TRANSCRIPT
1Q 2019 EARNINGS CALL

PHILLIPS 66 PARTNERS (NYSE: PSXP)
April 30, 2019 at 2:00 pm ET

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*

Justin Jenkins, *Raymond James & Associates, Inc.*

Theresa Chen, *Barclays*

Jeremy Tonet, *JP Morgan*

Dennis Coleman, *Bank of America Merrill Lynch*

Barrett Blaschke, *MUFG Securities*

Michael Blum, *Wells Fargo Securities*

Ryan Levine, *Citigroup*

Christopher Sighinolfi, *Jefferies*

TRANSCRIPT

Operator:

Welcome to the First Quarter 2019 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 First Quarter Earnings Conference 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 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.

Kevin J. Mitchell:

Thank you, Jeff. Good afternoon, everyone. In the first quarter we operated well and delivered solid financial results during a period that was impacted by significant refinery turnarounds. We also advanced our major growth projects, including construction of the Gray Oak Pipeline. During the quarter the Sand Hills Pipeline achieved record volumes of 494,000 barrels per day following its fourth quarter expansion, and the second phase of the Bayou Bridge Pipeline was completed.

Our Board of Directors recently approved a first quarter distribution of $0.845 per common unit, an increase of $0.01 from the previous quarter and 18% higher than the first quarter 2018 cash distribution. We've increased the distribution every quarter since the IPO in July 2013.

Looking forward, we remain committed to delivering a competitive and growing distribution while maintaining strong coverage and leverage ratios. Our portfolio of organic projects and financial strength position us well for future growth.

Moving on to Slide 4 to discuss the financial results, Partners reported first quarter adjusted EBITDA of $281 million compared with $309 million in the prior quarter. The decrease reflects lower volumes from our wholly-owned assets due to the impact of turnarounds at refineries operated by Phillips 66. Earnings from our equity affiliates declined as a result of lower volumes on the Bakken and Explorer pipelines, partially offset by higher Sand Hills Pipeline volumes. First quarter distributable cash flow was $226 million, a decrease of $12 million from the prior quarter primarily due to lower earnings from our wholly-owned assets, partially offset by lower maintenance.

Slide 5 highlights our financial flexibility and liquidity. We ended the first quarter with $2 million of cash and $15 million of outstanding borrowings under our $750 million revolving credit facility. Our debt to EBITDA ratio on a revolver covenant basis was 2.8 times; our distribution coverage ratio was 1.3 times. Long term, we're targeting leverage of 3.5 times and distribution coverage of over 1.2 times.

The Partnership continues to advance its major projects. In the first quarter, our growth capital spend was $195 million, including investment in the Gray Oak Pipeline project, as well as the new isomerization unit of the Phillips 66 Lake Charles Refinery and the Clemens Caverns expansion. The Partnership's strong financial position enables us to fund our 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 6 lists the projects we have ongoing that will drive EBITDA growth for the next two years.

During the quarter we advanced our growth projects. I'll just take a moment to comment on a couple of the larger projects. We made progress in the Gray Oak Pipeline. This 900,000 barrel per day pipeline will transport crude oil from the Permian and the Eagle Ford to Texas Gulf Coast destinations. Construction continues on the 850 miles of pipeline and the 17 facilities. We have purchased all the pipe, most of which has been delivered. 98% of the right-of-way has been acquired and all 17 foundations have been poured. We are experiencing cost pressures from higher fuel costs, labor rates, and right-of-way. The total cost of the project is now expected to be approximately $2.7 billion. We have all Army Corps of Engineer permits, and the pipeline remains on track to start up in the fourth quarter of this year.

Gray Oak will connect to multiple terminals in Corpus Christi, including in the South Texas Gateway Terminal in which PSXP has a 25% ownership. The marine terminal will have two deep water docks with initial storage capacity of about 7 million barrels and up to 800,000 barrels per day of throughput capacity. The project has expanded since sanctioned and is supported by additional customer commitments. The facility is expected to start up by mid-2020. The remaining projects listed are all on schedule to complete on time.

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. Maybe just starting off on Gray Oak, if we could, and just looking at the cost increase. Is there any impact or any flow-through on—so, I guess the tariffs you're going to be charging, or is this sort of eating into some of the project returns at this point?

