

PHILLIPS 66 PARTNERS LP
Form 10-Q
October 28, 2016
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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 September 30, 2016
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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer Accelerated filer Non-accelerated filer
Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes [] No [X]

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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 | | Nine Months Ended | |
| | September 30 2016 | 2015* | September 30 2016 | 2015* |
| Revenues and Other Income | | | | |
| Operating revenues—related parties | \$108,471.1 | | 315.7 | 204.0 |
| Operating revenues—third parties | 1.8 | 0.7 | 5.9 | 2.7 |
| Equity in earnings of affiliates | 33.8 | 25.2 | 88.5 | 51.9 |
| Other income | 0.3 | 0.1 | 0.8 | 0.2 |
| Total revenues and other income | 144.3 | 97.1 | 410.9 | 258.8 |
| Costs and Expenses | | | | |
| Operating and maintenance expenses | 25.5 | 20.3 | 76.4 | 56.3 |
| Depreciation | 15.1 | 6.1 | 43.5 | 16.8 |
| General and administrative expenses | 9.2 | 7.4 | 26.0 | 23.2 |
| Taxes other than income taxes | 1.2 | 3.1 | 12.3 | 8.9 |
| Interest and debt expense | 9.9 | 9.2 | 30.8 | 24.6 |
| Other expenses | 0.1 | — | 0.1 | 0.1 |
| Total costs and expenses | 61.0 | 46.1 | 189.1 | 129.9 |
| Income before income taxes | 83.3 | 51.0 | 221.8 | 128.9 |
| Provision for income taxes | 0.2 | 0.1 | 0.8 | 0.2 |
| Net Income | 83.1 | 50.9 | 221.0 | 128.7 |
| Less: Net income (loss) attributable to Predecessors | — | (1.4) | 18.1 | (1.0) |
| Net income attributable to the Partnership | 83.1 | 52.3 | 202.9 | 129.7 |
| Less: General partner's interest in net income attributable to the Partnership | 26.0 | 11.5 | 62.9 | 26.9 |
| Limited partners' interest in net income attributable to the Partnership | \$57.1 | 40.8 | 140.0 | 102.8 |
| Net Income Attributable to the Partnership Per Limited Partner Unit—Basic and Diluted (dollars) | | | | |
| Common units | \$0.57 | 0.50 | 1.53 | 1.40 |
| Subordinated units—Phillips 66 | — | — | — | 0.82 |
| Cash Distributions Paid Per Limited Partner Unit (dollars) | \$0.50 | 0.400 | 1.444 | 1.110 |
| Average Limited Partner Units Outstanding—Basic and Diluted (thousands) | | | | |
| Common units—public | 40,392 | 24,139 | 32,007 | 23,120 |
| Common units—Phillips 66 | 60,163 | 57,743 | 59,408 | 40,366 |
| Subordinated units—Phillips 66 | — | — | — | 17,028 |

*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 | | Nine | |
| | Months | | Months | |
| | Ended | | Ended | |
| | September | | September | |
| | 30 | | 30 | |
| | 2016 | 2015* | 2016 | 2015* |
| Net Income | \$83.1 | 50.9 | 221.0 | 128.7 |
| Defined benefit plans | | | | |
| Plan sponsored by equity affiliate, net of tax | (0.4) | — | 0.3 | — |
| Other Comprehensive Income | (0.4) | — | 0.3 | — |
| Comprehensive Income | \$82.7 | 50.9 | 221.3 | 128.7 |

