TRANSCRIPT
4Q 2018 EARNINGS CALL

Phillips 66 Partners

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*

Rosy Zuklic, *Vice President and Chief Operating Officer*

Tim Roberts, *Director and Vice President, Operations*

MEETING PARTICIPANTS

Spiro Dounis, *Credit Suisse*

Elvira Scotto, *RBC Capital Markets*

Dennis Coleman, *Bank of America Merrill Lynch*

Jeremy Tonet, *JP Morgan*

TRANSCRIPT

Operator:

Welcome to the Fourth 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 Fourth Quarter Earnings Call. Participants on today's call will include Kevin Mitchell, Vice President and CFO; Tim Roberts, Vice President, Operations; and Rosy Zuklic, 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. 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. I'll start on Slide 3, which shows our distribution history. Our Board of Directors approved a fourth quarter distribution of $0.835 per common unit, a 5.4% increase from the previous quarter. We reached a significant milestone with Partners achieving its five-year 30% compound annual distribution growth target. We have delivered 21 consecutive quarters of increases since our IPO, demonstrating industry-leading distribution growth.

Moving on to Slide 4, 2018 was a successful year for the Partnership. We operated safely and reliably and achieved record financial results. The Partnership saw strong volumes across its diversified portfolio of wholly-owned assets and equity affiliates. The Partnership reported 2018 earnings of $796 million, a 73% increase from the prior year.

Adjusted EBITDA for the year was $1.1 billion, up 51% from the prior year. We accomplished our $1.1 billion run rate Adjusted EBITDA target ahead of schedule in the second quarter and ended 2018 at a $1.2 billion run rate.

As you can see from the chart on this slide, we've grown Philip 66 Partners at a rapid pace. With our scale, financial strength, and the opportunities ahead of us, we are well-positioned to fund an organic capital program to deliver continued growth.

During the year, we sanctioned our largest project to date, The Gray Oak pipeline, and this quarter completed the expansion of the Sand Hills pipeline.

On to Slide 5, the fourth quarter Adjusted EBITDA of $309 million is an increase of $4 million from the previous quarter. The improvement reflects strong performance from our equity affiliates, driven by higher Bakken pipeline volumes that average more than 500,000 barrels per day. Our wholly-owned assets benefited from increased volumes associated with higher utilization at Philip 66 refineries. Fourth quarter

distributable cash flow was $238 million, an increase of $20 million from the prior quarter, primarily due to increased JV distributions and lower maintenance capital.

Slide 6 highlights our financial flexibility and liquidity. We ended the fourth quarter with $1 million of cash and $125 million of outstanding borrowings under our $750 million revolving credit facility. Our debt-to-EBITDA ratio on the revolver covenant basis was 2.8x. Long-term, we expect leverage to be around 3.5x. Our distribution coverage ratio is 1.39x.

The 2019 adjusted capital budget of $1.2 billion is predominantly for our growth projects, which will be covered on the next slide. JV level financing for the Gray Oak pipeline will reduce capital spending to approximately $600 million. The Partnership's strong financial position enables funding of the 2019 capital program with operating cash flow and debt capacity.

I'll now turn it over to Rosy to provide an update on our growth projects.

Rosy Zuklic:

Thanks, Kevin, and hello, everyone. Slide 7 lists the projects we have underway that will drive EBITDA growth for the next two years. Our disciplined approach to capital investment combined with our scale and financial strength have not only enabled us to fund a larger capital program, but one that will provide strong returns.

During the quarter, we made good progress on our growth projects. The Gray Oak Pipeline will provide 900,000 barrels per day of crude oil transportation from the Permian and Eagle Ford to Texas gulf coast destinations. We have received 360 miles of pipe, trenched 75 miles, and have started construction on all 17 tanks. We remain on track for the pipeline completion in the fourth quarter this year.

Gray Oak will connect to multiple terminals in Corpus Christi, including the new South Texas Gateway Terminal that is being developed by Buckeye Partners. The terminal will have two deep water docks and planned storage capacity of 6.5 million to 7 million barrels, up from the original project's scope of 3.4 million barrels. We have a 25% ownership in the terminal, which is expected to be in operation by mid-2020.

Announced this morning, PSXP is expanding its Sweeny to Pasadena net pipeline capacity by 80,000 barrels per day, and at the Pasadena terminal we are adding 300,000 barrels of product storage, along with connections to third-party terminals. The project enables the Partnership to offer customers additional storage services at the Pasadena terminal while improving product placement optionality. The expansion is expected to be completed in the second quarter of 2020.

Commercial operations for the Bayou Bridge pipeline extension from Lake Charles to St. James, Louisiana, are now expected to begin in March. Philip 66 Partners owns a 40% interest in the pipeline joint venture. The remaining projects are all on track to complete on schedule.

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.

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

Spiro Dounis:

Hey, good afternoon everyone and, Rosy, congrats once again on your new role.

Rosy Zuklic:

Thanks.

