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DCP - Q3 2019 DCP Midstream LP Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing-by and welcome to the Q3 2019 DCP Midstream Earnings Conference Call. At this time all participants are in a listen-only mode, after the speakers presentation there will a question-and-answer session. (Operator Instructions)

I would now like to hand the conference over to your speaker today Sarah Sandberg, Senior Director of Investor Relations. Thank you, please go ahead Ma'am.

Sarah Sandberg - *DCP Midstream, LP - Senior Director of Communications & Public Affairs*

Thanks Chris. Good morning and welcome to the DCP Midstream third quarter 2019 earnings call. Today's call is being webcast and I encourage those listening on the phone to view the supporting slides which are available on our website at dcpmidstream.com.

Before we begin, I'd like to point out that our discussion today includes forward-looking statements. Actual results may differ due to certain risk factors that affect our business. Please review the second slide in the deck that describes our use of forward-looking statements. And for a complete listing of the risk factors, please refer to the partnership's latest SEC filings. We will also use various non-GAAP measures, which are reconciled to the nearest GAAP measure and scheduled in the appendix section of the slides.

Wouter van Kempen, CEO; and Sean O'Brien, CFO will be our speakers today. And after their remarks, we will take your questions.

With that, I'll turn the call over to Wouter.

Wouter van Kempen - *DCP Midstream, LP - Chairman of the Board and CEO*

Thank you, Sarah. Good morning, everyone. We appreciate you joining us for the call today. And we have a lot of great news to discuss. So on today's call we're excited to share how we continue to enhance unitholder value through consistent progress towards our financial targets, solid execution of our predominantly fee-based capital projects and the elimination of our IDRs.



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But before we jump into details on the quarter, let's start with our IDR elimination on Slide 4. Yesterday, we were very, very happy to announce the closing of a transaction that permanently eliminates our general partners economic interest including IDRs in exchange for 65 million DCP common units. This transaction is valued at approximately \$1.53 billion based on a 20 day volume weighted average price of \$23.62 as of the markets close on November 5. The deal represents a nine times multiple of current total general partner distributions. And Enbridge and Phillips 66 maintain equal ownership in the non-economic interest of the GP, which now owns 57% of DCP's outstanding common units.

Let's move to Slide 5. In the past when we discussed the potential IDR elimination, we continued to reiterate two key themes. First, a deal would be fair to all stakeholders and secondly we will transact from a position of strength. And we have absolutely delivered on both of those commitments. Let me highlight a few points on this slide to drive home that first theme. This transaction ensures complete economic parity between our common unit holders, Enbridge and Phillips 66. The elimination of our IDRs lowers our future cost of capital, positioning DCP for continued long-term success and continued ability to grow. This agreement represents one of the lowest multiples compared to similar IDR elimination transactions and one that we believe is very fair to all unitholders. It has minimal impact on our financial metrics with only a 0.05 impact to coverage and a de minimus effect on our leverage. And with this deal we solidify our track record of maintaining or growing the distribution throughout the history of our Company due to our strong financial position.

I also want to highlight our commitment to transacting from a position of strength and why the timing of the deal is very strategic. Our financial flexibility remains solid with great year-to-date distribution coverage, ample liquidity, a continued commitment to no need for common equity and line of sight to increase in cash flows, which brings me to our capital allocation strategy. Today, 50% of our EBITDA comes from our logistics and marketing segments, representing a substantial increase from just 10% of EBITDA in 2011. Looking to our 2019 and 2020 growth portfolio, we are continuing to expand our fee based margin profile.

From DJ Basin gathering and processing to NGL and gas takeaway pipelines and the Sweeny Fracs, these projects further integrate and expand our value chain while continuing to balance our portfolio and mitigate against potential overbuild. 90% of these projects are fee based, adding approximately \$270 million of incremental adjusted EBITDA on an annualized basis. Coupled this strategic growth with our solid financials and the time was right for us to eliminate our IDRs from a position of strength. In summary, this transaction further enhances DCP's value proposition as a premier, fully integrated midstream service provider and we believe this is a great result for the LP unitholders and for the future of our Company.

And before I turn to the quarter, I'll once again emphasize that we are very, very pleased with and tremendously excited by this outcome. We wanted to get this right and I strongly believe that we did.

Now looking to our Q3 highlights on Slide 7. The elimination of our IDRs comes on the back of another strong quarter demonstrating the competitive advantage of our diversified portfolio and fully integrated value chain. Year-to-date, our adjusted EBITDA totaled \$904 million and our DCF is \$587 million, bringing our distribution coverage to 1.27 times for the year. In addition, to solid outcomes from both segments, which offset lower commodity prices, we continue to successfully execute on our disciplined growth strategy with a focus on increasing capital efficiency and mitigating against overbuild risk.

We remain in lockstep with our customers' needs in the DJ Basin and actively expanding G&P residue gas and NGL takeaway capacity. The O'Connor 2 plant is in service and is currently averaging about 130 million cubic foot per day of natural gas throughput. Our marketing team has done a great job executing on incremental interim takeaway solutions in the DJ allowing us to exceed our initial volume expectations at the plant. Following the FERC approval for Cheyenne Connector in September, we exercise an increased ownership option of 50% on the pipeline. The 600 million cubic feet per day residue gas pipeline is expected to be in surface within the first half of 2020 and will fully alleviate all constraints in the DJ Basin, unlocking the full potential of our customers production.

In the Permian, the Gulf Coast Express pipeline was placed in service in September, slightly ahead of expectation and adding approximately two Bcf per day of needed gas takeaway from the Delaware Basin. Our team continues to deliver on our operational, financial and structural commitments to drive our company forward and increase unitholder value.

Now I'll turn it over to Sean to discuss our financial results.



