

PHILLIPS 66 PARTNERS LP
Form 10-Q
July 27, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the quarterly period ended June 30, 2018
or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the transition period from to
Commission file number: 001-36011

Phillips 66 Partners LP
(Exact name of registrant as specified in its charter)

Delaware 38-3899432
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

2331 CityWest Blvd., Houston, Texas 77042
(Address of principal executive offices) (Zip Code)

(855) 283-9237
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Smaller reporting company ☐

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

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Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

The registrant had 122,912,893 common units outstanding as of June 30, 2018.

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

Consolidated Statement of Income Phillips 66 Partners LP

	Millions of Dollars			
	Three Months		Six Months	
	Ended		Ended	
	June 30		June 30	
	2018	2017*	2018	2017*
Revenues and Other Income				
Operating revenues—related parties	\$244	216	493	426
Operating revenues—third parties	10	11	17	21
Equity in earnings of affiliates	100	48	198	81
Other income	—	2	1	11
Total revenues and other income	354	277	709	539
Costs and Expenses				
Operating and maintenance expenses	85	79	182	153
Depreciation	29	28	57	56
General and administrative expenses	16	18	32	35
Taxes other than income taxes	9	8	19	17
Interest and debt expense	29	24	59	48
Total costs and expenses	168	157	349	309
Income before income taxes	186	120	360	230
Income tax expense	—	1	2	1
Net income	186	119	358	229
Less: Net income attributable to Predecessors	—	16	—	29
Net income attributable to the Partnership	186	103	358	200
Less: Preferred unitholders' interest in net income attributable to the Partnership	10	—	19	—
Less: General partner's interest in net income attributable to the Partnership	55	37	108	69
Limited partners' interest in net income attributable to the Partnership	\$121	66	231	131
Net Income Attributable to the Partnership Per Limited Partner Unit (dollars)				
Common units—basic	\$0.99	0.61	1.89	1.21
Common units—diluted	0.94	0.61	1.80	1.21
Cash Distributions Paid Per Common Unit (dollars)	\$0.714	0.586	1.392	1.144
Weighted-Average Limited Partner Units Outstanding (thousands)				
Common units—basic	122,189	109,189	121,901	108,300
Common units—diluted	136,008	109,189	135,720	108,300

*Prior-period financial information has been retrospectively adjusted for acquisitions of businesses under common control.

See Notes to Consolidated Financial Statements.

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Consolidated Statement of Comprehensive Income Phillips 66 Partners LP

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017*	2018	2017*
Net Income	\$186	119	358	229
Defined benefit plans				
Plan sponsored by equity affiliate, net of tax	—	—	—	—
Other comprehensive income	—	—	—	—
Comprehensive Income	\$186	119	358	229
*Prior-period financial information has been retrospectively adjusted for acquisitions of businesses under common control.				
See Notes to Consolidated Financial Statements.				

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Consolidated Balance Sheet Phillips 66 Partners LP

	Millions of Dollars	
	June 30 2018	December 31 2017
Assets		
Cash and cash equivalents	\$151	185
Accounts receivable—related parties	83	83
Accounts receivable—third parties	6	3
Materials and supplies	13	12
Prepaid expenses and other current assets	10	9
Total current assets	263	292
Equity investments	2,104	1,932
Net properties, plants and equipment	2,948	2,918
Goodwill	185	185
Deferred rentals and other assets	6	7
Total Assets	\$5,506	5,334
Liabilities		
Accounts payable—related parties	\$21	21
Accounts payable—third parties	49	39
Accrued property and other taxes	16	15
Accrued interest	36	34
Short-term debt	25	25
Deferred revenues	61	35
Other current liabilities	2	2
Total current liabilities	210	171
Long-term debt	2,921	2,920
Asset retirement obligations and accrued environmental costs	12	11
Deferred income taxes	7	5
Deferred revenues and other liabilities	23	66
Total Liabilities	3,173	3,173
Equity		
Preferred unitholders (2018 and 2017—13,819,791 units issued and outstanding)	747	746
Common unitholders—public (2018—54,152,756 units issued and outstanding; 2017—52,811,822 units issued and outstanding)	2,381	2,274
Common unitholder—Phillips 66 (2018 and 2017—68,760,137 units issued and outstanding)	538	487
General partner—Phillips 66 (2018 and 2017—2,480,051 units issued and outstanding)	(1,332)	(1,345)
Accumulated other comprehensive loss	(1)	(1)
Total Equity	2,333	2,161
Total Liabilities and Equity	\$5,506	5,334
See Notes to Consolidated Financial Statements.		

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Consolidated Statement of Cash Flows Phillips 66 Partners LP

	Millions of Dollars Six Months Ended June 30 2018 2017*	
Cash Flows From Operating Activities		
Net income	\$358	229
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	57	56
Undistributed equity earnings	(7)	(9)
Deferred revenues and other liabilities	(43)	—
Other	5	4
Working capital adjustments		
Decrease (increase) in accounts receivable	(3)	6
Decrease (increase) in materials and supplies	—	(1)
Increase (decrease) in accounts payable	(3)	(2)
Increase (decrease) in accrued interest	2	—
Increase (decrease) in deferred revenues	30	10
Increase (decrease) in other accruals	1	(2)
Net Cash Provided by Operating Activities	397	291
Cash Flows From Investing Activities		
Restricted cash received from combination of business	—	318
Collection of loan receivable	—	7
Cash capital expenditures and investments	(234)	(188)
Return of investment from equity affiliates	22	17
Net Cash Provided by (Used in) Investing Activities	(212)	154
Cash Flows From Financing Activities		
Net contributions to Phillips 66 from Predecessors	—	(151)
Issuance of debt	—	1,103
Repayment of debt	—	(1,398)
Issuance of common units	67	171
Quarterly distributions to preferred unitholders	(18)	—
Quarterly distributions to common unitholders—public	(74)	(50)
Quarterly distributions to common unitholder—Phillips 66	(96)	(73)
Quarterly distributions to General Partner—Phillips 66	(98)	(60)
Other cash contributions from Phillips 66	—	12
Net Cash Used in Financing Activities	(219)	(446)
Net Change in Cash, Cash Equivalents and Restricted Cash	(34)	(1)
Cash, cash equivalents and restricted cash at beginning of period	185	2
Cash, Cash Equivalents and Restricted Cash at End of Period	\$151	1

*Prior-period financial information has been retrospectively adjusted for acquisitions of businesses under common control.

See Notes to Consolidated Financial Statements.

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Consolidated Statement of Changes in Equity Phillips 66 Partners LP
 Millions of Dollars
 Partnership

	Preferred Unitholders Public	Common Unitholders Public	Common Unitholder Phillips 66	General Partner Phillips 66	Accum. Other Comprehensive Loss	Net Investment— Predecessors*	Total
December 31, 2016	\$—	1,795	476	(704	)(1	)—	1,566
Net income attributable to Predecessors	—	—	—	—	—	29	29
Net contributions from Phillips 66—Predecessors	—	—	—	—	—	751	751
Issuance of common units	—	171	—	—	—	—	171
Net income attributable to the Partnership	—	54	77	69	—	—	200
Quarterly cash distributions to unitholders and General Partner	—	(50	)(73	)(60	)(—	—	(183)
Other contributions from Phillips 66	—	—	—	17	—	—	17
June 30, 2017*	\$—	1,970	480	(678	)(1	)780	2,551
December 31, 2017	\$746	2,274	487	(1,345	)(1	)—	2,161
Cumulative effect of accounting change	—	13	17	1	—	—	31
Issuance of common units	—	67	—	—	—	—	67
Net income attributable to the Partnership	19	101	130	108	—	—	358
Quarterly cash distributions to unitholders and General Partner	(18)	(74	)(96	)(98	)(—	—	(286)
Other contributions from Phillips 66	—	—	—	2	—	—	2
June 30, 2018	\$747	2,381	538	(1,332	)(1	)—	2,333

*Prior-period financial information has been retrospectively adjusted for acquisitions of businesses under common control.

