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Andeavor Logistics LP (ANDX)

Q3 2018 Earnings Call

CORPORATE PARTICIPANTS

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Vice President-Investor Relations, MPLX LP

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Senior Vice President-Operations, Andeavor Logistics LP

Gary R. Heminger
Chairman and CEO

OTHER PARTICIPANTS

Jeremy Bryan Tonet
Analyst, JPMorgan Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Andeavor Logistics' Third Quarter Earnings Conference Call. My name is Michelle, and I will be your operator for today's conference. At this time all participants are in a listen only mode. Later, we will conduct a question-and-answer session. [Operator Instructions]

Please note that this conference is being recorded.

I would now like to turn the conference over to Kristina Kazarian. Kristina, you may begin.

Kristina A. Kazarian
Vice President-Investor Relations, MPLX LP

Good morning, and welcome to the Andeavor Logistics' third quarter 2018 earnings webcast and conference call. On the call today or Gary Heminger, Chairman and CEO of Andeavor Logistics; Don Sorensen, President of Andeavor Logistics; Greg Goff, Executive Vice Chairman of MPC; Tim Griffith, CFO of MPC; Andy Woodward, Vice President of Finance of Andeavor Logistics; and other members of the management team.

We invite you to read the Safe Harbor statements and non-GAAP disclaimer in our earnings release

which can be found on our website at andeavorlogistics.com, and reconciliations to certain non-GAAP measures we will be discussing today. It's a reminder that we will be making forward-looking statements during the call and during the question-and-answer session that follows. Actual results may differ materially from what we expect today. Factors that could cause actual results to differ are included there as well as in our filings with the SEC.

Now, I will turn the call over to Gary Heminger for opening remarks.

Gary R. Heminger
Chairman and CEO

Thanks, Kristina and good morning to everyone and thanks for joining our call. I would like to start by welcoming Andeavor Logistics to the Marathon Petroleum family. The addition of this business deepens our presence in the Permian and Bakken regions, and the expanded platform will create new opportunities across some of the fastest growing production regions in the U.S. Andeavor Logistics delivered

across some of the fastest growing production regions in the U.S. Andeavor Logistics delivered EBITDA of \$309 million for the quarter an increase of \$66 million over the prior year. Distributable cash flow attributable to common unitholders was \$251 million up 70% year-over-year. This provided distribution coverage of 1.05 times -- this provided distribution coverage of 1.05 times for the quarter. The company ended the quarter with \$4.8 billion of debt and approximately 3.7 times last 12 months pro forma EBITDA. EBITDA growth during the quarter was primarily driven by contributions from the \$1.6 billion drop down completed in August. This acquisition included Permian Basin and Bakken crude oil logistics assets as well as the majority of the remaining Andeavor refining logistics assets. As we look forward, the macro backdrop in the Permian region of the business continues to be compelling. We believe that U.S. production growth and global demand will remain strong across all key hydrocarbons of crude oil, natural gas, and NGLs and support an expanded opportunity set for the key parts of our business. In the Permian Basin, we continue to see a strong drilling and completion environment, which will continue to support the Permian region as one of the lowest cost in the United States.

Lastly, as we referenced in the third quarter distribution announcements we have held the distribution level flat as we evaluate the financial business plans of Andeavor Logistics. Given the evaluation of the business, we will not be providing any distribution growth guidance at this time. As we continue to enhance our understanding of the business, we reiterate our focus on meaningfully higher coverage, moderate leverage levels, and independent sustainability with limited parent support of the partnership. Additionally, MPC will be engaging advisors and will begin the process of assessing all options for the two MLPs in the near term. Our comments on any potential combination of the partnerships will be limited

through the evaluation process and an update will be provided to investors at the appropriate time.

Now let me turn the call over to Don to review operational highlights for the third quarter. Don?