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Sean P. O'Brien - DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC

Thanks Wouter and good morning. I'm excited to walk through another terrific quarter for DCP, driven by solid results from both of our segments. Slide 8 highlights our strong execution in Q3, delivering DCF of \$190 million resulting in a distribution coverage of 1.23 times. Our Logistics and Marketing segment continues to perform extremely well, driven by new volumes and earnings from our GCX investment, increased cash generation from our NGL and gas marketing team and sustained strong margins on Sand Hills. These results were partially dampened by lower Guadalupe earnings impacted by narrowed basis spreads between Waha and Katy.

In our G&P segment, we had a solid quarter with continued record volumes in the DJ, increasing volumes out of the Eagle Ford and Permian and a one-time settlement on our Discovery JV driving improved margins over last quarter. We continue to see adverse impacts due to lower commodity prices. However, these have been more than offset with new project cash flows and solid base business earnings, driving our Q3 results to be up 10% versus Q2, despite \$11 million of price headwinds over the same period of time. In Q3, we saw lower costs from a non-recurring Q2 charge, as a result of the voluntary separation program, which expect to drive full year cost efficiencies in 2020 and forward.

As guided on our last call, we saw a slight sequential increase of \$2 million in overall costs as we bring new assets online and accelerate our transformation. Looking to the remainder of 2019, we anticipate sustained commodity headwinds in Q4, partially offset by a full quarter earnings from GCX, strong DJ Basin results driven by increasing processing volumes at O'Connor 2 and incremental cash flows from the DJ Southern Hills extension. We're now guiding our 2019 growth capital to modestly exceed the high end of our range of \$800 million and settle somewhere around \$850 million. There's two key drivers for this adjustment. First, the capital efficient offload agreement does significantly reduce our overall and 2020 growth capital program. However, it pushed more capital into 2019 versus the original Bighorn project expectations and this project therefore moved us to the top end of our capital range. Secondly, the economic decision to increase our ownership in the fee-based Cheyenne Connector project from one-third to 50%, push the 2019 program up to the approximate \$850 million range.

On Slide 9, I want to highlight our solid financial position as we move into the last quarter of the year. Our year-to-date coverage is 1.27 times, this coupled with around \$155 million of proceeds from year-to-date non-core dispositions allows us to self-fund a portion of our growth. We have ample liquidity and financial flexibility with \$1.2 billion available in our bank facility.

On the risk management side of the equation, with the addition of some recent Q4 hedges, our 2019 margin is now 78% fee-based or hedged. Looking to 2020, with all of our new fee-based cash flows coming online, the fee portion of our margin is now expected to grow to 70%. Additionally, we've already hedged 12% of our 2020 open commodity position with recent crude gas and NGL hedges. Together, this takes our 2020 fee and hedge percentage to 74%, positioning us with more fee and hedge margin than we had at this time going into 2019. Our strong financials and growing fee-based portfolio, position the company well to eliminate the IDRs, maintain and grow the distribution in the future and thrive into 2020 and beyond. And in that vein, while we will give full 2020 guidance in early February, I wanted to provide you some color on expected trends and outlooks on Slide 10. We're anticipating the industry's long super-cycle of growth to slow as companies focus on operating within cash flows. Additionally, we're planning for a sustained relatively low commodity price environment.

Our DCP 2020 and DCP 2.0 strategy has set us up to perform well in this environment in our disciplined capital approach will add \$270 million of new predominantly fee-based cash flows from 2019 and 2020 projects, which are all highlighted on the left side of Slide 10. Complimenting our disciplined capital allocation approach is our DCP 2.0 digital transformation, which is built to drive margin uplift through operational optimization and increased cost efficiencies through lean manufacturing approach. These efforts are driving increased margins around our base business, helping the company grow overall costs, while offsetting inflation and expenses correlated to asset growth. We've executed well on our strategy and continue to successfully navigate a very dynamic industry environment.

And with that, I'll turn it back over to Wouter.

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Wouter van Kempen - *DCP Midstream, LP - Chairman of the Board and CEO*

Thank you, Sean. Let me wrap it up on Slide 11, as a result of our dedicated strategic approach, we have achieved strong year-to-date results that enable us to not only improve our financial flexibility, but also to ensure that we were eliminating IDRs from a position of strength.

With IDRs out of the way, we're excited about the future and our ability to drive increased value for our company, for our investors and for everyone on the DCP team. Our results and outlook are underpinned by our DCP 2020 and DCP 2.0 strategies that we began executing years ago in anticipation of slowing industry growth. We now have a well balanced portfolio being optimized in real-time by cutting-edge technology, coupled with a line up of strategic growth projects built to meet the needs of our customers, increase margins year-over-year and further integrate our value chain. We have grown cash flow by \$40 million or by 8% year-to-date despite \$70 million of commodity price headwinds. And I know our strategy will continue to drive value as we move into 2020, combine our financial performance and upcoming capital projects with our IDR elimination and stakeholder alignment and we have line of sight to a very bright future for DCP and our unitholders.

I'm looking forward to taking your questions. And Chris, please kick us off on Q&A.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) And our first question comes from the line of Jeremy Tonet with J.P. Morgan. Your line is now open.

Jeremy Bryan Tonet - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Good morning. Just wanted to start off with the IDRs here and with the elimination in the rear view at this point, if you could maybe expand a bit more as far as what your strategy is or what new opportunities could you guys undertake now, not that the IDRs are there or any other change in strategy now that the structure has been simplified in a sense?

Wouter van Kempen - *DCP Midstream, LP - Chairman of the Board and CEO*

Well, Jeremy, it's Wouter. I don't think this is a change in structure. This change in structure isn't giving you a change in strategy. I think our strategy has been very clear about what we want to do. We want to grow our business and we want to predominantly grow and integrate our business. And make sure that we are a fully integrated midstream service provider. We continue to do that. We continue to be very disciplined about the growth that we're putting in. We've spoken many times and I've spoken many times to all of you around the fact that you don't want to own the last gas processing plants. You don't want to own the last pipeline. And so you want to have very high utilization that means you got all float and use someone else's capacity. You probably should do that. That's a smart thing to do. So we continue to do that. And so from that point of view, I think our strategy is no different. At the same time, what we continue to do is build a, what I call, lean manufacturing kind of system within DCP. Be a low cost operator, use technology to take cost out to be more efficient, to be more reliable, to be safer.

