REFINITIV STREETEVENTS

EDITED TRANSCRIPT

DCP.N - Q4 2021 DCP Midstream LP Earnings Call

EVENT DATE/TIME: FEBRUARY 10, 2022 / 3:00PM GMT

CORPORATE PARTICIPANTS

Michael Fullman *DCP Midstream, LP - Director Corporate Development & Strategy*

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

Wouter T. van Kempen *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

CONFERENCE CALL PARTICIPANTS

Daniel Walker

Elvira Scotto *RBC Capital Markets, Research Division - Director & Chief Analyst*

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

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

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

Michael Jacob Blum *Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst*

Michael Raphael Cusimano *Pickering Energy Partners Insights - Research Analyst*

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

Tristan James Richardson *Truist Securities, Inc., Research Division - VP*

PRESENTATION

Operator

Good morning, ladies and gentlemen. Thank you for standing by, and welcome to the DCP Midstream Fourth Quarter 2021 Earnings Conference Call. At this time, all participants are in listen only mode. After the speaker's presentation, there will be a question and answer session. (Operator Instructions)

I would now like to turn the conference over to our speaker host, Mike Fullman. Please go ahead, sir.

Michael Fullman - *DCP Midstream, LP - Director Corporate Development & Strategy*

Thank you. Good morning, and welcome to the DCP Midstream fourth quarter 2021 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 financial measures, which are reconciled to the most comparable GAAP financial measure in schedules 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'll take your questions.

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

Wouter T. van Kempen - *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

Thank you, Mike, and good morning, everyone. We appreciate you joining us. Before we cover our Q4 results and our outlook for 2022, I'd like to spend some time reviewing our 2021 performance. And during the year, we said 2021 would be successful if we could accomplish 3 things; first, control what we can control by maintaining our cost savings and strict approach to capital discipline; second, reduce our absolute debt and further strengthen our balance sheet; and finally, accelerate our progress on sustainability and emissions reductions. While we found ourselves battling through a continued global pandemic and the impact of winter storm Uri and once again extremely proud of our team's performance.

For the year, the business exceeded all of our financial targets, generating record results for a partnership. We produced approximately $1.3 billion of adjusted EBITDA and approximately $870 million of DCF, $59 million over the high end of our guidance. We also generated a record $500 million of excess free cash flow, which has more than doubled year-over-year. And we accomplished all of this while maintaining approximately 100% of our 2020 cost savings. These results highlight the strength of our fully integrated business model, which includes a diversified GMP franchise that positions us to benefit from strong commodity environments and supplies volumes to our downstream logistics network.

During the year, we took critical actions to accelerate our progress towards successfully executing a long-term sustainability strategy. We were recognized with the GPA Environmental Excellence Award for the sixth time. We established a board-level sustainability committee. We added an executive leadership position to lead our sustainability and energy transition efforts. And we released our second annual sustainability report, which substantially increased our transparency at large. We had great activity, but more importantly, we delivered great results.

From 2018 to 2020, we saw a 16% reduction in our total greenhouse gas emissions and a 23% reduction in methane emissions. And we fully expect to see those trends continue when we report our 2021 emissions numbers later this year and as we make continued progress towards accomplishing our 30 by 30 targets. We were also able to make significant progress in strengthening our balance sheet. We entered the year with a goal of finishing 2021 at 4.0x leverage. And I'm extremely pleased to report that we exited the year with leverage at 3.8x. This trajectory has an accelerated pace to reach or 3.5x target and allows us to advance our strategy towards returning additional capital to our unitholders this year. We plan to execute the strategy by increasing our distribution in 2022 and pursuing additional capital allocation options, which I will discuss later on the call.

But first, I'll turn it over to Sean to walk through our Q 4 and 2022 guidance.

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

Thanks, Wouter, and good morning. On Slide 4, I'll walk you through our fourth quarter performance and the drivers that impacted our results. For the quarter, we generated $330 million of adjusted EBITDA, $219 million of distributable cash flow, and $122 million of excess free cash flow. Fourth quarter earnings came in lower than expectations primarily due to timing and marketing results. However, the earnings power of the business remains intact, and we're seeing improving trends so far this year. Going back to the fourth quarter, we realized higher costs and sustaining capital as we proactively managed the Q1 impact of winter storm Uri and shifted spend into the second half of the year.

Our L&M business was impacted by the timing of tax payments on Sand Hills and Southern Hills, and the very warm start to the winter dampened our marketing results as limited volatility impacted our trading business, and we saw fewer opportunities to optimize our gas and NGL storage assets. While NGL and crude prices were up approximately 10% from the third quarter, we did realize a lower natural gas price versus NYMEX due to widening basis differentials. During the quarter, our Permian and DJ Basin G&P regions continued to perform well, with Permian volumes up 5% versus the third quarter. And while our DJ volumes were impacted by the timing of new wells coming online, the asset performed extremely well, delivering higher margins quarter-over-quarter. I'm extremely pleased with our full year results as we exceeded all of our financial targets. And with the month of January behind us, we are seeing some positive trends. costs and sustaining capital returning to normalized levels and strong commodity pricing has provided an uplift to the base business, creating opportunities to optimize our portfolio like our gas storage asset.

