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DCP.N - Q3 2021 DCP Midstream LP Earnings Call

EVENT DATE/TIME: NOVEMBER 03, 2021 / 2:00PM GMT

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PRESENTATION

Operator

Thank you for standing by, and welcome to the Q3 2021 DCP Midstream, LP Earnings Conference Call. (Operator Instructions) As a reminder, today's conference call is being recorded.

I would now like to hand the conference over to your host, Mr. Mike Fullman. Sir, you may begin.

Michael Fullman - *DCP Midstream, LP - Director, Investor Relations*

Good morning, and welcome to the DCP Midstream Third 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 today and hope you are all safe and well. On today's call, we will discuss our third quarter results for 2021, our outlook for the remainder of this year and an early preview of 2022.

Before getting into the third quarter highlights, I'd like to acknowledge and thank the DCP team. Over the last 5-plus years, DCP and our industry in general, has faced significant headwinds and had to manage through extreme volatility. Managing through these cycles has created a stronger and more resilient DCP. Through the years, we took aggressive actions, made difficult decisions and executed our strategy to ensure DCP's long-term sustainability in any commodity environment. We've extended our value chain, prioritized capital discipline and invested in DCP 2.0 to drive efficiencies in our business while rightsizing our headcount and lowering our cost structure. Ultimately, these strategic actions have helped to balance and diversify our portfolio and stabilize our cash flows, while retaining favorable commodity upside.

The third quarter results highlight the value of our balanced portfolio and the DCP team's strong execution. For the quarter, we realized record adjusted EBITDA of approximately $355 million, DCF of $250 million and excess free cash flow of approximately $160 million. And we define excess free cash flow as free cash flow after paying all our distributions and funding all of our growth capital programs. Strong performance from our North and Permian assets, along with optimizing our portfolio across our value chains continues to drive favorable results and generated the sixth consecutive quarter of excess free cash flow. This record quarter continues our strong year-to-date performance.

So far this year, we have maintained our lean manufacturing model, which has us on target this year to sustain approximately $140 million of cost savings realized in 2020, while offsetting inflationary pressures. We've also generated $375 million of excess free cash flow, which is an approximate 60% increase from the full year 2020. And we have made strong progress towards investment-grade ratings, resulting in favorable rating agency actions as Moody's upgraded us in the second quarter and in the third quarter, Fitch moved us to a positive outlook. Our record third quarter results, coupled with our strong first half performance have DCP on track to exceed our 2021 financial guidance.

And with that, I'll turn things over to Sean to run through Q3's financial results.

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

Thanks, Wouter, and good morning, everyone. On Slide 4, I'll hit the key drivers to our record third quarter performance as DCF was up 11% and adjusted EBITDA was up 6% from Q2. The business benefited from the favorable commodity environment, primarily NGL up 28% and crude up 7%, which resulted in a $26 million quarter-over-quarter improvement. We realized favorable G&P earnings due to volume growth in our DJ and Permian regions, which are 2 of our highest margin business units. These 2 drivers more than offset the financial impact of planned maintenance across the portfolio, lower volumes in the South and lower earnings on Sand Hills. The planned maintenance drove higher costs and impacted our G&P volumes for the quarter.

Specifically, we had turnarounds at our National Helium Plant in the Mid-Continent and our O'Connor 2 and Lucerne 2 plants in the DJ. Additionally, our West Texas G&P assets were also impacted as deferred maintenance from the first quarter was completed. The lower G&P volumes had a direct impact on our L&M business as Southern Hills volumes were down 4% and Sand Hills volumes were down 1%. Overall, the strong business unit performance and favorable commodity pricing resulted in our leverage improving to 4.1x. The higher commodity pricing has been a tailwind for the business, but has also created a temporary increase in working capital needs supported by our hedges and normal business activities. We anticipate leverage continuing to improve as we close out the year strong.

On Slide 5, I'd like to provide an update on our outlook for the remainder of the year. Year-to-date, we've generated $650 million of DCF, $961 million of adjusted EBITDA and $378 million of excess free cash flow, which has us well on track to exceed our 2021 financial guidance. We're primed for the fourth quarter as commodity pricing and fundamentals remain constructive. With NGLs trading above $1 and crude above $80, we are set to realize another strong quarter of pricing upside.