Rosy Zuklic:

No. It's going to be eating into the project returns, but what I would say is that what we have on the slide there with the project being six to eight times multiple, that's true for all the projects. As we think about this project when it was originally sanctioned, it was sanctioned at 385,000 barrels per day. Obviously, the pipeline now at 900,000 barrels per day, commitments of 800,000 barrels per day, obviously it was at first leaning towards the lower end of the multiple. With the increase, it's now going to be leaning towards the

higher end of the multiple, but still a great project. We still are very excited about it and still expect to have great returns.

Obviously, once the pipeline is up and running, we'll, I'm sure, find other opportunities around it.

Spiro Dounis:

Okay. That kind of answered my second question which is, I guess, on an expansion that would presumably be at a very accretive multiple, so over time there's room for you to work that multiple down again.

Rosy Zuklic:

That's right.

Kevin J. Mitchell:

Yes. Spiro, this is Kevin. To add a little further on that, the returns that we show, those build multiples are for the projects on a standalone basis. As we've talked about, we're going into project financing on this project also, which will further enhance the returns on a levered basis, so still looks very attractive to us.

Spiro Dounis:

Okay. That's a good point. The second question just with respect to some of the Midstream assets still up at PSX, thinking specifically about Sweeny frac expansion and the LPG export terminal, is there a logical pathway for those assets making their way to PSXP? I fully understand that you guys have sort of shifted away from dropdowns, but it seemed like there were some interesting comments on the PSX call around LPG export rates being around $0.10 right now, and I think that could maybe spark some long-term contracting, which makes this asset maybe a little more attractive from an MLP and midstream standpoint.

Kevin J. Mitchell:

Yes. Looking at that from a PSX standpoint, clearly the LPG export terminal and the fracs, once complete. So fracs 2 and 3, those assets, would lend themselves to the MLP model, the MLP structure. While, as you rightly point out, we've sort of transitioned away from dropdown and a lot more organic focus. That still doesn't preclude us from entering into dropdown transactions to get those assets down into the MLP. No plans to do that anytime soon, but the potential is certainly out there.

Spiro Dounis:

Got it. Appreciate the color. Thanks, everyone.

Operator:

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

Elvira Scotto:

Hi, everyone. Just going back to the Gray Oak cost overruns, so is that going to be financed; that incremental, will that just be financed off the revolver, or is that part of project financing, or how do we think about that financing?

Rosy Zuklic:

Maybe let me talk about capital in total and maybe we can hit it this way. If I think about back in October, the PSXP Board approved a $1.2 billion capital program. That is now, because of the Gray Oak overage, largely it tends to be trending more to be about 10% higher, so somewhere in the $1.3 billion, $1.32 billion. The $1.2 billion, the original budget, was post-project financing was around $600 million. Now, it's looking to be between $700 million and $750 million. That kind of gives you an idea of how that's looking like. Before project financing and after project financing, and how the Gray Oak overage is impacting both numbers.

Kevin J. Mitchell:

To the extent that the net of financing capital budget for PSXP is increasing, which is what Rosy has just described, then, in effect, that will be funded by essentially debt at the PSXP level, all other things being equal.

Rosy Zuklic:

Right.

Elvira Scotto:

Thank you. That's very helpful. Is there any change in outlook to your maintenance capex spend?

Rosy Zuklic:

No, not at this point. No. Still around $80 million, $78 million I believe is the number, yes.

Elvira Scotto:

Okay. Perfect. Then just on the Gray Oak Pipeline, can you just help us understand, so of the commitments which you've got contracted on there, do those contracts all come online day one? Then sort of as a follow-up to that, how do you expect the actual volumes to ramp on Gray Oak?

Rosy Zuklic:

From a volumes perspective, the way we're thinking about it is the fourth quarter is when the pipeline is going to be available. And so the thought is, as with any major pipeline, it's going to take some time for—and also as when shippers are available, effectively when the production is available for them to bring in. It's going to take a little bit of time. If I think back, to our involvement, obviously with the Bakken Pipeline. It took a couple of months for that pipeline to come to full—it was having the pipeline full. It'll take at least a couple of months, so sometime in the first quarter is where we're really thinking that the pipeline will have the full capacity.

Elvira Scotto:

Okay. Great. Then just in terms of, because I know the pipeline can go to Corpus Christi and then also into Sweeny, how much capacity can actually move into Sweeny?

Rosy Zuklic:

We haven't really given a split out.

Tim, do you want to comment on that?

Timothy D. Roberts:

Yes. I think what we can tell you on that line—and we haven't disclosed that, and not for any other reason with the exception that it is a new-build pipeline—but we do expect to meet commitments for PSX. PSX is undertaking some commitment on the pipeline. We're not the anchor shipper, but obviously this helps optimize our Sweeny asset, having those barrels available. But, it is a less—the line is sized lower than what it would be going if it were going straight to Corpus.

