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DCP.N - Q4 2020 DCP Midstream LP Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Q4 2020 DCP Midstream Earnings Conference Call.

(Operator Instructions)

Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Ms. Sarah Sandberg, Senior Director of Investor Relations. Thank you. Please go ahead, madam.

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

Thanks, Justin. Good morning, and welcome to the DCP Midstream Fourth Quarter 2020 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 today that our discussion 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 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 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.

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

Thank you, Sarah. Good morning, everyone. Appreciate you joining us on our call today. After an incredibly challenging year, we are really proud to reflect on the performance of our teams throughout 2020. We were able to navigate a double black swan event that eviscerated demand, plunged oil prices into negative territory and fundamentally changed the way we operate as a company. The team rose to the challenge to produce extremely strong financial and operational performance as a result of our multiyear strategic evolution, our COVID and downturn mitigation plans and a focus on sustainability and operational excellence, which I'll walk you through on Slide 3.

Over the past decade, we've transitioned the company into a fully integrated midstream service provider with our Logistics and Marketing Segment generating 61% of our 2020 adjusted EBITDA. This has stabilized our cash flows and allowed us to capture more earnings along our extended value chain. Additionally, in the years leading up to 2020, we optimized existing infrastructure as part of our Supply Long, Capacity Short strategy, keeping our utilization rates high and minimizing our capital spending.

In 2016, we launched our DCP 2.0 digital transformation, which has revolutionized our company. Our investment, over the past several years, enabled us to deploy proven fourth industrial revolution technologies to achieve substantial improvements in our processes and operations, resulting in enhanced operational excellence and efficiencies. We've also focused on margin optimization and increased productivity by the utilization of digital twins of our assets in our Integrated Collaboration Center and significant enhancement to our reliability and predictive maintenance.

Across our footprint, as a result of our ICC and our operations team, this year represented our best operational reliability in the company's history, relevant to plant run-time, plant-based recoveries and major equipment malfunctions. Underpinning our business continuity was our Pandemic Response Plan that ensure the health of our workforce and communities while maintaining safe and reliable operations. And to protect the health of our business, we took early and aggressive action that resulted in over $1.1 billion of increased cash flow year-over-year, driven by reductions in costs, reductions in capital and a measured reduction of our distribution to secure liquidity, generate excess free cash flow and ultimately reduce debt.

Before we detail our financial performance, I want to mention a few other highlights from 2020. We made significant improvements to our emissions profile in our Permian asset as a result of improved reliability and continued operational discipline. Following our inaugural report in 2020, we expect to highlight the details of this reduction and other ESG metrics in our second sustainability report, which will be published this summer. Our sustainability efforts were recognized by GPA Midstream this year through the awards of Environmental Excellence and Energy Conservation, and we look forward to continued ESG improvements.

And lastly, on the operations side of the business, the Cheyenne Connector and the Latham 2 Offload came online in 2020, increasing needed residual gas takeaway and processing capacity in the DJ Basin.

All of this hard work culminated in the financial results you see on Slide 4. For 2020, our assets generated a 4% increase in adjusted EBITDA year-over-year, totaling $1.252 billion, and a 12% increase in DCF compared to '29 (sic) ['19], totaling $850 million and exceeding the high end of our 2020 guidance range.

We introduced excess free cash flow as a financial metric within our guidance during 2020 and exceeded the midpoint of our range with $237 million generated in excess free cash flow this year. Inclusive of working capital adjustments, we used this excess free cash flow to pay down $300 million of debt, and we closed out 2020 with 0 borrowings on our bank facility and a leverage ratio of 3.9x, better than our 4.0x guidance target.

Total capital was down 74% year-over-year, with growth capital of $205 million slightly exceeding the high end of our range, driven by increased cost on the Cheyenne Connector.

In all, we're tremendously, tremendously proud of our team's execution, and we look forward to carrying this momentum into 2021.

So let me turn it over to Sean to walk you through the details of the fourth quarter, the full-year and our 2021 guidance.

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

Thanks, Wouter, and good morning. Looking to the fourth quarter, we generated adjusted EBITDA of $289 million and DCF of $178 million, which represents a 2% increase over Q4 2019. Commodity prices and dampened volumes pressured our margins. However, we more than offset these headwinds through $20 million of improved costs and sustaining capital savings and higher NGL pipeline throughput, driven by better-than-expected ethane recovery and a 46% increase in volumes on Southern Hills compared to Q4 2019, partially offset by third-party ethane rejection on Sand Hills.

As we guided on our November call, Q4 represents a one-time increase in cost as deferred projects were brought back online, and our January results already show a cost run rate similar to mid-2020, demonstrating our ability to maintain our efficiencies year-over-year.

