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DCP.N - Q2 2021 DCP Midstream LP Earnings Call

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the DCP Midstream Second Quarter 2021 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, Mike Fullman, Director of Investor Relations. Please go ahead.

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

Thank you, Shannon. Good morning, and welcome to the DCP Midstream Second 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 measures in the schedules in the appendix section of the slides. Wouter van Kempen, CEO, and Sean O'Brien, CFO, will be our speakers today. And after the 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're all safe and well. On today's call, we will discuss our second quarter and first half results for 2021 and our outlook for the remainder of this year. Before getting to that, I would like to say thank you to team DCP for delivering another strong quarter of results. Compared to the last 15 months, the second quarter was relatively quiet. Instead of managing through unprecedented events and responding to historic volatility, we focused 100% of our time and efforts on executing our strategy, providing safe and reliable operations for our customers, accelerating progress on ESG and sustainability, and investing in our employees and our culture.

Our second quarter results highlight and demonstrate the strength of our diversified portfolio, the transformation we've undertaken over the last 5-plus years, and the earnings power of the DCP business model, which was recently recognized by Moody's with a full turn upgrade.

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For the quarter, we generated $333 million of adjusted EBITDA and $225 million of DCF, representing 21% and 29% increases versus Q1 as volumes strengthened across the portfolio. Within the quarter, we generated a record $132 million of excess free cash flow, which was the fifth consecutive quarter generating positive excess free cash flow, which we define as cash flow after paying our distributions and funding our capital programs. This strong quarter and fast start to the year, coupled with favorable commodity environment and producer activity, has us confident that we will meet the upper end of our financial guidance.

The DCP business model, strategy and track record of execution has the partnership well positioned as we look towards the second half of the year. As we aim to close the year with a strong second half and build momentum for 2022, we're also taking steps to position DCP for the long-term future as we accelerate our ESG and sustainability efforts, which brings me to our next slide.

On Monday, we published our second annual sustainability report, Resiliency and Evolution, which highlights our sustainability performance from the 2020 calendar year, announces forward-looking goals on greenhouse gas emissions reductions and inclusion and diversity, and outlines our strategies within a variety of ESG-related efforts. Importantly, we substantially increased our disclosures by aligning with SASB, the Sustainability Accounting Standards Board, the Energy Infrastructure Council, EIC, and the GPA Midstream Association ESG reporting template, the latter of which we helped to create as a participant in a joint ESG working group.

Before I review the highlights of our reports, I want to set some context. The United Nations expects the global population of 7.7 billion people to increase to almost 10 billion by 2050, with the potential to peak at 11 billion by the century's end. As one of the largest natural gas processors and natural gas liquids producers in the United States, DCP plays a critical role in meeting the rapidly increasing energy demands of a growing global society that is constantly striving for enhanced living standards. From creating electricity, fuels and heat sources to providing feedstock for countless consumer and industrial products, the natural gas and NGLs that DCP processes and transports are a fundamental pillar to improving quality of life, both here in the United States and abroad. And this is why our company purpose is Building Connections to Enable Better Lives.

We know that hydrocarbons continue to fuel our global society with increased long-term demand for natural gas for decades to come. We also know that we have a duty to ensure that our role in the energy value chain is as clean, as responsible, and as sustainable as possible. We've established a Sustainability Council and an Energy Transition Team, focused on building and executing long-term strategies to ensure our company sustainably enhances values for our stakeholders and that we are a proactive participant in the energy transition. Our council has established concrete 3-year strategies to drive our sustainability performance, and in our newly published report, we outline how well the team executed last year.

At DCP, 2020 was not defined by the challenges we faced, but by the achievements we celebrated, including our financial and strategic execution as well as our ESG performance. Several highlights of our team's hard work during our company's most trying time include a 46% decrease in recordable injuries since 2016, with an industry lead in TRIR of 0.44 in 2020. A 16% reduction in Scope 1 and Scope 2 greenhouse gas emissions and a 23% reduction in methane emissions since 2018. We established a company-wide Inclusion & Diversity Committee, and we increased diversity on our Board of Directors. We achieved an employee engagement survey score of 76%, which was above the industry and represents a 3-percentage point increase since 2018. And as a company, we donated $1 million to our community partners, including $325,000 to local food banks during COVID-19 crisis.