Spiro Dounis:

Just maybe wanted to start off—two-part question on the pipeline tariffs. Just thinking about first quarter, I think they came in the fourth quarter a little bit weaker than they thought, so just wondering how to think about that as we move forward. Then also on the PSX call, I believe they mentioned some heavy refinery turnaround coming up. How do we think about that as it impacts PSXP?

Rosy Zuklic:

Spiro, the pipeline tariffs, actually, what I would say is $0.62 to $0.63 is actually the normal run rate. The fourth quarter and actually the third quarter both had normal T&D routine adjustments that are making the quarter-over-quarter variance to look a little bit off. I think the third quarter was at $0.66 and the fourth quarter coming in at $0.61, really both of them are outside the normal range. If you look over the last eight quarters, $0.62 to $0.63 is really more of a normal run rate, so I would say that that's kind of a better gauge to use.

Then to your second question, as far as the utilization rate, you're spot on. The refining system for PSX of guiding to the mid-80% is obviously going to have an impact on our throughput volume. Third quarter and fourth quarter at over 100%, specifically in the Mid-Con, obviously contributed to the strong earnings that we saw in both quarters. So, normally, what I would say is as you look across the four quarters, the first quarter always is weaker and the fourth quarter is always stronger, and that kind of follows the trend of the refining system as far as the first quarter being the heavier turnaround period.

Spiro Dounis:

Got it. Very helpful. Second one just on Southern Hills. I believe DCP and SemGroup are proposing to effectively convert Southern Hills into Gladiator crude pipeline and then build a new NGL line to replace Southern Hills. First, am I thinking about that correctly; then, second, obviously the unknown on Southern Hills, would you have an option to participate in Gladiator, maybe rather than develop Red Oak?

Rosy Zuklic:

Obviously, the open season is still ongoing, so a little bit too early to talk much about that, but you are thinking about it right. At this point, DCP, what they're thinking about is the current Southern Hills Pipeline at 190,000 barrels a day capacity for NGLs as a crude line could be a 300,000 barrel a day pipeline. They're thinking that if that gets converted to a crude line, then you could then build another line for NGL. But, beyond that, really not much I could really share on it.

Spiro Dounis:

No worries. Appreciate the color. Thanks, everyone.

Operator:

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

Elvira Scotto:

Hey, everyone. Can you provide a little more detail around the ACE Pipeline? You guys talked about—there was a press release about an open season. When does the open season run through? Is there anything in the budget for that pipeline in 2019?

Rosy Zuklic:

Yes. We don't really give timelines on our open seasons. That's just a normal practice for us, so can't really tell you when it ends. It did just here recently open, so think about a normal timing being somewhere in the 30 to 60 days. Just to clarify, the open season is specifically for the new build pipeline that's going to be from St. James down to go Clovelly, and the JV premise is with it being ourselves, PBF, and Harvest. Harvest would be contributing the CAM pipeline, which CAM currently runs from Clovelly up all the way Meraux. Obviously, that is servicing the PSX Alliance refinery, the PBF refinery, all the way up to Valero's refinery.

We're really excited about it. We do have it premised in the budget. So, answering your question directly for 2019, hoping to see the open season conclude here, but from a PBF and ourselves perspective, obviously there's upside. Additionally, from the refining PSX has come crude optionality for Alliance, so I think that there's upside that we would see from the open season.

Elvira Scotto:

Okay. Great. Then you guys didn't provide any EBITDA guidance, which is consistent with your previous comments, but should we read anything into your comments on we will continue to reward our unitholders with increasing distributions, kind of versus your previous targeting top quartile distribution growth?

Kevin Mitchell:

Hey, Elvira. This is Kevin. You're correct that we did not provide EBITDA guidance, and we're really giving guidance in terms of looking at the fundamental business and the new assets that will be coming online as you look ahead to 2019. Rosy talked about the impact as you look in the near term, in the first quarter of the PSX refining utilization being down, and you've got the page out there that Rosy covered that had all of the growth projects. So, there's some information available that can enable you to sort of build your models and come up with your own EBITDA estimates around that.

In terms of distributions, we did not restate the first quartile guidance, in part because we found that wasn't particularly helpful in terms of really what is first quartile today. It was a little bit different back in the days where there was a lot of emphasis and focus on high rates of distribution growth, but given the way the investor base has shifted with regards to how it's looking at distribution growth and the appetite for distribution growth versus the ability to manage an organic capital program within operating cash flow and, in our case, certainly some moderate debt. So, from a dividend distribution standpoint, we do expect to continue to increase the distribution. We expect to be very competitive in that regard. We're just staying further away from hard targets around what that growth is going to look like.

Elvira Scotto:

Okay. That makes a lot of sense. The question we always ask, but given that many of your large cap peers have eliminated IDRs or are in the process of eliminating IDRs, and we know that IDRs may keep some investors away from investing in PSXP, can you provide us your latest thoughts on IDR elimination, and what are some of the key factors that keep PSX and PSXP from announcing an IDR elimination today?

Kevin Mitchell:

Our comment on that is very consistent with what we've said in the past, which is you look back and PSXP has grown very successfully over this last five years or so. The IDR lifecycle has continued to evolve over that time period. Clearly, it's much shorter than we originally assumed, and we understand that. We understand the way this works. The reality is we will end up addressing the IDRs much sooner than we would have expected originally.

