**

**Jerren Holder**, *Goldman Sachs*

**Spiro Dounis**, *Credit Suisse*

**Dennis Coleman**, *Bank of America Merrill Lynch*

**Barrett Blaschke**, *MUFG Securities*

**Jeremy Tonet**, *JP Morgan*

**Christopher Sighinolfi**, *Jefferies*

**TRANSCRIPT**

**Operator:**

Welcome to the Third Quarter 2018 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 the Phillips 66 Partners' Third 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 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 Kevin Mitchell.

**Kevin J. Mitchell:**

Thank you, Jeff. Good afternoon everyone. The Partnership reported record net income of \$217 million, an increase of \$31 million from the previous quarter. We also achieved record adjusted EBITDA of \$305 million. We delivered a great quarter with strong performance from our operated assets, as well as record volumes in the Bakken and Sand Hills pipelines. We achieved our \$1.1 billion run-rate adjusted EBITDA target ahead of schedule. Our Board of Directors approved a third quarter distribution of \$.0792 per common unit, a 5.3% increase from the previous quarter. Our distribution coverage ratio is 1.36 times.

Moving on to Slide 4, the Partnership's substantial growth since its 2013 IPO has enabled 20 consecutive quarters of distribution increases. We will achieve our five-year annual distribution growth target next quarter.

On to Slide 5, the third quarter adjusted EBITDA of \$305 million is an increase of \$29 million from the previous quarter. Our joint ventures contributed higher earnings from increased volumes, including the Bakken, Explorer and Sand Hills pipelines. Third quarter throughput on the Bakken pipeline exceeded 500,000 barrels per day. Earnings from our wholly-owned assets increased as a result of high utilization at the Phillips 66-operated refineries in the Mid Continent region. Third quarter distributable cash flow was \$218 million, an increase of \$14 million from the prior quarter.

Increased adjusted EBITDA was partially offset by higher maintenance capital. As expected, maintenance capital was higher in the third quarter than in the first two quarters of the year.

Slide 6 highlights our financial flexibility and liquidity. We ended the third quarter with \$100 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 2.8 times. Long term we expect leverage to be around 3.5 times. The Partnership's strong financial position enables funding of the 2018 capital program with cash on hand, debt capacity, and selective use of the ATM program.

Before I turn the call over to Tom I'd like to make some comments about our capital program. We intentionally grew at a rapid pace during our first five years. With our scale, financial strength and the opportunities ahead of us, we are well-positioned to fund and sustain a significant organic capital program. As we have previously announced, our 2018 capital program is approximately \$750 million, an increase of \$150 million from the original budget due to the Gray Oak Pipeline. For 2019, with the robust portfolio of projects that we are progressing, we expect our capital budget to be approximately \$1.2 billion. We will provide more information on our 2019 capital program in December.

Now, Tom will provide an update on our growth projects.

**J.T. (Tom) Liberti:**

Thanks, Kevin. Hello, everyone. Slide 7 highlights the projects mentioned by Kevin that will drive our EBITDA growth through 2020. Our scale and financial position have enabled us to fund and sustain this larger capital program. We continue to advance these projects during the quarter.

The Gray Oak Pipeline is our largest organic project to date and expands our footprint into the high-growth Permian Basin. We are seeing strong customer demand for crude oil takeaway for the Gulf Coast. Supported by customer commitments, capacity of the pipeline will be 900,000 barrels per day. Total cost is anticipated to be \$2.2 billion and we remain on schedule for completion by the end of 2019. Phillips 66 Partners will be the largest owner in the pipeline.

In Corpus Christi, the Gray Oak Pipeline will connect to the South Texas Gateway Terminal that is being developed by Buckeye Partners. We have a 25% ownership in the terminal, which allows us to offer a complete logistics solution to our Gray Oak customers. In connection with the Phillips 66 project to add NGL fractionation at the Sweeny Hub, the Partnership is increasing storage at Clemens Caverns from 9 million to 15 million barrels. Project completion is expected in late 2020. This is another great example of how integration with our sponsor provides accretive growth projects for the MLP.

The Sand Hills Pipeline is increasing capacity to meet growing NGL takeaway demand in the Permian Basin. Sand Hills reached 440,000 barrels per day of capacity at the end of the third quarter and is expected to be at 485,000 barrels per day by the end of this year. We own a one-third interest in Sand Hills and it has been a strong contributor to our EBITDA growth.