The outlook from our DJ and Permian businesses continues to improve due to incremental producer activity. And the majority of our large scheduled maintenance projects are complete, which has our assets prepared as we approach the winter season. During the quarter, we expect to realize costs related to the timing of deferred work and also expect to see increased sustaining capital driven by increased producer activity. As we closed the year, leverage and liquidity will improve as 2021 hedges expire and the business is well positioned to continue to generate strong excess free cash flow.

On Slide 6, I want to highlight our improved financial position and trends we see continuing into 2022. Coming into the year, we outlined our commitment to strengthen our balance sheet and prioritize debt reduction until hitting our approximately 3.5x leverage target, which would provide us financial flexibility and screen very well to investment-grade metrics. Year-to-date, our balanced portfolio has performed extremely well. Excess free cash flow continues to increase. Leverage will continue to improve with strong earnings.

And over the last 12 months, we've received favorable rating agency actions from S&P, Moody's and Fitch. As we head into 2022, we continue to build momentum with the rating agencies and are on track to hit our approximate 3.5x leverage target, which will provide additional financial flexibility and afford us the opportunity to leverage the earnings power of the portfolio. Our multiyear hedging strategy targets an 80% to 90%

mix of fee-based and hedged earnings. With our improving leverage and liquidity, we will enter 2022 at 82%, while keeping our eye on the potential to add opportunistic hedges further out the curve.

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

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

Thanks, Sean. So as we move to Slide 7, let's take a look at some of the industry trends and how DCP is prepared to manage the risks and opportunities they present. Looking to next year, we're optimistic on the quality outlook. Demand for our products continues to increase. Global inventory levels are below average, and U.S. shale producers currently remain committed to maintaining capital discipline and are taking a measured approach to growth. This sets up well for the DCP portfolio as we've extended our value chain and built a balance of strong fee-based assets like Sand Hills, Southern Hills, Gulf Coast Express, while also maintaining favorable exposure to commodity pricing through our G&P business.

While producers are currently taking a disciplined approach to development plans, we're starting to see an uptick in opportunities across our footprints. We're anticipating this to benefit our DJ and Permian regions while also offsetting legacy volume declines in the Mid-Continent and the South. While the fundamentals set up well for commodity pricing and producer activity, the industry is still faced with excess capacity, which will continue to impact rates on securing new volumes. In the last couple of years, we've been able to leverage our integrated value chain to secure incremental volumes, and we believe this will be a key component to our success as we move forward.

One last item affecting our industry is the inflationary environment impacting the global economy. Like other industries, we're facing inflationary pressures and supply chain disruptions, which are impacting materials and labor pricing. However, our business is also able to partially offset these factors by leveraging built-in contractual escalators within our L&M and our G&P businesses. With a strong commodity outlook, the ability to leverage our integrated value chain and built-in hedges against inflationary pressures, the DCP portfolio is well positioned as we enter 2022, which brings me to our next slide and our priorities for next year.

To begin, the business is set up to maximize earnings, and we plan on leveraging this favorable environment to make critical and strategic investments in our business to drive long-term value for our unitholders. Yesterday, I announced the realignment of our executive team. DCP's first executive management role focused on energy transition and sustainability was introduced, and we've added technical knowledge and long-term experience in our North value chain to continue to drive operational excellence. Ultimately, these changes will accelerate our efforts in the key areas we'll cover on Slide 8.

Since 2015, we've built a culture based on operational excellence and safety is our #1 priority. I'm proud of our past success. I'm also very excited about the continued progress that we're making. As of today, we have set an all-time DCP company record of 125 days without an employee OSHA recordable injury. Within our operational excellence framework, reliability and asset utilization are critical to our success. Our customers rely on us and our reliability is our scorecard that builds trust and ultimately positions us to maintain and grow our business. The importance of runtime and reliability are magnified during these periods of high commodity pricing, and it's critical for us to maintain focus on our operational excellence.

Another priority for us in 2022 will be accelerating the progress on our sustainability efforts. During our second quarter earnings call in August, we released our long-term ESG and sustainability goals of reducing Scope 1 and Scope 2 emissions by 30% by 2030 and ultimately, net 0 by 2050. To achieve these goals, I highlighted our 3 strategic horizons: Clean the Core, Adjacent to the Core, and Beyond the Core. Clean the Core means continuing to improve our emissions profile through increased efficiency and modernization of existing operations. Between 2018 and 2020, we made significant progress with a 16% reduction in Scope 1 and Scope 2 emissions, and we've continued driving that progress here in 2021. For example, sustaining capital projects are now evaluated not just through the lens of profitability and reliability, but also in a way that reduces our emissions profile and supports our efforts to Clean the Core.