We will continue to do all of that. And so eliminating the IDR doesn't really change that. I think what eliminating the IDR does do is it takes uncertainty away for people. And I think that is important. The other thing that it does, it gives you an opportunity to, over time think about raising the distributions and raising the distributions in a way that everybody has kind of an equal part of the pie. And everybody equally participates in that distribution raise versus a GP owner and IDR owner getting significantly more than the LP unitholder. So that's how I would look at this overall. And the strategy I think that we've worked on is a good strategy. Our leverage continues to stay in check. We are continuing to build coverage well above where we expect to probably be two, three, four years ago and were many of you expected us to be two, three or four years ago. And we do that in a commodity environment that is a relatively low commodity environment. So I feel tremendously good, things are lining up for us right now.

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Jeremy Bryan Tonet - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Got it. And maybe just a quick question on Southern Hills here. It seems like there's some other competitors coming online (inaudible) narrow there or has been narrow. Just wondering any other thoughts you could provide as far as the outlook there going forward?

Sean P. O'Brien - *DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC*

Jeremy, it's Sean. I can talk about the volumes a little bit and I'll also include Sand Hills just so I can get some of the drivers out there. But on Southern Hills specifically, we saw -- you did see some increase in rejection. The gas prices strengthened a little bit, ethane prices weakened. So you saw about a doubling of rejection between Q1 and Q3. That's all economic though. Obviously, when we're modeling that and when the producers are modeling that, they're modeling it where we make more money ultimately. But that did reduce some volumes on Southern Hills. By the way, that was the driver. I know many people were thinking about Sand Hills as well. The other thing that we saw is we did see on Southern Hills in particular, we have volumes and third-party volumes to other pipelines, but we have T&Ds on those volumes, so the margin side of the equation remains intact. You did have some volumes come offline. We also had some shorter term volumes on Southern Hills and that was intended that rolled off. That was intended to bridge our gap when we -- up until we knew White Cliffs was coming online. You've got a lot of new volumes out of the DJ that are going to come in through that White Cliffs connection and we're pretty excited about that. I can tell you we feel very comfortable, very strong about our Sand Hills margins and our Southern Hills margins, which by the way, year-over-year or year-to-date we're up about 25%. So we continue to grow those margins around those assets.

Jeremy Bryan Tonet - *JP Morgan Chase & Co, Research Division - Senior Analyst*

That's all for me. Thanks for taking my question.

Operator

Thank you. And our next question comes from the line of Spiro Dounis with Credit Suisse. Your line is now open.

Spiro Michael Dounis - *Crédit Suisse AG, Research Division - Director*

Hey, good morning everyone. Just start off with some comments yesterday from one of your sponsors. Had some pretty complimentary things, let's say, about you disrespect your ability to turn the company around over the last few years. But I think the other thing to kind of mention was a strong desire to see distribution growth going forward. Wouter, you mentioned that in some of your comments, but I guess, specifically just pointed out to this range of 3% to 5% distributable cash flow growth going forward. Just curious what your view is on that growth target and maybe how you plan on achieving it?

Wouter van Kempen - *DCP Midstream, LP - Chairman of the Board and CEO*

Yes. So, Spiro, obviously our job is to return cash to shareholders -- all the shareholders. And the good thing about this deal that we did yesterday, all shareholders are going to be treated equally now, if and when we can start raising the distribution. So for us we haven't given any guidance specifically on 2020, but we are tremendously comfortable around the \$3.12. There has been people and put things out around, hey, maybe the distribution is at risk. I think the one thing that you'd take away from this transaction. The distribution is absolutely not at risk. Not now, not tomorrow, not for a long time to come. When we think about this transaction, we obviously don't just look at what is happening on November 6 or November 7. We look at what our 2020 look like, 2021 look like and, and thinks alike. So we are very comfortable around the distribution and then for us, we have to continue to not only maintain that distribution and maintain our record of never lowering the distribution. It is about how do we grow the distribution.



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We spoke about the fact that we have \$270 million of EBITDA coming online here over the next kind of year or so of additional growth projects that are great growth projects. I don't think anybody is looking at those projects as risky. I don't think anybody says, hey, GCX is probably not going to be full. Your DJ plants are not going to be full. Cheyenne Connector is not going to be full. The Sweeny Fracs are not going to be full. So I think we have tremendously good projects that are coming online and take all that together, take that with, I think some really good cost controls that we have in this company. Better reliability, better safety, utilization of technology when you get yourself into a place where hopefully we can start growing the distribution in a reasonable manner and in a way where unitholder is going to be treated equally.

Sean P. O'Brien - DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC

Spiro, this is Sean. I'm only going to add two things to what Wouter said. If you think about a transaction like this, obviously there's a lot of analysis. We're going to give 2020 guidance early next year, but there's a lot of analysis around the -- where the company is going to go, where -- the health of the company over the long-term. So this ought to be a good sign. When you look at a transaction like this and moving forward that the owners you mentioned some of their comments and the parties involved, we had -- a lot of confidence around where this company is going to go. The other thing I'll mention and obviously, we don't talk about it a lot. We did talk to the rating agencies with the treasurer and myself through this transaction, all three of them, very positive outlook. And remember they also are looking at two, three, four years down the road. So that ought to give some comfort that people saw -- looked at this transaction beyond just today, beyond just the next year and say, this really sets the company up well going forward.

