Andeavor Logistics First Quarter 2018 Webcast Transcript

Date: May 7, 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 first quarter earnings.

Greg Goff, Chairman and CEO and Steven Sterin, President and CFO will be presenting during this 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.

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.

I'd like to start by highlighting the strong operational performance of our business in the quarter as we continue to have success growing the Company. Our assets performed very well with no meaningful unplanned downtime. Crude oil volumes in the Permian continue to set new records and we are making excellent progress on our organic projects and acquisitions. We are well-positioned to continue to drive substantial growth in the Permian. Our terminalling business had lower volumes and earnings sequentially this quarter, but in line with our guidance and expectations, due to major planned refinery maintenance on the West Coast.

Before I go further, I would like to take a moment to discuss the recently announced strategic combination between Marathon and Andeavor. First, I want to be very clear, Andeavor Logistics will continue to execute its strategy to grow and improve the business. The merger does not change this. The plans we communicated at our 2017 Investor and Analyst Day and in subsequent press releases will move forward. The merger will not impact our focus, dedication, or ability to deliver on our strategic and financial targets. We are unwavering in our commitment to drive significant unitholder value and execute on our stated plans. None of our growth plans, financial targets, drop downs or announced investments are expected to be impacted by the proposed combination of Andeavor and Marathon Petroleum.

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

In the Permian, we continue to see tremendous growth in crude oil production and requests for proposals for new gathering systems. In fact, this growth has exceeded our previous outlook for the Delaware Basin and we are well positioned to capture these opportunities. We have been, and will continue to invest, in bringing top talent into this business. We remain dedicated to our customers and will not be satisfied unless we are providing the highest quality of service and performance, always doing so in a safe and sustainable manner.

The Conan Crude Oil Gathering system construction is proceeding very well and will be part of the expected August drop down, transferred at cost plus incurred interest. We are also in process of connecting the Conan system and the recently acquired Rio Pipeline, which allows us to efficiently move crude oil from the Delaware Basin to Midland. We expect our volumes to increase on the system as Andeavor moves volumes away from third party pipelines. The connected system will also provide producers an additional takeaway option for the rapid production growth in the Delaware Basin.

In our fourth quarter earnings release, we announced two high-return crude oil gathering systems in the Delaware Basin with acreage commitments totaling 40,000 acres.

I am very pleased to announce that we have been awarded three additional crude oil gathering systems with high quality producers, including acreage commitments totaling 32,000. Total capital expenditures for these three new projects are expected to be $40 to $45 million with attractive returns consistent with our previously announced gathering systems. We anticipate the systems will be commissioned in late 2018 and early 2019. Our total acreage commitments are now 72,000 in the region.

Our success and ability to capture high return projects is driven by our strong asset base strategically located in the Delaware Basin, the tremendous work by our business development and construction teams and our focus on customer service and excellence. We think these are key differentiators for Andeavor Logistics, and we are just getting started.

Further executing on our Permian strategy, Andeavor announced its participation in the Gray Oak Pipeline with Phillips 66 Partners and the South Texas Gateway Terminal with Buckeye Partners and Phillips 66 Partners. Andeavor's participation in a long-haul pipeline with connected marine capability will further strengthen Andeavor's and Andeavor Logistics' competitive position when pursuing new gathering projects in the Permian as it allows us to provide customers with multiple attractive takeaway opportunities out of the region.

In addition, the newly announced system extends Andeavor's footprint, allowing for more organic opportunities for Andeavor Logistics throughout the region and leverages existing infrastructure and connectivity to deliver higher volumes throughout our assets.

Together, these Permian projects exemplify our ability to compete and win crude oil gathering, transportation and storage projects in the region. Since our December 2017 Investor and Analyst Day, we have executed or been awarded eight distinct Permian opportunities. We are on track to achieve well over our 2020 target of $110 million of net earnings or $200 million of EBITDA from our business in the Permian. Overall, we remain very excited about the opportunities we see in the Permian Basin and look forward to sharing more details as we continue to execute on our plans.

We continue to further advance our organic growth projects across our business. In the Bakken, we moved our scheduled downtime of the Robinson Lake gas processing facility from March to May to allow for additional capacity expansion construction, which positions us to meet producer demand for more processing. We have already expanded our gathering lines in the area and continue to add new wells to the system.