	Preferred Units Public	Common Units Public	Common Units Phillips 66	General Partner Units Phillips 66	Total Units
December 31, 2016	—	43,134,902	64,047,024	2,187,386	109,369,312

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Units issued in public equity offerings	—	3,323,576	—	—	3,323,576
June 30, 2017	—	46,458,478	64,047,024	2,187,386	112,692,888
December 31, 2017	13,819,791	52,811,822	68,760,137	2,480,051	137,871,801
Units issued in public equity offerings	—	1,340,934	—	—	1,340,934
June 30, 2018	13,819,791	54,152,756	68,760,137	2,480,051	139,212,735
See Notes to Consolidated Financial Statements.					

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Notes to Consolidated Financial Statements Phillips 66 Partners LP

Note 1—Business and Basis of Presentation

Unless otherwise stated or the context otherwise indicates, all references to “Phillips 66 Partners,” “the Partnership,” “us,” “our,” “we,” or similar expressions refer to Phillips 66 Partners LP, including its consolidated subsidiaries. References to Phillips 66 may refer to Phillips 66 and/or its subsidiaries, depending on the context. References to our “General Partner” refer to Phillips 66 Partners GP LLC, and references to Phillips 66 PDI refer to Phillips 66 Project Development Inc., the Phillips 66 subsidiary that holds a limited partner interest in us and wholly owns our General Partner.

Description of the Business

We are a growth-oriented master limited partnership formed to own, operate, develop and acquire primarily fee-based crude oil, refined petroleum products and natural gas liquids (NGL) pipelines, terminals and other midstream assets. Our common units trade on the New York Stock Exchange under the symbol PSXP.

Our operations consist of crude oil, refined petroleum products and NGL transportation, processing, terminaling and storage assets. We conduct our operations through both wholly owned and joint venture operations. The majority of our wholly owned assets are associated with, and are integral to the operation of, nine of Phillips 66’s owned or joint venture refineries.

We primarily generate revenue by providing fee-based transportation, terminaling, processing, storage and NGL fractionation services to Phillips 66 and other customers. Our equity affiliates primarily generate revenue from transporting and terminaling NGL, refined petroleum products and crude oil. Since we do not own any of the NGL, crude oil and refined petroleum products we handle and do not engage in the trading of NGL, crude oil and refined petroleum products, we have limited direct exposure to risks associated with fluctuating commodity prices, although these risks indirectly influence our activities and results of operations over the long term.

Basis of Presentation

We have acquired assets from Phillips 66 that were considered transfers of businesses between entities under common control. This required the transactions to be accounted for as if the transfers had occurred at the beginning of the transfer period, with prior periods retrospectively adjusted to furnish comparative information. Accordingly, the accompanying financial statements and related notes have been retrospectively adjusted to include the historical results and financial position of the acquired businesses prior to the effective date of each acquisition. We refer to these pre-acquisition operations as those of our “Predecessors.”

The combined financial statements of our Predecessors were derived from the accounting records of Phillips 66 and reflect the combined historical results of operations, financial position and cash flows of our Predecessors as if such businesses had been combined for all periods presented.

All intercompany transactions and accounts within our Predecessors have been eliminated. The assets and liabilities of our Predecessors in these financial statements have been reflected on a historical cost basis because the transfer of the Predecessors to us occurred within the Phillips 66 consolidated group. The consolidated statement of income also includes expense allocations for certain functions performed by Phillips 66, including operational support services such as engineering and logistics and allocations of general corporate expenses related to executive oversight, accounting, treasury, tax, legal, information technology and procurement. These allocations were based primarily on the relative carrying values of properties, plants and equipment and equity-method investments, or number of terminals and pipeline miles, and secondarily on activity-based cost allocations. Our management believes the assumptions underlying the allocation of expenses from Phillips 66 are reasonable. Nevertheless, the financial results of our Predecessors may not include all of the actual expenses that would have been incurred had our Predecessors

been a stand-alone publicly traded partnership during the periods presented.

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Note 2—Interim Financial Information

The interim financial information presented in the financial statements included in this report is unaudited and includes all known accruals and adjustments necessary, in the opinion of management, for a fair presentation of our financial position, results of operations and cash flows for the periods presented. Unless otherwise specified, all such adjustments are of a normal and recurring nature. Certain notes and other information have been condensed or omitted from the interim financial statements included in this report. Therefore, these interim financial statements should be read in conjunction with the audited consolidated financial statements and notes included in our 2017 Annual Report on Form 10-K. The results of operations for the three and six months ended June 30, 2018, are not necessarily indicative of the results to be expected for the full year.

Note 3—Changes in Accounting Principles

Effective January 1, 2018, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business,” which clarifies the definition of a business with the objective of adding guidance to assist in evaluating whether transactions should be accounted for as acquisitions of assets or businesses. The amendment provides a screen for determining when a transaction involves an acquisition of a business. If substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset, or a group of similar identifiable assets, then the screen is met and the transaction is not considered an acquisition of a business. If the screen is not met, the amendment requires that to be considered a business, the operation must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create an output. The guidance may reduce the number of future transactions accounted for as business acquisitions. At the time of adoption, this ASU had no impact on our consolidated financial statements.

Effective January 1, 2018, we adopted ASU No. 2016-01, “Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” The majority of this ASU’s provisions amend only the presentation or disclosures of financial instruments; however, one provision can affect net income. Equity investments reported under the cost method or the lower of cost or fair value method of accounting, in accordance with previous U.S. generally accepted accounting principles (GAAP), are now reported at fair value with changes in fair value recognized in net income. For equity investments that do not have readily determinable fair values, we elected to carry such investments at cost less impairments, if any, adjusted up or down for price changes in similar financial instruments issued by the investee, when and if observed. At the time of adoption, this ASU had no material impact on our consolidated financial statements.

Effective January 1, 2018, we adopted ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606),” using the modified retrospective transition method applied to all contracts. Under the new revenue recognition guidance, recognition of revenue involves a multiple step approach including: (i) identifying the contract with the customer, (ii) identifying the separate performance obligations, (iii) determining the transaction price, (iv) allocating the transaction price to the performance obligations and (v) recognizing the revenue as the performance obligations are satisfied. Additional disclosures are required to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. In addition, all but one of our equity-method investees adopted ASU No. 2014-09 as of January 1, 2018. The remaining equity method investee will adopt this ASU in 2019.

We recorded a noncash cumulative effect adjustment of \$31 million to increase the opening balance of our equity as of January 1, 2018. This adjustment reflected amounts recorded by us and our equity-method investees related to the acceleration of revenue recognition on certain minimum volume commitment contracts with recovery provisions.

Certain agreements for transportation, terminaling and fractionation services with Phillips 66 are considered operating leases under FASB Accounting Standards Codification (ASC) 840, "Leases." We identified the separate lease and service elements of our revenue under these operating leases and applied ASU No. 2014-09 only to the service element, while the lease element continued to be accounted for under ASC 840. See Note 9—Operating Revenues, for additional information.