*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 | |
|--|---------------------|-------------------|
| | September 30, 2016 | December 31, 2015 |
| Assets | | |
| Cash and cash equivalents | \$ 19.0 | 50.3 |
| Accounts receivable—related parties | 39.8 | 21.4 |
| Accounts receivable—third parties | 1.6 | 3.3 |
| Materials and supplies | 5.5 | 4.5 |
| Prepaid expenses | 3.8 | 1.9 |
| Other current assets | 0.4 | 2.3 |
| Total Current Assets | 70.1 | 83.7 |
| Equity investments | 1,103.4 | 944.9 |
| Net properties, plants and equipment | 1,674.3 | 1,644.1 |
| Goodwill | 2.5 | 2.5 |
| Deferred rentals—related parties | 5.3 | 5.6 |
| Deferred tax assets | — | 0.1 |
| Other assets | 24.9 | 0.7 |
| Total Assets | \$2,880.5 | 2,681.6 |
| Liabilities | | |
| Accounts payable—related parties | \$ 7.3 | 3.9 |
| Accounts payable—third parties | 19.6 | 66.9 |
| Payroll and benefits payable | — | 0.7 |
| Accrued property and other taxes | 11.8 | 7.7 |
| Accrued interest | 5.1 | 22.2 |
| Short-term debt | 50.0 | — |
| Deferred revenues—related parties | 10.0 | 4.6 |
| Other current liabilities | 1.1 | 0.9 |
| Total Current Liabilities | 104.9 | 106.9 |
| Notes payable—related party | — | 964.0 |
| Long-term debt | 1,091.4 | 1,090.7 |
| Asset retirement obligations | 4.0 | 3.9 |
| Accrued environmental costs | 0.9 | 0.8 |
| Deferred income taxes | 1.0 | 0.3 |
| Deferred revenues—related parties—long-term | 19.9 | 11.0 |
| Total Liabilities | 1,222.1 | 2,177.6 |
| Equity | | |
| Net investment—Predecessors | — | 113.9 |
| Common unitholders—public (2016—43,134,902 units issued and outstanding; 2015—24,138,750 units issued and outstanding) | 1,790.3 | 808.9 |
| Common unitholder—Phillips 66 (2016—60,162,787 units issued and outstanding; 2015—58,349,042 units issued and outstanding) | 468.9 | 233.0 |
| General partner—Phillips 66 (2016—1,978,603 units issued and outstanding; 2015—1,683,425 units issued and outstanding) | (599.6) | (650.3) |
| Accumulated other comprehensive loss | (1.2) | (1.5) |

| | | |
|---|-----------|---------|
| Total Equity | 1,658.4 | 504.0 |
| Total Liabilities and Equity | \$2,880.5 | 2,681.6 |
| See Notes to Consolidated Financial Statements. | | |

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Consolidated Statement of Cash Flows Phillips 66 Partners LP

| | Millions of Dollars Nine Months Ended September 30 2016 2015* | |
|--|--|------------|
| Cash Flows From Operating Activities | | |
| Net income | \$221.0 | 128.7 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation | 43.5 | 16.8 |
| Deferred taxes | 0.5 | — |
| Deferred rentals | 0.3 | 0.3 |
| Accrued environmental costs | 0.1 | 0.6 |
| Undistributed equity earnings | (3.8 |)(2.7) |
| Deferred revenues—long-term | 8.9 | 3.3 |
| Other | 4.4 | 1.6 |
| Working capital adjustments | | |
| Decrease (increase) in accounts receivable | (16.2 |)(4.1) |
| Decrease (increase) in materials and supplies | (1.0 |)(1.8) |
| Decrease (increase) in prepaid expenses and other current assets | (2.0 |)(2.1) |
| Increase (decrease) in accounts payable | 2.8 | (8.6) |
| Increase (decrease) in accrued interest | (17.1 |)3.2 |
| Increase (decrease) in deferred revenues | 5.4 | 5.7 |
| Increase (decrease) in other accruals | 3.5 | 5.6 |
| Net Cash Provided by Operating Activities | 250.3 | 146.5 |
| Cash Flows From Investing Activities | | |
| Sand Hills/Southern Hills/Explorer equity investment acquisition | — | (734.3) |
| Cash capital expenditures and investments | (248.9 |)(676.9) |
| Return of investment from equity affiliates | 10.4 | 8.2 |
| Other | (24.2 |)— |
| Net Cash Used in Investing Activities | (262.7 |)(1,403.0) |
| Cash Flows From Financing Activities | | |
| Net contributions from Phillips 66 to Predecessors | 89.2 | 36.1 |
| Acquisition of noncontrolling interest in Sweeny Frac LLC | (655.6 |)— |
| Issuance of debt | 427.6 | 1,669.7 |
| Repayment of debt | (686.0 |)(498.6) |
| Issuance of common units | 983.1 | 396.4 |
| Offering costs | (11.3 |)(12.5) |
| Debt issuance costs | — | (9.9) |
| Distributions to General Partner associated with acquisitions | — | (145.7) |
| Quarterly distributions to common unitholders—public | (41.4 |)(25.0) |
| Quarterly distributions to common unitholder—Phillips 66 | (85.4 |)(38.5) |
| Quarterly distributions to subordinated unitholder—Phillips 66 | — | (25.0) |
| Quarterly distributions to General Partner—Phillips 66 | (50.0 |)(18.8) |
| Other cash contributions from (to) Phillips 66 | 10.9 | (0.2) |
| Net Cash Provided by (Used in) Financing Activities | (18.9 |)1,328.0 |

| | | |
|--|---------|------|
| Net Change in Cash and Cash Equivalents | (31.3) | 71.5 |
| Cash and cash equivalents at beginning of period | 50.3 | 17.4 |
| Cash and Cash Equivalents at End of Period | \$19.0 | 88.9 |