Also in the Bakken, we are beginning to mobilize construction on the North Dakota NGL Logistics Hub. All contracts are in place, and we are on track for partial operations late in the fourth quarter of this year.

We also continue to find ways to partner with Andeavor's refining and commercial operations to grow the Terminalling & Transportation business. For example, we completed the first phase of our Stockton, California Terminal expansion in the first quarter and the second phase is expected to be completed within the second quarter. Once completed, we will be able to increase truck rack throughput and offload ethanol by rail car.

In addition, our project at the East Hynes Terminal to enable third party refined product volumes into our Southern California pipeline system is mechanically complete, with expected start up this quarter.

In addition to making progress on our organic projects, on May 1st, we closed on the Wamsutter acquisition. Transition and integration of the business is off to a great start with no interruptions to operations or customers. We expect the system to be a critical component of supplying additional advantaged crude oil to Salt Lake City refineries, including Andeavor's refinery.

Lastly, we announced our plans to accomplish our three-year drop down and asset transfer plans, communicated at our Investor and Analyst Day, this year. The assets are expected to include the Conan Crude Oil Gathering System, the Los Angeles Refinery Interconnect Pipeline, Andeavor's existing Permian assets - which now include the RIO Pipeline, and the majority of Andeavor's refining logistics assets. We plan to complete the drop down in August 2018 and estimate the transaction to have a total value of $1.6 to $1.7 billion. Our total capital investment expectations for 2018 to 2020 remain unchanged. Steven will share further details on the transaction and strategic rationale.

In summary, we remain confident 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 increased our 2020 net earnings and EBITDA guidance from $885 million and $1.5 billion, respectively, to at least $965 million and $1.6 billion, respectively, with no incremental increase in capital expenditures, reflecting our substantive progress and increased confidence in the business.

With that, I'll ask Steven, to provide more details about our business performance and results for the quarter.

Steven Sterin: Thanks, Greg.

We reported first quarter net earnings of $139 million and EBITDA of $273 million, an increase of $61 million over the prior year. As Greg mentioned, our results were reduced by $8 million due to expected and planned maintenance activities at Andeavor's West Coast refineries, which were well-executed and completed in the first quarter.

Moving to our business segments,

Terminalling and Transportation segment operating income was $120 million, an increase of $22 million from the prior year. Results compared to the prior year were primarily driven by the Western Refining Logistics acquisition and a full quarter of contribution from the November 2017 Anacortes Logistics Assets drop down. In the quarter, the aforementioned planned maintenance at Andeavor's refineries impacted demand for crude oil movements at our marine terminals and reduced short-haul crude oil and refined product pipeline movements. For the remainder of the year, we do not expect any material impact from planned Andeavor refinery maintenance.

Looking forward, we see a strong and growing macro-economic environment continuing for our business. Vehicle miles traveled and light product demand on the West Coast are showing solid growth over 2017. On a comparable basis, we've seen demand for light products at our terminals in the first quarter increase about 2.5% year-over-year.

Shifting to the Gathering and Processing segment,

Gathering and Processing segment operating income was $74 million for the first quarter 2018, an increase of $12 million from the prior year and segment EBITDA was $124 million, an increase of $23 million from the prior year. The year-over-year increase was primarily due to contributions from the Western Refining Logistics acquisition, Permian volume growth and organic growth at the Robinson Lake gas processing facility.

Crude Oil Gathering throughput decreased 7% to 304 thousand barrels per day from the prior quarter. In the Bakken, our volumes decreased due to lower demand for certain movements on our High Plains Pipeline system. As other third-party connections to DAPL have been completed, we've seen lower third-party volumes. First quarter volumes were still in line with our plan outlined at our 2017 Investor and Analyst Day, and we are already seeing higher nominations in the second quarter. With continued production growth from higher drilling activity and significant improvements in well productivity, we see the potential for increased movements on the system. While it is too early to quantify the potential upside, we will continue to provide updates throughout the year.

In the Permian, pipeline volumes increased approximately 5% over the prior quarter - another record on our system - driven by the robust pace of drilling activity, higher than expected initial production from new wells and organic growth from volumes related to trucking Conan Gathering system production prior to pipeline commissioning.

Gas Gathering and Processing throughput increased slightly from the prior quarter to 1,005 MMBTU per day, as new well completions in the Uinta Basin and Robinson Lake areas more than offset natural declines.

