

DCP Midstream Partners

**September 09, 2015
11:45 AM EDT**

Helen Rue: Hello. My name is Helen Rue, MLT analyst at Barclays. Our next presenting company is DCP Midstream Partners. This is a premier midstream MLP with strong sponsorship from Phillips 66 and Spectra, as evidenced by a deal announced last night where the (inaudible) are contributing cash and assets. So we'll be hearing more about this. But I'm very pleased to introduce Wouter van Kempen, Chairman and Chief Executive Officer. We also have Sean O'Brien, CFO, to assist with Q&A.

Wouter van Kempen: Great. Thank you, everyone. My name is Wouter van Kempen. As Helen mentioned, I'm the President, Chairman, and CEO of DCP Midstream and DCP Midstream Partners. And today with me is Sean O'Brien, our CFO, and here in the front, Andrea Attel, our IR director. And first of all, Helen, let me thank you for putting together this event, giving us the opportunity to talk to you about the DCP enterprise on the heels of what we believe is some pretty exciting news that we put out yesterday. So I know we're all eager to jump in, so I'll point you to our safe harbor statement on Slide Number 2 about any forward-looking statements that I may make, and then we can get underway.

So that everyone is on the same page, I'll quickly offer up the glossary around our naming conventions for those who may be newer to our story. So when I talk about the DCP enterprise, I'm referring to the combination of DCP Midstream, the private joint venture owned 50/50 by Phillips 66 and Spectra Energy, and the publicly-traded MLP, DCP Midstream Partners, which I will call DPM. And DCP Midstream, as I think all of you know, owns the general partner of DPM.

I'll spend my time today discussing why DPM continues to be a tremendously compelling investment opportunity, especially in the context of the announcement by our owners. I think there's going to be much greater appreciation and clarity around the strength of both DCP-- of DPM and its general partner, DCP Midstream. I'll keep this presentation relatively short today so I can take some time for Q&A towards the back.

Okay. On to Slide Number 5. The timing truly couldn't be better for us to be here with you today, and I'm pretty confident that everybody has already read or heard firsthand from Greg Ebel and Greg Garland about the announcement by Phillips 66 and Spectra

Energy and their intent to recapitalize DCP Midstream. It's really a terrific story, and I can't underscore enough the strong demonstration of owner support benefitting the entire DCP enterprise. And in brief, in case you missed it, Phillips 66 will contribute \$1.5 billion of cash, which we will use to pay down debt at DCP. And Spectra Energy will contribute their one-third interest in Sand Hills and Southern Hills to DCP Midstream. And both owners will continue to retain their 50% interest in DCP Midstream. These contributions will provide capital stabilization to DCP Midstream and solidifies the DCP enterprise industry leading position for the future. So again, all these measures speak to the strong commitment of our owners for DCP's long-term success, and it underscores our belief and their belief in the earnings power and strategic position of our assets in the premier U.S. basins.

Let's move on to Slide Number 6, and let me drill down how this strong show of owner support benefits both DCP Midstream and DPM. First, DCP Midstream will use the \$1.5 billion of cash to pay down debt, and this transaction will significantly strengthen the DCP balance sheet and it will insure bank covenant compliance and it improves our overall liquidity. And that results in DCP becoming one of the strongest capitalized G&P companies, positioning the DCP enterprise to maintain and grow our premier leadership position in the major basins and across the Midstream value chain. And a contribution of Spectra's one-third interest in Sands and Southern Hills provides diversified fee-based margins and cash flows to DCP Midstream.

Let's switch to DPM on the right side of the slide. This DCP Midstream structuring solution is great news that reinforces the strength of DPM and its general partner. I know some of you expressed concerns that a solution could require a large amount of equity by DPM. Now let me be crystal clear about that. This transaction requires no DPM equity. It does not contemplate a cut to DPM's distribution. Let me repeat that. This transaction requires no DPM equity and does not contemplate a cut to DPM's distribution. Most importantly, this action demonstrates an indisputable statement of continued strong owner support by both Phillips 66 and Spectra and provides DPM with a stable platform to continue to grow the partnership.