Now let's move to Slide 5 and our guidance for 2022. For the year, we are set up to deliver increased earnings and continue to generate excess free cash flow. Our 2022 adjusted EBITDA range is $1.35 billion to $1.5 billion and our DCF range is $900 million to $1.01 billion. Driven by increased producer activity, we expect sustaining capital to increase to $100 million to $140 million and a growth capital range of $100 million to $150 million. For the year, we will see increased costs associated with absorbing the impacts of inflation, increased reliability spend to improve run time and profitability of our assets, and additional spend to ensure we stay in front of regulatory changes. These increased costs are all very manageable, and we are committed to maintaining approximately 50% of our post-COVID savings over 2 years after they were realized.

Even with this uptick, our costs are some of the lowest we've seen in the past decade, and these inputs lead to an excess free cash flow target of $425 million to $585 million. Our guidance outlined today assumes a $1.56 per unit distribution. But as Wouter mentioned, we anticipate using a portion of our excess free cash flow to make a distribution increase later this year. At the bottom of the slide, you can see the commodity price assumptions that drive the midpoint of our guidance ranges and our sensitivities to help you adjust expectations based on your commodity outlook. If the current forward curve holds up, we will realize $140 million of uplift to our outlook, and our adjusted EBITDA and DCF would exceed our guidance ranges, demonstrating how well positioned we are to benefit from improved pricing outlook.

Moving on to Slide 6. I'd like to provide some additional details on our 2022 assumptions. On the G&P side of the house, we expect overall volumes to increase 2% to 5% driven by growth in our DJ Basin and Permian assets. This growth is partially offset by expected declines in our South and MidCon businesses. Our favorable G&P outlook feeds the L&M business, and we're assuming 3% to 5% growth on our NGL pipelines. For the full year, we are forecasting DCP operating plans remain in ethane recovery, while third-party customers operate in rejection.

With expected increases to domestic and international ethane demand, we could see a benefit of around 20,000 barrels per day on Sand Hills if pricing supports a third-party switch into ethane recovery, which would be another significant tailwind for our outlook. Our L&M business will benefit from FERC escalators on NGL pipeline tariffs during the second half of the year, which provides a natural hedge to inflation and will help us mitigate any margin pressure we may face as we work to secure incremental NGL supply.

Lastly, we are entering the year with an 82% fee and hedged earnings mix, and we'll continue to take advantage of strong markets to add additional hedges for the second half of the year and for 2023.

Now I'll turn it back to Wouter to provide some additional details on our 2022 strategy and business outlook.

Wouter T. van Kempen - *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

Thanks, Sean. On Slide 7, I'll cover some key themes for 2022. Fundamentals are strong, and we continue to see demand strengthening with U.S. shale playing a critical role in supplying international markets. Producers remain committed to prioritizing capital discipline and shareholder returns, which supports the near-term commodity outlook. And there are signs from our customers that activity levels are ramping up, leading to moderate growth. This constructive environment is driving an uptick in opportunities from DCP. Generally, the projects we have line of site to are organic bolt-on projects that will provide strong cash-on-cash returns and short payback periods. Along with advancing these growth opportunities, we plan to make some critical and strategic investments in our business that will strengthen DCP's position for the long term.

And lastly, 2022 is an inflection point for DCP as we advance our capital allocation strategy. For the last 2 years, our strategy was to use every single dollar available to reduce our absolute debt and strengthen our financial position. By the end of 2022, we expect to have reduced our debt by approximately $1 billion since 2020, all while growing our DCF and our EBITDA. These accomplishments provide us a clear path to reach 3.5x leverage on an accelerated timeline and the ability to meaningfully increase our distribution, which leads me to our capital allocation strategy. We set a target to reach 3.5x leverage to ensure DCP's ability to manage through any commodity environment. At today's prices, we are looking at a high commodity cycle with NGLs, crude, and natural gas trading at some of the best levels that we've seen in years.

Historically, this industry has been considered a long-cycle business. But in recent years, the duration of these cycles has significantly shortened, and we've experienced some very quick transitions that can prove challenging for any balance sheet. When we built our long-term plans and do our scenario planning, we do not assume commodities stay at the current levels forever. Instead, we take a disciplined approach to our planning to ensure we're sustainable in any environment. March 23, 2020, was a very difficult day as we have to take the necessary step to manage through the last down cycle and reduce our distribution. The 50% reduction to the distribution was very measured relative to what was happening in the market. However, it is a lever that we never want to pull again. So while you see us continue to delever to ensure we stay below 4.0 in a down commodity cycle, we believe that reaching 3.5x will provide financial flexibility to take a much more balanced approach. And given the significant progress made in Q4, reducing our leverage from 4.1 to 3.8, we are quickly approaching our leverage goal.

Once reached, we have multiple options available to us to utilize the $0.5 billion of excess free cash flow we will generate this year, and we will execute a sustainable plan to return additional capital to our unitholders. In order to deliver immediate value, we believe a meaningful distribution rate is an important first step, and we should be able to execute this race as soon as the middle of this year. Following this race, our strong excess free cash flow will afford us the optionality to consider additional capital allocation options such as distribution increases, opportunistic repurchases, or execute low multiple and capital-efficient investments that fit our footprint and strengthen DCP's competitive position.