Elvira Scotto:

Got it. Okay. Great. Thank you very much.

Operator:

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

Justin Jenkins:

Hi. Thanks. Good afternoon, everybody. I want to start on Bayou Bridge and maybe see if you could offer any comments in terms of how that ramp has gone here for the first month of operations. Then second question is, does that give you maybe a bigger leg up with the ACE Pipeline development process and how that maybe unfolds?

Rosy Zuklic:

Yes. Everything is going well with Bayou Bridge as expected. The PSA started April 1, so we expect to see earnings starting a month later, and then cash distributions a month after that. So, everything as expected.

From an ACE perspective, you hit it on the head. It'd be nice to have it all, as you kind of think about the way everything is planned out. You've got the Bakken Pipeline going down to Beaumont, and then Bayou then takes crude all the way to St. James, and then ACE would then complete it all the way to the PSX Alliance Refinery. That would be a nice tie-in to not only Lake Charles but the Alliance Refinery, so it's part of the plan.

Justin Jenkins:

Got it. Thanks, Rosy. Second question, maybe on the operating cost side of things; it increased pretty big quarter-over-quarter. It looks like a similar offset on the revenue line, but any color on maybe the choppiness there, Kevin, in terms of how the sequential costs played out?

Rosy Zuklic:

Sure. Actually, what happened there, Justin, if you'll allow me. The MSLP turnaround is what you're seeing there. There's about $50 million to $55 million associated with the MSLP turnaround. And so what you're seeing in the expense line is the expense for the turnaround, and the revenue is the reimbursement. When we dropped that asset in, there was a prearrangement for PSX to reimburse PSXP for turnaround expense. And so the same phenomenon has actually happened back in the first quarter of 2018. It's just that the number was much less, it was about $20 million. But that's really what you're seeing there.

Justin Jenkins:

Got it. Thanks, Rosy.

Operator:

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

Theresa Chen:

[Thank you for taking] my questions. First, in terms of the potential expansion of the Bakken JV pipeline above the 570,000 current capacity, can you remind us what is the potential hydraulic capacity of the system if you do add additional pumping and storage capabilities, but still taking into account the 24-inch segments of ETCO?

Rosy Zuklic:

The pipeline today is at 570,000 barrels per day. As far as getting above the 570,000, I think from what I've seen, the pipeline has the ability to go up to 800,000 barrels. But that's not necessarily what we are expanding to with this further expansion. We are currently just—the partners are looking into what further expansion to do, but we're not talking about actually doing any sort of looping. We're really just talking about pumping and storage.

Theresa Chen:

The 800,000 barrels per day, would that include looping, or would that still be within the 24-inch?

Rosy Zuklic:

No. I believe that would just be adding just pumping. I don't believe that would be any sort of looping.

Theresa Chen:

Got it. I wanted to touch on the recent open season to expand Bayou Bridge with various origins, including Bakken, PRB, Cushing, Permian, and such. What are you seeing in terms of interest from shippers so far? Given these origin points, I'm guessing this implies potential connectivity with your other projects under development, be it Liberty and Red Oak at the parent or the Gray Oak Loop at PSXP. Can you provide an update on how these projects are progressing?

Timothy D. Roberts:

Yes. Theresa, this is Tim Roberts. From a PSX view, because of the projects we're working on, as far as the open seasons with Red Oak and Liberty, I'll weigh in on that. Look, from Bayou Bridge, where it's located at, and the connectivity it's got from Beaumont, and you've got the Bakken coming in, and there are other pipelines that are going to be coming into that particular area to get barrels either to the Beaumont, Nederland area, or get barrels to St. James or get barrels down to LOOP, or get barrels potentially to the refining systems in Southeast Louisiana. So, we see some of these pipelines are going to be coming in, and we're a logical alternative to getting down to Houston or other destinations.

We're just, at this point, working with our partners as far as joint tariff opportunities through a binding open season. S what the interest level is. It's no more than that. We think we're creating more optionality into the Louisiana side, and we'll see what the interest is from people getting barrels in different basins down to that region.

Theresa Chen:

Got it. On the revenue reimbursement related to maintenance from the dropdowns, is that a forever type of thing, or do you do it for a certain amount of years, and then it stops?

Rosy Zuklic:

We have a contractual agreement for MSLP for 15 years. And so we'll obviously have to renegotiate this once the contract is done. This was just something that we did at the time of the drop.