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Note 4—Acquisitions

Gray Oak Pipeline Project Acquisition

On April 20, 2018, we entered into a Purchase and Sale Agreement with Phillips 66 PDI to acquire its 100 percent interest in Gray Oak Holdings LLC, a limited liability company that, at that time, owned a 100 percent interest in Gray Oak Pipeline, LLC (Gray Oak LLC), an entity formed to develop and construct the Gray Oak Pipeline system. Under common control accounting, we considered the cash consideration paid of approximately \$3 million to be a reimbursement of Phillips 66 PDI's previously incurred costs, and expensed this amount to "General and administrative expenses" in the second quarter of 2018. Another party has the right, but not the obligation, to acquire up to a 35 percent interest in Gray Oak Holdings LLC. Subject to certain conditions, the option expires on November 30, 2018. At June 30, 2018, the option had not been exercised. See Note 5—Equity Investments, for additional information on Gray Oak LLC, including our variable interest entity assessment.

Bakken Pipeline/MSLP Acquisition

In September 2017, we entered into a Contribution, Conveyance and Assumption Agreement with subsidiaries of Phillips 66 to acquire a 25 percent interest in each of Dakota Access, LLC (Dakota Access) and Energy Transfer Crude Oil Company, LLC (ETCO), together referred to as the Bakken Pipeline, and a 100 percent interest in Merey Sweeny, L.P. (MSLP). Collectively, the assets acquired in the acquisition are referred to as the Bakken Pipeline/MSLP Acquisition. We paid Phillips 66 total consideration of \$1.65 billion, consisting of \$372 million in cash, the assumption of \$588 million of promissory notes payable to Phillips 66 and a \$450 million term loan under which Phillips 66 was the obligor, and the issuance of 4,713,113 common units to Phillips 66 PDI and 292,665 general partner units to our General Partner to maintain its 2 percent general partner interest. The Bakken Pipeline/MSLP Acquisition closed in October 2017.

In connection with the Bakken Pipeline/MSLP Acquisition, we entered into commercial agreements with Phillips 66 and amended the omnibus and operational services agreements with Phillips 66. See Note 13—Related Party Transactions for additional information on our commercial and other agreements with Phillips 66. Pursuant to the tolling services agreement entered into with Phillips 66 and related to MSLP operations, we received \$53 million from Phillips 66 for the prepayment of services related to MSLP's next scheduled maintenance turnaround, which was recorded as deferred revenue in our consolidated balance sheet as of the acquisition date.

Common Control Transactions

The Bakken Pipeline/MSLP Acquisition was considered a transfer of businesses between entities under common control, and therefore the related acquired assets were transferred at historical carrying value. The aggregate net book value of the underlying acquired assets in the Bakken Pipeline/MSLP Acquisition, at the time of acquisition, was \$729 million. Because the Bakken Pipeline/MSLP Acquisition was a common control transaction in which we acquired a business, our historical financial statements were retrospectively adjusted to reflect the results of operations, financial position, and cash flows of the acquired assets as if we owned the acquired assets for the period from February 1, 2017, through October 5, 2017. For periods prior to February 1, 2017, both the Bakken Pipeline and MSLP investments were accounted for under the equity method of accounting by Phillips 66 and, thus, were not subject to retrospective adjustments.

The following tables present our results of operations and cash flows giving effect to the Bakken Pipeline/MSLP Acquisition. The second column in both tables presents the retrospective adjustments made to our historical financial information for the acquired assets prior to the effective date of the acquisition. The third column in both tables presents our consolidated financial information as retrospectively adjusted.

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	Millions of Dollars		
	Three Months Ended June 30, 2017		
	Phillips		
	66		
	Partners		
Consolidated Statement of Income	LP	Acquired Bakken Pipeline/MSLP Predecessor	Consolidated Results
	(As		
	previously		
	reported)		
Revenues and Other Income			
Operating revenues—related parties	\$186	30	216
Operating revenues—third parties	11	—	11
Equity in earnings of affiliates	37	11	48
Other income	—	2	2
Total revenues and other income	234	43	277
Costs and Expenses			
Operating and maintenance expenses	57	22	79
Depreciation	26	2	28
General and administrative expenses	16	2	18
Taxes other than income taxes	7	1	8
Interest and debt expense	24	—	24
Total costs and expenses	130	27	157
Income before income taxes	104	16	120
Income tax expense	1	—	1
Net income	103	16	119
Less: Net income attributable to Predecessors	—	16	16
Net income attributable to the Partnership	103	—	103
Less: General partner's interest in net income attributable to the Partnership	37	—	37
Limited partners' interest in net income attributable to the Partnership	\$66	—	66

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	Millions of Dollars		
	Six Months Ended June 30, 2017		
	Phillips		
	66		
	Partners		
Consolidated Statement of Income	LP	Acquired Bakken Pipeline/MSLP Predecessor	Consolidated Results
	(As		
	previously		
	reported)		
Revenues and Other Income			
Operating revenues—related parties	\$370	56	426
Operating revenues—third parties	21	—	21
Equity in earnings of affiliates	70	11	81
Other income	7	4	11
Total revenues and other income	468	71	539
Costs and Expenses			
Operating and maintenance expenses	119	34	153
Depreciation	52	4	56
General and administrative expenses	32	3	35
Taxes other than income taxes	16	1	17
Interest and debt expense	48	—	48
Total costs and expenses	267	42	309
Income before income taxes	201	29	230
Income tax expense	1	—	1
Net income	200	29	229
Less: Net income attributable to Predecessors	—	29	29
Net income attributable to the Partnership	200	—	200
Less: General partner's interest in net income attributable to the Partnership	69	—	69
Limited partners' interest in net income attributable to the Partnership	\$131	—	131

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	Millions of Dollars			
	Six Months Ended June 30, 2017			
	Phillips			
	66			
	Partners			
	LP		Acquired Bakken Pipeline/MSLP	Consolidated
	(As		Predecessor	Results
	previously			
	reported)			
Cash Flows From Operating Activities				
Net income	\$200	29		229
Adjustments to reconcile net income to net cash provided by operating activities				
Depreciation	52	4		56
Undistributed equity earnings	2	(11)	) (9	)
Other	5	(1	) 4	
Working capital adjustments				
Decrease (increase) in other current assets				
Decrease (increase) in accounts receivable	6	—		6
Decrease (increase) in materials and supplies	(1	) —		(1
Decrease (increase) in prepaid expenses and other current assets	(1	) 1		—
Increase (decrease) in accounts payable	(2	) —		(2
Increase (decrease) in accrued interest	1	(1	) —	
Increase (decrease) in deferred revenues	10	—		10
Increase (decrease) in other accruals	(2	) —		(2
Net Cash Provided by Operating Activities	270	21		291
Cash Flows From Investing Activities				
Restricted cash received from combination of business	—	318		318
Collection of loan receivable	—	7		7
Cash capital expenditures and investments	(128	) (60	) (188	)
Return of investment from equity affiliates	17	—		17
Net Cash Provided by (Used in) Investing Activities	(111	) 265		154
Cash Flows From Financing Activities				
Net contributions to Phillips 66 from Predecessors	—	(151	) (151	)
Issuance of debt	1,103	—		1,103
Repayment of debt	(1,263	(135	) (1,398	)
Issuance of common units	171	—		171
Quarterly distributions to common unitholders—public	(50	) —		(50
Quarterly distributions to common unitholder—Phillips 66	(73	) —		(73
Quarterly distributions to General Partner—Phillips 66	(60	) —		(60
Other cash contributions from Phillips 66	12	—		12
Net Cash Used in Financing Activities	(160	) (286	) (446	)
Net Change in Cash, Cash Equivalents and Restricted Cash	(1	) —		(1
Cash, cash equivalents and restricted cash at beginning of period	2	—		2

Cash, Cash Equivalents and Restricted Cash at End of Period	\$1	—	1
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Note 5—Equity Investments

Gray Oak Pipeline

As discussed in Note 4—Acquisitions, on April 20, 2018, we acquired Phillips 66 PDI's then 100 percent interest in Gray Oak LLC. Gray Oak LLC is developing and constructing the Gray Oak Pipeline system which, upon completion, will provide crude oil transportation from the Permian Basin and Eagle Ford to destinations in the Corpus Christi and Sweeny/Freepport markets on the Texas Gulf Coast. The pipeline is expected to be placed in service by the end of 2019.