A third area of focus will be maintaining strong capital discipline. As we leverage this favorable environment to make long-term investments in our business, we will continue to prioritize our opportunities and only make select strategic investments. We have built a track record of disciplined growth as we've executed a supply-long capacity-short strategy and leveraged existing capacity versus large-scale capital expansions. We worked to develop capital-efficient solutions that benefited both our customers and DCP. This capital-light strategy has worked well, and we maintained high asset utilization, retained long-term optionality and strengthened the balance sheet. As we move forward, we will maintain this discipline as we work with our customers to identify needs and opportunities as they build out their development plans.

In some cases, this means investments across our G&P footprint may ramp up, especially in areas like the DJ and the Permian. These bolt-on capital-efficient investments will strengthen DCP's competitive position and provide further downstream earnings opportunities. Along with investing in our core business, we will continue to pursue and develop opportunities around energy transition as part of our Adjacent to the Core and Beyond the Core strategies. Our Adjacent to the Core effort means exploring opportunities to expand our business portfolio, leveraging our intellectual capital on existing infrastructure. And this could include carbon capture and sequestration and other emerging technologies. And lastly, Beyond the Core is largely supported by our DCP Tech Ventures group and focuses on new technologies.

The final area I would like to highlight is capital allocation. As we've transformed our business over the last couple of years, we've been able to strengthen our balance sheet. We expect to meet our approximately 3.5 leverage target in the second half of 2022, providing us with a strong balance sheet with the financial flexibility to withstand any economic cycle. And this flexibility will afford us the opportunity to pivot from a deleveraging focus to other capital allocation options such as select growth, distribution increases or unit repurchases. Any of these options or a combination of them will return additional value to our unitholders. With our strengthened balance sheet, favorable fundamentals and the DCP team's ability to continue to improve our operations, innovate and drive efficiencies, we are well prepared for 2022 and beyond.

And with that, we look forward to taking your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Shneur Gershuni of UBS.

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

Maybe to start off, I was wondering if we can talk about PPI a little bit here. I was wondering if you have any contractual arrangement that have PPI inflators in your business where you could see potential tariff increases kind of on the back of the whole PPI surge that we're seeing? Is there certain parts that are more exposed and there could be potential tariff upside?

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

Yes. Shneur, and I'll cover inflation maybe as a whole, but I'll hit your PPI. So bottom line, around the cost increases and inflation increases that we expect to see in 2022, the company is actually in a really good spot. We did a lot of good things in the last couple of years to reduce costs, $150 million plus, set ourselves up with efficiencies, digitization, 2.0 as we're going into this inflationary period. Having said that, we do anticipate some increases, so I'll cover some of those. We're seeing it in labor. We're seeing it in steel. We're seeing it in chems, lubes and ancillary things to labor-like contractors and so forth. So we do expect some of that in '22.

In regards to 2021, we haven't really been impacted in a big way. We've seen a few disruptions on the supply chain side, but really not a big story in '21. To get to your direct question, as we move into '22, there will be the cost side, which have increases. But there's 2, what I'll call, hedges against those cost increases. One, of course, is commodity prices, obviously, an inflationary measure, and that's really helping the company out quite a bit with our portfolio. And the short answer after all that to your question is yes, we have PPI, CPI indicators or things that we can increase on both the L&M and the G&P side that were intended to help, obviously, the Midstream company and more specifically our company in areas of high inflation. So at the end of the day, you'll see -- ledger by ledger, you're going to see increased costs next year, but there will be margin offsets and commodity price offsets.

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

Yes. And maybe to add to that on the increased cost that Sean is talking about, obviously, we do have a number of CPI/PPI inflators. So that's going to help the margin. But I think one of the things that is important in a business like ours, we are a cyclical business, and there's times where you have the wind in your face, and there's times when you have the wind in your back. I think right now as a company, as an industry, we have the wind in our back a little bit. I think next year feels pretty good if we look at our outlook. And I think it's also a good time to invest in your business and make sure you drive long-term value.

So next year, we have a fairly heavy turnaround and overhaul year. We're going to continue to invest in operational excellence and reliability, making sure that we run the business as good as possible. We're going to invest in our workforce and continue to do that. We are trying to build a multi-skilled workforce. And I think that's important, especially given what you're seeing today with the work environment. We're going to invest in energy transition. And we're going to invest to make sure that we stay ahead of potential regulatory changes, pipeline maintenance, leak detection. Think about the things we started in 2020 via Kairos Aerospace, where we started the largest methane leak detection program on a voluntary basis here in the United States. It makes sure that you run your assets better.