Commercial operations on the Bayou Bridge Pipeline extension from Lake Charles to St. James, Louisiana, are expected to begin by the end of this year. This crude pipeline currently operates from Nederland, Texas, to Lake Charles, and we have a 40% ownership interest. At the Phillips 66 Lake Charles Refinery, the Partnership is adding product export capability for our Clifton Ridge Marine Terminal. Partners is developing a new pipeline that will connect clean product storage in Lake Charles to the terminal and provide up to 50,000 barrels per day of product export capacity to meet growing demand. This \$25 million project is expected to be completed in mid-2019.

We have a long-term agreement with Phillips 66 that includes minimum volume commitments for the pipeline and the marine dock.

We're further expanding our footprint of the Phillips 66 Lake Charles Refinery with the construction of a new 25,000-barrel-per-day isomerization unit. The unit will increase production of higher-octane gasoline blend components. We have a long-term agreement with Phillips 66 for processing services, including a minimum volume commitment. The project is expected to be completed in the third quarter of 2019.

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. As we open the call for questions, as a courtesy to all participants, please limit yourself to one question and a follow-up. 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.

Jerren Holder from Goldman Sachs, please go ahead. Your line is open.

**Jerren Holder:**

Thanks. Good afternoon. Maybe I'll start with just the capex outlook here. Thanks for providing the granular detail on the capital projects. Can you give us a sense of the projects coming online in 2019 and 2020? What's been spent already in 2018 just so we could get a sense of what those projects, the capex outlook is for 2019 at the moment.

**J.T. (Tom) Liberti:**

Yes. Jerren, it's Tom. If you look at the slide that we provided, some of this capital obviously had been spent in 2018. I won't give you the specifics on each project, but the \$750 million is the budget that we've looked at for—we increased for 2018. Then 2019, Kevin gave you an approximation of where we're looking in 2019. There's a small amount that spills over then into 2020 also. You can kind of look at where the projects are and when they come online to see where the bulk of the spend, I think, would be.

Now, in addition to that there are other projects that we will have that will have 2019 spend for that we haven't announced. They haven't been vetted at this point in time.

**Jerren Holder:**

Maybe going back to the original \$600 million to \$750 million guidance, so that \$150 million we should assume is your 42% of Gray Oak; is that fair?

**Kevin J. Mitchell:**

That's right. That's the primary reason for that increase was Gray Oak. Gray Oak was not included in the original budget was set.

**Jerren Holder:**

Got it. Then on Gray Oak, are you guys set on the 900,000 barrels per day number? Can that be expanded by adding pumps or DRAs or anything like that, if you guys were to receive more commitments?

**J.T. (Tom) Liberti:**

You know, everything can be expanded, but at this point in time, we might be able to get a little bit of volume with a little bit of capex, but to get any significant increase in that line it would be a larger capex investment.

**Jerren Holder:**

Okay. Then maybe lastly, on your operating and maintenance expense, it looks like we started the year off a little bit high at \$97 million and the last couple of quarters have been around \$85 million. Is that a decent run rate to continue going forward for the business, the \$85 million range?

**J.T. (Tom) Liberti:**

Yes. I think the last two quarters are—you've got to remember, too, in the first quarter we had some expense from the Merey Sweeny with the turnaround expense too, so, yes, the last two quarters are more of a run rate.

**Operator:**

Spiro Dounis from Credit Suisse, please go ahead. Your line is open.

**Spiro Dounis:**

Hey, good afternoon. Thanks for taking the question. Just wanted to start off on the Bakken pipeline if we could. Seeing a pretty large bump there in performance and I guess what we're hearing is that it's running pretty much full at this point and I see that there's an open season out there. Just curious; from your perspective is there an expansion in the works there beyond what it's currently running or do you think that you're just more looking to firm up the current capacity there?

**J.T. (Tom) Liberti:**

Yes. The third quarter it ran at about 508,000 barrels a day, so you're right; we did have a bump from the second to third quarter. The open season is actually looking at expansion capacity up to about 570,000 barrels a day. That would come with minimal to no capital expense. If we would go beyond that—and ETP could give you more specifics on this obviously as the operator—but if you would go beyond that then we'd be looking at more significant capital expenditures.