Spiro Michael Dounis - Crédit Suisse AG, Research Division - Director

Yes. No, that's really helpful color. Appreciate that. And then second question just on the hedge book, was encouraging to see the fee-based amount step up next year. But looks like you saw maybe some hedging getting around the hedges. Just wondering if you just walk us through what the strategy is there. Does it kind of pave the way to hedge at this point? And is your targets still to get to about 80% fixed hedge for 2020?

Sean P. O'Brien - DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC

Yes. So the answer is yes, no doubt. I'm very excited -- I did throw that out there, that 70%. Remember the company was 10%, 15% not that long ago. We got the 65 last year. We were 60 the year before that, we're going to grow to 70 next year at least. I'm excited with some of the movements that we should get into the winter months and there was a little bit of volatility earlier. We were able to get crude gas, propane, C4+ hedges on. So we're already 12% hedged. And hopefully, that wasn't lost on people, we are going into 2020. When you at the growth in the fee and that 12% of our book already hedged, we have more fee in hedge going into 2020 than we had. At this time last year, going into 2019, 80% is absolutely a target for us. But I think the other thing to think about. And by the way, we take a multiyear approach, we try and hedge out the curve as far as we can. As you know, that's going to differ, you can go a little bit further out on gas and crude than you can on NGL. But we're looking our team is constantly looking for those opportunities to layer hedges on at coverage ratios that are very complimentary to our long-term strategy.

So we're excited about that 74% where we're at already. But I think the key and Wouter mentioned it earlier, that people should think about, year-over-year prices down significantly. I saw some reports that said, hey, Q3 they're down a little bit versus Q3. We had \$0.87 NGL last year in Q3, we had almost \$70 crude, we had almost \$3 gas. And we're still making more money as a company, even with 50% declines in some of those commodities year-over-year. That's pretty impressive. And that just speaks to the move to fee, that speaks to the new capital that's coming online as fee-based and it really speaks to where this company can go. Commodity is becoming less and less of a driver. We're really -- even in low commodity environments driving pretty strong cash flows.

Spiro Michael Dounis - Crédit Suisse AG, Research Division - Director

Yes. That's very helpful color. Thank you, gentlemen.



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Operator

Thank you. And our next question comes from the line of Shneur Gershuni with UBS. Your line is now open.

Shneur Z. Gershuni - UBS Investment Bank, Research Division - Executive Director in the Energy Group and Analyst

Good morning everyone. Wanted to first start off with -- on a post simplification environment, just wanted to talk about your -- I guess, your largest shareholders at this point right now. Is their tax basis negative that would prevent them from selling any units? And then does the relationship change at all or does it improve in your ability to potentially partner, let's say with Phillips on some potential growth projects?

Sean P. O'Brien - DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC

I can handle the tax. I'll let Wouter talk about the future opportunities, Shneur. The simplest way I can tell you is this transaction, it had no impact on the tax basis. And I think Enbridge over the years, Spectra has talked about a negative or very low tax basis, which makes -- which just speaks to the value in the cash flow that this company has sent back to its main biggest owner. So no change if there were hindrances before around low tax basis on a sale of a company, obviously eating up the gains, those are still there. And in terms of going forward, selling the company one or the other, nothing's really changed on that front. So any time -- just because you shifted an IDR and GP interest to LP, it still makes the issue of a gain a problem. I don't want to speak for the owners, but I think all the math that was there before around selling doesn't change and the local tax basis doesn't change. And I'll let Wouter talk about additional opportunities.

Wouter van Kempen - DCP Midstream, LP - Chairman of the Board and CEO

Yes. Shneur, I think you've got to take this as -- it's pretty simple. The only thing that has changed with this transaction that is when we increase our distribution, everybody gets an equal part of the pie. Not someone gets 50% more than someone else. That is the only thing that changed with this transaction. When it comes to strategic projects, again, nothing has changed from that point of view either. We have done multiple transactions with one or more of our owners, more with Phillips 66 because the way kind of some of our business opportunities dovetails a little bit better together. And we'll continue to look at that. So as you think about things like the Sweeny Fractionators, I think that is a great project. It's a great project for us to participate in that than to commit barrels to that. So overall that really doesn't change. I think the relationships there have been really good, continued to be very good. And we'll look at doing smart projects together when we can do it and when it makes sense.

Shneur Z. Gershuni - UBS Investment Bank, Research Division - Executive Director in the Energy Group and Analyst

All right, perfect. Just moving on, as we sort of think about 2020, and I realize you haven't given guidance but you gave some trends and so forth. But when I look at Slide 9, you talk about the 65% fee-based in 2019. You also mentioned 70% in 2020. And then I look at Slide 11, you talk about 90% of the \$270 million of new EBITDA is going to be fee-based as well too. So when I sort of think about your fee-based earnings generation for 2020, are you effectively saying that you're going from a little bit below \$800 million guided for this year to well over \$1 billion next year?

Sean P. O'Brien - DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC

Once again, I'm not going to give guidance. There's other moving parts. I think what we want people to understand is and we went out a little bit ahead of obviously giving a pure DCF number in terms of guidance for 2020, Shneur. But I think we want people to understand that the annuity type revenue streams and margin streams that this company has continues to grow. And we still have some commodity exposure. Obviously I talked about it in my written remarks. That doesn't fully go away next year, right. That we're still not 100% fee, but the core of this company delivers very strong cash flows. We've shown that this year in a big way with commodity coming off massively and still we're producing very good cash flow numbers.



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And I think what we were just trying to show on that slide is that we feel we have a great plan or great foundation going into 2020. There are still going to be other -- to give you a couple of color, obviously commodity. We're not planning on a big rebound. It's on that slide, I do think that slowing in the industry, Wouter has been talking about it for a long time. The super-cycle slow down, we think will continue. Again in some ways that's a good thing, managing within cash flows but the key of that slide is not to say, hey, we're going to exponentially increase going into next year. I mean the key is to say, we continue to have more and more of this company's cash flow fee-based, annuity-based, you can count on it. We're proven that this year. And quite frankly, if commodity comes back stronger, you have more upside.