And overall, I think what it does, it will create tremendous benefit to your asset base, not only in 2022, but '20 or well beyond that. And I think lastly, what is important if you think about cost structure. Our cost structure next year is still going to be significantly lower than what we saw in years like 2018, 2019. I believe our cost structure in those years was about $1.40 billion or so. We're about 15% below that. While we're having higher EBITDA, while we're being -- having better safety, while we have better reliability, while we have lower emissions. And next year is going to be similar like that. So pretty nicely set up.

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

Great. Given that you have the wind at your back, you had mentioned in your prepared remarks about capital allocation as being one of the key priorities for 2022. Just wondering if we can talk about the excess free cash flow optionality that you discussed. Is there something that you're favoring? Is it towards buybacks? Does it work towards a distribution increase, both? Are you even considering special distributions? Just trying to understand kind of the order of priorities that you're thinking about with respect to returning capital.

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

Yes. No. I think that's the right question. And obviously, kind of expected you were going to ask us that, Shneur. And it's a very fair question. Like our focus over the last number of quarters, as you know, has been on the balance sheet. That has been our #1 priority, reduce debt at an absolute level, make sure that we set this company up to withstand any economic cycle. We lowered our leverage here in this quarter. I think we're going to end up the year probably with a leverage ratio that has a 3 in front of it. And I believe that we're going to be somewhere in the second half of 2022. I expect to be at a 3.5 target. Very pleased with the results that we've seen so far from the team this year. We're well ahead of our -- ahead of schedule.

I also think that if you look back at the last, you know, year, 2 years or so, we continue to maintain a very healthy distribution. I think we took a very measured approach when things turned for the worst in kind of March, April of 2020. The business continues to perform really well. We have $370 million of excess free cash flow year-to-date are positive for the last 6 quarters. We're up 60% in excess free cash flow since 2020. And what all of that provides us here sometime in, I think, the second half of 2022 is great optionality and it's nice to have great optionality.

So what can we do? I think we can invest in energy transition, if there's opportunities there, where it makes sense. We can continue to invest in the most important areas in our company from a G&P point of view, like the Permian, like the DJ, you can raise the distribution. You can do buybacks. I think any option or a combination of those is going to create additional value for unitholders. And I think we're going to be in a great place in the second half of 2022 to execute on any or all of those options.

Operator

Our next question comes from Michael Blum of Wells Fargo.

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

I wanted to ask a little bit about the Mid-Con. Just want to get sort of your outlook on what you're seeing there from producers. Do you think there's going to be any uptick in drilling activity? Just wanted to try to get your sense of if we could see any change there.

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

Yes. I think, Michael, we see -- obviously, Q3, we had our largest asset, our huge asset was out in the Mid-Continent in Q3. And the area actually produced still pretty strong margins. So in terms of thinking through the rest of the year, I think we see it closing the year flat to maybe slightly up. And then as we think about 2022, from a producer's side, from the bigger producer's side, we're seeing some activity, some increased activity, but it's very disciplined, but I think there's some potential growth there. And then it's one of those areas where the smaller producers, and there are many of them are actually actively adding quite a bit of activity. So I think it's an area that could be -- that could surprise us.

I think Q4, we'll be pleased with what we see. And then I think as we are laser locking in on '22, it's an area that probably you will see some growth flat to up. And when I say flat, that would be offsetting base declines with more growth than we would have thought. The only thing I would remind you though is we had a very strong quarter from a G&P perspective, and that's because the areas we're seeing bigger growth like the DJ and the Permian are higher-margin areas. The Mid-Continent is a solid area, but it's not driving as much margin value as those other 2 areas. But outlook is probably neutral to positive for sure.

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

Great. Second question, I wanted to ask about ethane rejection, just where that was this quarter? And then any views you have on how that will trend into 2022.

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

So we saw -- I mean, it's been hovering very, very -- if I look at the last 3 quarters, the last 4 quarters, it's been really consistent. We are mostly in ethane recovery, specifically -- obviously, the Southern Hills assets where we control most of the barrels we've been in recovery and the barrels we control on Sand Hills. Because of the value chain that we have, we've been in recovery. Third-party rejection has stayed relatively constant. There was some periods, Michael, in Q3, where we -- where a couple of producers came out and went into recovery, but nothing significant. It's really a pretty linear trend this year.