On Slide 9, I'd like to highlight the strength of the DCP portfolio. Over the last decade, we were able to leverage our G&P footprint to transform the company from a pure-play G&P business to a fully integrated midstream provider. Our L&M earnings grew by almost 400% during this time as we built Sand Hills, Southern Hills, and we supported the development of Front Range, Texas Express, Gulf Coast Express, and the Cheyenne Connector, all underpinned by strong supply from our G&P assets. Looking to 2022 and beyond, we will continue to advance our value chain position and securing and maintaining NGL supply will be critical to meeting this goal. For DCP, key areas of opportunity for supply growth will come from our DJ and our Permian Basin positions.

Starting with the DJ Basin. We've seen incredible growth over the last decade. Gas volumes are up over 250% and NGL production is up well over 400%. This growth has allowed us to drive downstream investments and provide much-needed takeaway optionality for our customers. With the major infrastructure in place, we will have the ability to support DJ growth by making incremental investments to our gathering system over the next 2 years. Depending on producer permitting and local approval of development plans, we see the potential for a larger scale capacity expansion, and we're working with our key producers to ensure the alignment and timing of our plans.

Moving to the Permian Basin. We benefit from a large-scale footprint that provides exposure to both the Delaware and Midland basins. We've been executing a capital-efficient strategy, focused on building out our Delaware Basin gathering infrastructure while utilizing excess third-party processing capacity. In the near term, we will continue to execute the strategy to support our customers' drilling plans while maintaining flexible processing options.

Within our Midland Basin footprint, we see a lot of opportunity driven by private producers ramping up their activity levels. And with this increased activity, we're well positioned to participate in Midland Basin growth by executing on some smaller scale projects to enhance our gathering system and fill open capacity. As we develop these targeted G&P investments to aggregate supply, this strategy will drive value through our downstream assets, providing steady fee-based earnings.

Moving to Slide 10 to close it out. I'd like to reiterate how we will measure our success in 2022. As a starting point, it's imperative for us to maintain our focus on operational excellence, providing safe and reliable operations is critical to the success of DCP and our customers. Second, we will continue to strengthen our balance sheet to investment-grade metrics, while returning additional capital to unitholders. Third, we set measurable sustainability targets to improve our mission's performance and increase our workforce diversity. DCP has a record of not just meeting but exceeding goals. And as we issue our third sustainability report later this year, I expect to announce our continued progress towards these targets. Finally, improving fundamentals are creating some attractive growth opportunities. We will capitalize on these new prospects while maintaining our strategy of capital discipline. We're investing in our business, which includes our assets and our people to ultimately lead to improved profitability.

On our third quarter call, I noted not that this is the best setup, Sean and I've seen in the roughly 10 years we've been leading the company. And as we look at today's macro landscape, our improved balance sheet, and our record excess free cash flow, DCP is set up extremely well in 2022 and beyond. Our team has built a strong track record of executing our strategy and meeting our commitments, and we look forward to delivering exceptional results once again in 2022.

With that, we'll open it up to your questions. Thank you so much.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question coming from the line of Miro Dennis with Credit Suisse.

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

Two things I want to start on just based on your comments and the slides. So one, value[Word] mentioned the larger scale capacity increases to the system that could be coming. The other item was extending the value chain down towards the export dock. So on expanding the system, can you talk a little bit more about how much of that is actually incorporated in the guidance already, if at all? And then just how you're thinking about the timing of when those assets or expansions could start cash flowing? And then on extending the value chain down to the dock, I know that's something you guys have talked about in the past is kind of a longer-term strategy, but noticed that put into the slides in and around the 2022 outlook context. So just curious if that's becoming kind of a more imminent strategy we should expect you guys to execute on going forward?

Wouter T. van Kempen - *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

Let me take those. Starting with the larger scale capital and processing, that's really what we're talking about, potential additions. What we're looking at is the DJ Basin. So I love more insight around the DJ Basin. As I mentioned, we've seen massive tremendous growth over the last, call it, decade or so, both on the NGL side. On the processing side, we've built a number of different plants there. We are pretty full. And so if you look at the DJ Basin overall, we're the largest processor and we're also the ones that are the fullest from our system point of view. So what we're doing is working very closely with our producer customers who, I think, are looking through some of the regulatory changes that we've had here in the last couple of years, looking at a little bit more calmer waters knowing how to work the regulatory construct that we have in place. And within that, they are seeing some really, really nice growth going forward. But it is not going to be, though, it's kind of exponential type of growth. So what we see some pretty good steady growth our kind of next, call it, a year or 2, we think we will have to do a number of investments around our gathering system and making sure that we can move the gas that will come to us from our producers to our plants or potentially third-party plants and make sure that we kind of deal with that growth.

Then what we're looking at is in no way, shape or form is a certain yet. It really depends on what the producers are going to get from their big growth programs in '23, '24, '25, '26. There is a potential for us that we may have to build another plant. We already hold a permit, so that is great, so we can do that. So we are working together with the producers looking at their plants and say, okay, what is needed in '22, what is needed in '23, again, mostly around the infrastructure of the gathering footprint. And then if you go further out, there may be a potential to build another plant in the DJ Basin, which I think would be an excellent thing if we can -- if it comes to fruition. So to the question of what is built here in '22, 2022 is really more focused around the smaller infrastructure type of capital. Nothing is building for maybe in 2, 3, 4 years, where we have to build some processing capacity.