**Spiro Dounis:**

Got it. Okay. That's great color. Then as far as Gray Oak goes, I think you guys have talked about that in a typical 6X to 8X return type range. Does this upsizing to 900,000 kind of move that needle closer to six or is that really more dependent on getting the walk up rates on any of the open capacity?

**Kevin J. Mitchell:**

Yes. I mean, I think the way to look at that is you're probably still in that range. As you upsize the capacity, as we have done, the incremental return continues to look better, so from an overall return standpoint, it continues to improve.

**Spiro Dounis:**

Great. Last one if you don't mind, just on Bayou Bridge and Sand Hills coming in the fourth quarter, should we expect much of an impact at all in 4Q results or really not that much?

**J.T. (Tom) Liberti:**

Yes. Sand Hills has been ramping as it's gone along, so that's increased on an every quarter basis until it gets to that final end capacity of 485,000. Bayou Bridge I would expect really minor impact in the fourth quarter and more of that impact then coming in the first quarter. Then, a full effect of Sand Hills in the first quarter of next year also.

**Spiro Dounis:**

Got it. Really appreciate it. Thanks, everyone.

**Operator:**

Dennis Coleman from Bank of America Merrill Lynch, please go ahead. Your line is open.

**Dennis Coleman:**

Yes. Hi. Good afternoon. Thanks. I know there were some questions on the parent call this morning or I guess early this afternoon about some of the issues that have also come up at one of your major competitors, just rolled up their MLP and I think there were some comments about why Phillips 66 used PSXP a little differently. I wondered if I might just get you to run through a little bit of that again.

**Kevin J. Mitchell:**

Yes. This is Kevin. Just to sort of reiterate the comments from this morning, if you look at where PSXP sits, we have outgrown it rapidly over this five-year period, so \$1.1 billion of EBITDA from I think at IPO it was \$70 million, something in that order, so, really rapid growth. To date it's been a combination of drop-downs and organic.

As you look ahead, we're transitioning to being more organic growth and it all aligns with the PSX strategy of investing and growing the Midstream business, and PSXP is very integral to that overall strategy. We're really in a very different place than those MLPs out there that are purely sort of drop-down. Obviously there still is a portfolio of assets at the parent company that could still come down to the MLP and that provides great optionality for PSXP and for PSX from that standpoint. But at this point in time we've got some great projects ahead of us that we are investing in organically and we'll continue to drive growth for the MLP.

**Dennis Coleman:**

Great. Thanks for that, Kevin. I wonder, any updates or updated thoughts on the IDR, you're sort of up in the high-30s take now that starts to be a level where people are—well, just broadly across the industry obviously people are scrutinizing IDRs as of currently. So, any update?

**Kevin J. Mitchell:**

Yes. That's right. I'd kind of sort of reiterate the comments I just made around the MLP has grown very successfully and with that has been growth in the distribution, growth in the IDR take. We know the way this works. We know the way the math works and we see how this plays out. From a PSX standpoint, obviously acknowledge that we will get around to doing the IDR restructuring at some point. I would just, again, reiterate on one of Greg's comments that as we do that, that transaction has to make sense for the LP holders, as well as for the PSX shareholders. We have to be able to strike that balance to where it works for everyone.

**Dennis Coleman:**

Got it. Anything with regard to project completion or anything with regard to the budget that might tie into that decision or make it a little more logical to do?

**J.T. (Tom) Liberti:**

No. We'll have projects coming online now. We have so many projects in the hopper now and in-flight. We'll have projects coming on at any point in time, so, I mean, the way we would structure it, I don't think it would be a major influence on the way we would structure it when we make a decision.

**Dennis Coleman:**

Got it. Okay. I'll leave it there. Thanks.

**Operator:**

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

**Barrett Blaschke:**

I think I probably know the answer to this one, but could you give us any color around what you're thinking as far as 2019? It seems like the capital budget is laid out. Do we have some more clarity on what distribution growth might look like?