We're proud of the progress that we've made. We're excited about setting new forward-looking targets, which brings me to Slide 5. Looking forward, we must continue to evolve and proactively meet the needs of our employees, our customers, our investors and communities. There is a remarkable opportunity for our company to thrive and ensure the sustainability of DCP for the long term. We've been a strong midstream company for over 90 years. And by successfully enhancing our ESG outcomes, we ensure we can operate as a leading midstream business for decades more to come. In our reports, you'll find that among many targets and aspirations for improvement, we've highlighted several new forward-looking goals. We have two goals for emission reductions, including that by 2030 we will reduce our total Scope 1 and Scope 2 greenhouse gas emissions by 30% from the 2018 baseline. And that by 2050, we will achieve net zero greenhouse gas emissions. We plan to achieve those targets through three strategic horizons focused on Cleaning 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. And we know that we're going to spend most of our efforts here over the next decade. Adjacent to the Core focuses on expanding our business portfolio, where DCP's existing intellectual and social capital is relevant to compete in complementary business lines that improve our outcomes and provide

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solid returns. And this includes, can include, carbon capture and sequestration and other emerging technologies. And Beyond the Core is a strategy to ensure that DCP is positioned well for the rapidly changing energy ecosystem and tomorrow's energy solutions. In addition to our emissions reduction targets, we've also established formal inclusion and diversity builds. And these include, by 2028 and 2031, ensuring our workforce, our leadership and our succession pipeline represents gender and racial demographics of the local communities in which we operate. Secondly, we continue to invest in our people and are committed to maintaining employee satisfaction and belonging scores above the industry benchmark over the next five years. And finally, on an annual basis, ensuring the representation of veterans in our workforce aligns with national demographics.

When aligned with our focus on safety, reliability, transformation, efficiency and culture, these goals are about continuing to do what is right, while strengthening our company. We're proud to back our words up with action. On Monday, we also announced a renewal of our $350 million accounts receivable securitization facility with the addition of ESG-linked KPIs. This is a first of its kind agreement within the entire energy industry as we have leveraged our annual pricing against our safety performance relevant to our peers and year-over-year reductions in our greenhouse gas emissions intensity rate. Our goal is to demonstrate accountability to improving our sustainability performance.

As always, we welcome your feedback on our report, our targets and our strategy looking forward. And with that, I'll turn things over to Sean to run through the second quarter financial results.

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

Thanks, Wouter, and good morning. On Slide 6, I'll hit the key drivers to our strong second quarter performance. We generated $333 million of adjusted EBITDA and $225 million of DCF, which were significant improvements from the first quarter as the industry rebounded from the impact of winter Storm Uri in Q1. Volumes across our G&P business continued to strengthen through the quarter, which allowed us to maximize the impact of the favorable commodity environment. Sand Hills and Southern Hills volumes were up 26% and 10% versus Q1 as the pipelines benefited from growing G&P volumes and increased third-party ethane recovery early in the quarter. As expected, we realized higher costs and sustaining capital as deferred maintenance work from Q1 took place in the second quarter. While there was an increase in spend quarter-over-quarter, we will continue to aggressively manage our costs and capital as we finish the year. We're committed to maintaining the savings we realized in 2020, while managing the impact of inflationary pressures on the business.

We saw a slight increase in leverage for the quarter, moving from 4.1x to 4.2x due to the timing of working capital, which was primarily a result of collateral posted associated with our 2021 and 2022 hedging programs. We fully expect this to normalize over the next two quarters and position us to finish the year in line with our 4.0x guidance.

Now moving to Slide 7. I'd like to provide an update on our second half outlook. We continue to see favorable indicators as we move into the second half of the year. G&P volumes were up 6% quarter-over-quarter and trending favorable to Q2 2020 after normalizing to account for the large contract expiration in the Eagle Ford that took effect on January 1. We're seeing producers accelerate drilling plans, resulting in improved volume outlooks, specifically in the DJ and Permian, as we close the year.