On April 23, 2018, a co-venturer acquired a 25 percent interest in Gray Oak LLC, along with sufficient voting rights over key governance provisions such that we no longer could assert control over Gray Oak LLC. At that time, we began using the equity method of accounting for our investment in Gray Oak LLC. Gray Oak LLC is considered a variable interest entity because it does not have sufficient equity at risk to fully fund the construction of all assets required for principal operations. We have determined we are not the primary beneficiary because we and our co-venturer jointly direct the activities of the Gray Oak Pipeline that most significantly impact economic performance. At June 30, 2018, our maximum exposure to loss was \$28 million, which represented the aggregate book value of our equity investment in Gray Oak LLC. Another party has the option to acquire a 10 percent interest in Gray Oak LLC. Subject to certain conditions, the option expires on July 29, 2018. At June 30, 2018, the option had not been exercised.

South Texas Gateway Terminal

On April 23, 2018, we acquired a 25 percent interest in the South Texas Gateway Terminal under development by Buckeye Partners, L.P. This marine terminal will connect to the Gray Oak Pipeline in Corpus Christi, Texas, and will have an initial storage capacity of 3.4 million barrels. The terminal is expected to begin operations by the end of 2019.

South Texas Gateway Terminal LLC is considered a variable interest entity because it does not have sufficient equity at risk to fully fund the construction of all assets required for principal operations. We have determined we are not the primary beneficiary because we and our co-venturers jointly direct the activities of the terminal that most significantly impact economic performance. At June 30, 2018, our maximum exposure to loss was \$14 million, which represented the aggregate book value of our equity investment in South Texas Gateway Terminal LLC.

The following table summarizes the carrying value of our equity investments.

	Percentage Ownership	Millions of Dollars	
		June 30, 2018	December 31, 2017
Bakken Pipeline	25.00	% \$609	621
Bayou Bridge Pipeline, LLC (Bayou Bridge)	40.00	231	173
DCP Sand Hills Pipeline, LLC (Sand Hills)	33.34	567	515
DCP Southern Hills Pipeline, LLC (Southern Hills)	33.34	208	209
Explorer Pipeline Company (Explorer)	21.94	121	118
Gray Oak Pipeline, LLC (Gray Oak)	75.00	28	—
Paradigm Pipeline LLC (Paradigm)	50.00	142	131
Phillips 66 Partners Terminal LLC (Phillips 66 Partners Terminal)	70.00	72	53
South Texas Gateway Terminal LLC (South Texas Gateway Terminal)	25.00	14	—
STACK Pipeline LLC (STACK)	50.00	112	112
Total equity investments		\$2,104	1,932

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Earnings (losses) from our equity investments were as follows:

	Millions of Dollars			
	Three Months Ended June 30 2018		Six Months Ended June 30 2017	
	2018	2017	2018	2017
Bakken Pipeline	\$39	11	71	11
Bayou Bridge	3	2	8	4
Explorer	8	6	24	11
Gray Oak	—	—	—	—
Paradigm	2	—	4	(1)
Phillips 66 Partners Terminal	6	1	15	3
Sand Hills	31	20	56	37
South Texas Gateway Terminal	—	—	—	—
Southern Hills	9	7	16	14
STACK	2	1	4	2
Total equity in earnings of affiliates	\$100	48	198	81

Note 6—Properties, Plants and Equipment

Our investment in properties, plants and equipment (PP&E), with the associated accumulated depreciation, was:

	Millions of Dollars	
	June 30 2018	December 31 2017
Land	\$19	19
Buildings and improvements	88	88
Pipelines and related assets*	1,382	1,372
Terminals and related assets*	691	671
Rail racks and related assets*	137	137
Processing and related assets*	842	837
Caverns and related assets*	584	583
Construction-in-progress	97	47
Gross PP&E	3,840	3,754
Less: Accumulated depreciation	892	836
Net PP&E	\$2,948	2,918

*Assets for which we are the lessor.

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Note 7—Debt

	Millions of Dollars	
	June 30 2018	December 31 2017
2.646% Senior Notes due 2020	\$ 300	300
3.605% Senior Notes due 2025	500	500
3.550% Senior Notes due 2026	500	500
3.750% Senior Notes due 2028	500	500
4.680% Senior Notes due 2045	450	450
4.900% Senior Notes due 2046	625	625
Tax-exempt bonds at 1.75% and 1.94% at June 30, 2018, and December 31, 2017, respectively	100	100
Total	2,975	2,975
Net unamortized discounts and debt issuance costs	(29)	(30)
Total debt	2,946	2,945
Less: Short-term debt	25	25
Long-term debt	\$ 2,921	2,920

The fair value of our fixed-rate and floating-rate debt is estimated based on observable market prices and is classified in level 2 of the fair value hierarchy. The fair value of our fixed-rate debt amounted to \$2,723 million and \$2,918 million at June 30, 2018, and December 31, 2017, respectively. The fair value of our floating-rate debt approximated carrying value of \$100 million at both June 30, 2018, and December 31, 2017.

Note 8—Equity

Our initial \$250 million continuous offering of common units, or at-the-market (ATM) program, was completed during the three months ended June 30, 2018. At that time, we commenced issuing common units under our second \$250 million ATM program. For the three and six months ended June 30, 2018, on a settlement date basis, we had issued an aggregate of 1,152,119 and 1,340,934 common units under our ATM programs, generating net proceeds of \$58 million and \$67 million, respectively. For the three and six months ended June 30, 2017, on a settlement date basis, we had issued an aggregate of 2,578,608 and 3,323,576 common units under our ATM programs, generating net proceeds of \$131 million and \$171 million, respectively. Since inception through June 30, 2018, we had issued an aggregate of 5,059,802 common units under our ATM programs, generating net proceeds of \$259 million. The net proceeds from sales under the ATM programs are used for general partnership purposes, which may include debt repayment, acquisitions, capital expenditures and additions to working capital.

Note 9—Operating Revenues

Revenues are primarily recognized for pipeline transportation, terminaling, storage, processing and fractionation services generated under long-term agreements. A significant portion of our revenues are derived from Phillips 66. The majority of our agreements for transportation, terminaling, storage, processing and fractionation services with Phillips 66 are considered operating leases under GAAP. As part of our adoption of ASU No. 2014-09, we applied the new revenue recognition standard only to the service element of these operating leases. The separation of the lease and service elements was based on an analysis of service-related and lease-related costs for each contract, adjusted for representative profit margins. The lease element continues to be accounted for under lease accounting standards.

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Revenues from fixed minimum volume commitments are recognized over the performance obligation period for stand-ready service contracts. Revenues from the variable element of these stand-ready contracts and other contracts without fixed elements are recognized based on the actual volumes transported, stored, processed and fractionated at contractual rates because the actual volumes specifically relate to our efforts to transfer the distinct services. Generally, our services are billed and payments are received on a monthly basis.

Disaggregated Revenues

Total operating revenues disaggregated by type of service were as follows:

	Millions of Dollars
Three Months Ended June 30, 2018	Six Months Ended June 30, 2018
Pipelines	\$ 111 213
Terminals	38 77
Storage, processing and other revenues	105 220
Total operating revenues	\$ 254 510

During the three and six months ended June 30, 2018, lease revenues were \$143 million and \$287 million, respectively, and service revenues were \$111 million and \$223 million, respectively. Lease and service revenues were recorded in the “Operating revenues—related parties” and “Operating revenues—third parties” lines on our consolidated statement of income.