Now looking to our full year results on Slide 6. The team's hard work enabled us to overcome the substantial headwinds of 2020 and grow DCF by 12% year-over-year. Although commodity price exerted a $144 million negative impact on our business, this was fully offset by our $145 million reduction in costs year-over-year, exceeding our $120 million goal.

Looking to our G&P business, as a result of pricing and other dynamics, our producer customers drastically reduced their capital, resulting in a $19 million adverse impact from volume declines. Though, we saw increased volumes in the DJ Basin and Permian, where margin per well McF is the highest, this growth was offset by Midcontinent and South declines.

Accounting now for over 60% of our adjusted EBITDA in 2020, our Logistics and Marketing Segment grew margin by $76 million, driven by a full year of Gulf Coast Express, the expansions on Front Range and Texas Express and NGL Marketing. These segment drivers more than offset lower earnings on Guadalupe. Our risk-based prioritization of projects, coupled with low product replacement, drove sustaining capital expenditures below the low end of our guidance range. Our excess free cash flow generation allowed us to pay down our debt by $300 million and increased our liquidity to $1.44 billion.

We reduced our leverage, exit-to-exit and continued to focus on debt reduction as our top capital allocation priority. As a result of our strong financial execution, Fitch revised our outlook to stable in September, with S&P filing suite in December, resulting in a stable outlook from all 3 rating agencies.

To close our remarks on 2020, I want to offer my thanks to the team for delivering strong results that enabled us to improve our balance sheet during this downturn.

Now moving to Slide 7. I want to highlight some details of our 2021 guidance. The way we have a conservative outlook on pricing and volumes as we continue to face uncertainty due to COVID-19, we anticipate a solid year with potential for substantial pricing upside. Our 2021 adjusted EBITDA range is $1.12 billion to $1.26 billion and our DCF range is $710 million to $810 million. We're targeting a sustaining capital range of $45 million to $85 million and a growth capital range of $25 million to $75 million, reflecting an over 50% reduction in total capital from 2020.

Finally, after paying $325 million in distributions, our excess free cash flow range is $310 million to $460 million, representing an over 60% increase year-over-year. At the bottom of the slide, you can see the commodity price assumptions that drove the midpoint of our guidance ranges, and our sensitivities to help you adjust expectations based on your commodity outlook. If you were to mark the current improved prices, our DCF would be at the top end of our guidance range, and our leverage would improve beyond our target, demonstrating how well positioned we are to benefit from improved pricing.

Pricing is one variable among many that influence our results. So let me give an overview of our key assumptions on Slide 8. First, with a favorable capital outlook, we anticipate being completely self-funded in 2021, meaning we expect to retire our $500 million September maturity with excess free cash flow, eliminating any need to access capital markets. 75% of our earnings are fee-based in 2021, underpinned by growth in our Logistics asset. And we've been able to layer on opportunistic hedges, bringing our total fee and hedge percentage up to 88%, our highest starting level.

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Importantly, approximately half of our equity length is hedged, offering increased stability, while also allowing potential upside of $50 million to $90 million, based on current forward and spot prices. As we stated, we plan to maintain the cost reductions achieved last year, with 2021 costs equally weighted between the first and second halves of the year and peaking into Q2 due to planned maintenance. Our lower costs are driven by efficiencies from improved reliability and continued innovation efforts to help mitigate dampened volumes and anticipated margin compression due to overcapacity across the midstream industry.

We expect slight growth across our Logistics segment, driven by increased ethane recovery and a full year of earnings from the Cheyenne Connector, partially offset by lower anticipated earnings on our Guadalupe asset as pricing spreads tighten.

Finally, on the G&P side of the house, we expect overall volumes to slightly decline, with growth anticipated in the DJ Basin, offset by declines in the South and Midcontinent. We expect contract roll-off in the Eagle Ford and East Texas, and I'll also note that the Latham 2 Offload is not expected to be a driver of earnings in 2021.

In all, the external environment continues to be tremendously dynamic, but we are confident in our team, our portfolio and our financial position, and look forward to delivering a very solid year in 2021.

And now I'll turn it back over to Wouter.

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

Thank you, Sean. I'm looking to Slide 9. Building on our DCP 2.0 efforts and following the completion of our multiyear capital program, we have now sustainably lowered our cost basis and minimized our total capital expenditures, all while maintaining our leading safety metrics, delivering our best reliability outcomes and lowering our emissions.