Within the logistics business, we continue to forecast Sand and Southern Hills at high utilization rates, as Southern Hills continues to benefit from the steady supply of volumes from our MidCon business, as well as the growth we're seeing coming out of the DJ Basin. On Sand Hills, we are currently seeing third-party ethane rejection as natural gas prices have increased over the last 2 months. In this environment, DCP's commercial team has done an outstanding job working with our customers to incentivize some level of ethane recovery to generate incremental value for DCP and our customers.

As for the rest of the year, we do anticipate volumes on Sand Hills continuing to improve, and there remains potential upside with increased ethane recovery over the last five months of the year. The commodity outlook has stabilized and the forward curve remains strong, with all three commodities trading at higher prices than we realized in the first half of the year. This will provide a nice tailwind given our unhedged equity positions. And while we will see increased costs in sustaining capital relative to the first half of the year, we are tracking in line with our full year expectations. With favorable volume trends we're seeing and assuming the forward curve remains strong, we are well-positioned to meet the upper end of our financial guidance. And with that, I'll turn it back over to Wouter.

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

Thanks, Sean. So to close us off on Slide 8, the DCP team continues to deliver strong results and has us well-positioned to meet our 2021 commitments. Our diversified business model and execution of our long-term strategy continue to deliver value for unitholders. Over the last 5-plus years, we've built our stable fee-based logistics business, generating almost 60% of our earnings. We permanently removed $150 million of costs from the company. We executed a capital-efficient supply-long capacity-short strategy, and all of this while retaining favorable commodity upside. This transformation execution sets us up well to generate significant cash flow during these favorable commodity environments. Within the first six months of the year, we generated nearly the same amount of excess free cash flow as we generated in all of 2020. Our capital allocation priorities remain unchanged as we're committed to reducing our absolute debt and strengthening our balance sheet.

Looking forward, we're seeing favorable indicators, which has us optimistic to deliver towards the high end of our 2021 financial guidance. We're very well positioned as we enter the second half of the year and look to build momentum heading into 2022 as we transition to returning additional value to unitholders. We'll take the next step in the DCP journey as we accelerate and continue to drive step-change improvement on the ESG and sustainability fronts. We set aggressive targets that I'm confident that the DCP team will deliver on. We're incredibly proud of the accomplishments of our team to date, and we're excited to continue our sustainability journey for decades to come. With that, we look forward to taking your questions, and Shannon, please kick us off.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Jeremy Tonet with JPMorgan.

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

For the guidance out there, I just want to confirm the commodity price deck being used there, is that kind of unchanged from what you said last quarter? And so if you kind of marked to the strip, you might get to something a bit higher? And just wanted to see exactly what's baked in for ethane expectations there, recovery pricing, and do you see Southern Hills volumes picking up there and that helping as well?

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

Yes, sure. So I think you're thinking about it right, Jeremy, what we've done for the second half of the year. And look, I'm excited that we went to the high end of the guidance. Obviously, that includes, if you think about Q1, that includes more than covering, well more than covering the Uri impacts. But specifically, to the price deck, if you take the current strip, you're going to get some more upside than probably what we have baked in, right? We sort of have a view where it's in line with what we've seen in the first half of the year, maybe even slightly better than that. But current spot, if that holds for the remainder of the year, you'd definitely have some upside to the guidance that we gave. But definitely, we baked in some favorable price uplift in the second half of the year, it could be better. On the ethane recovery/rejection side of the fence, I'll remind you we came into the year assuming full recovery.

Obviously, that -- it's been sporadic. Q1, we didn't see a lot. We saw a little bit in Q2. And I want to be clear, this is third-party. Because of our value chain, we've been in recovery the whole time. So the barrels that we control, we've been in full recovery. But on third party, you saw a little bit. We incentivized some recovery early in the quarter, people went back into rejection mode. I think Wouter and I talked about it, gas has just been screaming, so that kind of pushes people and their economics back into probably rejection. That also, by the way, if we see recovery click back on the remainder of the year, all boats rise, that would be upside for us. We are assuming rejection -- third-party rejection -- for the remainder of the year. So a couple of good things that could go our way. If spot prices continue to hold and we see something a little stronger than our outlook, awesome. And then obviously if we move into recovery, that's upside above and beyond what we thought, what we've baked in.