*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 | | | | | | | |
|--|------------------------------------|-------------------------------------|---|--------------------------------------|---------------------------------------|---------------------------------|---------|--|
| | Common Unitholder Public | Common Unitholder Phillips 66 | Subordinated Unitholder Phillips 66 | General Partner Phillips 66 | Accum. Other Comprehensive Loss | Net Investment Predecessors* | Total | |
| December 31, 2014 | \$415.3 | 57.1 | 116.8 | (517.0) | — | 91.7 | 163.9 | |
| Net income attributable to Predecessors | — | — | — | — | — | (1.0) | (1.0) | |
| Net contributions from Phillips 66—Predecessors | — | — | — | — | — | 36.1 | 36.1 | |
| Issuance of common units | 383.9 | — | — | — | — | — | 383.9 | |
| Conversion of subordinated units | — | 105.8 | (105.8) | — | — | — | — | |
| Deemed net distributions to General Partner associated with acquisitions | — | — | — | (145.0) | — | — | (145.0) | |
| Net income attributable to the Partnership | 30.3 | 58.5 | 14.0 | 26.9 | — | — | 129.7 | |
| Other comprehensive loss | — | — | — | — | (1.5) | — | (1.5) | |
| Quarterly cash distributions to unitholders and General Partner | (25.0) | (38.5) | (25.0) | (18.8) | — | — | (107.3) | |
| Other contributions from Phillips 66 | — | — | — | 4.1 | — | — | 4.1 | |
| September 30, 2015 | \$804.5 | 182.9 | — | (649.8) | (1.5) | 126.8 | 462.9 | |
| December 31, 2015 | \$808.9 | 233.0 | — | (650.3) | (1.5) | 113.9 | 504.0 | |
| Net income attributable to Predecessors | — | — | — | — | — | 18.1 | 18.1 | |
| Net contributions from Phillips 66—Predecessors | — | — | — | — | — | 134.5 | 134.5 | |
| Issuance of common units | 971.6 | — | — | — | — | — | 971.6 | |
| Allocation of net investment to unitholders | — | 232.5 | — | 34.0 | — | (266.5) | — | |

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| | | | | | | | |
|---|-----------|--------|----|--------|-------|----|----------|
| Net income attributable to the Partnership | 51.2 | 88.8 | — | 62.9 | — | — | 202.9 |
| Other comprehensive income | — | — | — | — | 0.3 | — | 0.3 |
| Quarterly cash distributions to unitholders and General Partner | (41.4 |)(85.4 |)— | (50.0 |)— | — | (176.8) |
| Other contributions from Phillips 66 | — | — | — | 3.8 | — | — | 3.8 |
| September 30, 2016 | \$1,790.3 | 468.9 | — | (599.6 |)(1.2 |)— | 1,658.4 |

*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

| | Common Units Public | Common Units Phillips 66 | Subordinated Units Phillips 66 | General Partner Units Phillips 66 | Total Units |
|---|---------------------------|--------------------------------|--------------------------------------|--|-------------|
| December 31, 2014 | 18,888,750 | 20,938,498 | 35,217,112 | 1,531,518 | 76,575,878 |
| Units issued in public equity offerings | 5,250,000 | — | — | — | 5,250,000 |
| Units issued associated with Sand Hills/Southern Hills/Explorer equity investment acquisition | — | 1,587,376 | — | 139,538 | 1,726,914 |
| Subordinated unit conversion | — | 35,217,112 | (35,217,112) | — | — |
| September 30, 2015 | 24,138,750 | 57,742,986 | — | 1,671,056 | 83,552,792 |
| December 31, 2015 | 24,138,750 | 58,349,042 | — | 1,683,425 | 84,171,217 |
| Units issued in public equity offerings | 18,996,152 | — | — | — | 18,996,152 |
| Units issued in Initial Fractionator Acquisition* | — | 412,823 | — | 8,425 | 421,248 |
| Units issued in Subsequent Fractionator Acquisition* | — | 1,400,922 | — | 286,753 | 1,687,675 |
| September 30, 2016 | 43,134,902 | 60,162,787 | — | 1,978,603 | 105,276,292 |

*See Note 4—Fractionator Acquisitions, in the Notes to Consolidated Financial Statements.
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.

Business Description

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 transportation and midstream assets. Our common units trade on the New York Stock Exchange under the symbol PSXP.

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

We generate revenue primarily by providing fee-based transportation, terminaling, storage and NGL fractionation services to Phillips 66 and other customers. Our equity affiliates generate revenue primarily 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.

In March and May of 2016, in two separate transactions, we acquired an NGL fractionator and associated storage caverns from Phillips 66, along with a refined petroleum products pipeline system. See Note 4—Fractionator Acquisitions for additional information.