To your question around wellhead-to-water, wellhead-to-water has been a big part of our strategy. We believe that in the long run, the wellhead-to-water players will be the main players and the winners in this industry. We've obviously worked ourselves from a strategy, from a gathering and processing footprint only to now a company that has residue pipelines, NGL pipelines. We have spread a lot of fractionator interests. And so our L&M, our logistics and marketing business now is 60% of our overall earnings profile. And yes, we absolutely have a desire and believe there is an opportunity for us to go further downstream. How if and when that will take place that is to be seen. Hard for me to comment on at this very stage. But I think what we tried to kind of show you in the slide that you mentioned is how do we look at the future, what do we believe, strategically needs to happen and the wellhead-to-water strategy is one of those.

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

Second question, calendar earnings call go by without talking about everybody's favorite topic this season, which is Permian gas takeaway. I know you guys in the past were able to utilize the Guadalupe pipeline pretty well, take advantage of some wider spreads. I think since then, you've contracted a lot of that capacity out. So I'm not sure what the tenor of those contracts looks like if they could be coming up for renewal, maybe around a good time, but it seems like there's a potential for spreads to maybe break out again in '23 and '24. Curious how you see the impact to you? And then just more broadly, how do you think this gas takeaway issue gets resolved?

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

I can start with the spread comment. Spiro. This is Sean and I'm about to talk about the long-term takeaway. So we have taken -- we took advantage of a few years ago and ran contracts out in 2 forms obviously, some financial contracts, and then we actually did some physical contracts on Guadalupe. They typically went out on average 5 years. We don't hedge the whole 100% of the capacity. So as you think about our portfolio, it declines in terms of the hedge percentage over the years. We were close to 80%, 90% last year. We're probably a little bit on the lower end of that, but similar this year. So there's still some -- that's our strategy as a whole. We still leave ourselves some room to take advantage, as you mentioned, of the spread widening. And then that diminishes in terms of the amount hedged over time. So if you're thinking about '23, '24, you're going to get closer and closer to about 50% hedged based on some of those contracts rolling off. We still -- just like we do in our normal business, we'll look at opportunities to hedge that when the spreads are wide. But we definitely have -- I think it's a nice balance approach. We have enough fee-based type revenue stream and we leave ourselves anywhere between probably 30% to 20% of upside on Guadalupe.

Wouter T. van Kempen - *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

And then maybe to add to that, Spiro, if you just go back to the first residue pipe, new residue pipe that came out of the Permian was Gulf Coast Express. And between us and Kinder, we were the codevelopers on that pipe. So I think we have a history of looking at the basin so is there an opportunity to develop a pipe or to go develop a pipe. It's very important to our business. We have a large G&P business. So being able to have our own takeaway on the residue side and the NGL side is something that is -- that we're always keenly interested in.

For Permian residue takeaway pipe to happen, you need long-term commitments. And what that will mean is that some producers will have to step up with some type of long-term commitment. The most significant growth that we're currently seeing in the Permian is from the privates. The privates historically do not have a tendency to sign up 5 or 10-year commitments that may change. And the question is, are the large publics -- are they going to be willing to sign up. So I think that is one thing that is to be seen and to be worked but that is very important. And then lastly, I think what I would like to add to Sean like, yes, we have Guadalupe, we have GCX, that's existing steel. Existing steel is always better from a rate point of view than new steel. So I think over time when we have some contract roll-off, they beat it at either GCX and Guadalupe, we will have an opportunity to recontract that probably at significantly higher rates than what we currently have in place. So that's a pretty good outlook for us overall.

Operator

Our next question coming from the line of Michael Blum with Wells Fargo.

Michael Jacob Blum - *Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst*

I apologize for maybe kind of a naive question to start here. But you show on the slide here the upside to your guidance based on the current forward curve. And my question is simply like why -- what's preventing you from locking in hedging more of that and locking that in the current pricing environment into your numbers for 2022?

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

Yes, Michael, I can start and give you a couple of things. Just the process itself, there's always going to be a difference between when we come out with our guidance and when we improve our budgets. And I know that wasn't your question, but just to give you a little bit, that stuff happens good 6 weeks ago, we're locking in, getting 22 approved. And obviously, guidance is going to be in line with what our formal budget is. To your second question, on the $140 million of upside, we are out hedging some of that. We're -- I think I showed we're 82% fear hedged. So we continue to take those opportunities to go out and add some hedges. I'll remind you that the hedges -- in terms of another tailwind, the hedges that we have on the books for 2022 are at better commodity prices than the hedges we had for '21, that should make sense to everyone. So the answer is yes. We are taking advantage. We are going out and locking in some of that forward curve for sure out the curve and adding to our hedge percentage. On the flip side, maybe the last thing I would say is that spot prices are higher than the forward curve. So as we sit here 6 weeks into the year, we're even benefiting even more than that forward because spot prices are -- you typically have backward dated curves. Spot prices are stronger. So that's one reason, obviously, you're still trying to take advantage in the shorter term of an even stronger market than what the forward would show you. But we will take advantage of those curves, you will see us go out and layer on some additional hedges.