And as you may recall, we went into the year hoping we'd be in recovery. Even the third party, we're not. But that, we've been seeing that every quarter. Right now, and we'll give you more color in February. But right now, if I was to tell you what we're predicting for '22, we're in that same mode. DCP assets in recovery because of the value chain economics, third parties in rejection. And that's probably what you'll see in our guidance as we come out next year. We're not seeing it flip significantly. The frac spread and the strength of gas is still keeping people on rejection.

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

Yes. And I think maybe just to add to that, like the ethane recovery rejection, the way we're looking at today is a bit of a, I don't know, a champagne problem. Historically, yes, we're looking at it -- and gas and ethane were both fighting to be kind of the lowest. Right now, you're looking at $0.43 ethane here on spot $5.50 gas. So it's a bit of an -- it's not as meaningful of potentially an issue as probably you would think about this in the last number of years.

Operator

Our next question comes from Jeremy Tonet of JPMorgan.

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

Just wanted to get back to the cash flow optionality. As you talked about, after hitting 3.5x leverage, we see, yes, DCP really gushing a lot of cash flow in the back half of next year. And just want to drill in specifically as you think about the buyback option. And if you do pursue that, do you see more value in pursuing something programmatic or opportunistic as it relates to buybacks?

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

Yes, Jeremy, Wouter here. I don't think at this very moment, I'm willing to kind of go into significant detail around that. I think that the closer and closer we get to that 3.5x target that we have, and hopefully, then our expectation is we get there in the second half of 2022. We will obviously give you more details around at that very time. I think what's important and continues to be tremendously important is how we set up this company. We're very comfortable with where things are today. If I look at Sean and I, we have been sitting in our chairs, now I think for 8-plus years. We've done 30-plus earnings calls together, and I don't think we've ever felt this comfortable going into a new year as where we're sitting here today.

At the same time, you know that this industry things change relatively quickly. It's supposed to be long cycle, but we have seen a lot of short cycles and a lot of changes. So the good thing for us is we're set up tremendously well, not only for the rest of this year. I think we're going to meaningfully exceed our guidance ranges that we have. We're set up very, very nicely for next year. The balance sheet already starts to look really good. It's going to look better. It's going to look really, really solid and investment-grade rated metrics sometime in the middle of next year. And that just provides this company a tremendous amount of optionality to do things and create additional value for unitholders. And then yes, that's our job and that's what we're laser-focused on. And as we get closer and closer to that, we'll give you more details.

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

Got it. That's very helpful here. And just want to pivot towards DC for a minute here and granted there's a lot of uncertainty and my crystal ball is quite cloudy. But just wondering if there's anything that you're looking for there. And specifically, I'm thinking if the 45Q language kind of comes through that's been talked about or even adding renewables to MLPs, just wondering what type of impact that could have on DCP?

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

Yes. No, I think, Jeremy, you're right. I'm like the crystal ball, it's quite cloudy. I would think that's even an optimistic way to talk about it. There are so many uncertainties. I think it is so difficult right now to speculate around what is going to happen. There are so many moving pieces and things keep changing like on hourly, daily type of basis. We have a number of people within our company that are closely monitoring that and closely working with people in DC. Obviously, via our industry associations, we're very closely involved.

But you know what, what exactly is going to come out, we'll see. Maybe I'll take the question a little bit broader and talk about a couple of other items. So around the 45Qs, carbon capture and sequestration is something that we already doing. We're doing it in Southeast New Mexico and our business there. We believe as part of our Adjacent to the Core strategy that we have reaching our 30 by 30 that carbon capture and sequestration is something that is a really good opportunity for us as gathering plants are large ethane or large aggregation points for greenhouse gases.

And so -- but we believe places like DJ, Southeast New Mexico, Michigan, we have optionalities there. At the current 45Q language, it -- and the incentives probably doesn't work. But hey, we hope that things are getting raised and the 45Q is going to be worth more. As you saw in my announcement yesterday, we added a position here on the executive team that is going to be focused around energy transition and continued transformation. And we're going to spend good significant amount of time on that.

Maybe give a quick update on the EPA methane update. You saw that yesterday as well that there is a number of changes that are in the works. We're obviously closely monitoring that. I think what is important when you think about that update from the EPA specifically is that we're headquarter -- we're sitting here in Denver, Colorado. We are operating in State of Colorado. We're operating in New Mexico. Those 2 states have the most stringent methane emission rules and regulations in the country. And we are running a very successful business in those areas.

