PHILLIPS 66 PARTNERS LP
Form 10-Q
April 30, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2019
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 incorporation or organization)	(I.R.S. Employer 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 [X] No [ ]
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes [X] 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 [X] 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 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 [X]
The registrant had 124,726,087 common units outstanding as of March 31, 2019.

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PHILLIPS 66 PARTNERS LP

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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 Ended March 31	
	2019	2018
Revenues and Other Income		
Operating revenues—related parties	$296	249
Operating revenues—third parties	6	7
Equity in earnings of affiliates	119	98
Other income	2	1
Total revenues and other income	423	355
Costs and Expenses		
Operating and maintenance expenses	139	97
Depreciation	29	28
General and administrative expenses	18	16
Taxes other than income taxes	11	10
Interest and debt expense	27	30
Total costs and expenses	224	181
Income before income taxes	199	174
Income tax expense	1	2
Net income	198	172
Less: Preferred unitholders’ interest in net income	10	9
Less: General partner’s interest in net income	69	53
Limited partners’ interest in net income	$119	110
Net Income Per Limited Partner Unit (dollars)		
Common units—basic	$0.96	0.91
Common units—diluted	0.92	0.87
Weighted-Average Limited Partner Units Outstanding (thousands)		
Common units—basic	124,258	121,610
Common units—diluted	138,078	135,429

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 March 31	
	2019	2018
Net Income	$198	172
Defined benefit plans		
Plan sponsored by equity affiliates, net of income taxes	—	—
Other comprehensive income	—	—
Comprehensive Income	$198	172

See Notes to Consolidated Financial Statements.

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Consolidated Balance Sheet Phillips 66 Partners LP

	Millions of Dollars	
	March 31 2019	December 31 2018
Assets		
Cash and cash equivalents	$2	1
Accounts receivable—related parties	87	90
Accounts receivable—third parties	3	5
Materials and supplies	13	13
Prepaid expenses and other current assets	11	20
Total current assets	116	129
Equity investments	2,897	2,448
Net properties, plants and equipment	3,104	3,052
Goodwill	185	185
Other assets	51	5
Total Assets	$6,353	5,819
Liabilities		
Accounts payable—related parties	$21	22
Accounts payable—third parties	82	88
Accrued interest	32	36
Deferred revenues	22	60
Short-term debt	15	50
Accrued property and other taxes	13	9
Other current liabilities	3	5
Total current liabilities	188	270
Long-term debt	3,173	2,998
Obligation from equity interest transfer	341	—
Other liabilities	97	42
Total Liabilities	3,799	3,310
Equity		
Preferred unitholders (2019 and 2018—13,819,791 units issued and outstanding)	747	746
Common unitholders—public (2019—55,965,950 units issued and outstanding; 2018—55,343,918 units issued and outstanding)	2,523	2,485
Common unitholder—Phillips 66 (2019 and 2018—68,760,137 units issued and outstanding)	600	592
General partner—Phillips 66 (2019 and 2018—2,480,051 units issued and outstanding)	(1,315)	(1,313)
Accumulated other comprehensive loss	(1)	(1)
Total Equity	2,554	2,509
Total Liabilities and Equity	$6,353	5,819

See Notes to Consolidated Financial Statements.

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Consolidated Statement of Cash Flows Phillips 66 Partners LP

	Millions of Dollars Three Months Ended March 31 2019			2018	
Cash Flows From Operating Activities					
Net income	$	198		172	
Adjustments to reconcile net income to net cash provided by operating activities					
Depreciation	29			28	
Undistributed equity earnings	2			(8	)
Other liabilities	10			(38	)
Working capital adjustments					
Accounts receivable	4			(5	)
Prepaid expenses and other current assets	9			(3	)
Accounts payable	(4		)	(4	)
Accrued interest	(5		)	(2	)
Deferred revenues	(40		)	29	
Other accruals	2			2	
Net Cash Provided by Operating Activities	205			171	
Cash Flows From Investing Activities					
Cash capital expenditures and investments	(634		)	(74	)
Return of investment from equity affiliates	20			14	
Proceeds from sale of equity interest	81			—	
Net Cash Used in Investing Activities	(533		)	(60	)
Cash Flows From Financing Activities					
Proceeds from equity interest transfer	341			—	
Issuance of debt	725			—	
Repayment of debt	(585		)	—	
Issuance of common units	32			9	
Quarterly distributions to preferred unitholders	(9		)	(9	)