Wouter T. van Kempen - *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

Yes. And I think maybe the last one, even to add to that. You never want to be in a position where you hedge 100% of your position. That would be great if we're in a perfectly completely steady business, but you take events like Uri, you take a winter storm like we had a week or 2 ago or last week in Texas, there's all kind of upsets that can happen, and you don't want to be at a 100% hedged situation here.

Michael Jacob Blum - *Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst*

Second question I just wanted to ask was on CapEx, really on both, but particularly on sustaining CapEx, it's -- I went back and look, I mean, the last time you were at $100 million or this level or higher was literally like 2018, it's been much lower in the last few years. So I just wanted to understand what's going on there. And then just what is in the growth capital numbers there?

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

Yes. So on the sustaining side, Michael, it is an uptick and your math is right. Still pretty low levels if you go back 10 years. But what you're seeing on that, there's 2 things in general. One, obviously, the Permian and the DJ, we better covered some of the short-term trends that we really like what we're seeing there. So that does require us to go out, connected gas. I think that's a strong thing in terms of product replacement. So we're seeing some increases in product replacement. You are seeing, as you think about 2022, the applicable increases in the margin and the volumes tied to that. We talked about those 2 areas being up 5% to 7% on the margin side. So that's PR. I think that's a good trend. Obviously, that's -- and it is higher than maybe the last couple of years, but it's still, in my mind, very disciplined in terms of the increases we're seeing there.

The other thing that hits sustaining, and I talked about it a little bit in our remarks is the investments in reliability, the investments in some of the regulatory changes that are coming down the path. So we are -- it's a higher reliability year for us. We put a bunch of new assets in about 3 years ago in the DJ, some very large assets. Those require maintenance sort of on a 3-year cycle. So we're going to be investing in some of that. And then with a lot going on in the regulatory front, mega rule emissions things of that nature, we're investing and spending some money on those assets as well or those types of investments.

The other thing I would point out is those actually do increase topline returns, right. The more reliable, we rerun the more gas we keep in the pipeline, the more money we've made. So I don't want you to think that those sustainability investments are not driving revenue increases either. But those are the primary drivers of the sustaining. As you think about growth, Wouter kind of covered it earlier, again, right back to those 2 areas. Outside of just sustaining the volumes, we are seeing some opportunities with -- in particular, producers in the Delaware Basin that are investing more in 2022 than they did in prior years. So we're adding some volume growth and going out and spending some money, that's going to be compression. That's going to be gathering that's going to be connecting to wells. And the same thing in the DJ, exactly the same type of investments, not the big plants that Wouter talked about down the road, but we do see an uptick in growth. Again, I see that as a very positive thing. Our 2 best return regions are the DJ and the Permian. And that's where we're -- if you think about sustaining and growth, that's we're investing money in 2022.

Operator

Next question coming from the line of Tristan Richardson with Truist Securities.

Tristan James Richardson - *Truist Securities, Inc., Research Division - VP*

I appreciate those comments on the DJ around investing in your assets and the processing landscape there. And Sean, I think you may have even touched on in the previous question. But just on the Permian, Wouter you made DCP's position very clear over the past several years. But just on access third-party processing, you're seeing some of your peers maybe add a plant here and there to the medium-term schedule. Do you see a lot of latent third-party capacity still available or at some point, do we see a tightening begin and does DCP start to look at internal project developments there?

Wouter T. van Kempen - *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

Midstream is a regional business, correct. It's a real estate business. So it all depends on location. So there obviously are some areas with some profiles where people say, hey, I'm short and I need to build something. And then there are other areas where you do have some overcapacity. So we see here in kind of the shorter term and whatever short means 18 months or so, we definitely still see some opportunities for us to utilize a third party. And then the question is, is there an opportunity to do something different in the longer run, and we'll continue to look at that very, very closely. But I don't see a situation right here right now where we're sitting and saying, hey, everything is chockablock full from a G&P point of view in the Permian and therefore, you got to pivot and go do something else. But we do -- I think you're -- in general, we started our supply loan capacity short strategy kind of in 2019. So that is a good 3 years ago. And at some moment, there is going to be a change to that where you say, hey, I need to build my own some additional infrastructure that I own myself. I think in general, that would be a good thing. If that's the case, and as I said earlier, probably we see some of that on the horizon in the DJ Basin. Depending on where things go in the Permian, we may have to go the same route as well.

Tristan James Richardson - *Truist Securities, Inc., Research Division - VP*

Appreciate it. And then just on potential tailwinds this year makes sense what you guys have laid out just from a commodity standpoint. But then just on the third-party ethane opportunity, maybe just give us a scale of what that could look like this year if you do see an incremental pull?

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

We've been in and I think you're alluding to it -- we've been in our plants, our assets have been of recovery for quite a while now for a couple of years. It's off and on with the third parties. Obviously, third parties have different downstream contracts. They have different downstream economics. We're very fortunate we have the ICC. We're looking at those decisions on a real-time basis, and you see us optimizing that. But bottom line, we did not see a lot of third-party recovery last year, maybe a slight uptick in Q4. And as I indicated, we kept that trend in our guidance for 2022. If -- and -- now we've seen the frac spread kind of increase and obviously, the decision that these guys run the models, they run are more than just the frac spread, but at least that's going our way. If we do see third-party plants go into recovery mode, we think somewhere in that 20,000 barrel per day uplift. And then obviously, that would be for the full year. And that's substantial. That could be $20 million, $30 million of additional margin if we see that. So that's a great tailwind. And so far, the fundamentals are pointing to that. But we'll -- and the last thing I would say is we do work with individual producers to try and incentivize them. As I mentioned, we didn't see a ton of that last year, but maybe some more opportunities this year. So it could be a good tailwind for the company.