So that's -- I think, in general, what we're going to continue to focus on is Cleaning the Core, Adjacent to the Core, Beyond the Core. There's a variety of things that we're doing there to make sure that we run our business more reliable. We do it safe and we do it with the lowest emissions profile as possible. And that's where our focus is going to be on and we're going to closely watch what's happening in DC.

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

Got it. That was a very helpful response. And maybe just a last one, if I could, real quick. Permian and DJ producer activity, what are you seeing into '22 at this point? And how does it vary between public versus private? We've heard different messaging over time. Do you -- just wondering for an updated perspective from you there.

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

Yes. I mean, clearly, there is a differentiation between publics and privates. Obviously, the privates, you're seeing a lot more activity in both of those regions that you mentioned. I think the shift, Jeremy, that we've seen maybe is you are seeing the publics start to -- and it's very measured, very disciplined, which is what we want to see. That's what this industry has needed for a long time. But we are seeing some positive signs in both of those areas from some of the bigger producers. But again, very measured. That's what we like that I think the industry can perform very, very well with modest growth. And that's probably the big shift since we spoke to you last, is that the publics are doing a little more activity. But again, very measured with a lot of focus on capital allocation in other areas as well.

So that bodes -- if you listen to Wouter's remarks, that's why we feel pretty comfortable going into 2022. Those are the areas that we make some of the most margins, some of our best margin areas. And then there's potential, and we'll give you more color maybe in February. Areas like West Texas, there is a -- we're looking at areas where you could see some good opportunities. And obviously, we have assets there in 2022. And we're pretty excited about that, too early maybe to book it, but we're seeing some pretty good activity from a lease perspective and a potential recap perspective in West Texas.

Operator

Our next question comes from Tristan Richardson of Truist Securities.

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

Really appreciate all the comments on 2022 and what you're seeing this early. You talked about growth in your core operating areas and just thinking of the leverage target, that certainly implies growth for 2022. But I guess just to clarify, does that leverage target sometime in the second half, I assume an LTM view or more of an annualized run rate type of leverage target?

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

It is a -- when we think about the leverage target, Tristan, we're basically talking about trailing 12 months. And when Wouter said, hey, we think we'll be there in the middle portion of the year. I mean I think there's 2 things to think about. We continue to -- we improved Q2 to Q3. I think you'll see a pretty good improvement. As Wouter mentioned, we hopefully have a 3-handle. We're set up pretty well in Q4 to drive that. And then basically, as we continue to stack on very strong quarters to a record quarters that we saw in Q3, and we anticipate Q4 to be really strong. We expect that 3.5 on a trailing 12 month to be there in the first half of the year.

And barring anything significant changing in the current forecast, I think we're well set up to get there. So that's how we look at it. And then at the end of the day, you got to be able to sustain it. So we are taking a forward look as well. But with the assets, with the leverage reduction, with the things that the company has been able to deliver, I think we're set up for a pretty good trend even post hitting that 3.5.

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

Makes sense. That's great, Sean. And then just on the capital side. I mean, you talked about really selective investments in the assets and then as well as the new energy transition group. Do you see some of those opportunities materialize in 2022? And I'm just thinking of 2022 relative to 2021, where we really saw a sort of a extreme capital discipline there. So just thinking about the timing of when opportunities materialize and how you think about investing in the existing asset base.

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

Let me give maybe high level, Tristan here. So if I think about the DJ Basin, if I think about the Permian, we continue to see good activity by the producer's discipline, but good activity. I would think most of the investments that we would have to do there or will be doing there to get new volumes online are focused around field infrastructure. So it is not having to build a new plant and spending $200 million, $300 million, $400 million. It is much more manageable kind of field infrastructure, pipe compression and things alike, which is significantly less capital than having to do very significant large infrastructure. So I think that is a good thing.

As it pertains to energy transition, I think it's going to depend on what opportunities we see there. What happens to kind of the earlier question that Jeremy asked about what are the 45Qs going to look like? What is the optionality to do things? How do you get and work with states and state approvals to get Class 6 wells drilled and permitted and things like that. So I think that's a little bit of a to be determined. But what you're not going to see, I think, in 2022 is announcements of really large multi-hundred million, $0.5 billion type of project. It's much more granular around field with obviously helps us a lot in creating significantly excess free cash flow.