Specific to our cost reductions and expectations, we lowered year-over-year costs by 14% in 2020, and our team is fully committed to maintaining those efficiencies moving forward. Our 2021 total capital spend is down 88% from 2019 and represents less than half of our 2020 expenditures.

Aligned with our capital allocation strategy, we have transitioned from a primary focus on organic growth to harvesting returns from our premiere portfolio of assets, resulting in an expected 62% increase in excess free cash flow year-over-year, enabling debt reduction and improved value for our unitholders.

So let me wrap it up on Slide 10. While we're taking a conservative approach, we believe we have a very solid year ahead of us as a result of the focus areas you see on this slide. First and foremost, we are always committed to operational excellence, and we'll continue to prioritize our best-in-class safety performance above all else.

As we just discussed, we will continue the momentum we created in 2020 relevant to cost efficiencies and capital reductions. We will utilize our increasing excess free cash flow to retire our upcoming $500 million maturity and strengthen the balance sheet.

Our DCP 2.0 initiatives, including incremental advanced technology adoptions, will be reprioritized in 2021. Additionally, we will enhance our sustainability outcomes by building on our 2020 progress and emissions reductions across our footprint and advancing other ESG initiatives.

In all, 2020 has proven the strength of our asset base, the power of our digital transformation, the stability of our cash flows and the creativity and unbelievable grade of the DCP team. We are now off to a great start in 2021, and I'm confident in the earnings power in our -- of our assets as we recover from this downturn. We are well positioned to build on our success, benefit from improved commodity prices and increase unitholder value.

And with that, I want to say thank you again to our employees for their hard work and to our investors for their continued commitment to DCP. And I look forward to taking your questions.

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So Justin, please kick us off.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Michael Blum from Wells Fargo.

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

So I just really had a question about the NGL pipelines. If I look at the -- if I go from EBITDA to DCF, taking the midpoints from 2020 to 2021 guidance, there's about $100 million delta there, and it looks like at least 60% of that is equity earnings. And so I just wonder if you could just speak to the outlook for Sand Hills in 2021. And especially in light of the fact that your guidance commentary says that you're expecting higher NGL volumes due to ethane recovery.

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

Yes. I think, Mike -- well, a couple of things to think through, and I'll recap 2020 that we were in rejection for the most of the year. And I'm being specific to Sand and Southern. We went into full recovery in Q3, and then we saw partial recovery in Q4. As we think about 2020 to 2021, Sand Hills is relatively flat from a volumetric perspective. We do expect recovery. We do have recovery baked in on the Sand Hills side of the equation. And -- but we're still expecting to be pretty flat from a volumetric perspective, 2020 to 2021.

SoHi is a little bit different story. We have some growth there. We had the expansion that came in. We're seeing -- one theme we're seeing, Michael, is this -- the volumes we control, we can't -- we stated in recovery, for example, in all of Q4, we expect to be in recovery for all of all of 2021. Some third-party volumes have gone into rejection and stayed in rejection. That's more prevalent on Sand Hills than it is Southern Hills.

So from a volumetric perspective, Sand Hills, relatively flat, and there are some offsets there. We'll be in recovery. Some third parties may not be. And then SoHi, we do have some volume growth related to our expansion last year, and the fact that we control more of those barrels and the decision on whether it goes into recovery or rejection. But overall, a pretty solid outlook for 2021 on the NGL side, specifically the pipeline side of the equation.

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

Got it. That's very helpful. And then just -- I want to make sure I heard this correctly. So I believe you do have a debt maturity in 2021. And would your plan be to pay that off or refinance it?

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

Our plan is to pay it off. We -- I'm pretty excited, Michael. We took $300 million of debt off the books in 2020, and we still want -- yes, we think it's still important to continue to shore up the balance sheet. So in 2021, when that $500 million comes due in September, we'll use excess free cash flow, which, as we mentioned, is growing by over 60% between '20 and '21. And if we -- if that doesn't cover it all, we'll use our revolver for any remaining piece. But our plan is to delever and take as much of that off the books as we can.

Operator

And our next question comes from Shneur Gershuni from UBS.

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

I was wondering if I can start off -- I sort of looked at your expectations for costs this year to be kind of flattish. When I think about your peers, they were able to maintain about 50% to 80% of their reductions from last year. It looks like you're expecting to get, I guess, close to 100% of that.

I presume 2.0 is kind of part of this. Is that kind of the continued focus for this year for DCP 2.0 to continue to improve on the cost side to offset any of the variable costs that would go up or is there a pivot this year where you focus on revenue enhancement in terms of optimization on margins and so forth?

Just wondering if you can share with us the focus of DCP 2.0 this year. And what element is baked into your -- or targets are baked into your guidance for this year?

