

Andeavor Logistics Second Quarter 2018 Webcast Transcript

Date: August 6, 2018
Presenters: Greg Goff, Chairman and CEO
 Steven Sterin, President and CFO
 Andrew Woodward, Sr. Director, Finance and Investor Relations

Andrew Woodward:

This is Andrew Woodward, Senior Director of Finance and Investor Relations. Welcome to the Andeavor Logistics webcast, which includes a review of the progress we are making on our business plans, financial strategies as well as our second quarter earnings. Greg Goff, Chairman and CEO and Steven Sterin, President and CFO will be presenting during this pre-recorded webcast.

The earnings release, which can be found on our website at andeavorlogistics.com, includes financial disclosures and reconciliations for non-GAAP financial measures that should help you analyze our results. A transcript of this webcast will also be available on our website. Our comments during this webcast will include forward-looking statements that refer to management's expectations or future predictions. These statements are made as of the date of this webcast and we are under no obligation to update these forward-looking statements in the future. They are subject to risks and uncertainties that could cause actual results to differ from our expectations. Please refer to the earnings release for additional information on forward-looking statements. Now, I will turn it over to Greg Goff, Chairman and Chief Executive Officer of Andeavor Logistics' General Partner.

Greg Goff:

Thanks, Andy.

In December 2017, at our Investor and Analyst Day, we provided growth plans and financial targets for Andeavor Logistics. The proposed strategic combination of Andeavor and Marathon is not expected to impact those growth plans and financial targets. The very strong second quarter performance and recent strategic actions demonstrate that Andeavor Logistics is delivering on the plan to grow the Company and will continue to execute its strategy to grow and improve the business to create unitholder value. Subject to the approval of shareholders and customary closing conditions, the strategic combination between Andeavor and Marathon is expected to close on October 1, 2018.

I'd like to start by highlighting our record business performance this quarter. We delivered net earnings of \$148 million and EBITDA of \$289 million, an increase of \$37 million and \$49 million over the prior year, respectively. Our business performed very well with no meaningful

Andeavor Logistics Second Quarter 2018 Webcast Transcript

unplanned downtime. Crude oil gathering volumes in the Permian Basin set another record and our terminalling and transportation business had record volumes, operating income, and EBITDA this quarter from higher asset utilization and strong refined product demand.

We are very pleased to announce the completion of the \$1.6 billion drop down of assets to Andeavor Logistics this month, which includes high-growth Permian Basin crude oil logistics assets as well as the majority of the remaining Andeavor refining logistics assets. The drop down also included the transfer of the Conan Crude Oil Gathering System and the Los Angeles Refinery Interconnect Pipeline. The drop down is expected to generate 2019 annual net earnings of \$105 to \$115 million and EBITDA of \$195 to \$205 million. This represents an EBITDA multiple of approximately 8.4 times in 2019, when including additional capital investments of approximately \$150 million that we will spend in 2018 and 2019 in relation to dropped projects that are under construction.

Now, let me take a moment to discuss the progress of our growth strategy in the Permian Basin, the Bakken and throughout our business.

In the Permian Basin, we continue to see strong growth in crude oil production and requests for proposals for new gathering systems. Our existing integrated logistics and refining infrastructure positions us well to capture these opportunities at attractive economics. The Conan Crude Oil Gathering system construction is proceeding very well and at this time the project is approximately two-thirds complete, with full operations expected later this year. As previously mentioned, this system was transferred at cost plus incurred interest as part of the drop down. The project to connect the Conan system to the Rio Pipeline is expected to be completed late this year as well. The connected system will provide producers an additional takeaway option for the rapid production growth in the Delaware Basin. In our prior two earnings releases, we announced five crude oil gathering projects in the Delaware Basin. I am very pleased to announce that we have been awarded an additional crude oil gathering system with a top-tier producer. These six Permian Basin gathering projects awarded over the last three quarters total approximately \$75 to \$85 million of capital investment, generating a 6 to 7 times EBITDA multiple. Andeavor Logistics acreage dedications in the Permian Basin now total 76,000 acres.

With the assets included in the recent drop down and continued execution of our growth projects, we expect to exit 2018 with an annual run rate of \$90 million of net earnings and \$150 million of EBITDA from our business in the Permian Basin. Our success in the Permian Basin is underpinned by a strategically located asset base that allows us to maintain attractive project economics. Delivering projects on-time is paramount to our customers and a critical focus for us. Through the dedicated work of our business development and construction teams, we will continue to demonstrate that we execute projects on-time and on-budget, delivering on our commitments to our customers. We further differentiate ourselves and add

Andeavor Logistics Second Quarter 2018 Webcast Transcript

value by leveraging the expertise of Andeavor's commercial and refining operations to find win-win solutions for our customers, Andeavor Logistics and Andeavor. We look forward to sharing more details as we continue to execute on our plans.