NGL volumes increased 4% from the prior quarter to 11.8 thousand barrels per day, driven by higher ethane recovery at our Blacksfork and Ironhorse gas processing facilities in the Rockies.

Looking forward in the Rockies, although too early to see an impact, there are some encouraging signs that could lead to future growth. For example, as new producers have acquired acreage and entered the region, we are seeing plans for increased activity. With certain producers, we are seeing a trend of larger completion designs and increasing initial production rates. We continue to see volumes relatively flat in the second quarter as new well completions partially offset natural decline. The current level of activity and outlook is consistent with our plan, with any growth being incremental. As we move into spring and summer, when more drilling and completion activity occurs, we will continue to provide more information on the potential upside to our plans from the Rockies.

In the Bakken, we see continuing oil, natural gas, and NGL production growth. There are currently 59 active rigs, an increase of 18% over the prior year. Crude oil production in February was up 14% year-over year, nearing record levels.

Natural gas and NGL production in the Bakken hit a new record in February, up 23% over the prior year. As Greg mentioned, we are focused on working closely with our customers and executing new projects, which will drive growth, such as the NGL Logistics Hub, the Robinson Lake gas processing facility expansion and other crude oil gathering systems and connections.

In the Permian, we continue to see a robust drilling and completion environment. In Lea, Loving, and Eddy Counties, the primary counties with close proximity to our Delaware Basin assets, rig count has increased from 73 this time last year to 113 currently, an increase of 55%. We continue to be highly successful in winning new crude oil gathering projects, almost doubling our dedicated acres from the prior quarter. We believe the widening differentials producers are seeing in the basin underscores a continuing need for gathering and takeaway infrastructure. Second quarter nominations on our systems are up about 7% so far over the prior quarter. We are very excited about the opportunities we see in the Delaware Basin and continue to remain highly-focused on executing our growth strategy there. We differentiate ourselves from the competition by bringing the expertise of Andeavor's commercial and refining operations to find win-win solutions for customers, Andeavor and Andeavor Logistics.

Shifting to the Wholesale segment,

Wholesale segment operating income was $4 million for the first quarter 2018, a decrease of $2 million from the prior quarter and segment EBITDA was $7 million, a decrease of $1 million from the prior quarter. Results compared to the prior quarter were driven by lower volumes due to seasonality. We are already seeing improved volumes in the second quarter as we begin to enter the spring and summer driving season.

Now, let me take a moment to discuss our balance sheet, cash flow and our strategic priorities for creating long-term unitholder value.

Our balance sheet and financial flexibility remain strong. As of the end of the first quarter, total debt, net of unamortized issuance costs, was $4.1 billion and we had approximately $1.7 billion of availability under our revolving credit facilities. Our leverage in the first quarter 2018, as calculated per our credit agreements, was below our target of approximately 4 times.

On April 18, 2018, we announced our first quarter distribution of $1.015 per limited partner unit, or $4.06 per unit on an annualized basis - our 28th consecutive quarterly distribution increase.

This represents an increase of 1.5% over the prior distribution and an increase of 8% over the past year. We continue to expect to grow our distribution by 6% or greater and have the growth plans, financial discipline and balance sheet to do so.

Our distribution coverage was just under 1 times in the first quarter, which was in line with our expectations. We expect coverage to continue to sequentially improve as distributable cash flow growth exceeds distribution growth. As a result, we remain confident in achieving our target annual coverage of approximately 1.1x in the second half of this year and expect coverage to improve further in 2019. The General Partner's distribution waivers for 2018 and 2019 remain in effect as instituted in 2017 under the terms of our limited partnership agreement and are not impacted by the proposed strategic combination of Andeavor and Marathon.

During the quarter, we invested $61 million in high-return, growth capital projects and had $10 million of net maintenance capital expenditures, bringing our total net capital expenditures to $71 million for the quarter.

For 2018, we now expect to invest a total of $2.2 to $2.3 billion, which includes $325 million in growth capital, $75 million in net maintenance capital, $180 million for the recently completed Wamsutter acquisition and $1.6 to $1.7 billion in drop downs and asset transfers.