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

No. I appreciate that, Shneur, and there's a lot in there. So I'm going to try to just take a couple of things here. First of all, as it pertains to cost, we set a tremendously aggressive goal last year, $120 million of cost out, and we beat that handily. And even while spending a little bit of extra money in the fourth quarter, as we all told you, we were going to do in November to make sure that we were setting ourselves up nicely for 2021. And even in that fourth quarter, where we spent a little bit extra money, we still actually reduced cost by $20 million versus 2019.

So cost is always front and center for us. If you kind of think about the discussions we started, probably 18 to 24 months, where we said the super cycle of growth is going to come to an end and we need to create a lean manufacturing platform in the industry that can operate in a very lean, safe and reliable manner. And I think the team has been focused on that. DCP 2.0 has been a huge part of that. But it's focus for -- and the culture of 1,800 people within this company to always think about how can we do things smarter? How can we do it better? And yes, the digital transformation and DCP 2.0 is a huge enabler of that.

So we will continue to focus on that. I'm super proud of the team being able to maintain those savings. And we're going to spend more money on DCP 2.0. I put that in my prepared comments because we believe there is more to be done. But we're going to do that within kind of the realm of keeping all the costs that we saved year-over-year. So I think that is a great thing.

And then, you asked about revenue enhancement. Hey, we're always looking at ways to revenue -- for revenue enhancement, how can we optimize our assets. DCP 2.0 is actually on the ICC, the Integrated Collaboration Center. It's a huge part of that. If you see about what's going in the markets today and where kind of spot prices are yesterday, today, tomorrow, the rest of this month, there's an unbelievable opportunity to optimize your asset base, rapid fire, really quickly and to start benefiting from that. That's what our ICC is doing in combination with -- working with our operations teams in the field.

So yes, we continue to see a lot from DCP 2.0 on the cost side and the revenue side. And then, also on kind of, if you think about energy transitions and things like that. We're working very hard with our DCP ventures team around things. Is there -- obviously, this is all about -- on the one hand, about compliance, but on the other hand, it's all about, hey, can you create revenue opportunities out of this, and we're working on both very, very hard.

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

Great. No, I definitely appreciate all the color, Wouter. Maybe just a technical question with respect to ethane rejection. When I sort of look at the third quarter, ethane traded at a fairly high thermal equivalency premium, trended down in the fourth quarter. We saw the volumes -- we saw, I guess, rejection on your system in the fourth quarter.

We're back up in terms of thermal equivalency now. I was wondering if you can tell us based on your experience, where producers tend to reject versus recover ethane? Is there kind of like a flip point? Is it 130% equivalency, 140%, where it sort of flips over? I'm just wondering if you can give

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us any color as to when we should anticipate producers in the Permian flipping between ethane rejection and ethane recovery. If you have some experience on what percentage, that would be helpful.

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

Yes. So Shneur, I can give you some generalities. I can't give you everyone's -- and we're not privy to everyone's exact thermal equivalent or a frac spread targets. But a couple of things I can tell you, and I was alluding to it earlier. We -- based -- there's the thermal equivalent and then there's a formula that we have internally that bakes in the value because we're a fully integrated midstream company. There's more to it, right? There's the downstream value to get the ethane all the way through to the Gulf Coast. And that, that is a positive for companies like DCP that has that infrastructure.

So the reason I bring that up is, and I mentioned it earlier, we were in recovery in all of Q4, and we expect to be in recovery for, barring some -- if you look at some interesting stuff that's happening in the market today with gas just going crazy, but -- and generally speaking, that's the math we run. It's the -- your version of the thermal equivalent frac spread, plus we work into the equation what's the value of downstream barrels and the downstream earnings that we would make.

Every other producer has their own equation. Many of them don't have those extra components. So they're going to be in rejection, and that's what we saw. Even thermal equivalent aside, they'll be in rejection in times when probably companies like us are in recovery. We have a feel. Our marketing arm that sits in Houston definitely, probably has a pretty good indicator when some of these guys are going to flip.

And then, the last thing I would tell you as well in some interesting periods you may recall over the last half decade, we did some things due to flip producers into recovery with some short-term incentive rates that augmented that thermal recovery equation. But I think we have a pretty good feel, but I don't know that we know exactly at what point these guys are going to flip.

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

Yes. And maybe Shneur, Wouter here, to add one thing to that. None of the producers behind our systems have contractual rights to tell us we would like to have recovery or rejection. But we obviously have a lot of third-party midstreamers and plants that deliver into the Sand and the Southern Hills system and those are the ones that Sean talks about. We don't always have insights in what a third-party midstreamer has in their contracts with their producers. And we do know that some producers own third-party plants that flow into Sand and Southern Hills, have the right to reject or recover.