Shneur Z. Gershuni - *UBS Investment Bank, Research Division - Executive Director in the Energy Group and Analyst*

Okay. And one final question if I may. When we sort of think about CapEx for 2020, is it fair to say that you expect CapEx to be meaningfully lower than it was this year and that the focus is really on optimizing your capital as it stands, which you've done a good job on this year. And kind of a focus on the DCP 2.0 strategy that needs to bear fruits over the last two years?

Sean P. O'Brien - *DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC*

Yes, I think the short answer is absolutely yes. I think what we've always talked a lot, I mean, we've had some capital projects. These are phenomenal projects. That \$270 million of cash -- of mostly 90% fee-based cash flow are tied to these projects. And they're delivering very well. We do anticipate again, I'm not giving guidance here, but we do anticipate capital levels to come down in 2020 and maybe even more so as you think out the curve even in future years. But the focus and I think the point you made, which is the strongest point, which I know we've been talking about for a long time, the focus is getting as much out of the base assets and the new assets as we can. And I think that's why the company has been on this massive transformation 2.0 digitization -- transformation for now about two or three years. Because I think if you can -- that's going to be what differentiates people getting more out of what they have. We still have some capital coming online, you heard Wouter talk about Sweeny. And then obviously, we've got Cheyenne Connector and some other small things coming on next year. But I think everything you said is accurate, just giving you a little more color.

Shneur Z. Gershuni - *UBS Investment Bank, Research Division - Executive Director in the Energy Group and Analyst*

All right, perfect. Thank you very much. Appreciate the color and hope to see you in B. Riley.

Operator

Thank you. (Operator Instructions) And our next question comes from the line of Gabe Moreen with Mizuho. Your line is now open.

Gabriel Philip Moreen - *Mizuho Securities USA LLC, Research Division - MD of Americas Research*

Hi, good morning. I was wondering if we can stay on 2000 -- if we can stay on 2020 and given DCP 2.0. And how we ought to maybe calibrate thinking about some of the cost saving measures you've taken this year on the personnel G&A side versus the O&M from bringing on all these new assets, can you help us maybe think about directionally where G&A and O&M may shake out next year?

Sean P. O'Brien - *DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC*

I can start on some of that, Gabe. I think I've been -- I've tried to be pretty clear. We believe costs are going to be lower this year than they were last year. We're trending along those lines. By the way, that's not a small fee, right, you've got inflation, you've got merit, you've got new assets coming online. We've got additional growth and we're not only offsetting that, we are reducing costs and a large chunk of that is coming from efficiencies from these 2.0 efforts, digitization, automation, we're seeing some pretty good progress. I think a fair way to think about it going into 2020 is that we expect that to continue. So I do anticipate and again, we'll give you more guidance in February that as those things build, I referenced the

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voluntary separation program in my comments will get more benefits in 2020 around that than we did in 2019. That's around, continuing to drive digitization and efficiencies. I think that trend continues into 2020. So, if you think about the cost of the company, our goal next year is still to bring that trajectory down while absorbing a full year of O'Connor 2, while absorbing new assets coming online, there's costs with those. And of course merit, we're in a very strong employment environment right here and we have to pay people more money every year. But our goal is to continue to drive those efficiencies to bring our cost trends down. More color on that in February. But that is the key.

Gabriel Philip Moreen - Mizuho Securities USA LLC, Research Division - MD of Americas Research

Thanks Sean. And then maybe if I can also turn to, with GCX having come online here, has anything changed in terms of your position, in terms of your equity volumes coming out of the Permian, whether it's capacity that you may hold on GCX. And is it true that just Guadalupe is still open and we should think about that relationship, you've always thought about it or is something changed with GCX coming online?

Sean P. O'Brien - DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC

I don't think anything's changed from a volume perspective with GCX coming online. In other words, stuff moving off of Gulf Coast, to GCX, the way to think about Guad. And it's still a very strong -- so GCX is earning phenomenal earning. As we continue to get a full year of benefit from that next year, it's going to be very significant. Guadalupe prior to GCX the spreads on our open position there that we manage -- got very, very extreme. We've taken approach as a company as you think forward on Guadalupe. We've hedged and done some long-term contracts to lock-in what we think are pretty attractive rates on Guadalupe. I'll give you some percentages. That assets going into next year -- into Q4 is about 70% locked via hedges and long-term contracts, roughly and going into next year about 60%. We think that's important -- that's smart. We've taken something that had some volatility and yes, we benefited from that this year. When those spreads just blew and we were able to capture longer term annuities at very attractive rates. So, maybe not the blowout rates that you saw on the spot, but there are long-term rates that are much higher than what we would have earned in the past. So Guad kind of levelizes as you think about Q4 and the remainder and next year at a level we're very comfortable with. And then of course GCX is performing quite well, very full in terms of volumes and giving us a lot of opportunity there to obviously earn the return on that.

One last point, I could say just from a color perspective, a lot of people thought that the spreads on Guad would diminish quite a bit when GCX came online. Although, we saw some tightening, I referenced that nowhere near what people thought. There was another project. That was delayed into 2021 in the Permian that probably kept the spreads a little bit wider. So on the open position, I mentioned to you, we have about 30% or 40% depending on the period, still open. We're seeing stronger spreads than we thought we would. At some point, you would think that spread narrows even more when that new pipeline comes online in 2021. But we'll have to wait and see.

Gabriel Philip Moreen - Mizuho Securities USA LLC, Research Division - MD of Americas Research

Thanks, Sean. That was helpful. And then just two housekeeping ones from me. One is maybe what the impairments were for in the quarter and if you can quantify the one-time benefit from the Discovery settlement?