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

Got it. That's helpful. So spot and ethane recovery upside to the top end of the guide as you laid out there, so that's great to hear. Maybe just kind of pivoting towards producer conversations at this point, commodity prices moving up here, producers have really been kind of disciplined on production growth. But the privates are a bit more active and then it seems even with the publics, I guess, if the leveraging is going down, maybe there's more kind of activity picking up there, especially as we go into '22. Just wondering if you could peel the onion a little bit more with your producer conversations and how you see things trending across your footprint there?

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

I can start, Jeremy. With some of the big producers, you're spot on. So there's obviously a lot of optimism. They like the environment that they're seeing, but the discipline continues. I actually think that's a pretty good thing because we are seeing some rigs, some rig increases. We're seeing some activity. Obviously, the growth that we did assume in areas like the DJ and the Permian are not only happening this year the way we thought, in a lot of cases they've been accelerated a little. So that's good, and I think that bodes well for the second half of the year. Wouter can talk a little bit, but we are seeing more around the small guys. Not as big of a driver, but you definitely are seeing more activity there. As you think about '22, and that's sort of the picks we were trying to set, we feel like we're going to exit the year pretty strong based on what we're seeing from our producers, what we're hearing. And I think that discipline will continue, but it will drive, I think, a nice even keel growth outlook and volume outlook for '22. And I think that's really good for our industry at this moment. So definitely, significantly better than what we would have thought 6 or 8 months ago.

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

That's really helpful. And just one last quick one, if I could. When it relates to CCUS and given there's a lot of pending legislative efforts out there that could change the picture, but just wondering specifically as it relates to DCP, if you could build a bit more about what specific initiatives could be pursued if the right policy support comes through there?

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

Yes. So maybe I'll take that one. So if we think about CCUS, that really is probably -- I spoke about Clean the Core, so those are the tangible projects that we have where we already are kind of doing things around modernizing our footprint, asset reliability. And then you've got the Adjacent to the Core. CCUS, or for us probably more CCS, is really going to be around Adjacent to the Core. We are already doing a significant amount of carbon capture and sequestration in our Southeast New Mexico business today. And we have additional opportunities to do that in New Mexico, in Colorado, in Michigan.

If you think about it, gas processing plants are fairly significant aggregation points for carbon. And if we can find a way where both from a regulatory regime at the federal level, think 45Qs, as well as kind of a speed to the ball at state levels. And I'm then thinking about, hey, how do you get Class 6 wells permitted in a reasonably fast time period? You can build a good returning business there where we would earn above our weighted average cost of capital and take a very, very significant amount of carbon and Scope 1 emissions out of your footprint. So it's something that the team is looking at quite diligently. There's a lot of opportunity. We're already doing it. So it's something that we're familiar with. We do need to have the 45Qs to be going up a little bit from where they're sitting today. We do expect that there's bipartisan support for that, and that will happen. And then you are kind of thinking about how you can get, from a permitting point of view, how can you get things in place in an expedient manner?

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

Got it. Makes sense. Hopefully, the Railroad Commission gets primacy there, and that would help with the Class 6 wells a lot. So thank you for all your thoughts there. That was very helpful.

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Operator

Our next question comes from Shneur Gershuni with UBS.

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

I just wanted to clarify one of your responses to the prior questions on guidance. You had sort of said there's extra cushion with respect to commodity pricing. But do you also have some extra cushion with respect to volumes, just given how strong the volumes were this quarter as well, too?

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

I would tell you, Shneur, where I see the potential cushion, and I was alluding to it, is on the pipelines potentially. And if we end up going into full recovery, that would bode very well for Sand Hills. I mean, we're seeing good -- look, the capacity utilization of both pipes, we're very happy with. There is some upside there. It's still -- look, volumes have come back strong, I think we have some growth, per my written remarks, the remainder of the year. Is there some upside? I think we've baked in mostly what the big guys have told us, but there's always potential that things could come in a little bit stronger. So I'd keep an eye -- the bigger thing, I think, is recovery. And then, of course, if commodity stays screaming like the spots, that would be upside for the company as well.