Kevin J. Mitchell:

Specific to that asset.

Rosy Zuklic:

Correct.

Theresa Chen:

What about the other assets?

Rosy Zuklic:

No, we do not.

Theresa Chen:

Got it. Thank you very much.

Operator:

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

Jeremy Tonet:

Hi. Good afternoon. Hope that you could clarify a little bit for me, when you talk about the Liberty Pipeline and the DAPL expansion, do these projects kind of overlap in any sense, or could you kind of clarify what the objectives are with the two expansions?

Timothy D. Roberts:

Yes. I think they're serving two different purposes—this is Tim Roberts, by the way, sorry—from the PSX view. I'll talk specifically to Liberty. Liberty really is trying to access from different basins on the west side of the Bakken, coupled with Powder River, DJ Wattenberg. Liberty is really hitting a different part that Bakken doesn't really fully serve currently. That's really the difference between the two pipelines. We still think there's room for continued expansion on the eastern side of the Bakken, and then obviously on the western side, as we head out towards, again, Powder River and those other basins.

Jeremy Tonet:

That's helpful. Thanks. Just wanted to go to Gray Oak real quick, just a clarifying question with regards to the economics being closer to an eight times build multiple at this point; our understanding is that PSXP received a promote in the whole formation of the partners coming in, and so when you state that level of economics, is that before or after considering that promote payment?

Rosy Zuklic:

It's after.

Jeremy Tonet:

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

Operator:

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

Dennis Coleman:

Just one last question on Gray Oak. Any guidance you can—I mean, how much has been spent? Where do you stand percentage-wise with the project? I guess, really what I'm trying to get at is what the spend level is from here.

Rosy Zuklic:

Maybe I'll try to tackle this question kind of holistically. The project is about 50% done, and this is all-inclusive, engineering, and construction obviously, in and of itself, is going to be at a different stage than engineering. But, as I think about the project being 50% done, from a spend perspective, it's largely there, maybe a little bit more weighted towards a back half [of 2019] with some of it falling in 2020. The vast majority is going to be remaining in 2019. Obviously because you're going to have a little bit of spend in 2020, maybe you're going to see that in the first quarter of 2020.

Dennis Coleman:

Okay. Thanks for that. All my other questions have been asked.

Operator:

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

Barrett Blaschke:

Hey, guys. Most of mine have been addressed, but I did want to ask, Rosy, you said before kind of what the three drivers were for cost increases on Gray Oak. Could you give us a little breakdown; is it mostly coming from materials cost, labor, or right-of-way, just if you kind of quantify it a bit?

Rosy Zuklic:

No, I can't. But, additionally, one of the things that I'd also want to touch on, and Greg spoke to it in the PSX call, is we also have facilities. One of the things that Gray Oak offers that some of the other pipelines don't offer is optionality, and that optionality is built into our facilities. The facilities also have added some costs, but I'm not going to be able to give you a split between those things.

Barrett Blaschke:
Okay. Thanks.

Operator:

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

Michael Blum:

Thanks. Thanks for taking my questions. Just a couple more on the Bakken Pipeline. Just to clarify, do you intend to get to the 800,000 of capacity by late-2020? That was the first part. The second part is what capital would be involved with that? Then I guess the third part of that is, is this an FID project because it's not listed on the slide? Thanks.

Rosy Zuklic:

I'm not sure I understand by late-2020. You mean by for…

Jeff Dietert:

I think Energy Transfer is really the right person to ask that as the operator of the pipeline.

Rosy Zuklic:

I'm sorry. I was thinking Gray Oak. I'm sorry.

Kevin J. Mitchell:

Yes. Bakken.

Rosy Zuklic:

Bakken.

Michael Blum:

Okay. I'm just referencing in your press release where it says, "The partners are progressing plans to further increase the capacity by late 2020." That's what I'm referencing.

Rosy Zuklic:

Right. No, that's right. That's right. No. The partners are talking about obviously increasing the capacity of the pipeline. At this point, Michael, we're talking through the details of exactly what we're going to do, so we don't have much more to give you at this time. As far as that timing, we're going to work through the permitting and all that stuff. Hopefully we do it before 2020, but I don't really have more color to give you.

Michael Blum:

Okay. Thank you very much.

Operator:

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

Ryan Levine:

Good afternoon. I just wanted to clarify one point on Bayou Bridge. Given the open season that's outstanding, is there any potential for the existing contracts to be altered in connection with that open season, or would everything be additive?