Quarterly distributions to common unitholders—public	(46)	(36)
Quarterly distributions to common unitholder—Phillips 66	(58)	(46)
Quarterly distributions to General Partner—Phillips 66	(67)	(47)
Other distributions to Phillips 66	(4)	—
Net Cash Provided by (Used in) Financing Activities	329	(129)
Net Change in Cash and Cash Equivalents	1	(18)
Cash and cash equivalents at beginning of period	1	185
Cash and Cash Equivalents at End of Period	$ 2	167

See Notes to Consolidated Financial Statements.

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Consolidated Statement of Changes in Equity Phillips 66 Partners LP

	Millions of Dollars					
	Preferred Unitholders Public	Common Unitholders Public	Common Unitholder Phillips 66	General Partner Phillips 66	Accum. Other Comprehensive Loss	Total
December 31, 2017	$746	2,274	487	(1,345)	(1)	2,161
Cumulative effect of accounting change	—	13	16	1	—	30
Issuance of common units	—	9	—	—	—	9
Net income	9	48	62	53	—	172
Quarterly cash distributions to unitholders and General Partner ($0.678 per common unit)	(9)	(36)	(46)	(47)	—	(138)
March 31, 2018	$746	2,308	519	(1,338)	(1)	2,234
December 31, 2018	$746	2,485	592	(1,313)	(1)	2,509
Cumulative effect of accounting change	—	(1)	—	—	—	(1)
Issuance of common units	—	32	—	—	—	32
Net income	10	53	66	69	—	198
Quarterly cash distributions to unitholders and General Partner ($0.835 per common unit)	(9)	(46)	(58)	(67)	—	(180)
Other distributions to Phillips 66	—	—	—	(4)	—	(4)
March 31, 2019	$747	2,523	600	(1,315)	(1)	2,554

	Preferred Units Public	Common Units Public	Common Units Phillips 66	General Partner Units Phillips 66	Total Units
December 31, 2017	13,819,791	52,811,822	68,760,137	2,480,051	137,871,801
Units issued in public equity offerings	—	188,815	—	—	188,815
March 31, 2018	13,819,791	53,000,637	68,760,137	2,480,051	138,060,616
December 31, 2018	13,819,791	55,343,918	68,760,137	2,480,051	140,403,897
Units issued in public equity offerings	—	622,032	—	—	622,032
March 31, 2019	13,819,791	55,965,950	68,760,137	2,480,051	141,025,929

See Notes to Consolidated Financial Statements.

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Notes to Consolidated Financial Statements Phillips 66 Partners LP

Note 1—Description of the Business
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.

We are a growth-oriented master limited partnership formed to own, operate, develop and acquire primarily fee-based midstream assets. Our operations consist of crude oil, refined petroleum products and natural gas liquids (NGL) transportation, terminaling, processing 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 fractionation services to Phillips 66 and other customers. Our equity affiliates primarily generate revenue from transporting and terminaling crude oil, refined petroleum products and NGL. Since we do not own any of the crude oil, refined petroleum products and NGL we handle and do not engage in the trading of crude oil, refined petroleum products and NGL, 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.

Note 2—Interim Financial Information

The unaudited interim financial information presented in the financial statements included in this report is prepared in accordance with generally accepted accounting principles in the United States (GAAP) 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 2018 Annual Report on Form 10-K. The results of operations for the three months ended March 31, 2019, are not necessarily indicative of the results to be expected for the full year. Certain prior period financial information has been recast to reflect the current year’s presentation.

Note 3—Changes in Accounting Principles

Effective January 1, 2019, we elected to adopt Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2016-13, “Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,” which amends the impairment model to utilize an expected loss methodology in place of the incurred loss methodology for financial instruments and off-balance sheet credit exposures. The amendment requires entities to consider a broader range of information to estimate expected credit losses, which may result in earlier recognition of losses. The adoption of the ASU did not have a material impact on our consolidated financial statements.