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

That makes perfect sense. And I assume that the fact that GCX and PHP are online, that doesn't change any of the experience, if at all?

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

No.

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

No.

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Operator

And our next question is from Spiro Dounis from Crédit Suisse.

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

First question is just on the hedging strategy. It seems like there's a considerable amount of upside here on both spot and forward curve. So just curious, if you guys could talk a little bit about your plan to fill the remaining hedge book here for '21 and what the plan is for 2022?

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

Yes. So a couple of things, Spiro. I mean, we do have a disciplined hedging strategy. So it's not a trade book and you can always second-guess it. But we're really pleased with the amount of hedges we've been able to get up and on the system.

I'll take the opportunity to remind you that our fee grew by 5% this year. So we're 75%. I think that's the third or fourth year in a row because of the Logistics business, you've seen that grown. And we have about half our position hedged. We use -- we have targets. We have a very disciplined approach, but that has left us with about half the position open. That's what's driving -- you heard I think, both Wouter and I mention that we have to pick your price between spot and forward. There could be $50 million to $90 million of incremental upside.

I would let you know that since we set our budget, we've been able to get some additional hedges on. I'll give you a little color. Crude's been constructive. Propane plus portion of the NGL barrel has been constructive. We haven't been able to do ethane. We're keeping an eye on it. Boy, if ethane runs, that's a really good day for this company.

So we have a very disciplined plan. You mentioned 2022, we've been able to get out there and get some '22 hedges, obviously, not to the degree or magnitude of 2021. But we're -- the company is set up very, very well. I think it's a really good mix of fee-based hedges that give us cash flow stability with some pretty substantial upside. I mean, if spot prices stay where they are, it's going to be a very good year for the company.

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

Very helpful. Sean, just a quick clarification on one thing you said there. You said, if ethane runs, it's going to be really strong. So as we think about that $50 million to $90 million, pick your price, if there was an ethane run up, it sounds like it would be incremental around top of that $50 million to $90 million. Just want to understand the sensitivity.

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

No, no. No, sorry. What I was saying is, I mean, it could be because it could run above current pricing. My point, Spiro, was that ethane is one of the -- if you think about us materializing that $50 million to $90 million, ethane is a big component of that because the heavier end of the barrel has run and crude has run already, and we've been able to hedge some of that.

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

Understood. Okay, that makes sense. Second question, just maybe getting your latest view on assets of a period of time, you're fairly active until (inaudible) mix shift. There's some early signs about assets (inaudible) potentially. So just curious as you pursue delevering and maybe even look to accelerate it, do asset sales come back into the strategy?

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

Spiro, we're obviously always looking at other kind of opportunistic assets that you can sell. I think, we've said multiple times on -- publicly that there are probably 1 or 2 assets in the company that may not be kind of a perfect match, and strategically may fit tremendously well, but they're good assets. And that means that if there is a buyer who says, hey, you want to pay value for those assets, and it fits better with them than with us, then we'll probably enter in some negotiations and discussions.

But we are definitely not, kind of at this very moment, having active discussions. So don't expect something to kind of come up in the next week or in the next month. We also -- as you know, we never bake asset sales in our budget or guidance. I know there's people who rely on proceeds from asset sales to kind of work the balance sheet or other things. We will work the balance sheet with what we're doing operationally, 24/7. And if we sell something, it's going to be over and it's going to be gravy.

But at this very moment, nothing that is active. But with the market getting a little bit better, who knows if there's people who say, we would like to do something with DCP, and we're always open to that.

Operator

And our next question comes from Jeremy Tonet from JPMorgan.

James M. Kirby - *JPMorgan Chase & Co, Research Division - Research Analyst*

This is James on for Jeremy. Just want to dig into maybe the G&P assumptions here for the '21 guide. I guess, to start off, give -- I know it's a short sample size, but in the 1.5 months to start the year, I guess, how are you guys seeing activity across your footprint?

And then the second part, maybe with North volumes expected to grow 5% to 10% this year. And assuming that was budgeted back in December, do you foresee maybe upside to volumes there, given the move in commodities? And just given producers there, how are conversations progressing there, I guess, to start the year?

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

A couple of things, James. From a -- and we indicated, obviously, in our guidance, two areas where we think we're being a little conservative, but that's our style. One is commodity, one is volume. So let's talk about the volumes on the volume side. First, you referenced the North. The North is one area where we do expect potentially to see a little bit of growth next year, nowhere near where the levels pre-COVID would have been, but it is an area that we think will hang in there. We'll see a little bit of growth.