Rosy Zuklic:

It would be additive. Yes. The contracts that we have in place are long-term contracts, 5 to 10 years, and so, really, we're really looking for additives.

Ryan Levine:

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

Operator:

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

Christopher Sighinolfi:

Hey, good afternoon. Thanks for taking my question. Kevin, if I could just start, I want to follow up on Spiro's dropdown question, but ask it in the context of Greg's comment from the PSX call about the potential to eliminate PSXP IDRs. He had noted a desire to have such a transaction be accretive to the LP unitholder, and I'm just curious if that means it's likely to entail a combination of dropdown and IDR elimination at one time, and then also how we might think about accretion relative to—you've noted it competitive and growing distribution, but one where a numerical growth rate hasn't been provided. Any help with that would be really helpful.

Kevin J. Mitchell:

Yes. Certainly, doing a dropdown transaction and doing an IDR elimination at the same time, that's a formula you've seen out there. That's been done by several others, and we would certainly give that consideration. But I would say at this point, while we and, so Greg laid out our thinking around IDRs in terms of acknowledgment that this is something we need to get to, and we will get to. And we want to make sure we do this in a way that works for both the MLP and for the general partner. We don't have any specific guidance to give on either when it's going to happen exactly other than sooner than we would've originally anticipated or exactly what that structure is going to look like.

You've highlighted that doing a dropdown along with that is something that we could consider, and we will consider it, but that's not to say that—we don't have any firm plans to do that as such.

Then from a distribution standpoint, we have steered away from giving specific growth guidance. You see the portfolio of organic projects that we have and the approximate timing of when those projects complete and the estimates of the EBITDA generation that will come from that. So, you can see that we have a portfolio that will allow us to continue to grow the distribution. But we're not going to get caught up in a sort of specified target or objective around exactly what that growth needs to be. We want it to be competitive, but we also are mindful of the need to manage the big picture in terms of the balance sheet, leverage metrics, coverage metrics, the ability to continue to fund growth given that it is predominantly pretty much mostly a self-funding model now. And so we just try to balance all of those factors.

Christopher Sighinolfi:

Okay. No, that is very helpful. I appreciate that color. I did have two follow-ups, I think probably for Rosy. It was helpful, the reminder on the MSLP reimbursement as it pertains to the income statement. I also noticed that, as it pertains to the maintenance capital, you had a footnote there, it looks like there's a modest differential between maintenance capital and then what's reported in the DCF, and it seems like that's attributable to the same thing. I just wanted to make sure I understood that correctly.

Rosy Zuklic:

I believe so. Yes.

Christopher Sighinolfi:

It looked like you had 15 versus 9, and I just didn't know if that was related to the same 15-year agreement on turnarounds, which we saw last year as well.

Rosy Zuklic:

Yes. I believe that is the case. I will look into it because I don't know that I've confirmed that for you, but I believe that is the case.

Christopher Sighinolfi:

Okay. Then the final question for you on this, Rosy, obviously predominantly a capital program is being debt financed, I did see a little equity noted in the PSX release in terms of what PSXP had raised. I think it was $32 million in the period. I was just curious if there was any formal expectation for an equity component to sort of marry alongside the debt being raised.

Kevin J. Mitchell:

Yes, this is Kevin. Certainly not from the standpoint of doing an actual equity offering. We have the ATM program in place, and we utilize that, which provides a little bit of funding, but that's really minor in the context of the overall capital program.

Christopher Sighinolfi:

Okay. So, we shouldn't expect what we saw in the first quarter to be sort of a run rate or anything of that nature?

Kevin J. Mitchell:

The first quarter was $32 million or so, which that's all ATM. I mean, it's not unreasonable to assume there'll be something like that will continue. But what you're not going to see is a several hundred million dollar equity offering.

Christopher Sighinolfi:

Understood. Understood. Okay. Thanks a lot, guys. Appreciate the time.

Operator:

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

Theresa Chen:

Thank you for letting me back in the queue. I just had a quick follow-up related to one of Elvira's questions on the Gray Oak ramp. Rosy, completely understand that it's going to take a couple of months to get to full capacity, so sometime within Q1 of 2020. But for the commitments, will they also ramp around the same time frame? Will we get to 800,000 by Q1 2020 as well, or will the actual commitments and volumes, is it expected to ramp at a slower pace versus capacity?

Rosy Zuklic:

No. It'd be consistent with capacity.

Theresa Chen:

Great. Thank you very much.

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 this afternoon, or Phillips 66 Partners. If you have any questions, please call Brent or me. Thank you.

Operator:

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