We also continue to advance our organic growth projects across other areas of our business. In the Bakken, I am pleased to say that we successfully completed the expansion of our Robinson Lake gas processing facility, in order to meet customer demand, and are already looking at projects to increase capacity further to meet our growing customer production. Also in the Bakken, construction is underway on the North Dakota NGL Logistics Hub. We continue to expect initial operations to start late in the fourth quarter of this year and full operations in the first quarter of 2019. We also continue to expect the project to deliver annual net earnings of \$15 to \$19 million and \$22 to \$26 million of annual EBITDA, representing a 6 to 7 times EBITDA multiple.

We continue to find ways to partner with Andeavor's refining and commercial operations to grow the Terminalling and Transportation business. Our Stockton, California Terminal project to build ethanol rail offloading capacity is complete and expansion efforts to increase terminal throughput are progressing. Providing ethanol supply logistics strengthens supply reliability to Andeavor and increases our participation across the logistics value chain. At our East Hynes Terminal in California, we completed a new pipeline connection so that third-party refined product volumes can now flow into the Andeavor Logistics Southern California Pipeline System and our connected product terminals. Not only will this increase volumes and utilization, but it also provides additional redundancy for refined product supply in case of refinery interruptions.

The Wamsutter Pipeline acquisition that closed on May 1st, 2018, is already performing above expectations, driven by better tariff mix and volumes that are exceeding our initial forecasts. Integration efforts are progressing well and we expect the system to be a key component in delivering more advantaged crude oil supply to Salt Lake City refineries.

In summary, we remain confident in delivering the strategic and financial targets announced at our 2017 Investor and Analyst Day and in our updates since, including generating \$685 to \$785 million of annual net earnings or \$1.2 to \$1.3 billion of annual EBITDA in 2018. We continue to expect to achieve at least \$965 million of net earnings and \$1.6 billion of EBITDA in 2020. With the completion of the drop down, acquisition of the Wamsutter Pipeline system and continued execution of organic projects, we have demonstrated substantial progress towards achieving these goals.

With that, I'll ask Steven to provide more details about our business.

Andeavor Logistics Second Quarter 2018 Webcast Transcript

Steven Sterin:

Thanks, Greg.

We reported second quarter net earnings of \$148 million and EBITDA of \$289 million, an increase of \$37 million and \$49 million, respectively, over the prior year and an increase of \$9 million and \$16 million, respectively, over the prior quarter. Results for the quarter were driven by stronger utilization and record volumes in Terminalling and Transportation while Gathering and Processing benefited from improving market fundamentals.

Please note Gas Gathering & Processing performance was impacted by \$5 million of lower earnings in Q2 due to planned downtime at our Robinson Lake gas processing facility to support increased demand in the Bakken. The project was successfully completed in the second quarter. And, due to the continued growth in production and associated gas in the Bakken, we are already working on ways to further expand our processing capacities.

Moving to our business segments,

Terminalling and Transportation reported a record quarter with segment operating income of \$128 million, an increase of \$4 million from the prior year. Results compared to the prior year were primarily driven by contributions from the Western Refining Logistics acquisition, the November 2017 Anacortes Logistics Assets drop down and organic growth projects. Record volumes in the quarter were driven by strong demand for refined products throughout our system, no material unplanned downtime and higher Andeavor refinery utilization. Historically, volumes in this business were driven primarily by macro demand for transportation fuels and Andeavor's growth. However, our teams have continued to find innovative ways to creatively improve this business by working with third parties and Andeavor by optimizing our network of integrated assets and by delivering high levels of customer service and reliability and driving productivity to offset inflation. Looking forward, we continue to see a positive macro-economic environment. Vehicle miles traveled and light product demand on the West Coast are continuing to show growth over 2017. On a comparable basis, we've seen demand for light products at our terminals in the second quarter increase about 2.8% year-over-year.