Now let's move on to Slide 7. As shown by this map, the DCP enterprise's industry-leading position is geographically diverse across the United States, with a large portfolio of assets in gathering and processing, as well as downstream logistics. We view our footprint as a strong competitive advantage, as it provides us with access to multiple resource plays, contract types, and customers. And the DCP enterprise has phenomenal assets, with some if not the best positions in this industry. I'm really proud to say that we've just found out that we will continue to hold the illustrious number one ranking for the third straight year as the largest natural gas processor and largest NGL producer in the United States.

While 2015 continues to be challenging for the industry, we're absolutely confident about the long-term industry fundamentals. I've said this many, many times before: We are a must-run business. Over 75% of the gas produced in the United States requires some level of treatment or conditioning. DCP processes about 12% of the nation's gas supply through our 63 plants, so that makes DCP integral to our country's energy needs.

Next slide. Let's turn to how this great announcement by our owners pairs up with our

strategy and our execution. We've been talking a lot about this on our earnings calls, our internal strategic framework that we call DCP 2020. It's the focus of our entire management team, it's the focus of all of our 3,200 employees. It's all about operational excellence and performing well each and every day. It's being focused on efficiency and reliability and on risk management, and with that focus, we're seeing some great results. We right sized and streamlined our organization earlier this year. We reduced our cost base and we're rationalizing our systems to insure they're profitable through any commodity environment. In the past year, we've already divested multiple small plants and gathering assets that were non-core to the DCP Midstream footprint for about \$200 million in proceeds to DCP. This adds efficiencies, reduces costs, and generates significant cash flow for the enterprise.

Additionally, with our new 200 million a day Zia II plant in the Permian now online, we have the opportunity to consolidate some less efficient plants. We've also improved our operations and the reliability of our current fleet. Projects like Lucerne 2 and Grand Parkway are increasing our operational efficiency and reliability of the DJ system for DCP and our producers, as evidenced by the recent earnings calls from multiple producers and Noble Energy's press release yesterday.

And lastly, we're specifically managing our commodity exposure, so work is underway to de-risk the DCP enterprise and provide stable cash flows in all commodity environments. We've renegotiated many of our contracts and found opportunities to increase margins and convert certain of our PoP contracts to fee, and we've already seen sustainable margin improvements of more than \$50 million annualized across the DCP system. And we have a goal to reduce our commodity exposure, commodity exposed NGL equity position by a third over the next three years. Our focus on operational excellence will ensure the DCP enterprise delivers value to our shareholders and our unit holders in all commodity cycles, in all business environments. So that means making smart capital decisions, being disciplined, and controlling what we can control.

So, all in all, we feel the DCP enterprise will be a stronger, a fitter company in the future. And now, more than ever, DPM continues to be very well positioned in the current industry environment of 2015 and beyond.

With that context, let's switch over to DCP Midstream Partners. Turning to Slide 10, let's specifically address why DPM is a very compelling investment opportunity. First, DPM has a premiere footprint with a long and successful track record of executing owner strategy and delivering sustainable growth. DPM has one of the strongest balance sheets and distribution coverage ratios amongst its peers. And DPM's balance contract portfolio has growing fee-based margins with a multiyear hedging program, and that means reduced earnings volatility. All of this is founded on the strength of the DCP enterprise as a whole and the foundational support of Phillips 66 and Spectra Energy, sponsors that are clearly committed to our success. And all of this positions DPM strongly to deliver sustainable value to its unitholders in the current environment and beyond.

So let me take some time to step you through each of these points in more detail. In Slide 11, let's start with a deeper dive into our assets. On the middle map, you can see DPM's premier geographic footprint with strong positions in the DJ Basin and the Eagle Ford, as well as a significant network of NGL pipelines, making it a very strong integrated

midstream service provider. And shown in a call out from the left on the right side of the slide, you can see that DCP Midstream holds the premier gathering and processing assets in the DJ and Permian Basins and in the Midcontinent, representing about 60% of the overall DCP enterprise, which is very significant. These areas provide the partnership with organic growth opportunities and continued footprint expansions. And just to give you some perspective, each one of DCP Midstream's remaining geographic areas in its own right is the size of many publicly-traded gathering and processing MLPs.