Contract-Related Assets and Liabilities

At June 30, 2018 and January 1, 2018, lease receivables were \$49 million for both periods, and service receivables were \$40 million and \$37 million, respectively.

Our contract liabilities primarily represent payments from our customers, mainly Phillips 66, for volume throughput less than the contractually required minimum throughput volumes. These deficiency payments are deferred and recognized at the earlier of the period in which our customers make up the shortfall volumes or when it is probable our customers will not make up the shortfall volumes prior to the expiration of the contractual make-up period. Our contract liabilities are included in the “Deferred revenues” and “Deferred revenues and other liabilities” lines on our consolidated balance sheet. At June 30, 2018, and January 1, 2018, total deferred revenues were \$80 million and \$93 million, respectively, of which \$9 million and \$13 million, respectively, are contract liabilities related to the service element. Service-related revenues recognized during the three and six months ended June 30, 2018, that were included in the contract liability balance at January 1, 2018, were \$5 million and \$9 million, respectively. For the three and six months ended June 30, 2018, there were no material differences between the amount that we recognized as revenues relating to minimum throughput deficiency payments compared to the amount that would have been recognized prior to the adoption of the new revenue recognition standard.

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Remaining Performance Obligations

We typically have long-term contracts with our customers, most of which have original durations of up to 15 years. The average remaining duration of these contracts is eight years. As of June 30, 2018, future revenues expected to be recognized for the fixed component of the transaction price of our remaining performance obligations from contracts with our customers with an original expected duration of greater than one year were:

	Millions of Dollars
Remainder of 2018	\$ 359
2019	699
2020	696
2021	685
2022	673
Remaining years	2,964
Total future operating revenues*	\$ 6,076

*Includes \$3.4 billion of future lease revenues from agreements with Phillips 66.

For the remaining performance obligation, we applied the exemption for variable prices allocated entirely to a wholly unsatisfied performance obligation or to a wholly unsatisfied promise to transfer distinct goods or service as part of a performance obligation.

Note 10—Net Income Per Limited Partner Unit

Net income per limited partner unit applicable to common units is computed by dividing the limited partners' interest in net income attributable to the Partnership by the weighted-average number of common units outstanding for the period. Because we have more than one class of participating securities, we use the two-class method to calculate the net income per unit applicable to the limited partners. As of June 30, 2018, the classes of participating securities included common units, general partner units and incentive distribution rights (IDRs). For the three and six months ended June 30, 2018, our preferred units are potentially dilutive securities and were dilutive to net income per limited partner unit. For the three and six months ended June 30, 2017, basic and diluted net income per limited partner unit are the same because we did not have potentially dilutive common units outstanding.

Net income earned by the Partnership is allocated between the limited partners and the General Partner (including the General Partner's IDRs) in accordance with our partnership agreement, after giving effect to priority income allocations to the holders of the preferred units. First, earnings are allocated based on actual cash distributions declared to our unitholders, including those attributable to the General Partner's IDRs. To the extent net income attributable to the Partnership exceeds or is less than cash distributions, this difference is allocated based on the unitholders' respective ownership percentages, after consideration of any priority allocations of earnings. For the diluted net income per limited partner unit calculation, the preferred units are assumed to be converted at the beginning of the period into common limited partner units on a one-for-one basis, and the distribution formula for available cash in our partnership agreement is recalculated, using the original available cash amount increased only for the preferred distributions which would not have been paid after conversion.

When our financial statements are retrospectively adjusted after a dropdown transaction, the earnings of the acquired business, prior to the closing of the transaction, are allocated entirely to our General Partner and presented as net income (loss) attributable to Predecessors. The earnings per unit of our limited partners prior to the close of the

transaction do not change as a result of a dropdown transaction. After the closing of a dropdown transaction, the earnings of the acquired business are allocated in accordance with our partnership agreement as previously described.

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	Millions of Dollars			
	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
Net income attributable to the Partnership	\$ 186	103	358	200
Less: General partner's distribution declared (including IDRs)*	57	36	108	68
Limited partners' distributions declared on preferred units*	10	—	19	—
Limited partners' distribution declared on common units*	91	68	179	131
Distributions less than (more than) net income attributable to the Partnership	\$ 28	(1)	52	1

*Distribution declared attributable to the indicated periods.

	Limited Partners' Common Units	General Partner (including IDRs)	Limited Partners' Preferred Units	Total
Three Months Ended June 30, 2018				
Net income attributable to the Partnership (millions):				
Distribution declared	\$ 91	57	10	158
Distributions less than (more than) net income attributable to the Partnership	30	(2	)—	28
Net income attributable to the Partnership (basic)	121	55	10	186
Dilutive effect of preferred units*	7			
Net income attributable to the Partnership (diluted)	\$ 128			
Weighted-average units outstanding—basic	122,188,646			
Dilutive effect of preferred units*	13,819,791			
Weighted-average units outstanding—diluted	136,008,437			
Net income attributable to the Partnership per limited partner unit—basic (dollars)	\$ 0.99			
Net income attributable to the Partnership per limited partner unit—diluted (dollars)	0.94			
Three Months Ended June 30, 2017				
Net income attributable to the Partnership (millions):				
Distribution declared	\$ 68	36	—	104
Distributions less than (more than) net income attributable to the Partnership	(2	) 1	—	(1)
Net income attributable to the Partnership	\$ 66	37	—	103
Weighted-average units outstanding—basic and diluted	109,189,217			
Net income per limited partner unit—basic and diluted (dollars)	\$ 0.61			

* The dilutive effect of preferred units assumes the reallocation of net income to the limited and general partners, including a reallocation associated with IDRs, pursuant to the available cash formula in the partnership agreement.

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	Limited Partners' Common Units	General Partner (including IDRs)	Limited Partners' Preferred Units	Total
Six Months Ended June 30, 2018				
Net income attributable to the Partnership (millions):				
Distribution declared	\$ 179	108	19	306
Distributions less than net income attributable to the Partnership	52	—	—	52
Net income attributable to the Partnership (basic)	231	108	19	358
Dilutive effect of preferred units*	14			
Net income attributable to the Partnership (diluted)	\$ 245			
Weighted-average units outstanding—basic	121,900,683			
Dilutive effect of preferred units*	13,819,791			
Weighted-average units outstanding—diluted	135,720,474			
Net income attributable to the Partnership per limited partner unit—basic (dollars)	\$ 1.89			
Net income attributable to the Partnership per limited partner unit—diluted (dollars)	1.80			
Six Months Ended June 30, 2017				
Net income attributable to the Partnership (millions):				
Distribution declared	\$ 131	68	—	199
Distributions less than net income attributable to the Partnership	—	1	—	1
Net income attributable to the Partnership	\$ 131	69	—	200
Weighted-average units outstanding—basic and diluted	108,299,570			
Net income attributable to the Partnership per limited partner unit—basic and dilutive (dollars)	\$ 1.21			

* The dilutive effect of preferred units assumes the reallocation of net income to the limited and general partners, including a reallocation associated with IDRs, pursuant to the available cash formula in the partnership agreement.

On July 18, 2018, the Board of Directors of our General Partner declared a quarterly cash distribution of \$0.752 per common unit attributable to the second quarter of 2018. This distribution is payable August 13, 2018, to unitholders of record as of July 31, 2018.