Don J. Sorensen

Senior Vice President-Operations, Andeavor Logistics LP

Thanks, Gary. Moving to our business segments. Terminalling and Transportation reported segment EBITDA of a \$180 million, an increase of \$38 million year-over-year. Terminalling throughput was 1.8 million barrels per day an increase of 3% from last year and pipeline transportation throughput was 1.1 billion barrels per day an increase of 18% year-over-year. Compared to the prior year results were primarily driven by contributions from the 2018 dropdown which contributed \$19 million of segment EBITDA during the quarter. The Western Refining Logistics acquisition, the 2017 Anacortes Logistics asset drop down as well as organic growth projects. These improvements were partially offset by lower volumes on our northwest product system due to planned refinery downtime as well as some unplanned third-party refinery maintenance in Salt Lake City.

In Terminalling and Transportation we continue to find ways to partner with our parents refining the commercial operations to grow this business as well as optimize our assets and attract additional third-party business. Construction of the Los Angeles Refinery Interconnect pipeline project continues and is expected to be completed by the end of the year.

Additionally we recently completed an expansion project at our Stockton, California terminal which allows renewable fuel offloading and generates higher terminal throughput. We also completed a new pipeline

connection enabling third-party connectivity into our southern California pipeline system and at our East Hynes Terminal in California.

Moving to Gathering and Processing, segment EBITDA was \$130 million, an increase of \$27 million from the prior year. The year-over-year increase

was primarily driven by contributions from the Permian Basin crude oil volume growth, higher crude oil volumes on our Bakken Connolly Gathering System and the Western Refining Logistics acquisition.

The 2018 dropdown contributed \$7 million of segment EBITDA in the Gathering and Processing segment during the quarter. During the quarter, we began construction on a crude oil gathering system for a major producer with connectivity into the High Plains pipeline system. This project is expected to be completed in early 2019.

We are also adding new well connections to our existing gathering systems including the Connolly Gathering System. In the Permian, construction continues on our Conan Crude Oil Gathering System and we expect it to be fully operational by the end of this year. For the third quarter volumes on the system were approximately 90,000 barrels per day. We have been connecting on average two central tank batteries to the system each week and expect that to continue through year end.

By the end of the year, we could see as much as a 40% increase in the volume from the third quarter. Our project to connect the Conan System to the recently drop Andeavor Logistics Rio Pipeline is expected to be completed in early 2019. The connected system will provide producers additional takeaway options out of this growing basin or pipeline capacity has remained limited today.

Turning to our natural gas – natural gas liquids business. Gas gathering and processing throughput were 722,000 million BTU per day. Please note that due to the adoption of a new revenue recognition standard, reported gas volumes were lowered by approximately 184,000 million BTUs per day.

On a comparable basis, volume decreased approximately 6% from the prior quarter, driven primarily by natural production

decline in the Rockies. As mentioned previously, this was due to an expiration of certain process and agreements with minimal impact to earnings. This volume decrease was partially offset by increased volumes in the Bakken to the recently completed Robinson Lake gas processing facility expansion. NGL volumes increased 4% from the prior quarter to 9,500 barrels per day. As our gas processing facilities in the Rockies were in ethane recovery for a portion of the quarter. We expect initial operations of the North Dakota NGL Logistics Hub start in late fourth quarter of 2018, as construction remains on schedule. The segment of the former Bakkenlink pipeline is currently undergoing NGL line fill with expectations of our first rail shipment in November. This project should be fully operational in the first quarter 2019 and we expect it to deliver annual EBITDA of \$24 million representing approximately 6.5 times EBITDA investment multiple.

Shifting to wholesale, segment EBITDA for the third quarter 2018 was \$11 million, an increase of \$2 million from the prior year. This increase compared to the prior year was driven by higher wholesale margin environment.

With that, let me turn the call over to Andy to cover some financial highlights.

[0J3D68-E Andrew Woodward]

Thanks, Don. We reported EBITDA of \$309 million and distributable cash flow attributable to common unitholders of \$251 million for the third quarter, both of which increased substantially versus the same quarter last year. Please remember third quarter EBITDA includes approximately \$6 million of transaction costs related to recent acquisitions.