Moving to our Gathering and Processing segment,

Segment operating income was \$70 million for the second quarter 2018, an increase of \$17 million from the prior year and segment EBITDA was \$122 million, an increase of \$26 million from the prior year. The year-over-year increase was primarily due to contributions from the growth in the Permian Basin, our Bakken Connolly Gathering system, Robinson Lake gas processing volumes and the Western Refining Logistics acquisition. Overall volumes in the Rockies remain stable versus last year. Crude Oil Gathering volumes were flat from the prior quarter, but still in-line with our expectations and plan. Record volume growth in the Permian

Andeavor Logistics Second Quarter 2018 Webcast Transcript

Basin and on our Bakken Connolly Gathering System was offset by the previously communicated - and expected - decreased demand on High Plains Pipeline in the Bakken due to DAPL.

I'd like to go into more detail regarding our Bakken volumes. Our Bakken volumes include two types of business: barrels that we gather from the wellhead, as well as barrels that we receive from third-party gathering systems for transportation and storage. Although our third-party system receipts in the Bakken have decreased due to completion of direct connections to DAPL, we continue to set new records in volumes that we gather at the wellhead. In general, barrels gathered at the wellhead generate two to four times more revenue and profit than barrels received on the High Plains Pipeline from third-party systems. As a result of this shift, crude oil gathering revenue and average revenue per barrel continue to increase despite overall volume modestly declining. There are multiple rigs working on our dedicated crude oil acreage in the Bakken and we expect wellhead gathered volumes to continue to increase going forward, driving further revenue growth.

In the Bakken, we continue to see crude oil, natural gas and NGL production growth throughout the basin. There are currently 67 active rigs in the Bakken, an increase of 16% over the prior year. Crude oil production set a new record of 1.25 million barrels per day in May - an increase of 18% over the prior year. Our geographically advantaged and integrated pipeline, transportation and storage systems are well-positioned to allow us to capture new production and to provide intra-basin transportation to DAPL or other key takeaway pipelines. We are also well positioned to capture additional gathering volumes on acreage dedicated to us as production grows and we make new connections - as well as compete for - and win - bids for new systems.

In the Permian Basin, pipeline volumes increased approximately 6% over the prior quarter - another record on our system - and have increased 26% over the prior year. Volume growth continues to be driven by higher than expected rig counts, new organic growth projects in execution, improving initial production from new wells and our ability to optimize our system-wide trucking fleet and partner with Andeavor's commercial organization. We continue to see a very robust drilling and completion environment. In counties with close proximity to our assets, the rig count has increased from 84, at this time last year, to 126, an increase of 50%. We are taking action to benefit from this increase - and, as stated, are expected to exit 2018 with a run rate of \$90 million of net earnings and \$150 million of EBITDA. This is more than three times the earnings seen in 2017.

On the Conan project alone, there are currently 16 rigs working on our acreage - well above our original expectations of 8 rigs. And as Greg mentioned, this quarter we secured another crude oil gathering project with a top-tier producer and continue to have line of sight to additional opportunities to further enhance our business in the Permian Basin.

Andeavor Logistics Second Quarter 2018 Webcast Transcript

Gas Gathering and Processing throughput was 784 thousand MMBtu per day. Please note that due to the adoption of a new revenue recognition standard, the presentation of some of gas volumes was lowered by approximately 150 thousand MMBtu per day. On a comparable basis, volumes decreased approximately 2% from the prior quarter, driven primarily by the planned downtime at the Robinson Lake gas processing facility. NGL volumes decreased 23% from the prior quarter to 9.1 thousand barrels per day, as our gas processing facilities in the Rockies were in ethane recovery for only a portion of the quarter given long haul takeaway constraints that forced this region into proration.

Natural gas and NGL production in the Bakken continues to set new records each month, currently up 25% over the prior year. As Greg mentioned, our key growth projects, including the North Dakota NGL Logistics Hub, are progressing well and we are working diligently to expand our natural gas gathering and throughput capacity as the basin continues to set new production records. Our Bakken natural gas volumes are expected to be higher in the third quarter as our Robinson Lake gas processing facility is expected to be on-line the entire quarter and at higher rates due to the recently completed expansion project.

Looking forward in the Rockies, gas volumes are expected to be reduced by 45 thousand MMBtu/d beginning in the third quarter of this year due to the expiration of certain processing agreements, however, earnings are expected to be impacted less than \$1 million on an annual basis. This impact is included in our third quarter volume guidance and has no meaningful impact on our business. Otherwise, we continue to see a stable production environment this year. However, there are encouraging signs that could lead to growth in the Rockies. In July, a major producer in the Uinta Basin sold its acreage position to a private equity backed entity. This transaction closely mirrors a similar event last year in the Pinedale area. Although too soon to quantify any impact, we view this as incrementally positive for future production. The current level of Rockies activity is consistent with our plan and outlook communicated previously, with any additional growth presenting possible upside opportunities for our business.