**Kevin J. Mitchell:**

No. Barrett, so obviously we've given very specific guidance through the end of 2018 on distribution growth. At this point we're not going to go beyond saying, look, we're investing in a robust suite of projects. The underlying EBITDA and DCF will continue to grow. The Partnership will have the ability to continue to grow distributions at a very healthy level, certainly very competitive, probably top quartile, I would expect. But we are not giving specific guidance at this point.

**Barrett Blaschke:**

Okay. As we look into next year also, one of the things that's still obviously out there is there are assets that continue to come down to PXSP from PSX. With the equity market still relatively locked up, are you less likely to do that and more to lean on your organic budget do feel like at this point, or does that influence the decision?

**Kevin J. Mitchell:**

Yes. The way I look at that, we have a suite of organic projects that will continue to drive very healthy growth at the MLP, and so the assets that still reside up at PSX just remain options for some point in the future when that makes sense, so we're not compelled to have to go to those, but at the same time there'll be a point in time where it probably does make sense to do so. I think it's a really nice position to be in that we've got that optionality of the drop-down assets, but we don't have to because we have got a great set of organic projects on the way.

**J.T. (Tom) Liberti:**

At this point in time, Barrett, PSXP has got an organic program, PSX has an organic Midstream program too, so that portfolio of assets continues to grow as an option, but PSXP, as you can see from Slide 7 and things, the number of projects is pretty significant.

**Barrett Blaschke:**

All right.

**Jeff Dietert:**

That table on Slide 7 really gives you the tools you need for projecting.

**Barrett Blaschke:**

Thank you.

**Operator:**

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



**Jeremy Tonet:**

Good afternoon. Just wanted to start off with kind of the results here this quarter. You guys passed the Median Street EBITDA estimate by about 10% so it seems like there's a bit more operating leverage to some of the volume increases we're seeing in the U.S. here. Just wondering if you could expand on that a little bit more as far as is this just kind of seasonal in nature or is this recurring in nature? How should we think about the run rate potential that you guys can go, granted, 4Q is generally the best quarter of the year, but maybe you could just help us calibrate that?

**J.T. (Tom) Liberti:**

Yes. Jeremy, if you look at where the volumes were increased and where the revenues increased, DAPL and Sand Hills pipelines are—I mean, DAPL is running about at capacity, so we would expect that to continue as long as the crude situation stays where it is. Sand Hills has been expanding and that NGL offtake from the Permian continues, so, again, we would expect fourth quarter and into next year those numbers to continue to meet capacity.

On a wholly-owned asset basis, as I think we mentioned on the call this morning, the Mid-Continent refineries ran at very high levels. Don't know whether that can keep up past that third quarter and into the fourth quarter of next year, so those high levels really kind of contributed to a lot of that extra pipeline volume. As we would look forward into fourth quarter, we don't give guidance, obviously, but if you look at something between the second quarter EBITDA of \$276 million kind of number and the third quarter \$305 million, we would expect that kind of a run rate in between those two numbers.

**Jeremy Tonet:**

That's very helpful. Thanks. Turning to the Bakken, while you noted an expansion potential of 50,000 barrels a day, given what we are already seeing from bottlenecks there and the growth potential in the basin, it seems like there could be need for significantly more takeaway than that. Just wondering how you think that gets resolved; is this just a rail situation, is there more upsizing of your pipe, would you look to build another pipe for takeaway from the Bakken? Just seems like there's a structural shortage that was kind of previewed a bit earlier with some of the refinery turnaround.

**Kevin J. Mitchell:**

Yes. I think you're right, Jeremy. There are infrastructure constraints getting crude out of the Bakken. In the near term, the solution will be rail as more compliance railcars become available, and we expect to see that pick up. Don't have a view at this point on whether there's additional new pipeline investments that there will be sufficient demand for to justify that, but certainly potential for some future opportunities, whether it's expansion of existing assets or incremental, or additional.

**Jeremy Tonet:**

That's helpful. Thanks. Maybe we could just touch base, lastly, real quick on Bayou Bridge and how that is progressing.

**J.T. (Tom) Liberti:**

Yes. We would expect Bayou Bridge to start up by the end of this year. We're still online for that estimate.

**Jeremy Tonet:**

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

**Operator:**

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

**Tom Abrams:**

Hey, thanks a lot. So, a couple of questions; first, when the payer sponsor announces some storage of a million barrels of storage, is that something that could come to the PSXP level as a construction project or is it more future drop-down inventory?