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

Let me just pivot to the questions that I had. Just curious, if you do end up in kind of an excess of guide kind of mode with excess cash generation, you've sort of labeled your priorities as reducing debt. You talked about the Moody's upgrades and so forth or the outlook upgrades and so forth, and that does remain a priority. Just kind of curious, though, is like kind of you've been paying off maturities as they come up, but when I sort of look at your capital structure right now, most of your debt is trading above par. Obviously, that's good as to your performance. But kind of curious if you'd be looking at other parts of your capital structure. For example, the junior sub notes, which do trade at a discount and do actually have pretty high coupons. Would that become kind of a focus kind of in between maturity expirations?

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

Shneur, why don't I start it and then Sean, you can jump in as well. I think in general you are spot on. We believe that this is the perfect time to set the company up well for the long term and that means getting to a very strong balance sheet. So we are very committed to 4.0x leverage by the end of this year. And I think if things stay as is, and that's kind of what Sean was talking to, if you have commodity prices like they are today, with our continued kind of good management around reliability, how we manage costs, capital, things like that, you get to an excess free cash flow profile where we should be somewhere in the 3.5x range in 2022. And that provides you a massive amount of flexibility. 3.5x is kind of a key number for us. It's really where we want to be.

And after that, you're absolutely right. There is a tremendous amount of flexibility. And that flexibility can be anywhere from, hey, are we going to raise the distribution, going to give dollars back to our unitholders that way? Is there a way to buy back units? Is there something to do around the preferreds that you're talking about? Some of those are trading at a premium as well. As you know, some of them are a little bit below, but we also get significant equity credit there, which we have to balance those two things together. But I think the key takeaway here in short run, continuing to get the balance sheet right. This is the perfect moment. We will get this company to a very, very strong balance sheet with investment-grade type of metrics. And after that, and if commodity stays like where we are today, you've got massive, massive flexibility in 2022 and beyond, and that's pretty exciting.

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

Perfect. Appreciate the color there. And maybe just to pivot, I was looking in kind of your appendixes around the hedging that's been in place. It looks like you've added some '22 hedges right now, and I think you're now at about 41% hedged versus 15% last quarter. Is that kind of enough? Is that kind of where you kind of need to be at this point right now? And also, as you've been layering on the hedges, especially on the gas side, just given the basis issue from last quarter with Winter Storm Uri, have you sort of adjusted the way that you're putting your hedges on and so forth?

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

Yes. So two things on that. First question, I couldn't have said it better. I mean, I think a couple of things. This price run-up has given us the ability, Shneur, so those '22 hedges when you really think about them, are at pretty significantly higher prices than '21. So if you're just going to mark hedge to hedge, there's a pretty good cash flow pickup there going to the pricing into '22. I do think you're thinking -- everything we've said thus far puts us a little more bullish around outlooks for next year. So I do think we will not go and be as hedged as we were in 2021. I mean we're about consistency in cash flows, taking advantages and locking in at good rates. But I do think we feel really good about where we're at in '22, so we probably will feel like that we probably are where we need to be at the moment. So yes, to that question.

And in terms of the Uri, the equity hedges did not pose any problem. They have longer duration. They -- obviously, they're not impacted by the volatility. Like Uri was all about volatility around spot prices and gas daily prices in like a 5-day period. So the longer-term hedges always performed well. That was more around selling the product that you had in those days. And obviously, the product wasn't there. And we have, by the way, to answer that question, we have added -- we have taken some different approaches that will safeguard the company so that we'll have, we'll be in a better position if you were to see another type issue like that in the winter.

Operator

Our next question comes from Michael Blum with Wells Fargo.

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

Just two quick ones for me. One, I wonder if you can just give us your outlook on the Mid-Continent specifically, what you're seeing there from a producer activity level? And also, I guess related, what's your view of how Southern Hills volumes will sort of trend here for the rest of the year and into next?

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

Michael, so far, Southern Hills showed a bunch of impact or positive improvements going into Q2. And a lot of that is -- Mid-Continent was obviously affected by Uri, but we're seeing -- we're not seeing massive growth, but we are seeing the Mid-Continent kind of hold the line. Which is probably a little better than if you and I were talking coming into the year than where we would have been. And you are seeing that.