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Note 11—Contingencies

From time to time, lawsuits involving a variety of claims that arise in the ordinary course of business are filed against us. We also may be required to remove or mitigate the effects on the environment of the placement, storage, disposal or release of certain chemical, mineral and petroleum substances at various sites. We regularly assess the need for accounting recognition or disclosure of these contingencies. In the case of all known contingencies (other than those related to income taxes), we accrue a liability when the loss is probable and the amount is reasonably estimable. If a range of amounts can be reasonably estimated and no amount within the range is a better estimate than any other amount, then the minimum of the range is accrued. We do not reduce these liabilities for potential insurance or third-party recoveries. If applicable, we accrue receivables for probable insurance or other third-party recoveries. In the case of income-tax-related contingencies, we use a cumulative probability-weighted loss accrual in cases where sustaining a tax position is less than certain.

Based on currently available information, we believe it is remote that future costs related to known contingent liability exposures will exceed current accruals by an amount that would have a material adverse impact on our consolidated financial statements. As we learn new facts concerning contingencies, we reassess our position both with respect to accrued liabilities and other potential exposures. Estimates particularly sensitive to future changes include any contingent liabilities recorded for environmental remediation, tax and legal matters. Estimated future environmental remediation costs are subject to change due to such factors as the uncertain magnitude of cleanup costs, the unknown time and extent of such remedial actions that may be required, and the determination of our liability in proportion to that of other potentially responsible parties. Estimated future costs related to tax and legal matters are subject to change as events evolve and as additional information becomes available during the administrative and litigation processes.

Environmental

We are subject to federal, state and local environmental laws and regulations. We record accruals for contingent environmental liabilities based on management's best estimates, using all information that is available at the time. We measure estimates and base liabilities on currently available facts, existing technology, and presently enacted laws and regulations, taking into account stakeholder and business considerations. When measuring environmental liabilities, we also consider our prior experience in remediation of contaminated sites, other companies' cleanup experience, and data released by the U.S. Environmental Protection Agency or other organizations. We consider unasserted claims in our determination of environmental liabilities, and we accrue them in the period they are both probable and reasonably estimable.

In the future, we may be involved in additional environmental assessments, cleanups and proceedings.

Legal Proceedings

Under our amended omnibus agreement, Phillips 66 provides certain services for our benefit, including legal support services, and we pay an operational and administrative support fee for these services. Phillips 66's legal organization applies its knowledge, experience and professional judgment to the specific characteristics of our cases, employing a litigation management process to manage and monitor the legal proceedings against us. The process facilitates the early evaluation and quantification of potential exposures in individual cases and enables tracking of those cases that have been scheduled for trial and/or mediation. Based on professional judgment and experience in using these litigation management tools and available information about current developments in all our cases, Phillips 66's legal organization regularly assesses the adequacy of current accruals and determines if adjustment of existing accruals, or establishment of new accruals, is required. As of June 30, 2018, and December 31, 2017, we did not have any material accrued contingent liabilities associated with litigation matters.

Indemnification and Excluded Liabilities

Under our amended omnibus agreement and pursuant to the terms of various agreements under which we acquired assets from Phillips 66, Phillips 66 will indemnify us, or assume responsibility, for certain environmental liabilities, tax liabilities, litigation and any other liabilities attributable to the ownership or operation of the assets contributed to us and that arose prior to the effective date of each acquisition. These indemnifications and exclusions from liability have, in some cases, time limits, dollar limits and deductibles. When Phillips 66 performs under any of these indemnifications or exclusions from liability, we recognize noncash expenses and associated noncash capital contributions from our General Partner, as these are considered liabilities paid for by a principal unitholder.

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Note 12—Cash Flow Information

Capital Expenditures and Investments

Our capital expenditures and investments consisted of:

Millions of
Dollars
Six Months
Ended
June 30
2018 2017*

Cash capital expenditures and investments \$234 188

Change in capital expenditure accruals 14 —

Total capital expenditures and investments \$248 188

*Prior-period financial information has been retrospectively adjusted for acquisitions of businesses under common control.

Millions
of Dollars
Six
Months
Ended
June 30
2018 2017

Capital expenditures and investments attributable to the Partnership \$248 128

Capital expenditures and investments attributable to Predecessors* — 60

Total capital expenditures and investments* \$248 188

*Prior-period financial information has been retrospectively adjusted for acquisitions of businesses under common control.

Restricted Cash

At June 30, 2018, and December 31, 2017, the Partnership did not have any restricted cash. The restrictions on the cash received in February 2017, as a result of the retrospective adjustment for the Bakken Pipeline/MSLP Acquisition, were fully removed in the second quarter of 2017 when MSLP's outstanding debt that contained lender restrictions on the use of cash was paid in full.

Note 13—Related Party Transactions

Commercial Agreements

We have entered into multiple commercial agreements with Phillips 66, including transportation services agreements, terminal services agreements, storage services agreements, stevedoring services agreements, a fractionation service agreement, tolling services agreements, and rail terminal services agreements. Under these long-term, fee-based agreements, we provide transportation, terminaling, storage, stevedoring, fractionation, processing, and rail terminal services to Phillips 66, and Phillips 66 commits to provide us with minimum volume commitments of crude oil, NGL, feedstock, and refined petroleum products or minimum monthly service fees. Under our transportation, processing,

and terminaling services agreements, if Phillips 66 fails to transport, throughput or store its minimum throughput volume, then Phillips 66 will pay us a deficiency payment based on the calculation described in the agreement.

Amended and Restated Operational Services Agreement

Under our amended and restated operational services agreement, we reimburse Phillips 66 for providing certain operational services to us in support of our pipelines, terminaling, processing, and storage facilities. These services include routine and emergency maintenance and repair services, routine operational activities, routine administrative services, construction and related services and such other services as we and Phillips 66 may mutually agree upon from time to time.

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Amended Omnibus Agreement

The amended omnibus agreement addresses our payment of an operating and administrative support fee and our obligation to reimburse Phillips 66 for all other direct or allocated costs and expenses incurred by Phillips 66 in providing general and administrative services. Additionally, the omnibus agreement addresses Phillips 66's indemnification to us and our indemnification to Phillips 66 for certain environmental and other liabilities. Further, it addresses the granting of a license from Phillips 66 to us with respect to the use of certain Phillips 66 trademarks.

Tax Sharing Agreement

Under our tax sharing agreement, we reimburse Phillips 66 for our share of state and local income and other taxes incurred by Phillips 66 due to our results of operations being included in a combined or consolidated tax return filed by Phillips 66. Any reimbursement is limited to the tax that we (and our subsidiaries) would have paid had we not been included in a combined group with Phillips 66. Phillips 66 may use its tax attributes to cause its combined or consolidated group to owe no tax; however, we would nevertheless reimburse Phillips 66 for the tax we would have owed, even though Phillips 66 had no cash expense for that period.

Related Party Transactions

Significant related party transactions included in our total costs and expenses were:

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017*	2018	2017*
Operating and maintenance expenses	\$5050		115	90
General and administrative expenses	15	17	30	33
Total	\$6567		145	123

*Prior-period financial information has been retrospectively adjusted for acquisitions of businesses under common control.

We pay Phillips 66 a monthly operational and administrative support fee under the terms of our amended omnibus agreement in the amount of \$8 million. The operational and administrative support fee is for the provision of certain services, including: logistical services; asset oversight, such as operational management and supervision; corporate engineering services, including asset integrity and regulatory services; business development services; executive services; financial and administrative services (including treasury and accounting); information technology; legal services; corporate health, safety and environmental services; facility services; human resources services; procurement services; investor relations; tax matters; and public company reporting services. We also reimburse Phillips 66 for all other direct or allocated costs incurred on behalf of us, pursuant to the terms of our amended omnibus agreement. The classification of these charges between operating and maintenance expenses and general and administrative expenses is based on the functional nature of the services performed for our operations. Under our amended and restated operational services agreement, we reimburse Phillips 66 for the provision of certain operational services to us in support of our pipeline, rail rack, processing, terminaling, and storage facilities. Additionally, we pay Phillips 66 for insurance services provided to us. Operating and maintenance expenses also include volumetric gains and losses associated with volumes transported by Phillips 66.