On May 10, 2016, we completed a public offering of 12,650,000 common units for total proceeds (net of underwriting discounts and commissions) of \$655.6 million (the First 2016 Unit Offering). The net proceeds from the First 2016 Unit Offering were used to repay a portion of the notes assumed as part of the consideration paid for the May acquisition described above. On August 12, 2016, we completed a public offering of 6,000,000 common units for total proceeds (net of underwriting discounts and commissions) of \$298.5 million (the Second 2016 Unit Offering). The net proceeds from the Second 2016 Unit Offering were used to repay the note assumed as part of the consideration paid for the March acquisition described above, as well as other short-term borrowings. See Note 8—Equity for additional information.

Other developments during the third quarter of 2016 included:

Formation of STACK Pipeline Joint Venture: On August 3, 2016, we and Plains All American Pipeline, L.P. (Plains) formed STACK Pipeline LLC (STACK Pipeline JV), a 50/50 joint venture that owns and operates a crude oil storage terminal and a common carrier pipeline that transports crude oil. Plains contributed the terminal and pipeline to the joint venture, and we contributed \$50.0 million in cash, which was distributed to Plains. See Note 5—Equity Investments for additional information.

Explorer Equity Investment Acquisition: On August 9, 2016, we acquired an additional 2.48 percent equity interest in Explorer Pipeline Company (Explorer). The acquisition increased our interest in Explorer from 19.46 percent to 21.94 percent. See Note 5—Equity Investments for additional information.

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 these acquired businesses prior to the effective date of each acquisition. We refer to these pre-acquisition operations as those of our “Predecessors.”

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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 took place within the Phillips 66 consolidated group. The consolidated statement of income also includes expense allocations for certain functions performed by Phillips 66, including allocations of general corporate expenses related to executive oversight, accounting, treasury, tax, legal, information technology and procurement; and operational support services such as engineering and logistics. These allocations were based primarily on relative values of properties, plants and equipment (PP&E) 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.

The presentation of prior-period prepaid expenses on the consolidated balance sheet has been recast to conform to the current year's presentation.

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 retrospectively adjusted consolidated financial statements and notes included in our Current Report on Form 8-K filed with the U.S. Securities and Exchange Commission (SEC) on August 1, 2016. The results of operations for the three and nine months ended September 30, 2016, are not necessarily indicative of the results to be expected for the full year.

Note 3—Changes in Accounting Principles

Effective January 1, 2016, we early adopted the Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes." The new update simplified the presentation of deferred income taxes and required deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The classification was made at the taxpaying component level of an entity, after reflecting any offset of deferred tax liabilities, deferred tax assets and any related valuation allowances. We applied the amendments prospectively to all deferred tax liabilities and assets.

In June 2014, the FASB issued ASU No. 2014-10, "Development Stage Entities (Topic 915): Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities (VIE) Guidance in Topic 810, Consolidation." The new standard removes the definition of a development stage entity from the Master Glossary of the Accounting Standard Codification (ASC) and the related financial reporting requirements specific to development stage entities. This ASU is intended to reduce cost and complexity of financial reporting for entities that have not commenced planned principal operations. For financial reporting requirements other than the VIE guidance

in ASC Topic 810, "Consolidation," ASU No. 2014-10 was effective for annual and quarterly reporting periods of public entities beginning after December 15, 2014. For the financial reporting requirements related to VIEs in ASC Topic 810, "Consolidation," ASU No. 2014-10 was effective for annual and quarterly reporting periods of public entities beginning after December 15, 2015. We adopted the provisions of this ASU related to the financial reporting requirements other than the VIE guidance effective January 1, 2015. We adopted the remaining provisions effective January 1, 2016, and updated our disclosures about the risks and uncertainties related to our joint venture entities that have not commenced their principal operations.

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Note 4—Fractionator Acquisitions

During 2016, in two separate transactions, we acquired an NGL fractionator and associated storage caverns from Phillips 66, along with a refined petroleum products pipeline system. Details on each of these transactions follow.

Initial Fractionator Acquisition

On February 17, 2016, we entered into a Contribution, Conveyance and Assumption Agreement (CCAA) with subsidiaries of Phillips 66 to acquire a 25 percent controlling interest in Phillips 66 Sweeny Frac LLC (Sweeny Frac LLC) for total consideration of \$236 million (the Initial Fractionator Acquisition). Total consideration consisted of the assumption of a \$212 million note payable to a subsidiary of Phillips 66 and the issuance of 412,823 newly issued common units to Phillips 66 Project Development Inc. (P66 PDI) and 8,425 general partner units to Phillips 66 Partners GP LLC (our General Partner) to maintain its 2 percent general partner interest. The Initial Fractionator Acquisition closed on March 1, 2016. Total transaction costs of