Operator

Our next question coming from the line of Jeremy Tonet with JPMorgan.

Daniel Walker

This is Dan Walker on for Jeremy. I just have a couple of questions. The first is on the tax payments on Sand Hills and Southern Hills that you pointed out in the release and in your prepared remarks. Could you quantify those for us? And I guess, by timing, when were those payments expected? And does this mean that these tax payments were pulled forward? And if so, would that have, I guess, positive implications for 1Q or this year?

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

The way I would think about it as a whole, we talked about sort of the Q4 in areas where we had some timing and maybe a miss. The cash distributions from our pipelines, essentially we had 0. If you really look at it, they were 0 in Q4. Typically, they're running $20 million to $30 million a quarter. The 2/3 or more of that was the tax payment. So you're talking about maybe $24 million, $25 million. I wouldn't say that we're pulled forward. Typically, we pay them either in late December or in early January. So just -- and obviously, if you think about 2020 being a COVID year, things were a little bit slower. That payment didn't happen in Q4 of '20, going into '21. It happened in '21. So we actually made that payment in Q1. And then obviously, things back a little more efficient. We made those payments in Q4 late. So to your point, that is a tailwind. That's why we call it timing. I mean you're going to pay your taxes no matter what. But that is something that, obviously, we paid late last year. So we won't have that -- the majority of that payment occurring in Q1 of this year. And again, setting us up pretty good for the quarter.

Daniel Walker

And then the second question we had was just on the costs versus top line. I mean you talked about the escalators in the second half kicking in and cost reductions that were largely you kind of held the line in '21. But what kind of OpEx pressures are you seeing, if any? And what are you budgeting? What's kind of baked in, I guess, for the '22 guide?

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

In terms of pressures, everyone's dealing with inflation. You've got the great resignation. So the company is doing some really smart things around investing in our people. I think those are prudent. I think the company has done an amazing job. I'll reiterate some of the things that I mentioned. I mean we cut $150 million out in 2020, obviously, during COVID, we held on to all of that. We stayed flat in '21. Very few companies did that. And then again, we're going to hold on to half of that 2 years later. But the pressures to your question, definitely some inflation, definitely some investments in our people. You heard me, I mentioned we're taking this opportunity to -- I think it's -- we're in a very productive fundamental environment. I think we're going to invest in our ESG front, you'll see us get ahead of a few things there. I think those are all prudent investments. And we're still holding on to half of those $150 million savings that we delivered 2 years ago. So I think they're all manageable. I think there are things that we clearly have our eye on. And then I think you highlighted something important that we do, as a company, have offsets to inflation. Commodity is a great one. It tends to correlate with inflation, and then we talked about the $140 million of forward curve uplift. And then in the second half of the year, we do have those escalators that kick in on some of our G&P contracts, but the bigger ones are tied to our pipelines, and those are meaningful as well. So the good news is we have good offsets to inflation, but those are some of the pressures we're seeing. I think we're doing a better job than many in terms of trying to mitigate some of those.

Wouter T. van Kempen - *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

Just one quick kind of macro like we all saw the numbers this morning. So 7.5% inflation, the highest we've seen in 4 decades. I can guarantee you that we will beat those numbers. You're not going to see our numbers go up by 7.5%. And we're going to continue, as Sean mentioned, to invest in our business. So not only are we going to be to 7.5% by quite a bit, we're also kind of on top of that invest in our business. So I think we have a great track record of running a tight ship, making sure that we deal with cost really, really well. Sean mentioned 2 years after the big COVID savings, we held on to 100% of those savings. If you start giving a little bit back in an environment like we are today, I think that is a pretty good place to be, and you're still going to be well below of those cost levels that you were 2 years ago or even well below cost levels that we were 4 or 5 years ago, while we're running a lot more assets, billions of dollars more assets, we're running them more profitable, more reliable, safer and with lower emissions. So net-net, I think around the cost story, it continues to be a really, really great story.

Operator

Our next question coming from the line of Michael Cusimano from Pickering Energy Partners.

Michael Raphael Cusimano - *Pickering Energy Partners Insights - Research Analyst*

Looking at the Midcon, you point to a moderate decline there. Just curious if that's consistent with your view on the basin as a whole or just your system? I know it's competitive G&P region. So can you just talk about what you're seeing there?

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

Yes. So a couple of things, Michael, in the Midcontinent. It's actually a slightly favorable story. So we are seeing -- as we gave the guidance for '22, we're saying modest declines. I -- when I look back at '21 and even '20, our portfolio has been outperforming the basin declines. So we've seen -- we've actually, I guess, backed into some increases in market share. So we've been able to do some interesting things. You may recall, we've consolidated a bunch of plants there. We're taking a lot of the gas to our most efficient plants. That's increasing our earnings, one of our most new and most technologically driven plants. So I think it could be -- in '21, it was a slight positive surprise to the company. And I think slight declines. I don't think you're going to find anyone that's seeing big growth out of the Midcontinent. But we have been slightly beating in my opinion, when I see we've been beating the trends of the basin. So kudos to the team for that. But I'll remind you, it's a good area, but our best profitable most highest return areas are the 2 that we are seeing some growth back to the Permian and the DJ. But overall, a decent story in the Midcontinent when considering the environment.