Sean P. O'Brien - DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC

Yes. So we'll do the easy one, about \$3.5 million on the one-time settlement on Discovery. So not huge but I knew people would want to model it so about \$3.5 million is good to get some money back from the Discovery. On the impairments, we look at -- companies look at goodwill every year. We always do it in Q3. So we had some goodwill on the books tied to a very -- non-core asset up in the north called Marysville. And we just took that non-cash hit on that goodwill, that's been there for a long time. And then we also had a, the remaining impairments were tied to some areas where we're seeing some lower volumes, obviously Western Midcontinent and portions of the Permian, not the growth areas of the Permian. But again, non-cash write downs, we look at that, our assets every quarter. No impact, ongoing cash flow whatsoever, but we do look at those every quarter and we took the goodwill and a little bit of non-cash assets in Q3.



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Operator

Thank you. And our next question comes from the line of Chris Sighinolfi with Jefferies. Your line is now open.

Christopher Paul Sighinolfi - *Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships*

Hey, good morning guys. Thanks for the time today. I was just wondering if you could maybe touch on just how the IDR elimination came together. You've discussed it for years, the late movement and the timing of your release in call seemed to indicate it might have coalesced fairly recently based on final terms and you're also approaching the end of the IDR waiver period that's started in 2017. So, I guess what I'm wondering was it the recent performance of the business that led you and the sponsors to conclude you could absorb a 5.5% increase in the cash outlays? Was it the termination of the IDR window or was it something else that sort of finally broke this multi-year long-term?

Wouter van Kempen - *DCP Midstream, LP - Chairman of the Board and CEO*

Okay. let's take a couple of those Chris. So, the IDR waiver period really doesn't have anything to do with this. Remember, when we on January 1, 2017 announced the transaction where we put everything into the publicly traded entity there was an IDR waiver if you would be below 1.0 coverage. And, we are every quarter since then, we have been very well, above that coverage. So that waiver wasn't insurance kind enough protection. It was a floor and we never had to call in the insurance, which is a great thing and I think shows you how we have executed as a company and you're sitting here at 1.27 coverage today with actually a commodity deck that is significantly lower than what we looked at on January 1, 2017. So, those are completely not related to in any way, shape or form. We obviously had a lot of discussions with people. And with Phillips, with Enbridge, amongst ourselves, when is the right time to do this. And, one of the things that I find interesting, some people have said, Hey you should do this is when commodity is high, guys why didn't you vouch or why didn't you do this in Q1 when commodity was high? And I think that's a tremendously narrow way of looking at things because commodities in the end, there are random walk and they really, if we would have done this during a high commodity barrier goal of Q1 of 2019 I still would have to deal with today's commodity prices. So commodity is the wrong way of looking at this.

The right way of looking at this is what are the different projects, how is the underlying business performing? So, for us it was always looking at the O'Connor 2 plant, is it coming online, is it filling up quickly? Gulf Coast Express, do we get the FERC to approve it? Do we take the ownership percentage? And then we actually cued on that Front Range and Texas Express is that coming online? The Southern Hills extension into the DJ basin, is that coming online? GCX massive project, is that coming online on time, is it filling up? The Sweeny Fractionators, how is that moving forward and if you take all of that together and I mentioned that in my prepared remarks, it's \$270 million of ongoing EBITDA. That is what we were looking at every second and say, Hey once that hits, we are very comfortable doing that and so we have great comfort that all of those projects have come online, how they've come online, how they've executed on a kind of day-to-day basis kind of what the go forward things are and how they came online. So, that's really how we have been looking at this together between kind of the management team here between the owners of the IDRs Phillips 66, Enbridge and a special committee of the board that in the end is together with their advisors is looking at this and say, Hey, does this make sense? And you take all of that together, Chris, I'm tremendously pleased with the outcome.

I'm like, this is one of the lowest multiples of any IDR transaction, I think it's a very fair deal. It's a reasonable deal. You have complete economic alignment between the LP and the GP, the distribution is protected. People can take the \$3.12 to the bank and that has always been tremendously important for all of us. It's a very low multiple, it is a 9x multiple. If you take the last, 10, 11, 12 deals together, they average 18x. The premium is 19% you take the last 10 plus deals together the average premium was set at 61%. You look at the coverage impact, it is 4% coverage impact on what we have. If you take this \$30 million roughly in premium, when you divide that over our DCF was 750 the midpoint of our guidance for this year, that is 4.2%, there's no leverage impact. There's minimal dilution of DCF per unit. It shows, once again, strong ownership is great for the LP, gets an extra up on it and have billion plus from the equity, which I think is helpful and it removes uncertainty. So it has, I think, a great win-win for everyone here. And you know what the best thing is, Chris, we can focus on talking about the business and how we execute on the business. Instead of talking about IDR deals and thinks alike and surprise us or no surprises, let's focus on the business, how our team at DCP is executing, how we're smart about putting projects online, how we're utilizing technology to continue to have cost savings, increase reliability, and be the safest midstream company in the industry. And that is what I'm super excited about.



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Christopher Paul Sighinolfi - Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships

Okay. I appreciate that. And Wouter I don't think as well any of us have the deal terms relative to a lot of other IDR eliminations in this space. Obviously much more favorable than what we've seen out of others. I think at some point in the future, somebody is going to have to explain to me why any premium is warranted in these types of deals. But that's probably for another day. I did have a question Sean, you had mentioned the fee based and hedge metric, you've offered that view for awhile now, you've offered a view that 74% for next year, but I don't think it's a metric that you report. And so I'm just curious, do you have a sense of where the business was in 3Q or year to-date 2019 on that metric?