Moving on to Slide Number 12, we have a demonstrated track record of execution and delivering sustainable growth at DPM. First, let me highlight how we execute it in 2015. We're on track to execute on \$300 million of fee-based growth projects in 2015, the majority already being in service and contributing to DCF. For example, our fee-based Keathley Canyon Connector went into service in the first quarter. It's already approaching its 440 million a day gathering capacity. Our new Lucerne 2 plant in the DJ was placed into service on time, on budget in the second quarter, and volumes are quickly ramping up from the (inaudible), with the plant averaging over 85% utilization in August. The DJ Basin continues to be a great story, setting new volume records in six of the past eight months.

Next, the Sand Hills lateral extensions. They're both in service. The Red Bluff Lake project, which connects Sand Hills to third party plants in the Delaware area of the Permian, went into service at the end of the second quarter. And the Lea County lateral extension connecting Sand Hills to DCP Midstream's Zia II Plant in southeast New Mexico is now receiving and transporting incremental NGL barrels from our plant. And lastly, construction is under way on our Grand Parkway gathering project in the DJ and the Panola NGL Pipeline expansion project in East Texas, which are both expected to come online later this year and early next year. Again, all of these are great fee-based assets.

So we just shared with you on our earning call a few weeks ago the partnership delivered strong results in the first half of 2015, and that's in spite of a difficult period for the industry. So let me reiterate. Adjusted EBITDA was \$312 million, up 26%. DCF, \$281 million, up 31% from 2014. And DPM's distribution coverage ratio was 1.17 times, which is our strongest Q2 coverage ratio ever. All of this supports our goal of delivering sustainable growth to our unitholders.

So going to the right side of the slide, since 2010, adjusted EBITDA and DCF have grown at a compounded annual rate of about 30%. If you take a look at our distribution history, you'll appreciate we have never made a cut. Our goal is sustainable distributions, which means that once a distribution is announced, our intention is to maintain it and ultimately grow it over time. We're proud and we're committed to that record of sustainable value. And in the current environment, we are very comfortable with our 2015 distribution of \$3.12 per unit annualized, driven by our strong execution and solid capitalization. Lastly, we continue to see organic growth opportunities around our footprint, and in order to realize these opportunities, we will stay in lockstep with our producer customers to insure we are ready to grow as they are ready to grow.

Moving on to Slide 13, which shows DPM's strong financial position at the end of the second quarter. DPM's average cost of debt was 3.7%, and we had ample liquidity of

\$1.15 billion available under our credit facility. We have demonstrated successful access to the debt and equity capital markets, raising \$3.4 billion in 2013 and 2014 to fund dropdowns and growth projects that are contributing to DPM's results. The partnership of strong leverage and coverage metrics with debt to EBITDA at the end of the quarter of 3.1 times, on the very low end of the target range and the lowest it has been since 2007, and our coverage ratio was 1.14 times for the trailing 12 months. So DPM's balance sheet continues to be strong, providing the DCP enterprise a solid platform for future growth. And to reiterate, as it pertains to the solution we announced yesterday, it requires no need to issue equity at DPM. So DPM continues to be a leading midstream MLP with a stable balance sheet, excellent growth opportunities, and strong coverage.

Moving to Slide 14, we proactively manage our commodity sensitivities on a portfolio basis through continued fee-based investments coupled with a multiyear hedging program. Doing a run-up of crude prices earlier in the second quarter, we layered on additional 2015 and 2016 crude hedges, and these additional hedges increased our 2015 hedge position to 80% of our non-fee-based margins, resulting in a total of 92% of our 2015 margins being either fee-based or hedged. And we increased DPM's 2016 hedge position to 45%, resulting in a fee-based or hedged margin of about 80% in 2016. So we continue to have limited exposure to commodity prices, both in 2015 and in 2016.

We're often asked about DPM's 2016 DCF and our ability to maintain a 1 times coverage ratio in 2016 with our hedges rolling off after the first quarter. So let me walk you through some high level math. In 2015, our hedges will generate about \$200 million of DCF. 25% of that is already covered in 2016 because we're fully hedged in the first quarter. Another 25% is covered by crude, C5, and gas hedges that extend through the remainder of 2016. And then, most importantly, the majority of the remaining balance is covered by fee-based DCF growth from projects that have come online this year and will come online early next year. And these include a full year of DCF for Keathley Canyon and Lucerne 2, and growth from Sand Hills, Southern Hills, Front Range, Grand Parkway, Panola, and Marysville. So we firmly believe that the partnership's diversified and growing fee-based revenue stream supports our DCF targets.