Your question around, is commodity pricing raising the outlook. It's -- look, I love that 40 days in, there are some really good signs and there are really some good signals across -- both around commodity and some other indicators. But I think what -- and Wouter can chime in, too. I think we're seeing more discipline, which is a great thing out of the big guys. They're not just moving, but they're focusing on free cash flow, they're focusing on things.

So I think it's a little too early to say that, that would drive incremental volumes. But that would be upside for the company, would be substantial upside. And I want to give you one other example on the North. In my remarks, I mentioned that Latham was not going to be a big driver of earnings. It would have been. It was when we decided to do that massively capital-efficient project a couple of years ago and got it in play. But it was predicated on a lot of volume growth, and we're seeing that diminish. If we get more volume growth, that Latham project goes from a -- not a big driver in earnings for the company, to a big driver. So I just want to give you that example of upside.

And I think the Permian is another area you could keep an eye on. We're hearing some good signals there. Again, producers are showing discipline, the one -- the big ones anyway. But those are the two areas we'll keep our eye on.

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I think Eagle Ford, I talked about the contract roll there and our expectations of volumes coming off. Midcontinent is in pretty perpetual base decline, don't see much changing there. But there is upside. I think it's a little too early to bake it into the models, but we'll keep our eye on it.

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

Yes, James, maybe to add just a couple of things on this. Like Sean and I, together, and the rest of the team, we've over a decade of upcycles and downcycles. And this one feels a little bit different from a potential upcycle point of view, that people don't come roaring back immediately and then kind of start crashing and destroying our own party again.

So -- I definitely, when I talk to our producer customers, I would say, I hear a little bit more bounce in their step, a little bit more optimism, but a lot of discipline and saying, hey, we're going to deliver free cash flow. We're not going to go out and just kind of throw rigs back in the field and creating a significant supply push. And that is, I think, the last thing that this industry needs is that before we have good line of sight to demand recovery, and obviously, things are feeling a little bit better, but we're still a long way to go to full demand recovery.

And I think, the good thing about the producers is, yes, there's some optimism around tone and other things, but they're very measured around what they want to do. And that's exactly how we have set up our year, pretty conservative. And you know what, that probably gives you a little bit more upside than downside from where you're sitting here today.

But we also know there's a long to go in this year. And if 2020 has taught us one thing, it is that a long-cycle business like ours can have a lot of very short cycles really, really quickly. So I hope that kind of gives you a little bit of insight of what Sean and I are seeing.

James M. Kirby - *JPMorgan Chase & Co, Research Division - Research Analyst*

No. It does, and I appreciate the color and the breakdown there. Second question, shifting to leverage. It seems like you guys are targeting pretty flat year-over-year at the 4x range. And I know in the slide decks that you say 3.5x kind of the IG ratings for the rating agencies have kind of set the goal forward. I guess, what is the timeline maybe to achieve that? And should we assume that any uplift in commodity prices that you guys laid out in the guide should be allocated to deleveraging, first and foremost?

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

Yes. So to start with the last portion of your question, yes. And I don't think we threw the number out there, James, but that upside could get you more than halfway towards that goal.

So look, if we see that -- again, if the commodity stays constructive and you see some volume response, without getting too specific, I think you're going to be knocking on the door of that goal. And look, I know, Wouter and I do a lot of outreach. We know a lot of models have us there very quickly. Again, we're being conservative, holding serve in one of the toughest environments. What I mean by that, staying around the same leverage metric, I think is -- and with a pretty conservative outlook is a good -- really good sign. That means, we do have not only upside on cash, but we will utilize that cash to continue to strengthen the balance sheet.

So I can't give you an exact date, but the reality is we could get there if we see constructive environment very quickly, but I definitely think we have line of sight to get there. And I hate to give timelines, but our goal is definitely over the next -- some time in '22. Hopefully sooner, but once again, you see that $50 million to $90 million of upside, we're going to be knocking on the door of that goal.

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

Yes. I think maybe kind of numbers that I have in my head, James, is if the $50 million of the current forwards, you put that on the midpoint of the guidance, you get to $810 million. And if you start looking at our leverage at that time, I think you're somewhere between 3.6x, and 3.7x. So it gets

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you probably 80% of goal. If you believe that commodity is going to be better or there is some volume upside, you know what, you could get there pretty quickly. But, hey, who knows where this year goes?

Again, I'm going to go back to a year ago where we had an earnings call around this time, and 30 or 45 days later, the world completely changed on us. And literally, the world changed on us. So I think, for us being conservative, is a good way to run your business. It provides you for much more upside than doing it the other way around.