Operator

Next question coming from the line of James Carreker with U.S. Capital Advisors.

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

I appreciate your comments about returning additional capital to equity. But just kind of curious if you have any thoughts around that plus or minus $500 million of excess free cash flow, a 10% raise an additional $30 million. I guess how do you think about allocating the rest of that for this year and then assuming you'll have free cash flow in '23 and beyond?

Wouter T. van Kempen - *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

No, good details on (inaudible). And I think the way we look at this, we have an all of the above kind of broad menu of opportunities that are available to us. I want to take people back, we -- our goal was to be at 4.0% at the end of 2021 and were at 4.1% at the end of the third quarter at 3.8% at the end of the fourth quarter, so a massive improvement. So what we kind of said is like, you know what, there's an opportunity to start accelerating capital return to unitholders instead of the second half of 2022, let's kind of start targeting the middle and what we believe we need to target is with the distributions.

At the same time, we're going to continue to have a commitment to the balance sheet. So we got to get first from 3.8% to 3.5%. And then what we always say is that, hey, 3.5% should really be a mid-cycle type of leverage. I think at the current prices that we're seeing, we're probably above mid-cycle. So you're going to continue to see additional dollars go back to the balance sheet. So we continue to lower our overall leverage so that if things go the other direction, and we get into some type of a lower cycle, which at some moment, we will, the balance sheet is still iron flat and we can still run a really, really good business. So -- but at the same time, once we hit that 3.5%, it's going to be kind of a dual-pronged approach, raise the distributions and continue to have dollars go to the balance sheet.

At that time, we're I think also having a much kind of broader view around what else is possible at that time. We spoke a lot about hey some growth in the DJ, some growth in the Permian. That's things that you want to do as long as it is good growth, and it's growth that makes a lot of sense. And I think we have a pretty good history in both the DJ and the Permian of putting profitable growth in place. Additional raises is something that could be on the table and then things around your common or your preferred is that something that you want to put on the table. All of those things we're going to be looking at here over the next number of months and the next number of quarters, what is available, what makes sense, why are we trading? So from a cost of capital that makes most sense.

I think the good thing and the takeaway is we're in a great position. We're going to be at 3.5% leverage here sometime in the middle of this year, we're going to raise the distribution, start putting cash back to unitholders. And then on top of that, we have a tremendous amount of option. As you pointed out, there's an unbelievable amount of excess free cash flow is still available. And we're going to see what the smartest thing is to do with us.

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

And then maybe as a follow-up, just any comments about, I guess, M&A kind of on either side. One of the partners in GCX just sold out a piece of there at $850 million. Is that a valuation that's interesting to you? And then on the flip side, do you see a use of free cash flow going out and being strategic and acquiring any assets or maybe both selling (technical difficulty)?

Wouter T. van Kempen - *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

Great questions. I think earlier in the call, we spoke about GCX a little bit. We were the original developer for us massively strategic assets. We like it. We like the earnings power. It's core to the business. We spoke a little bit about wellhead-to-water strategy. Well, that's not only NGL pipelines, it's also residue gas pipelines. We have GCX. We have Guadalupe. We have to Cheyenne Connector that we have out of the DJ Basin. So all of those fit really nicely into our system. We have a strong outlook for the Permian Basin. We have a strong outlook for G&P assets and our gas needs to find a way to go to market. And so owning your own pipes and infrastructure, paying yourself is always a good thing. So we do have co-option on GCX. We're going to review that. We have some time to review that. The other partners have the same. We are not anticipating to be a seller of GCX of our interest in GCX.

Then in broader M&A, we do believe that the market will continue to consolidate. We went from this high-growth kind of decade to a much more mature industry where we are now lower growth normally leads to M&A cycle starting up. We've seen some of that in '20 and '21. I think you're going to see more of it in '22, '23. M&A is not a strategy. It's a way to execute your strategy. If there's an opportunity to do something from our side, where we can expand the business in a logical way and either use a strong balance sheet or a strong currency and do something where we believe that strategically, we will make the business stronger for the next 5 years, the next decade, we're obviously going to look at that.

Operator

Our next question coming from the line of Gab Moreen with Mizuho Securities.

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

Just quick ones for me on the capital allocation question, following up on James' question around whether getting to investment grade is a priority at this point? And to what extent that may or may not be a gating factor to capital return or going below the 3.5x leverage target?

Wouter T. van Kempen - *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

For us, the number, the 3.5 and the investment-grade rated metrics, that's the most important thing. If the rating agencies then are going to fall suit -- that would be really nice, okay? But for us, it's not something where we're saying that if the rating agencies are going to move the goalpost on us that we say, okay, we're going to hold off on raising the distribution, that 3.5 is still kind of the gating item for us. And we would like to be investment-grade rated. We think we deserve it. Our outlook deserves it. I think a number of the agencies have put us on positive outlook or have taken positive action. And what I said earlier, Mike, it's not when you hit 3.5, then the other almost $0.5 billion of excess free cash flow is just going to be spent not. There's still money going to the balance sheet. So we think we will exit 2022 well below 3.5.