In order to achieve our 2020 EBITDA target of at least $1.6 billion, we still plan to invest a total of approximately $3.3 billion in capital investments, including maintenance capital, from 2018 to 2020, unchanged from our prior guidance. As we look forward, we expect most of the spending in 2019 and 2020 to be growth capital. And, as previously stated, we do not expect to issue any public common equity through 2020 to achieve the plans I just discussed.

Now I'd like to take a minute to discuss our drop downs plans in greater detail.

We announced our plans for a $1.6 to $1.7 billion drop down to occur in August 2018. The drop down is expected to include the following: first, Andeavor's existing high-growth assets in the Permian Basin, which include the recently acquired Rio Pipeline; second, most of Andeavor's remaining refining logistics assets; and third, the transfer of the Conan Crude Oil Gathering System and the Los Angeles Refinery Interconnect Pipeline. As a reminder, Conan and the LA Interconnect Pipeline will be transferred at cost plus incurred interest.

Accomplishing the drop downs this year is expected to provide increased growth visibility, allow for more efficient operational management of the assets, capture the growth of our Permian strategy at Andeavor Logistics and maintain reporting transparency as changes in lease accounting standards become effective in 2019.

The transaction is expected to be funded with approximately 40% to 50% common equity issued to Andeavor and the remainder funded by debt and retained cash. We expect the transaction to close in August 2018 and be immediately accretive. Although Andeavor will have drop-eligible assets after this transaction, additional drop downs are not needed to achieve our targets of $685 to $785 million of net earnings and $1.2 to $1.3 billion of EBITDA in 2018 and $965 million of net earnings and at least $1.6 billion of EBITDA in 2020. Importantly, no new public common equity is required to fund our growth plans through at least 2020 and achieve our leverage, distribution growth and coverage targets.

You can find additional details of our volume expectations and other elements related to our second quarter 2018 outlook in our earnings release.

In closing, with visible growth from our organic investments and 2018 drop downs, combined with no public common equity needs, we are well-positioned to achieve exceptional unitholder value creation in 2018 and beyond.

This concludes the webcast. Thank you.

Forward-Looking Statements

This earnings release contains “forward-looking” statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including without limitation statements concerning: our operational, financial and growth strategies, including growing the business through asset optimization and strategic acquisitions, execution of growth projects and opportunities, high return organic growth, and lowering our cost of capital and extending debt maturities; our ability to successfully effect those strategies and the expected timing and results thereof; our financial and operational outlook, and ability to fulfill that outlook; our financial position, liquidity and capital resources, including available capacity under our credit facilities; statements regarding the announced acquisition of Andeavor by Marathon Petroleum Corporation, including its expected impact on Andeavor Logistics; expectations related to drop downs and public common equity issuances; statements regarding distribution waivers for 2018 and 2019; expectations regarding future economic and market conditions and their effects on our business; our 2020 net earnings and EBITDA targets; statements regarding our ability to deliver on our 2018-2020 strategic and financial targets; our ability to achieve our financial objectives in 2018, including coverage, leverage and distribution growth; statements regarding Andeavor’s 2018 to 2020 drop down and asset transfer plans, including the expected drop down to us of Permian gathering assets, including the Rio Pipeline, the majority of Andeavor’s remaining refining logistics assets, the Conan Crude Oil Gathering System and the Los Angeles Refinery Integration Pipeline, including the expected benefits and timing thereof, and expectations with respect to our *financing of the acquisition; statements related to our Permian growth strategy; statements regarding our new crude oil gathering projects in the Delaware Basin, including expected capital investment, timing of completion, and net earnings and EBITDA contributed thereby; statements regarding our announced projects and acquisitions; statements regarding Andeavor's participation in the Gray Oak Pipeline and the South Texas Gateway Terminal, including the expected benefits to us; expected impact from planned Andeavor refinery maintenance; second quarter and full year 2018 guidance and expectations; 2018 expected investments, including the components thereof; 2018-2020 expected total investments; projected annual net earnings and EBITDA contribution from the Permian gathering projects; 2018 and 2020 Andeavor Logistics projected net earnings and EBITDA; and other aspects of future performance. For more information concerning factors that could affect these statements, see our annual report on Form 10-K, quarterly reports on Form 10-Q, and other public filings and press releases, available at http://www.andeavorlogistics.com. We undertake no obligation to revise or update any forward-looking statements as a result of new information, future events or otherwise.*