Operator

And our next question comes from Chris Tillett from Barclays.

Christopher Paul Tillett - *Barclays Bank PLC, Research Division - Research Analyst*

I was actually going to ask about the balance sheet, but you just spent some time talking about that and answering those questions there, so I appreciate that. I guess maybe just one more quickly for me. The high and low ends of the guidance, do they contemplate the commodity sensitivities that you guys have talked about or is -- are those ends more around sort of operationally how things might move?

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

Typically, they're -- Chris, they're more weighted towards commodity. So -- and that's how we have done it for the 11 years I've been here. So yes, short answer is more predicated on commodity ranges.

Operator

And our next question comes from Tristan Richardson from Truist Security.

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

Thank you for all the detail around the assumptions and guidances. I appreciate it. I think, just to follow-up on that last question. I think conversely, to get to the low end of the guide, do we need to see the world kind of go back to some of that demand destruction type of environment that we saw last year?

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

Yes.

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

Helpful. And then..

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

No, I'm (inaudible) to make this -- it's a short answer. I'm like yes. I'm like, it's some really bad things need to obviously happen.

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

Makes sense. And then, Sean, to your comment about kind of the high end and low end more representing the commodity. So should we think the high end does not really include any accelerated volumes, either in the Permian or the North above what you're talking about today?

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

Yes, that's a fair assumption. But again, back to my 11 years in this business, there's always -- there is -- it may not be a perfect one correlation, and there's always a lag, right? But if pricing stays at that level, obviously, Tristan, it's just a phenomenal world, right? You're going to benefit from that. At some point, you're going to see, hopefully, demand come back, you're going to see volumes come back. It's a really, really good day.

And I think that's one thing that we've talked a lot about. The earnings power of these assets, we've been in this dampened environment for so long, you forget, these assets, when pricing is constructive and volumes -- we're nowhere near the volume level we were back pre-COVID-19 just a year ago. If we got those volumes at these prices, these assets performed quite, quite well. So the answer is, there would be more potentially on the volume side, and it just shows the earnings power of the assets we have.

Operator

And our next question comes from Gabe Moreen from Mizuho.

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

I know that Spiro asked earlier about selling assets, but maybe about, Wouter, you've been more vocal than most about industry consolidation, just wondering where you think things stand there and whether the recovery and, I guess, a little more optimism in spring in people steps helps or hinders midstream consolidation?

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

Well, I think, I've been more vocal around consolidation from a point of view that I believe that -- and we believe that the company's strategy has been around, be Supply Long, Capacity Short, create a lean manufacturing profile for our company because you cannot always grow as an industry and super cycles of growth come to an end.

So we want to make sure that we were ready for when that happened. And obviously, we didn't think COVID-19 was going to kind of stop it as quickly as it did. We thought it was going to be more of a gradual kind of thing. But we wanted to be ready for when the inevitable super cycle of growth and to have a really lean manufacturing type of company that you can do things with. Run them really well yourself, but potentially is there something you can do in an industry consolidation cycle.

As it pertains to, do you see more, do you see less, I think, everybody is looking at the same facts. And the facts are that there is an industry that probably was built for 14 million, 15 million barrels of crude oil production a day. We went to 10 million. We are hovering around 11 million. And I think most of us think it's not going to be massively above 11 million kind of for the remainder of this year. So that means there is some overcapacity. That means there is no reason to go build new assets. And you're going to start looking at, hey, are there ways to create commercial synergies, optimization, cost synergies and things alike, and M&A tends to fit well in that model.

At the same time, we all know that M&A is really, really hard, correct? M&A is not a strategy. It's a way you execute on the strategy. And so other things are going to happen. I think the likelihood of consolidation is greater today than it was in '15, '16, when we also all spoke about consolidation. So I would say the likelihood is a little bit greater today than at that time, but it's hard.

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You also, I think, are dealing with the fact that you're not going to wake up one day and read, hey, DCP Midstream is buying a competitor at 20%, 30%, 40% premiums. That is not the way this market needs to consolidate. It needs to consolidate on kind of a merger of equals type of basis, no premium, low premium kind of things. So all the synergies that you create are going to the respective shareholder groups of each of the companies.

And again, that is hard to do. But is it something that, in my personal belief, needs to happen in this industry? Absolutely. And we'll see how it plays out. And I think the good thing, DCP is set up very well. Like I think this team has proven beyond a reasonable doubt that we know how to execute, how to streamline, how to take cost out and how to look over the horizon. And I think that's a good thing. That's a good thing if we continue to stay where we are or it's a good thing if the world goes into a consolidation cycle.