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

And then maybe I can follow up on the comments around competing for incremental barrels, I think, specifically maybe in the of the Permian. Has anything changed significantly since last quarter or 2 with that language? I mean, obviously, there's been some changes in assets, which may affect the competitive dynamic out there. Can you just speak to that a little bit, contract roll-offs, et cetera, et cetera?

Wouter T. van Kempen - *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

Not a lot of contract roll-off for us. I think the first contract roll-off is in early 2024 or mid-2024 that we have. So not a lot of contract roll-off there, is still quite significant overcapacity from an NGL point of view. So if you're thinking about, hey, we spoke about processing in the Permian, we spoke about residue gas, if you take NGL now, that -- there's more overcapacity in NGLs than there is in processing of residue gas. So from that point of view, competing for new barrels is definitely happening at lower rates today than where we were 3, 4, 5 years ago. And I think that was the comments that Sean was alluding to.

Operator

Our next question coming from the line of Elvira Scotto with RBC Capital.

Elvira Scotto - *RBC Capital Markets, Research Division - Director & Chief Analyst*

I had a follow-up call just on the question on the sustaining CapEx. How much of that is unique to 2022 that won't repeat next year? For example, I know you mentioned reliability spend, I mean, is that an ongoing expense or is that more of just a 2022 expense?

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

Somewhat '22 on the reliability side, that I alluded a little bit to it, I think, in some ways, it will be a little bit of a higher year. We had some big assets that went into the DJ. If you go back prior to the COVID year we invested a lot. And they are to every 3 years for some very good maintenance and reliability spend. So from that perspective, I would see it more as a little bit of a timing. When I reference the spend on the regulatory, I see that more as continuing. I think the environment we're in, we're going to continue to invest in ESG, we're going to continue to invest in our pipeline and trying to stay ahead of the regulatory environment. And I'll remind you, obviously, we're in Colorado and Southeast New Mexico, 2 very regulated states. We take a very proactive approach. So the answer is yes, I think, a little bit higher if you're going to focus on the reliability spend. I hope the product replacement spend continues.

`

Elvira Scotto - *RBC Capital Markets, Research Division - Director & Chief Analyst*

And then just looking at your 2022 adjusted EBITDA guidance, what drives the low end versus the high end? And that $140 million of upside from the forward, is that -- should we think about that versus the midpoint of your guidance or potentially from the high end of your guidance?

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

The $140 million versus the midpoint of our guidance. So if you take the mid -- we gave you the mid commodity deck that we used and obviously, the forward curve. So that's $140 million over the midpoint, look, the thing that can take you to the low end, obviously, it could be -- the big ones and they haven't changed are going to be, does the commodity dampen. We always have a range on the commodity deck. Right now, we're very fortunate as we look at that range is pointing significantly to the up and then volume growth. Again, the things could transpire a little bit slower on those 2 areas that we talked about in terms of volume growth. But as we sit here 6 weeks into the year almost, so things are looking good on that front. But those are the types of things that we think about when you're talking about what would take you to the lower end of the guidance. Commodity dampens quite a bit and producer activity dampens quite a bit. Those are the big ones. There's others, but those are the primary ones you're going to focus on.

Elvira Scotto - *RBC Capital Markets, Research Division - Director & Chief Analyst*

And then just one last one for me. Any significant weather impact that we should think about in the first quarter, given some of the recent storms?

Wouter T. van Kempen - *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

I can't talk to you about the rest of the quarter, but I can talk until February 10. And we obviously had the storm last week. I would say we were all that given Uri last year, but I think it went -- it was more like a normal storm. So yes, you have a little bit of impact from it and a little negative impact, but it's nothing to worry about vis-a-vis what the country saw and the state of Texas saw with Uri last year. So I would say it was more kind of a normal weather event.

Operator

And we have a follow-up question from the line of Jeremy Tonet with JPMorgan.

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

Just a real quick clarification here with regards to the potential for opportunistic buybacks in the thought process, whether to point that towards preferred or common, if you had anything you could share there?

Wouter T. van Kempen - *DCP Midstream, LP - Chairman, President & CEO of DCP Midstream GP, LLC*

Nothing really to share other than it is something that we're going to take a look at. As James pointed out, there's $0.5 billion of excess free cash flow available. And a meaningful double-digit distribution rate is, I think, is very important, but there is still a lot of optionality after that. It's going to be a little bit of, hey, what makes most sense and how -- what do we see from a growth point of view, what do we see from a distribution point of view, how are we executing, and then we're already units trading? Obviously, with a common and with the preferred, it's all about cost of capital and what makes most sense in the short run and the long run. And we'll be weighing all of that here in the next number of months and see where we come out.

Operator

I'm showing no further questions at this time. I would now like to turn the call back over to our speakers for any closing remarks.

Michael Fullman - *DCP Midstream, LP - Director Corporate Development & Strategy*

Appreciate you guys for joining us today. If you have any more follow-up questions, please feel free to reach out. Thanks. Have a good day.

Operator

Ladies and gentlemen, that does conclude our conference call for today. Thank you for your participation. You may now disconnect.