Effective January 1, 2019, we adopted ASU 2016-02, “Leases (Topic 842)” using the modified retrospective transition method. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and corresponding lease liability on the consolidated balance sheet for all operating leases with terms longer than 12 months. Leases will continue to be classified as either finance or operating, with classification affecting the pattern of expense recognition in the consolidated income statement.

We elected the package of practical expedients that allowed us to carry forward the determination of whether an arrangement contains a lease and lease classification, as well as our accounting for initial direct costs for existing contracts. We recorded a noncash cumulative effect adjustment to our opening consolidated balance sheet as of January

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1, 2019, to record an aggregate operating lease ROU asset and a corresponding lease liability of $45 million. See Note 5—Lease Assets and Liabilities, for the new lease disclosures required by this ASU for lessees.

Effective for periods after January 1, 2019, we elected to account for lease and service elements of contracts classified as leases on a combined basis under the provisions of ASU No. 2016-02, except for leases of processing-type assets, which contain non-ratable fees related to turnaround activity. For these types of leases, we continued to separate the lease and service elements based on relative standalone prices and applied the new lease standard to the lease element and the revenue standard to the service element. We recorded a noncash cumulative effect adjustment of $1 million to decrease our opening equity balance as of January 1, 2019. See Note 4—Operating Revenues, for additional impacts of adopting this ASU, including new lease disclosures required for lessors.

Note 4—Operating Revenues

Operating revenues are primarily generated from long-term pipeline transportation, terminaling, storage, processing and fractionation lease and service agreements, mainly with Phillips 66. These agreements typically include escalation clauses to adjust transportation tariffs and terminaling and storage fees to reflect changes in price indices. In addition, most of these agreements contain renewal options, which typically require the mutual consent of both our customers and us.

Total operating revenues disaggregated by asset type were as follows:

	Millions of Dollars Three Months Ended March 31	
	2019	2018
Pipelines	$109	102
Terminals	40	39
Storage, processing and other revenues	153	115
Total operating revenues	$302	256

The majority of our agreements with Phillips 66 are considered operating leases under GAAP. For reporting periods prior to our adoption of the new lease accounting standard, ASU No. 2016-02, as of January 1, 2019, the lease and service elements included in these contracts were separated with the lease element recognized in accordance with the existing lease accounting standard and the service element recognized in accordance with the revenue accounting standard. Effective for periods after January 1, 2019, we elected to account for lease and service elements of contracts classified as leases on a combined basis under the provisions of ASU No. 2016-02, except for leases of processing-type assets, which contain non-ratable fees related to turnaround activity. For these types of leases, we continued to separate the lease and service elements based on relative standalone prices and applied the new lease standard to the lease element and the revenue standard to the service element. As a result of our change in accounting policy, our lease and service revenues, lease and service accounts receivable and lease and service deferred revenues reported for the first quarter of 2019 are not prepared on the same basis as the amounts reported for the first quarter of 2018.

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Total operating revenues disaggregated by lease and service revenues were as follows:

	Millions of Dollars Three Months Ended March 31	
	2019	2018
Lease revenues	$257	144
Service revenues	45	112
Total operating revenues	$302	256

Accounts Receivable
We bill our customers, mainly Phillips 66, under our lease and service contracts generally on a monthly basis.

Total accounts receivable by revenue type was as follows:

	Millions of Dollars	
	March 31 2019	December 31 2018
Lease receivables	$72	53
Service receivables	17	41
Other receivables	1	1
Total accounts receivables	$90	95

Deferred Revenues
Our deferred revenues represent payments received from our customers, mainly Phillips 66, in advance of the period in which lease and service contract performance obligations have been fulfilled. The majority of our deferred revenues relate to a tolling agreement and a storage agreement that are classified as leases. The remainder of our deferred revenues relate to lease and service agreements that contain minimum volume commitments with recovery provisions. Our deferred revenues are recorded in the “Deferred revenues” and “Other liabilities” lines on our consolidated balance sheet. Total deferred revenues under our lease and service agreements were as follows:

	Millions of Dollars	
	March 31 2019	December 31 2018
Deferred lease revenues	$48	73
Deferred service revenues	1	6
Total deferred revenues	$49	79

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Future Minimum Lease Payments from Customers

At March 31, 2019, future minimum payments to be received under our lease agreements with customers were estimated to be:

	Millions of Dollars
Remainder of 2019	$ 506
2020	644
2021	639
2022	627
2023	585
Remaining years	1,559
Total future minimum lease payments from customers	$ 4,560

Remaining Service Performance Obligations

We typically have long-term service contracts with our customers, of which the original durations range from 5 to 15 years. The weighted-average remaining duration of these contracts is 11 years. These contracts include both fixed and variable transaction price components. At March 31, 2019, future service revenues expected to be recognized for the fixed component of the transaction price of our remaining performance obligations from service contracts with our customers that have an original expected duration of greater than one year were:

	Millions of Dollars
Remainder of 2019	$ 107
2020	139
2021	131
2022	130
2023	130
Remaining years	742
Total future service revenues	$ 1,379

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

Note 5—Lease Assets and Liabilities

We have agreements with Phillips 66 to lease land underlying or associated with certain of our assets that are classified as operating leases. Due to the economic infeasibility of canceling these leases, we consider them non-cancellable. Certain leases include escalation clauses for adjusting rental payments to reflect changes in price indices. There are no significant restrictions imposed on us in our lease agreements with regards to distribution payments, asset dispositions or borrowing ability.

Effective with our implementation of ASU No. 2016-02, we elected to discount lease obligations using our incremental borrowing rate. For all leases, we elected the practical expedient to not separate service and lease costs.

Our right-of-way agreements in effect prior to January 1, 2019, were not accounted for as leases as they were not initially determined

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to be leases at their commencement dates. However, modifications to these agreements or new agreements will be assessed and accounted for accordingly under ASU No. 2016-02. For short-term leases, which are leases that, at the commencement date, have a lease term of 12 months or less and do not include an option to purchase the underlying asset that is reasonably certain to exercise, we elected to not recognize the ROU asset and corresponding lease liability on our consolidated balance sheet.

Operating lease ROU assets are recorded in the “Other assets” line and lease liabilities are recorded in the “Other current liabilities” and “Other liabilities” lines on our consolidated balance sheet. At March 31, 2019, the total operating lease ROU asset was $45 million.
Future minimum lease payments and recorded short- and long-term lease liabilities at March 31, 2019, for operating leases were:

	Millions of Dollars		
Remainder of 2019	$	2	
2020	3		
2021	3		
2022	3		
2023	3		
Remaining years	91		
Future minimum lease payments	105		
Amount representing interest or discounts	(60		)
Total lease liabilities	45		
Short-term lease liabilities	(1		)
Long-term lease liabilities	$	44	

Operating lease costs and operating cash outflows for the three months ended March 31, 2019, were $1 million.

The weighted-average remaining lease term for our operating leases as of March 31, 2019, was 36 years. The weighted-average discount rate for our operating leases as of March 31, 2019, was 5.7%.

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Note 6—Equity Investments and Loans

Equity Investments
The following table summarizes the carrying value of our equity investments:

	Percentage Ownership		Millions of Dollars March 31 2019	December 31 2018
Dakota Access, LLC and Energy Transfer Crude Oil Company, LLC (Bakken Pipeline)	25.00	%	$597	608
Bayou Bridge Pipeline, LLC (Bayou Bridge)	40.00		286	277
DCP Sand Hills Pipeline, LLC (Sand Hills)	33.34		601	601
DCP Southern Hills Pipeline, LLC (Southern Hills)	33.34		209	206
Explorer Pipeline Company (Explorer)	21.94		110	115
Gray Oak Pipeline, LLC (Gray Oak)	65.00		741	288
Paradigm Pipeline LLC (Paradigm)	50.00		144	145
Phillips 66 Partners Terminal LLC (Phillips 66 Partners Terminal)	70.00		71	71
South Texas Gateway Terminal LLC (South Texas Gateway Terminal)	25.00		24	20
STACK Pipeline LLC (STACK)	50.00		114	117
Total equity investments			$2,897	