Sean P. O'Brien - DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC

Yes, so we've been running we don't really update. I mean, so we gave you that guidance coming into the year at 65% fee and then I think we've hedged the hedge portion would put us at 78% this year. So, on an equivalent basis as you about 2019, I think we're going to be really close to that 80% target that we were looking at. The points I've just been making, Chris is that coming into and we would always put hedges on through the year. We even put some Q4 hedges on during some of that turmoil over in Saudi, whatever a month ago. So, coming into the year at 74 versus being roughly 78 right now for 2019 I feel very, very good. I guarantee you will have opportunities to get more hedges on throughout the year. We'll -- and by the way, we will, when we give the guidance will solidify our budgets are getting approved with the boards over the next couple of weeks. We'll solidify that 70 but it continues to add, and had we pro forma that half a decade ago it would have been half of that or less. Very, very, very small position, so I make a big deal about it because I think that's why I think some folks are expecting more volatility in our earnings and when you continue to increase the base foundation of your earnings through either fee-based projects or hedging or even moving some of our G&P business more to fee. You're starting to see obviously some pretty good continuity out of our cash flow.

Christopher Paul Sighinolfi - Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships

Can I ask just one follow-up question on -- it actually has two parts in Sean? One is can you just -- at Guadalupe to the extent that there was an outsized opportunity with margin differential there or with that spread differential there, does that get captured in your allocation of fee? And then second, if I look at Slide 18, there's no price point on the NGL edges for 20. And you have a footnote there that you talked, you do give us what the butane and propane hedge prices are. I'm just curious, that composition, is that mostly propane and butane or did you not give us a total number because it would have skewed it some way?

Sean P. O'Brien - DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC

Nope, it's all propane and butane are the only, obviously in our discussions on reject ethane has been relatively low. So we've not seen those products get to the levels that they would need to be. So we can give that and no, you're right Chris. The hedging, if you're looking at the dollars that we're able to hedge yet in 2020, we were able to hedge at higher levels in terms of pricing at 2019. But I think the way to think about it is we target coverage ratios, right? As a company, we're trying to solidify coverage ratios in that one, two or better range. And we have a hedge and it's a tiered hedge program that goes over multiple years. As we're putting those hedges on, those are intended to help us get to those coverage ratios. So, even if pricing levels are going down on our hedges, going into 2020 we're still able to obtain those coverage ratios. And the reason that is, is because we're growing the fee based business more and more and more. So, you're relying less and less on the pricing.

Christopher Paul Sighinolfi - Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships

Right. Okay. And then on the Guadalupe side, sorry,



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Sean P. O'Brien - DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC

On the Guadalupe side that is a pipeline. It is fee. I mentioned we have about 60%, 70% of Guadalupe locked in. And it's, actually a basis spread between Waha and Katy. It's been pretty consistent. But it is a fee fee-based portion of our portfolio because we continue to lock-in those margins and continue to lock-in through either long-term contracts or just hedging as well.

Christopher Paul Sighinolfi - Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships

Great. Thanks very much for the time this morning guys. Appreciate it.

Operator

Thank you. Our next question comes from the line of David Amoss with Heikkinen. Your line is now open.

David Meagher Amoss - Heikkinen Energy Advisors, LLC - Research Analyst

Hey, guys. I just wanted to dig in a second on the CapEx number for this year. Thinking about the increased interest in Cheyenne, that's pretty simple, looks like \$35 million, \$36 million additional and just wanted to ask more on the Latham side or the Latham Offload. Is that primarily that that is going faster or you're spending faster than you expected when you came out with 2Q? Or is there something else going on there?

Wouter van Kempen - DCP Midstream, LP - Chairman of the Board and CEO

The majority of the dollars as we've solidified are going to be spent this year. So it is a timing Latham still great project. There's not been overruns. It's not that anything has gone up. As we solidified our capital program over the last month or so we've, Bighorn originally when we gave our guidance early in the year, the high-end of the range would have assumed some Bighorn, but the majority of the Bighorn capital expenditures were going to be in 2020. Obviously those are now mitigated. The Latham is a much more capital efficient project. So, it's just timing. You're spending more in 2019 on that project, you'll spend significantly less in 2020 on that. And then the Cheyenne you said you understood obviously it is just the upsizing.

David Meagher Amoss - Heikkinen Energy Advisors, LLC - Research Analyst

Great. Appreciate the color and really do like the IDR deal. Thanks.

Operator

Thank you. And our next question comes from the line of Elvira Scotto with RBC Capital Markets. Your line is now open.

Elvira Scotto

Hey, good morning everyone. So just on the fee based, can you remind us of that fee based, how much of that is contracted under, either MVC or take or pay commitments?

Sean P. O'Brien - DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC

You know, we do, we have some MVCs and T&Ds obviously on the pipelines there are some MVCs I think Elvira we've talked about recently in the DJ around some of the new plans that we put and they have minimum volume, minimum margin. The rest of it is going to be plant commitments



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essentially right into the pipelines. Those volumes are plant dedications. That's how we're filling up the pipelines but a lot of that is under our control. And obviously we feel very comfortable with the volume growth. But I can't remember the exact percentages. I can get that for you Elvira, but it's not going to be the production, the majority are going to be under MVCs or T&Ds.

Elvira Scotto

Got it. And then, looking at your fee-based for 2020, you're saying it's 70%. And as I look at Slide 10, Cheyenne Connector comes in, in the first half of 2020, Sweeny Frac is kind of in Q4. So as I look out to 2021, if I'm assuming say a flat commodity price environment, I mean, could you see that fee based, getting closer to 75% 80%.

Sean P. O'Brien - *DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC*

Yes.

Elvira Scotto

Okay, great. And then when you think about, we kind of talked about the outlook for 2020, our producers are living within cash flows. And, you still seeing a challenging commodity environment. And you're talking about meaningfully lower CapEx. How do you think about, and I know you've kind of talked about distribution growth and you're not guiding to distribution growth, but when you think about distribution growth, how do you think about that in terms of what -- what are the metrics you need to see that can trigger distribution growth? Is it a certain coverage ratio? Is it, a certain coverage ratio, given how much your business is fee-based you look at, just give us some sort of, thought on how to think about what can trigger this distribution growth.