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Other related party balances in our consolidated balance sheet consisted of the following, all of which were related to Phillips 66:

	Millions of Dollars
	June 30, 2018
	December 31, 2017
Deferred rentals and other assets	\$55
Deferred revenues	60 33
Deferred revenues and other liabilities	17 61

Equity Affiliate Guarantee

Dakota Access and ETCO are parties to a \$2.5 billion project financing transaction entered into in August 2016 to fund the construction of the Bakken Pipeline. In July 2017, as an owner of Dakota Access and ETCO, Phillips 66 and its co-venturers each issued a guarantee intended to cover their pro rata shares of interest expense for rolling six-month periods after the calculation date. In October 2017, as part of the Bakken Pipeline/MSLP Acquisition, Phillips 66 Partners substituted its guarantee for that of Phillips 66. Each co-venturer's guarantee has a maximum guarantee amount which changes over time. Our maximum exposure under the guarantee amounted to \$16 million at June 30, 2018.

Note 14—New Accounting Standards

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will continue to be classified as either financing or operating, with classification affecting the pattern of expense recognition in the income statement. Similarly, lessors will be required to classify leases as sales-type, financing or operating, with classification affecting the pattern of income recognition in the income statement. Classification for both lessees and lessors will be based on an assessment of whether risks and rewards, as well as substantive control have been transferred through a lease contract. Public business entities should apply the guidance in ASU No. 2016-02 for annual periods beginning after December 15, 2018, including interim periods within those annual periods. Early adoption is permitted. Entities are required to adopt the ASU using a modified retrospective approach, subject to certain optional practical expedients, and apply its provisions to leasing arrangements existing at or entered into after the earliest comparative period presented in the financial statements. We are currently evaluating the provisions of ASU No. 2016-02 and assessing its impact on our consolidated financial statements. As part of our assessment to-date, we have formed an implementation team, selected a software package, and completed software design and configuration within a test environment.

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Unless otherwise stated or the context otherwise indicates, all references to "Phillips 66 Partners," "the Partnership," "us," "our," "we" or similar expressions refer to Phillips 66 Partners LP, including its consolidated subsidiaries. References to Phillips 66 may refer to Phillips 66 and/or its subsidiaries, depending on the context. References to our "General Partner" refer to Phillips 66 Partners GP LLC, and references to Phillips 66 PDI refer to Phillips 66 Project Development Inc., the Phillips 66 subsidiary that holds a limited partner interest in us and wholly owns our General Partner.

Management's Discussion and Analysis is the Partnership's analysis of its financial performance and of significant trends that may affect future performance. It should be read in conjunction with the consolidated financial statements and notes thereto included elsewhere in this report. It contains forward-looking statements including, without limitation, statements relating to the Partnership's plans, strategies, objectives, expectations and intentions. The words "anticipate," "estimate," "believe," "budget," "continue," "could," "intend," "may," "plan," "potential," "predict," "seek," "show," "expect," "objective," "projection," "forecast," "goal," "guidance," "outlook," "effort," "target" and similar expressions identify forward-looking statements. The Partnership does not undertake to update, revise or correct any of the forward-looking information unless required to do so under the federal securities laws. Readers are cautioned that such forward-looking statements should be read in conjunction with the Partnership's disclosures under the heading: "CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS."

BUSINESS ENVIRONMENT AND EXECUTIVE OVERVIEW

Partnership Overview

We are a growth-oriented master limited partnership formed to own, operate, develop and acquire primarily fee-based crude oil, refined petroleum products and natural gas liquids (NGL) pipelines and terminals, and other midstream assets. Our common units trade on the New York Stock Exchange under the symbol PSXP.

Our operations consist of crude oil, refined petroleum products and NGL transportation, processing, terminaling and storage assets. We conduct our operations through both wholly owned and joint venture operations. The majority of our wholly owned assets are associated with, and are integral to the operation of, nine of Phillips 66's owned or joint venture refineries.

We primarily generate revenue by providing fee-based transportation, processing, terminaling, storage and NGL fractionation services to Phillips 66 and other customers. Our equity affiliates primarily generate revenue from transporting and terminaling NGL, refined petroleum products and crude oil.

Basis of Presentation

We have acquired assets from Phillips 66 that were considered transfers of businesses between entities under common control. This required the transactions to be accounted for as if the transfers had occurred at the beginning of the transfer period, with prior periods retrospectively adjusted to furnish comparative information. Accordingly, the accompanying financial statements and related notes have been retrospectively adjusted to include the historical results and financial position of the acquired businesses prior to the effective date of each acquisition. We refer to these pre-acquisition operations as those of our "Predecessors."

See the "Basis of Presentation" section of Note 1—Business and Basis of Presentation, in the Notes to Consolidated Financial Statements, for additional information on the content and comparability of our historical financial statements.

How We Evaluate Our Operations

Our management uses a variety of financial and operating metrics to analyze our performance, including: (1) volumes handled (including pipeline throughput, terminaling throughput and storage volumes); (2) operating and maintenance expenses; (3) net income (loss) before net interest expense, income taxes, depreciation and amortization (EBITDA); (4) adjusted EBITDA; and (5) distributable cash flow.

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Volumes Handled

The amount of revenues we generate primarily depends on the volumes of crude oil, refined petroleum products and NGL that we handle in our pipeline, terminal, rail rack, processing, storage and NGL fractionator systems. In addition, our equity affiliates generate revenues from transporting and terminaling NGL, crude oil and refined petroleum products. These volumes are primarily affected by the supply of, and demand for, NGL, crude oil and refined petroleum products in the markets served directly or indirectly by our assets, as well as the operational status of the refineries served by our assets. Phillips 66 has committed to minimum throughput volumes under many of our commercial agreements.

Operating and Maintenance Expenses

Our management seeks to maximize the profitability of our operations by effectively managing operating and maintenance expenses. These expenses primarily consist of labor expenses (including contractor services), utility costs, and repair and maintenance expenses. Operating and maintenance expenses generally remain relatively stable across broad ranges of throughput volumes but can fluctuate from period to period depending on the mix of activities, particularly maintenance activities, performed during the period.

Our operating and maintenance expenses are also affected by volumetric gains/losses resulting from variances in meter readings and other measurement methods, as well as volume fluctuations due to pressure and temperature changes. Under certain commercial agreements with Phillips 66, the value of any NGL, crude oil, or refined petroleum product volumetric gains and losses are determined by reference to the monthly average reference price for the applicable commodity. Any gains and losses under these provisions decrease or increase, respectively, our operating and maintenance expenses in the period in which they are realized. These contractual volumetric gain/loss provisions could increase variability in our operating and maintenance expenses.

EBITDA, Adjusted EBITDA and Distributable Cash Flow

We define EBITDA as net income (loss) plus net interest expense, income taxes, and depreciation and amortization attributable to both the Partnership and our Predecessors.

Adjusted EBITDA is the EBITDA directly attributable to the Partnership after deducting the EBITDA attributable to our Predecessors, further adjusted for:

- The proportional share of equity affiliates' net interest expense, income taxes and depreciation and amortization.
- Transaction costs associated with acquisitions.
- Certain other noncash items, including expenses indemnified by Phillips 66.