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

And then maybe if I could follow-up just in sort of the latest on Guadalupe. I know you termed out some of that widespread with longer-term contracts, but you also cited as a '21 versus '20 headwind. Just -- can you just talk about how much is contracted there and for how long and sort of what the delta impacts are?

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

Yes. I mean, real quick, Gabe, on the history. Obviously, in '19, the basis just blew out. And it was a windfall, right? I mean, here's an asset that made $10 million, $15 million a year. We made 4x or 5x of that in '19.

So what we did, and I think it was the smart move, is we created an annuity. And so we went out and we hedged somewhere between ranges, Gabe, 70% to 90% of that position over the next 5 years. Two things to think about. The percentage hedge declines as you go out the curve, so we're a little less hedged every year. And it was a backward dated curve. So your pricing goes down a little bit.

But what we did is we converted something that would only generate $10 million or $15 million a year of income into a really strong annuity. But it does decline year-over-year, both from a hedge percentage and from a price hedge percentage. So it does leave us -- things run-up in the short run. As we're a little less hedged probably in '21 than we were in '20 and '22 versus '21. But it's a set it and forget it. We have locked in those cash flows, and I think that was an important thing for the company. And we did it at a time when pricing was very high.

Operator

And our next question comes from James Carreker from U.S. Capital.

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

I was wondering if I could circle back to a comment you made earlier on Latham 2 Offload not really representing a big earnings driver this year. I was wondering if we could maybe flush that out a little bit. Is it neutral to earnings? Is it actually a drag or, I guess, what does it take for that to be significantly accretive to earnings?

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

Yes. It's not a drag, James. And it's funny, as I was going through the written remarks, I thought someone might take it that way. I think the way -- I can make it very simple. I'll give you a little history. 2, 3 years ago, everybody thought volumes were going to grow exponentially. And we did the smart thing, instead of building a $500 million plan or whatever it would have cost, we did this Offload agreement and took advantage of capacity that was available.

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But the point -- and by the way, I want to point out, we're honoring -- we have some MVCs we're honoring all of our MVCS. We have the volume to honor that, that kicked in late December, early January. Really, the way to think about it, when I say it's not upside, what I was sort of getting a feel in people's models is that they had a big windfall because of Latham. And the way to think about it is volumes are not growing at the rate that we thought. When we went into that contract, we had a better volume outlook for the DJ. Still growing, still probably one of the best areas we're in, one of the highest return areas we're in. But the way to think about it, when I said it's not going to be a big earnings driver in '21, that's really around volumes.

If we see volumes take off, and therefore, we have the Latham Offload going, we're in bypass mode and so forth, it's going to be very good for the company. That's not in our guidance. But it's not losing money. It's holding serve, and I felt that some people had in their models that it was going to be big upside.

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

Got you. Appreciate that. And then maybe just a technical question on the volume outlook presented in the presentation. Just to clarify, that is year-over-year volumes or is that relative to an exit rate of 2020?

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

Year-over-year.

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

Year-over-year. Got you. And then just on the Sand Hills drop in volumes in Q4, was a bit of a surprise. Have you guys talked about how much of Sand Hills throughput is kind of your own volumes versus how much is subject to third-party ethane rejection?

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

We haven't talked about in terms of the percentages. But what I can tell you is based on our expectations going into the quarter, we stayed in recovery, the volumes that we drive, and third-party went into rejection. So...

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

And it was -- essentially, all third-party was rejecting or was it a mix...

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

No, the largest third-party that puts volumes on that pipeline went into full rejection.

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

Yes. And I think the only thing, James, that we've ever said about, hey -- we are -- DCP is the largest shipper on the Sand Hills pipeline.

Operator

And we have a follow-up question from Spiro Dounis from Crédit Suisse.

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

Just one quick one. On Slide 9, it looks like your excess free cash flow is a bit second half weighted, if you look at the '21 figure there. I'm just curious, is that a function of CapEx maybe declining in the back half of the year or is that earnings ramping up? Just wondering if you can give us a little more clarity on the components.

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

It's really driven by our belief that we're still in a pretty uncertain world right now. We're trying to figure out how is COVID-19, how are vaccinations going, when is the world starting to open up, are we going to see any kind of setbacks on Brazilian, British, South African variances and stuff. So we really believe that kind of the second half is where recovery is going to take place, and that's why kind of the numbers are reflected they are.

Operator

And I would now like to turn the call back over to Sarah Sandberg for closing remarks.

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

Just want to say thanks everyone for joining us. Please give me a phone call if you have any questions, and have a great day.

Operator

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

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