Wouter van Kempen - *DCP Midstream, LP - Chairman of the Board and CEO*

Elvira, let me take this one. First of all I'm tremendously happy that's what we're talking about. And so I'm happy that you agree with me that the \$3.12 is very firm and helpful and protect us. And we talk about, if and when we're going to grow to distribution for us, what it really is, it's a bit of dynamic model. We're obviously looking every single day, where are you from a coverage point of view, where are you from a leverage point of view, how are your assets running, where are we in a commodity cycle and thinks alike? And we will take all of those together and combine that with, when do we get to free cash flow and completely self-funded entity. And that's how we how we look at that. But when we look at our models, I feel pretty, pretty optimistic about, 2020, 2021 and beyond and the potential for us to start growing to distribution when you look at all of the assets that are coming online, how we've set things up, how we're not overbuilding, how we're managing capacity. So, I can't give you the perfect, Hey, plug this in the model and this has got a buckled roll-out because it is dynamic, which I know you understand. But the good thing about it is now you can really start thinking about this because you can think about it in a way where everybody is treated equal and everybody gets the same type of benefit.

Elvira Scotto

Now, that makes sense. But, so how do you evaluate, I mean, the share repurchase or unit repurchase figure into the equation at all? I mean, you look at where your stock is trading, a distribution growth, right? When you set a distribution, you clearly want to be able to maintain it. Share repurchase, can bring down your share count that actually would help you on DCF cover -- your coverage. So how do you think about share repurchase versus growing the distribution?



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Sean P. O'Brien - *DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC*

I think in the short run obviously this year we're coming off, the capital program and yes, we're having a downward trajectory Elvira but as Wouter mentioned, you need to, I think you kind of need to get to that free, where you're totally covering all your capital and you are sitting on cash and then it makes maybe a lot of sense. But we, in some of our models, we've looked at some of that, but I think it's a little ways out for us with some really solid projects coming online this year. And then obviously with Sweeny Frac, that's a relatively large project that comes on online next year. It's in some of the equations we run. I just don't think it's something in the immediate term that we're going to do.

Wouter van Kempen - *DCP Midstream, LP - Chairman of the Board and CEO*

I think one of the other things I got to tell on, I say, you know what, we always talk about the \$3.12 being secure and today that, is a 13% yield. So, I don't think the \$3.12 is perfectly valued today. So, you've got to get to a place where that is being valued before you start thinking about increasing it. But I think from a pure financial power of the company we are feeling very, very comfortable with how things are set up.

Elvira Scotto

Okay, great. But just to follow up on that, but if you, if you have a 13% yield on what you're saying is a secure \$3.12 distribution and what's the incentive to raise the distribution? Wouldn't it just make more sense to buy back your shares? I mean, if you're not going to get rewarded for distribution that you're already maintained.

Wouter van Kempen - *DCP Midstream, LP - Chairman of the Board and CEO*

Well, and that's, I think you and I are saying the same that's why at this moment you're not sitting and say, hey, why would I increase the distribution? I think at this moment, what's more important is to continue to grow the coverage, to continue to make sure that, the excess coverage that we have. We utilize that to bring new good projects online in 2020 like, what we're doing with Sweeny Fractionators for instance, or Cheyenne Connector and then after that see how things will play up. So, I think you and I are in sync there.

Operator

Thank you. And our last question comes from the line of James Carreker with the U.S. Capital Advisors. Your line is now open.

James Eugene Carreker - *U.S. Capital Advisors LLC, Research Division - Executive Director*

Hey guys, thanks for the question. Congratulations again on the IDR deal. I know we and others have been pestering on you for several years on that. So I apologize in advance for my next question, but, I think some investors would say that you've eliminated an overhang, but there is still somewhat of an overhang and that you quasi private GP that still controls the non-economic general partner. And so I guess my question is there any discussions with PSX or Enbridge or is there any desire on your part to become a fully autonomous organization, whether that's done through a spin by your respective parents or some other mechanism? Is that anything that you guys have talked about, thought about, have any interest in. Thanks.

Wouter van Kempen - *DCP Midstream, LP - Chairman of the Board and CEO*

Hey James, Wouter here. First off, everybody is economically treated exactly the same way and I think, and there's no different way to anybody can be treated, so there's no gimmick things or other things that's going to happen. Everybody will be economically treated exactly the same way. I think that's the most important thing, talking about, seek option independent other stuff I think we should probably enjoy the moment for a day or two. And then we'll talk about those things. I'm sure we'll start talking about those next week with all of you and answering those questions. But I just think that is -- that's way too early and I think we should enjoy the moment for a day or so.



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Sean P. O'Brien - DCP Midstream, LP - Group VP & CFO of DCP Midstream, LLC

And James, I'm just going to add one thing I reiterated earlier about my conversations with the rating agencies around this transaction, obviously favorably viewed but the one thing I want add to your point is and S&P has been pretty clear about it and I think Moody's, look, they see value, right, of having to economically parodied investors and owners the size of those two companies that we have some strategic interfaces with Wouter talked earlier, they see massive value in that. So they see that as actually a benefit, as a differentiator for DCP that you've got two very large companies and in some cases that we can do some pretty strategic stuff with sitting on the top. So I just thought I'd throw that in there.

James Eugene Carreker - U.S. Capital Advisors LLC, Research Division - Executive Director

No, I understand. I appreciate the color. That's all I had. Thanks.

Operator

Thank you. And this concludes today's question-and-answer session. I would now like to turn the call back to Sarah Sandberg for any further remarks.

Sarah Sandberg - DCP Midstream, LP - Senior Director of Communications & Public Affairs

Great. Thanks for joining us today. If you have any follow up questions, please don't hesitate to give me a call. Have a good day.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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