Distributable cash flow is defined as adjusted EBITDA less (i) the difference between equity affiliate distributions and proportional EBITDA, (ii) maintenance capital expenditures, (iii) net interest expense, (iv) income taxes paid and (v) preferred unit distributions; plus adjustments for deferred revenue impacts.

EBITDA, adjusted EBITDA, and distributable cash flow are not presentations made in accordance with U.S. generally accepted accounting principles (GAAP). EBITDA, adjusted EBITDA and distributable cash flow are non-GAAP supplemental financial measures that management believes external users of our consolidated financial statements, such as industry analysts, investors, lenders and rating agencies, may find useful to assess:

- Our operating performance as compared to other publicly traded partnerships in the midstream energy industry, without regard to historical cost basis or, in the case of EBITDA and adjusted EBITDA, financing methods.
- The ability of our business to generate sufficient cash to support our decision to make distributions to our unitholders.
- Our ability to incur and service debt and fund capital expenditures.
- The viability of acquisitions and other capital expenditure projects and the returns on investment of various investment opportunities.

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The GAAP performance measure most directly comparable to EBITDA and adjusted EBITDA is net income. The GAAP liquidity measure most directly comparable to EBITDA and distributable cash flow is net cash provided by operating activities. These non-GAAP financial measures should not be considered alternatives to GAAP net income or net cash provided by operating activities. They have important limitations as analytical tools because they exclude some items that affect net income and net cash provided by operating activities. Additionally, because EBITDA, adjusted EBITDA, and distributable cash flow may be defined differently by other companies in our industry, our definition of these non-GAAP financial measures may not be comparable to similarly titled measures of other companies, thereby diminishing their utility.

Business Environment

Since we do not own any of the NGL, crude oil and refined petroleum products we handle and do not engage in the trading of NGL, crude oil and refined petroleum products, we have limited direct exposure to risks associated with fluctuating commodity prices, although these risks indirectly influence our activities and results of operations over the long term.

Our throughput volumes primarily depend on the volume of crude oil processed and refined petroleum products produced at Phillips 66's owned or operated refineries with which our assets are integrated, which in turn are primarily dependent on Phillips 66's refining margins and maintenance schedules. Refining margins depend on the cost of crude oil or other feedstocks and the price of refined petroleum products. These prices are affected by numerous factors beyond our or Phillips 66's control, including the domestic and global supply of and demand for crude oil and refined petroleum products. Throughput volumes of our equity affiliates primarily depend on upstream drilling activities, refinery performance and product supply and demand.

While we believe we have substantially mitigated our indirect exposure to commodity price fluctuations through the minimum volume commitments in our commercial agreements with Phillips 66 during the respective terms of those agreements, our ability to execute our growth strategy in our areas of operation will depend, in part, on the availability of attractively priced crude oil in the areas served by our crude oil pipelines and rail racks, demand for refined petroleum products in the markets served by our refined petroleum product pipelines and terminals, and the general demand for midstream services, including NGL transportation and fractionation.

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RESULTS OF OPERATIONS

Unless otherwise indicated, discussion of results for the three and six months ended June 30, 2018, is based on a comparison with the respective corresponding periods of 2017.

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017*	2018	2017*
Revenues and Other Income				
Operating revenues—related parties	\$244	216	493	426
Operating revenues—third parties	10	11	17	21
Equity in earnings of affiliates	100	48	198	81
Other income	—	2	1	11
Total revenues and other income	354	277	709	539
Costs and Expenses				
Operating and maintenance expenses	85	79	182	153
Depreciation	29	28	57	56
General and administrative expenses	16	18	32	35
Taxes other than income taxes	9	8	19	17
Interest and debt expense	29	24	59	48
Total costs and expenses	168	157	349	309
Income before income taxes	186	120	360	230
Income tax expense	—	1	2	1
Net income	186	119	358	229
Less: Net income attributable to Predecessors	—	16	—	29
Net income attributable to the Partnership	186	103	358	200
Less: Preferred unitholders' interest in net income attributable to the Partnership	10	—	19	—
Less: General partner's interest in net income attributable to the Partnership	55	37	108	69
Limited partners' interest in net income attributable to the Partnership	\$121	66	231	131
Net cash provided by operating activities	\$226	136	397	291
Adjusted EBITDA	\$276	166	523	329
Distributable cash flow	\$204	140	398	264

*Prior-period financial information has been retrospectively adjusted for acquisitions of businesses under common control.

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	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017	2018	2017
Wholly Owned Operating Data				
Pipelines				
Pipeline revenues (millions of dollars)	\$111	103	213	205
Pipeline volumes ⁽¹⁾ (thousands of barrels daily)				
Crude oil	1,020	871	984	873
Refined products and NGL	920	973	859	953
Total	1,940	1,844	1,843	1,826
Average pipeline revenue per barrel (dollars)				
	\$0.63	0.61	0.64	0.62
Terminals				
Terminal revenues (millions of dollars)	\$38	37	77	74
Terminal throughput (thousands of barrels daily)				
Crude oil ⁽²⁾	471	374	477	369
Refined products	806	742	763	772
Total	1,277	1,116	1,240	1,141
Average terminaling revenue per barrel (dollars)				
	\$0.33	0.36	0.34	0.36
Storage, processing and other revenues (millions of dollars)	\$105	87	220	168
Total operating revenues (millions of dollars)	\$254	227	510	447

Joint Venture Operating Data⁽³⁾

Crude oil, refined products and NGL (thousands of barrels daily) 638 443 621 397

⁽¹⁾ Represents the sum of volumes transported through each separately tariffed pipeline segment.⁽²⁾ Bayway and Ferndale rail rack volumes included in crude oil terminals.⁽³⁾ Proportional share of total pipeline and terminal volumes of joint ventures consistent with recognized equity in earnings of affiliates.

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The following tables present reconciliations of EBITDA and adjusted EBITDA to net income and EBITDA and distributable cash flow to net cash provided by operating activities, the most directly comparable GAAP financial measures, for each of the periods indicated.

	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017*	2018	2017*
Reconciliation to Net Income Attributable to the Partnership				
Net income attributable to the Partnership	\$186	103	358	200
Plus:				
Net income attributable to the Predecessors	—	16	—	29
Net income	186	119	358	229
Plus:				
Depreciation	29	28	57	56
Net interest expense	29	23	58	46
Income tax expense	—	1	2	1
EBITDA	244	171	475	332
Plus:				
Proportional share of equity affiliates' net interest, taxes and depreciation	28	12	43	24
Expenses indemnified or prefunded by Phillips 66	1	—	1	3
Transaction costs associated with acquisitions	3	—	4	1
Less:				
EBITDA attributable to Predecessors	—	17	—	31
Adjusted EBITDA	276	166	523	329
Plus:				
Deferred revenue impacts**†	(5)	)4	—	8
Less:				
Equity affiliate distributions less than (more than) proportional EBITDA	18	(4)	) 28	4
Maintenance capital expenditures†	10	10	20	21
Net interest expense	29	24	58	48
Preferred unit distributions	10	—	19	—
Distributable cash flow	\$204	140	398	264
*Prior-period financial information has been retrospectively adjusted for acquisitions of businesses under common control.				
**Difference between cash receipts and revenue recognition.				
†Excludes MSLP capital reimbursements and turnaround impacts.				

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	Millions of Dollars			
	Three Months Ended June 30		Six Months Ended June 30	
	2018	2017*	2018	2017*
Reconciliation to Net Cash Provided by Operating Activities				
Net cash provided by operating activities	\$226	136	397	291
Plus:				
Net interest expense	29	23	58	46
Income tax expense	—	1	2	1
Changes in working capital	(10)	8	(27)	(11)
Undistributed equity earnings	(1)			