Shifting to the Wholesale segment,

Wholesale segment reported record results with operating income of \$11 million for the second quarter 2018, an increase of \$7 million from the prior quarter and segment EBITDA of \$13 million, an increase of \$6 million from the prior quarter. Results compared to the prior quarter were driven by higher volumes due to seasonality and an improved margin environment. We continue to see a strong margin and volume environment in the third quarter.

Moving to the drop down,

We are very excited about the portfolio of assets we just acquired from Andeavor. There are several key benefits from the addition of these assets and businesses to our portfolio: First,

Andeavor Logistics Second Quarter 2018 Webcast Transcript

substantially all of Andeavor's Permian Basin assets are now owned by Andeavor Logistics, which positions us to more efficiently optimize, connect and capture growth. Second, nearly all of the traditional refining logistics assets and pipelines are now owned by Andeavor Logistics. This creates opportunities for operational synergies and asset optimization as well as the potential for bringing more third-party business into our systems. Third, the 5 asphalt terminals just acquired, along with the 4 terminals already in our business, positions us well to optimize trucking, distribution and operating costs - and the outlook for volumes in this business is constructive - especially with the upcoming changes related to low sulfur marine diesel fuel standards and our ability to partner with Andeavor's refining and commercial operations to create value. Finally, many of the assets dropped down have growth potential in the near term - which is quite different than the more traditional refining logistics asset drop downs of the past.

This broad, attractive and high-quality set of assets we acquired are expected to generate annual 2019 net earnings of \$105 to \$115 million and EBITDA of \$195 to \$205 million and 2020 annual net earnings of \$120 to \$125 million and EBITDA of \$215 to \$220 million. And, with the growth these assets are expected to provide, the multiple paid is very attractive and is immediately accretive to our unitholders. This acquisition has an expected EBITDA multiple of approximately 8.4 times in 2019 and 7.8 times in 2020, when including the additional capital required and resulting growth related to these assets. We expect to invest \$100 million in 2018 and \$50 million in 2019 primarily related to further investing in the Conan Crude Oil Gathering System as well as completing the LA Pipeline Interconnect Project.

Now, let me take a moment to discuss the funding for this drop down and the additional growth announced today, as well as our balance sheet, cash flows and our strategic priorities for creating long-term unitholder value. The drop down transaction was funded with \$300 million in borrowings under our revolving credit facilities and \$1.25 billion in common equity issued to Andeavor. Although different than our thinking earlier this year, which included a combination of Andeavor equity and hybrid equity, issuing common equity to Andeavor was an attractive source of funding given the recent weakness in the hybrid markets, in particular, the preferred equity market. With improving business fundamentals and when considering the additional capital required to fund our currently identified growth projects, this funding supports our capability to make these investments, achieve our stated leverage, coverage and distribution targets and deliver on our 2020 plans. As a reminder, our plan targets at least \$965 million of net earnings and at least \$1.6 billion of EBITDA in 2020, and following the recent capitalization and funding, we are positioned to achieve these plans without any additional common unit or hybrid equity issuances.

Our balance sheet and financial flexibility remain very strong. As of the end of the second quarter, total debt, net of unamortized issuance costs, was \$4.4 billion and we had

Andeavor Logistics Second Quarter 2018 Webcast Transcript

approximately \$1.4 billion of availability under our revolving credit facilities. Our leverage in the second quarter 2018, as calculated per our credit agreements, was slightly below our target of approximately 4 times.

Moving on to distributions and distribution growth: On July 24, 2018, we announced our second quarter distribution of \$1.03 per limited partner unit, or \$4.12 per unit on an annualized basis - our 29th consecutive quarterly distribution increase. This represents an increase of 1.5% over the prior distribution and an increase of 6% over the past year. We continue to expect to grow our distribution by at least 6% supported by our growth plans, financial discipline and balance sheet.

Our distribution coverage was 1.02x in the second quarter, which was in line with our expectations, following the recent IDR buy-in, and is sequentially improving as planned. We remain confident in achieving our target coverage of approximately 1.1 times by the end of 2018.

In conclusion, we are making significant progress toward achieving our 2020 targets. We expect to exit 2018 with an annual run rate of approximately \$740 million of net earnings and \$1.4 billion of EBITDA, which is a higher run rate than presented originally at our 2017 Investor and Analyst Day.

As always, you can find additional details of our volume expectations and other elements related to our third quarter 2018 outlook in our earnings release.

This now concludes the webcast. Thank you.