Moving on to distributions. On October 26 2018 we announced our third quarter distribution of a \$1.03 per limited partner unit or \$4.12 per unit on an annualized basis. Our distribution coverage was 1.05 times in the third quarter. Distributable cash flow was adjusted by \$18 million related to revenue recognition accounting standards, timing on recognition of minimum volume commitments and expenses related to recent transactions.

Turning to our balance sheet. As of the end of the third quarter total debt net of unamortized issuance costs was \$4.8 billion and we had approximately \$1 billion of availability under our revolving credit facilities. We ended the quarter with a leverage ratio of 3.7 times below our target of 4.0 times. Net capital expenditures for the third quarter of 2018 were \$175 million, which included a \$159 million of growth investments and \$16 million of net maintenance capital. Andeavor Logistics expects to invest approximately \$640 million in growth capital and \$80 million in net maintenance capital in 2018. Please be aware that 2018 capital expenditures have been retrospectively adjusted to include the historical investments of the assets from the 2018 dropdown prior to the August 6, 2018 effective date of the acquisition. Detailed information regarding 2018 capital expenditures can be found in the tables in the press release.

Now let me turn the call back over to Christina.

Unverified Participant

Thanks Andy. As we open the call for questions we ask that you limit yourself to one question plus a follow up. You may prompt additional questions as time permits. With that we will now open the call to questions. Michelle we're ready.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question and answer session. [Operator Instructions] [Operator Instructions] Our first question comes from the line of Jeremy Tonet with JPMorgan. Your line is open. Please go ahead.

Jeremy Bryan Tonet
Analyst, JPMorgan Securities LLC

Q

Good morning.

A

Hi, Jeremy.

Jeremy Bryan Tonet
Analyst, JPMorgan Securities LLC

Q

Thanks. Just pick up with – the thoughts you put out there as far ANDX kind of reviewing coverage leverage and financial flexibility there and on the numbers we see to get coverage for ANDX to reach MPLX that level, it takes kind of an extended period of time to achieve that. So, I'm wondering are there other avenues to you know to get to this final position as far as you know similar metrics or is just kind of a waiting game to growing into those type of metrics?

A

Jeremy, this is Tim. I think we'll you know again, there's sort of continuing evaluation going on so that we make sure we've got a crystal clear understanding of the business and its prospects. You know we're this is really part of this overall evaluation. You know we've – we've indicated that the intent will be to move coverage substantially higher to manage leverage at appropriate levels and that's exactly what we'll do. So I would say over that sort of coming months like we'll have more crystallized view on how we want to approach it and we'll certainly report out at the appropriate time.

Jeremy Bryan Tonet
Analyst, JPMorgan Securities LLC

Q

Thanks for that. And just want to see on the crude oil gathering volumes. Look like that it was a bit lighter than we were expecting. Any – any additional color that you can provide there?

Don J. Sorensen
Senior Vice President-Operations, Andeavor Logistics LP

A

Yes Jeremy this is Don. When you look at it on a year-over-year basis the bulk of what we've seen there has been a little bit of a drop off in the Bakken. We are seeing some sequential growth quarter-over-quarter as we move through 2018, and then still continue to expect very strong growth in the Permian.

Q

Thanks for that. That's it for me.

Operator: Thank you. Our next question comes from the line of Spiro Dounis with Credit Suisse. Your line is open. Please go ahead.

Q

Hey, guys. That's really John Mackay on for Spiro. I just wanted to follow up on Jeremy's last question there. Could you just kind of walk us through maybe by each basin what we saw for quarter-over-quarter on GNP? Just trying to get apples-to-apples for the drop.

A

Yeah, Spiro, this is Don again. I think when you look at the Bakken as we noted we certainly are seeing some strong opportunities in gathering particularly around well connects in our Connolly Gathering System area. So as we look at that quarter-over-quarter we're certainly seeing that walk up. And then, when you look at the Permian Basin for us really so much of that is what's come to us with the Conan system as part of the drop down. And as noted, we've seen continued strong growth with that and really by the end of the year we expect to see potentially 40% increase over where we were at ending the third quarter.