In closing, on Slide 15, I want to reiterate that DPM is a tremendously compelling investment opportunity, founded on the strength of the DCP enterprise as a whole, and strong sponsorship and support of Phillips 66 and Spectra Energy. You can see how the picture lines up. There's now clarity for everyone with a terrific solution that was announced by our owners. Let's offer some perspective around the magnitude of this solution. The assets and cash contributions from our owners is equal or larger than many of the companies in our space on a standalone basis. Again, we will continue to execute on our strategy, a strategy that's one of proven success, and the focus of our management team continues to be where it should be: committed to running the business reliably and safely and performing well for our customers, and delivering strong value for our unitholders and shareholders. And we're doing that, as evidenced by our strong results.

With that, I'll open it up for Q&A, and Sean and I are happy to take any questions you have.

Unidentified Audience Member: Thanks. Just on leverage, going forward, I'm curious as what you think you-- where you need to be. I know this is supposed to drop leverage by about a third, but what

range are you thinking about to kind of stay on the right side of the rating agencies going forward?

Sean O'Brien: I can take that. From a leverage perspective, I'll look at it in two ways. (Inaudible) about the private company at top, obviously it was a transaction that we're excited about. Takes \$1.5 billion of debt off, as well as adding \$100 million of EBITDA from a fee-based asset. And that puts us into compliance for '15 and '16 on our covenants, and gives us ample liquidity. So I'll take that off the table. Then you think about DPM. As Wouter indicated, we printed a 3.1 for the quarter. You know, our range tends to be 3, 3.5. We flex up in growth periods, and obviously down when we have a little bit of less growth. So we're going to maintain that range at DPM and we're going to stay in covenant compliance at LLC, the private company.

Last thing I would point out is, you know, the transaction that we're excited about here also hopefully will yield some benefits from the rating agency perspective. Hopefully you guys all were able to see the release last night from Moody's that took DPM to Ba1 stable, and LLC, the private company, to Ba2 stable. So, positive outcome there as well.

Unidentified Audience Member: Can you talk a bit about the prices that you need for products to be able to consider growing the distribution in the future?

Wouter van Kempen: Yeah, that's an excellent question. We currently, you know, in this environment, were looking at NGL prices somewhere in the low \$0.40, and we don't think that is a tremendously productive environment. We do believe that prices probably are going to stay low for a little bit longer than we all hoped. At the same time, I personally believe and I think our team believes that these low NGL prices are in the long run, this industry, does not work. So we do expect pricing to come up. I'm not willing to give and go out and give you any specific commodity guidance on what would it take for us to raise our distributions. I believe that raising distributions just based on NGL prices going up would not be the right thing to do, because, you know, prices may go up, prices may go down, and as I said in my comments, once we put an increase in, we are committed to keeping that increase in.

The other part that you do need to look at is when prices go up, we obviously will see more producer activity. If we see that producer activity, that means for us building laterals of our NGL pipelines, that means building new gathering systems, new processing plants. Putting that capital to work will give us the opportunity to raise distributions over time.

Unidentified Audience Member: Is there any thought to, I guess for future, the relationship between LLC and DPM, do you intend to continue to de-lever LLC, or are you going to keep I guess a more sustainable level of stability of cash flow up there? I'm kind of thinking like the DPM-- sorry, the two stakes that you just bought now, you know, is that something that kind of more belongs down at DPM and sort of growth for our future there, or are you trying to kind of stabilize LLC and let LLC stay there with, you know, \$3 billion of debt or so to support?