And one other thing, and we obviously all talk positive around, hey, how we look at the fourth quarter, how we look at 2022. At the same time, we also noticed this industry turns really rapidly and really quickly. So Sean and I always look at, hey, what is the downside? And if crude and NGLs and natural gas, let's say they go down by 50%. And that's a huge down cycle, and we don't expect that. But what does the company look like? And even in an environment like that, we continue to generate excess free cash flow after our distribution is fairly significant. So I think that is the really good thing about how we're balanced, how we're set up, how we are taking the current time in the last 6 quarters to set this company up with a really, really strong balance sheet and just being able to run through any type of environment that's going to be thrown at us.

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

Makes a lot of sense. And just one last one, if I could. Just on the -- in your appendix, you talk about sort of the bridge from last year to this year and highlight some of the costs. Sean, just curious if you can maybe frame for us how much of the incremental costs year-over-year were related to specifically the planned maintenance items you talked about versus sort of that general inflation theme that you guys talked about as well.

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

Tristan, for this year, we're going to -- I think we're going to be relatively flat 2020 to 2021. We committed to holding on. But I think you're right, the mix is going to be a little bit different. We drove a lot of corporate efficiencies coming out of COVID, and you didn't get a full year of those last year, you'll get a full year. And then what you're seeing is a little more investment even in 2021 as we went into a heavier maintenance cycle, heavier turnaround cycle. As you go into 2022, and we'll give you more detail, but there's 2 things happening. There will be some -- on the cost line itself, inflation is going to have some impact. We've been forecasting it, looking at areas.

One of the benefits though, to your earlier question, we're not in this huge build cycle. We're doing some build tied to areas that are growing, but it's not this gigantic capital program. So even though there'll be increases on the capital side, they'll be fairly measured. But we'll see labor. We're seeing the same things everyone else is, look, chems, lubes, steel, labor contracting costs, all that's going to go up. But don't forget, as Wouter and I mentioned, there are some really good offsets. I mean, this company does very well in an inflationary environment because we benefit from the commodity.

And again, we have some built-in escalators back to an earlier question in some of our G&P and our pipeline contracts that will be very advantageous to us next year. So line item by line item, when we give you '22 guidance, you'll see costs going up. But again, we're still -- as Wouter indicated, we'll still be at a low level when you go back 4 or 5 years because of all the hard work that the company has done on efficiencies, but there's going to be some offsets. But again, '20 to '21 flat, a little more investment in the assets and probably some additional efficiencies driven out of the corporate groups.

Operator

(Operator Instructions) Our next question comes from Spiro Dounis of Credit Suisse.

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

Wouter and Sean, just a few quick follow-ups from me. Just going back to capacity. Wouter, you mentioned the industry being capacity long. But of course, if I look at your system, it looks like some of it is getting a little bit stretched here. DJ, about 99% utilization. Of course, you've got the offload agreement deal with that. Permian seems like it's on a path. And so I know you mentioned really no plans for big sort of plant developments out there. And so curious, can you just highlight some of the areas where it's looking like you're going to have to invest a little bit here in the near term and either plant relocations or offloads are going to be enough to kind of address that issue?

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

Yes. I think plant relocations is not something that we are focused on right now. But as I may have said earlier, the DJ and the Permian is where we believe that additional growth is going to be. You're right. And kind of if you look at our overall system utilization, it's very high in both of these areas. But at the same time, there continues to be a lot of people around us that have significant plant availability. And if you take a look at the DJ Basin, there's a variety of plants that are sitting, I would say, not exactly full and there's availability for us to do things. So we're looking at that.

We also still have a permit in the DJ Basin. So if we need to go that route, I do not expect that, but we do have permits available in hand, where we could add capacity if needed. Right now, I don't think that is what is needed. So you're really looking at field infrastructure, predominantly in the DJ. And we look at the same in the Permian Basin. Southeast New Mexico, we are offloading into other people. There are offloads still available and continue to be available. We're going to utilize those versus building new plants. We probably have to do something around field infrastructure there as well.

And I believe Sean mentioned it, in West Texas, we do have some availability and some capacity, and we're seeing and talking to quite a lot of independents who are looking for additional processing capacity, and we are cautiously optimistic that we can start filling some of that in 2022. So that's, I think, where you should focus on DJ, Permian. And I think all the pipelines are doing very, very well. And we still have some availability in the pipeline as well, or we have other options on the not, call it, 100% owned or controlled pipelines like a Sand Hills, like a Southern Hills, where we can move things in other pipes where we have a smaller ownership percentages.