Q

And then just on the Rockies, if we are down a little bit quarter-over-quarter how do we see that trending into 2019?

A

Yeah. What we're seeing in the Rockies is it's been that natural decline, but with some of the new producers coming into both the Green River Basin and the Uinta Basin we're working very closely with them and we actually see the potential for that decline to get arrested somewhat and potentially start turning the other direction for us.

Q

All right. That's helpful. Thanks. Just one last one, prior to the merger we had some kind of longer dated guidance from ANDX just wondering if that's still intact, specifically looking at that \$1.6 billion of EBITDA by 2020 that they talked about.

A

Yeah John, we're not in a position to affirm guidance at this point. So just stay tuned and we'll continue to do our work and as soon as we finish this evaluation we'll be back to talk to the investors.

Q

Great. Thanks very much guys.

Operator: Thank you. [Operator Instructions] Our next question comes from Shneur Gershuni with UBS. Your line is open, please go ahead.

Q

Good morning guys. It's Shneur Gershuni here. I was just wondering if we can get a little granular if possible. When you sort of put out your – the commentary about you want leverage and you want coverage to be at X point. You showed us a trailing leverage metric which seems to be within your wheel house. In terms of how the coverage improves over time, historically Andeavor when it was – previously they had given guidance of a cadence of about \$1.5 billion up to 2020 and it had to do with the drop that was just put into place as well as the Conan system. Can we expect that same cadence of growth kind of in the Permian, in the Bakken and so forth over the next several quarters and we can see the coverage catch up as well. Also I was just wondering if you can at least talk specifically about the cadence of those assets?

A

Don you went to talk about the operations?

A

Yeah, in terms of the cadence of the assets – when you look at Conan we're finishing up the work on that and we'll have that at least the first phase of that project fully implemented by the end of the year and see in a very quick rampon the volumes and associated yield about a contribution from that project. And then as I mentioned in the Bakken, it's – it's really – those opportunities around our Connolly gathering system in the other project that we're – the gathering project that we're in the process of constructing that will be completed in the first quarter that will bring that additional growth in the Bakken Basin for us.

Q

So, is it fair to conclude that – that's going to give us growth on a year-over-year basis, and we could see the coverage improvement that you're targeting?

A

Well, as I just said earlier, we are – we're not in a position this day to give you any guidance on – on what the coverage will be in 2019 or you know what the EBITDA expectations are for 2019 and 2020. We will finish our work and as soon as we are comfortable with that then we'll make it public.

Q

Okay. And as a follow-up question, you know given the announcement of doing a strategic review as a conflicts committee informed as of yet?

A

Absolutely, we have. We formed the conflicts committee day one and in fact the conflicts committee remains to be the same conflicts committee that was for ANDX prior to our merger except for one person who has stepped off due to a conflict. But other than that it's of the conflicts committee remains the same.

Q

Any chance we'll get an update by the analyst day or is that too soon?

A

You won't see any updates prior to the analyst day and that I don't want to put any false hopes out that on analyst day, we're going to have a conclusion. As you know this takes time. We've had you know a number of questions over the past that we've hired advisors yet. The ANDX has not engaged in the advisory yet. First we're doing our internal work to determine what is the best path forward and then we will engage the appropriate advisors. I should say the Conflicts Committee will engage their advisers.

Q

Got it. Perfect. Thank you very much guys. Appreciate the color.

A

You're welcome.

Operator: Thank you. And I'm showing no further questions at this time and I would like to turn the conference back over to Kristina Kazarian for any further remarks.

Kristina A. Kazarian

Vice President-Investor Relations, MPLX LP

Thank you for joining us today and thank you for your interest in Andeavor Logistics. Should you have additional questions or would like clarification on any of the topics discussed this morning, we will be available to take your calls. With that, Michelle, I'll turn the call back to you.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone, have a great day.

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