Wouter van Kempen: We've not contemplated dropping any of these assets down, so that is not a part of the current plan. The plan is really to stabilize LLC. To de-lever the \$1.5 billion of cash

flow will help us de-lever, and then obviously of our growing EBITDA with the Sands and Southern Hills interest. So that's where we're focused on. You know, in addition to that, we're always-- you know, we talk a lot about the self-help that we do and what is that self-help that's taking cost out. We're at a run rate and this is at an enterprise level, taking \$100 million of cost out this year. We are talking about, you know, contract reformation, adding fees, adding margins, run rate of \$50 million-plus on an annualized basis for the enterprise. And then the third piece that we're looking at, is system rationalization, what are the pieces in the company that we don't think make sense for us to keep. And we've sold some smaller assets, and we've done about \$200 million of cash generation there, which will help us de-lever as well.

So it's a combination of, you know, retaining cash, de-levering, and growing the EBITDA at the same time.

Unidentified Audience Member: Could you discuss whether you're seeing any pressure from your customers to lower fees à la the Williams-Chesapeake deal?

Wouter van Kempen: Yeah, I think the Williams-Chesapeake deal was a very unique situation pertaining to a set of contracts that were put in place a number of years ago. I actually think we're probably looking at that the other way around. And like as I mentioned, we've increased over the last six or eight months, we've gotten to, you know, on an annualized basis, about \$50 million of increased margin because of renegotiating contracts and (inaudible). So we have very, I would say productive discussions with our producer customers around areas where we believe we don't make a fair return given the current environment, and increasing those rates and increasing returns. So, you know, no pressure on lowering. We actually are going the other way, and we're finding ways to increase the margins that we're getting at this time.

Unidentified Audience Member: As you look at 2016, can you put some numbers around what you would have to spend in terms of maintenance, capital spending, and growth capital opportunities, and what kind of returns you'd look on the growth spending in this environment?

Wouter van Kempen: Yeah. I think-- we haven't given guidance on 2016, but I can give you our 2015 numbers. If you look at, you know, our overall, as an enterprise, growth, it's about \$800 million of growth capital. \$250 million of that is maintenance capital, \$550 million is growth capital. If you then kind of separate those between DCP Midstream and LLC, the private entity and the partnership, from a growth point of view, the \$550 million, probably about \$300 million or so at the partnership, \$250 million at the private entity. And then from a maintenance capital point of view, about \$200 million at LLC and about \$50 million at the partnership. So some of those numbers give you a little bit of an indication what we've done here in 2015, and so you can probably extrapolate those maintenance numbers for 2016.

When it comes to growth capital, we're looking at what the producer is doing. I many times talk about we are not a build-it-and-they-will-come type of company. So we're very disciplined in how we're putting new capacity to work. We are continuing to permit, so we want to make sure that we reduce our overall cycle time, because the cycle time for building new plants is very different and much longer than what the producers need to start ramping up. So we're getting permits for plants, we secure long lead time

capital where needed and as needed, and we have a lot of very close discussions with our producer customers around what are the right economic incentives for us to build a plant as well as for our producers to build a plant. So I would say there are very active discussions right now, but for us to start committing more capital, we need to see a little bit more productive overall commodity environment.

Unidentified Audience Member: You talk about recontracting with customers. Just kind of, what kind of concentration is the customer base there, you know, in the legacy places in Permian, and then in the MidCon, are you talking four or five people? Are we talking hundreds of people? I mean, how does that play out?

Wouter van Kempen: Yeah. No, we're talking probably thousands, Mike. If you take a look at the DCP enterprise overall, you're talking about 10,000 customers, give or take. So it's a huge, huge population of customers. We have divvied these customers in three different tiers, basically by size. A tier one, tier two, tier three. Most of what you're seeing now, the \$50 million that I mentioned, are tier three customers, smaller customers, contracts that are in evergreen, more kind of low volume meters and wells. And what we did there is going out to people and basically sent them new contracts and via a deemed accepted process, increased fees or margins on the contracts.

The tier one are the very, very large customers. We are currently in very active negotiations with a couple of those customers, talking about millions of acres that we are renegotiating, recontracting, and moving from either a PoP to a complete fee or a combination of fee and PoP. So that's kind of the two sides of the spectrum, but very active negotiations and very, very good results to date. So I believe that gives it for our time. We will have a breakout session in Liberty 3.

Helen Rue: Liberty 3 is the breakout room.

Wouter van Kempen: Thank you very much.