When we get to that point, I think what's important to take away is we expect this to be done in a way that is fair to the Phillips 66 shareholders and the PSXP unitholders. The transaction needs to be structured in a way that it's a fair, appropriate transaction all around, and we expect to get to that sooner than later. But no specific guidance on exactly what those triggers are going to be, or exactly what the timing is going to be.

Elvira Scotto:

Okay. Thank you very much.

Operator:

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

Dennis Coleman:

Thank you. Hi, everyone. A couple for me, if you would; The first one relates more, perhaps more of a question for PSX, but on the fracs that are supposed to be on late 2020, but obviously that's been quite a topic lately, is there any ability to sort of accelerate those projects to bring them forward in 2020?

Tim Roberts:

Yes. On that—this is Tim Roberts, by the way—yes, I'll answer that from a sponsor view. You're right, it's a PSX level. But, no, this project, as far as with the schedules that we've seen, it looks like it's fairly well on schedule as it stands. It's hard to move these things forward, one, because you had to line up fabrication space, shop space, procurement, contractors, and getting all that lined up, so it's hard to accelerate those. Certainly, if we're good at what we do, you may see a slight movement forward, but it's a pretty hot market right now in the Gulf Coast, so maybe incrementally, but not much.

Dennis Coleman:

Okay. Thanks for that. Then I guess, Kevin, just with the balance sheet availability that you talked about going up to 3.5x from the current level of 2.8x, any incremental thoughts on dropdowns?

Kevin Mitchell:

No. I mean, you look at the program that we've got today at PSXP, there's a significant organic capital program. We like that. We have the ability between the coverage and available cash that that generates, and the balance sheet that's available. We have the ability to continue to execute on that organic program and do that, so the dropdowns, from a PSX standpoint, the dropdowns just remain option, gives optionality for some point in the future if we think that's appropriate; but for the time being, very much focused on the organic buildout.

Dennis Coleman:

Fair enough. That's all I have. Thank you.

Operator:

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

Jeremy Tonet:

Good afternoon. Just want to touch base on South Texas Gateway. I think you noted mid-2020 for the completion there. I was just wondering if parts of that could come online, enter service earlier than that, coincide with Gray Oak at year-end '19, or how do you think about that coming online in stages?

Rosy Zuklic:

Buckeye Partners, of course, is the operator of this. Just to get everybody up to speed, the original scope of this project started off at 3.4 million barrels, and now we're talking about it being almost 7 million barrels, so obviously twice the size of what the original scope was. The mid-2020 timing is really reflecting the significant growth in the scope of the project, and it is indicative of the entirety of the project being done. As the facility becomes available, as sections of the facility, whether its tanks or the docks, become available, then those are going to be made available to the customers.

So as we think about Gray Oak, obviously Gray Oak is going to have multiple destination points, not just at Corpus, but even within the Corpus area we have multiple terminals that we are delivering to, and so we're really not at all—there's no concern in our mind right now with any of the timing.

Jeremy Tonet:

Okay. Great. Thanks. For DAPL, I was just wondering if you would be able to share what the volumes were for the quarter. Also, it seems like there's definitely interest for the expansion up to 570,000. What kind of a timeframe would it take to kind of achieve that capacity expansion?

Rosy Zuklic:

As far as the quarter, so both third quarter and fourth quarter we ran over 500,000 barrels a day, and the open season that Energy Transfer went out with was successful, and it has concluded, and so we are looking to get it to the full capacity of 570,000 here in the short term. Minor modifications are going to have to be done to sustainably run at the 570,000, so I would think that sometime here in the next couple of quarters you would see it at that sustainable rate. Beyond that, I think, from the open season, our partner has communicated that they did see enough interest to expand further, but ETP as the operator is still obviously trying to assess what would need to be done in order to address the market needs, and so they would be the better person to ask the question to.

Jeremy Tonet:

Fair enough. Last one, if I could. It seems like the Bridger and Liberty pipes, the open seasons were announced at the PSX level, if I'm not mistaken there, and I was just wondering if you could expand a bit more as far as the drivers behind having this done at the PSX versus the PSXP level.

Tim Roberts:

This is Tim Roberts again. Well, at this point, right now at PSXP, we've got a really ambitious and really solid capital program already, so it's nice to see a pivot to the organic growth side. So, we've got a lot on their plate right now, and as we manage PSXP, we also don't want to lose out on opportunities that are also out there. We're looking at this from a PSX standpoint. We think that right now, as we incubate this and see if there's a real project to be had, which the open season with tell us, this doesn't preclude us from at some point it moving it down to the Partnership, but at this point in time we didn't want to also hesitate or wait on an opportunity to be sitting out there. That's why we're handling it at PSX at this point in time.

Jeremy Tonet:

That's helpful. I'll stop there. Thanks for taking my questions.

Kevin Mitchell:

Thanks.

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 all of you for your interest in Phillips 66 Partners. If you have additional questions, please call me or Brent. Thank you.

Operator:

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