**Kevin J. Mitchell:**

I think you're referring to the Beaumont Terminal expansion?

**Tom Abrams:**

Yes.

**Kevin J. Mitchell:**

Yes. That's all at that asset, the Beaumont Terminal, which sits that PSX. So I don't think you would see incremental storage being added at Beaumont going to the MLP. I think that you'd look at the entire asset and at some point in the future that could be a drop down; certainly, a drop-down candidate in that portfolio of options for future drop down.

**J.T. (Tom) Liberti:**

I mean, if you're asking, Tom, could we do it, could PSXP construct a tank on PSX property? I mean, contractually it could be done. It would be one of those—we've got kind of a separate organic list that's pretty long at this point, though.

**Tom Abrams:**

Sure. I just wondered how that worked internally. The second thing is about VLCCs off of Corpus. Just going back, there seem to be a time when the port wanted to build one and then I think Buckeye just mentioned it or South Texas Gateway has mentioned it as well. First off, is that something that we have competing projects or were they all talking about the same one? Secondly, when you think about the gating items for such a thing, particularly on the permitting side, what kind of new things do we have to think about, new agencies that have to get involved for offshore projects like that? Once it is permitted, how rapidly can those things be built?

**J.T. (Tom) Liberti:**

I think a couple of things. I don't know that we are totally familiar with all the permitting that would be needed, but as far as competing projects, as there's more crude exported out of Corpus Christi, there is need for, obviously, for more terminal capacity, and obviously it's easier the larger ship that you can load. So I think you know people are talking about a couple of different projects down there, so that'll be going. The timing of things is simply working with the port and working all over the permitting that would be needed.

**Kevin J. Mitchell:**

Yes. We don't have any specific comments on what it takes to do an offshore VLCC loading facility.

**Tom Abrams:**

Okay. I appreciate it. Great quarter. Thanks a lot.

**J.T. (Tom) Liberti:**

Thank you.

**Operator:**

Chris Sighinolfi with Jefferies, please go ahead. Your line is open.

**Christopher Sighinolfi:**

Hello again, guys.

**J.T. (Tom) Liberti:**

Hey, Chris.

**Christopher Sighinolfi:**

Just one question for me, just given the ramp, I guess, in capex with the organic expansions you have in flight, and maybe some of these more elongated construction profiles that you'll face, just curious how you guys are thinking now of that distribution coverage I guess both for 2019 and as more of an intermediate or long-range target.

**Kevin J. Mitchell:**

Yes. You've got the EBITDA/DCF growth that's coming as new projects are coming online, and as you can tell from that slide that we put out there, it is phased, we've got some new assets coming up at the end of this year with some coming up next year and some into 2020. So you've got a sort of phased in growth of DCF. We've got ability to finance with using the balance sheet, so the balance sheet is in really strong shape, so we've got plenty of debt capacity to help fund growth. So we're sort of triangulating around distribution growth, leverage metrics and then funding the capital program. It all works reasonably well at, I'd say, very respectable coverage ratios. So, north of 1.1, sort of 1.2-plus like coverage ratios is the way we model it.

**Christopher Sighinolfi:**

Okay. Then I guess a follow-up for me would be—and I lied there, I had a follow-up—is I guess what should we be thinking about in terms of Gray Oak for opportunities to project finance? I guess, would you impose on construction? Is this where—I guess as I'm thinking about—and I don't want to get too far ahead of myself, but if 2019 capex involves spend on a project, do you get some sort of cash back on 2020 to lead to spend on other projects, if you can put some financing actually on the asset itself?

**Kevin J. Mitchell:**

Yes. That's a fair question. Gray Oak could lend itself to doing some degree of project financing. It's not something we've made any definitive decisions around at this point, but there's certainly a possibility that that could happen. But, like I say, we haven't made any firm decisions on that yet.

**Christopher Sighinolfi:**

Okay. Thanks a lot for the time, guys.

**Operator:**

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

**Jeff Dietert:**

Thank you for your interest in Phillips 66 Partners. Any further questions, please contact Rosy or me. Have a good weekend.

**Operator:**

Thank you. Ladies and gentlemen, this concludes today's conference. You may now disconnect.