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

Got it. Okay. That makes sense. Appreciate the color there. Second one just on the topic of maximizing earnings. Wouter, you called that out earlier. And if I look at 3Q, you guys had a record level of EBITDA this quarter, and it's very simplistic to do this. But of course, if I just annualize that, I get to about $1.4 billion. If I consider maybe the maintenance issues you had and the commodity backdrop, I got to think that moves you closer to an earnings capacity of $1.5 billion or maybe more. And so I know you're not in a position to guide to 2022 yet, I'm not asking for that. But if you think about the earnings power of this business in this very strong commodity environment, I guess why is that not appropriate way to think about it? What are some of those puts and takes? I know you mentioned cost may be going higher next year, but it sounds like you're a bit hedged there as well. Just curious how to think about that.

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

Well, I think you're right around, hey, how do we look at things. And like I mentioned that Sean and I are -- have been doing this for quite some time. We're looking at 2022, and I think we're quite optimistic and probably more optimistic than we have been in most years that Sean and I have been in these chairs. And like for me, it's really hard to comment on what is 2022 going to look like. At the same time, what is so interesting is I was on the phone 2 weeks or so ago with some folks, and it was exactly 18 months ago that we saw minus $37 crude. So things changed tremendously rapidly in this business. For me, I cannot sit here and guide towards 2022 here. But we like what we see. We're optimistic in what we see. I think we got more things right than we got things wrong.

We took some very deliberate strategic positions around our company, creating a lean manufacturing kind of profile that is tremendously scalable. We've done that during difficult times, and that creates a lot of earnings power if you go into a current cycle like we're having, creating a good balance between fee-based business and at the same time, retaining commodity upside that we're doing. We're doing all of that. I think that is helping really nicely. Taking the capital or the excess free cash flow that we have and putting it towards the balance sheet. So you're creating an ironclad balance sheet and you're creating a business that can withstand any cycle. I think that has worked pretty well for us.

Our digital transformation that we've been doing, trying to make sure that we reduce our overall cost, that we optimize our operational excellence, that we optimize our run time, that we're lowering our greenhouse gas emissions. So I think we've done a lot of really hard work, difficult work, being supply long capacity short. We've done a lot of things that other people didn't do because we have some really strong beliefs on how we want to set this company up not just for tomorrow, the next week, the next month, the next quarter, but setting it up for a really, really good kind of long-term sustainability. And you know what, if you look at all of that together, I'm like, I think, 2022, if things stay the way they are today, should be a really solid year and a really good year for the DCP enterprise.

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

Yes. And I certainly would agree. One last one, just really quickly. One of your largest owners, Phillips recently made a decision to fold in some of its midstream assets. And I know, obviously, they're partial owners in Sand Hills, Southern Hills and some of the assets you own. Also, I imagine there are some assets that they've got that you might want to get your hands on at some point thinking about frac and export. And so curious if the simplification up at Phillips has any read-through to you. Is there any areas there for you to potentially get your hands on some of those assets going forward?

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

Yes. I don't think I am the one who can answer that question. I don't work for Phillips 66. And so therefore, I appreciate you asking, but I really think that is a question that is better answered for by other people. I do think what you're seeing is, hey, you're going to continue to see a trend of consolidation. I think in the last couple of weeks, we've seen now, I think, three kind of corporate-to-corporate types of transactions that are happening. And I would expect that you're going to continue to see M&A and consolidation in this industry. It is something that is needed and that makes a lot of sense.

If that's going to happen for DCP or not, I'm not going to opine on that. I'm not in a position to opine on that. But I am in a position to talk about is that, hey, we've set our company up to scale well in a environment like we are today. And I think we've done a tremendous amount of hard work and I applaud DCP team for all the hard work that they continue to do every single day to set this company up as good as possible, to benefit from a really good environment like we're seeing today in 2021 and hopefully in 2022 and beyond.

Operator

I'm showing no further question at this time. I'd like to turn the call back over to Mike Fullman for any closing remarks.

Michael Fullman - *DCP Midstream, LP - Director, Investor Relations*

Thank you all for joining us today. If you have any follow-up questions, feel free to reach out. Otherwise, thanks, and have a good day.

Operator

Thank you. Ladies and gentlemen, this does conclude today's conference. Thank you all for participating. You may now disconnect. Have a great day.