Southern Hills is a little different than Sand Hills in the sense that the majority of the volumes do come from barrels or gas that we control. So so far, Southern Hills outlook improved pretty good in Q2. I think we expect it to improve even more in Q3 and Q4, and that is partially driven by a slightly better Mid-Continent outlook than we would have thought. And the DJ is just going through the roof, right? The DJ is doing quite well, and you're seeing some pretty good stuff in terms of that feeding Southern Hills as well. So good outlook on Southern Hills and definitely volumes in areas like the Mid-Continent and the DJ catching up. I think I said on the last call, things started a little slow in the year and then you had Uri. We're definitely seeing things catch up to where we had anticipated. Mid-Continent probably slightly better than what we would have thought.

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

Got it. Second question I wanted to ask was about the A&D market. Clearly, I think it's been pretty active, more active lately in the midstream space. It looks like companies both looking to pick off some assets that fit their portfolio and also divest where it makes sense. Is there anything from your perspective? Like I just want to get your general perspective on that. Is the assets that you own today where you want to be? Do you see divestitures? Do you see anything you might want to add?

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

Yes. Good question, Michael. You're right, there is -- you see a little bit more activity. At the same time, I don't think you are seeing the type of activity yet that what you're seeing, for instance, on the producer side of the house, where you've seen more broad-scale consolidation. There are definitely some assets coming to market, where people are trying kind of discrete asset transactions. For us, I'm absolutely not saying no to that in any way, shape, or form. I also am not saying that, hey, we're having 10 things here on the table that we're very actively looking at from an acquisition point of view.

From a divestiture point of view, we are pretty happy where the portfolio is sitting today. So we're not running any active projects there either. I do continue to believe, and I've answered your questions and your colleagues' questions multiple times over the last 6, 12 months that the midstream industry as a whole, needs to consolidate. And I think that is something that is very, very important. There continues to be some pretty significant overcapacity in various areas. And I don't see that overcapacity being fully utilized anytime soon. So if you get into a more mature state of this industry, which we clearly are, you went from the big growth cycles into a much more mature harvesting cycle, then I do think M&A on a broader scale is something that is tremendously important. Are you going to kind of see us do that? I obviously cannot opine on that. I do believe that DCP, as I've said before, has earned the right to be a consolidator.

I think we -- if you think about what we have done around optimizing our asset base, lowering our cost, upping our reliability, I spoke about our sustainability performance. Our Scope 1, Scope 2 greenhouse gas reductions, things like that, I do believe that we know how to take assets and optimize them. But you know what? It's also M&A is not a strategy. I think M&A is an execution of a strategy potentially, but we'll see where it goes.

Operator

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

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

First question on propane. Wouter, curious, can you just opine a little bit on the strength we're seeing in that market right now? I'm just curious how sustainable you think that is. And Sean, on the hedge position for 2022, that $0.74 a gallon, curve seems to suggest maybe that gravitates closer to 80% as you layer in more hedges. But you mentioned that sort of big step-up in the hedge position from 2021 to 2022. Can you share roughly what your sort of propane hedge position is from a price perspective in '21?

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

Yes, let me quickly start and then hand it over to Sean, Spiro. In general, around propane, I'm like, you're taking a look right now where inventory levels are sitting compared to 5-year average, and we're obviously fairly low. We're starting to get close to the end of the summer and going into winter. Feel pretty good about things right now. I think we also know that if you don't get a winter start kicking in, in November, December, then quickly you're going completely the other direction. But obviously, quite helpful where things are today. And then Sean, maybe you can talk about the hedging side of the house?

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

Yes. So Spiro, in terms of 2022, I think we're -- obviously, propane was constructive. So if you think about '21, we were, the biggest opportunities for hedges in '21 have been gas. Obviously, we've been able to do some stuff since then. As you think about '22, NGLs and crude have been constructive, but we're still pretty lightly hedged on the NGL side. We probably have about no more than 1/5 or 20% of those types of hedges on the books for NGL and propane would make up a chunk of that. So there's still a fair amount of propane upside as we think about '22. Your 80% mark I think is about right. I think that's where we would probably, if we gave a number on 2022 right now, we'd be about 80% fee or hedged. As you think about '21, we're closer to 90%. So that's -- my comments earlier about leaving some of that position open because we're a little bullish, was alluding to that 10% delta. But still a lot of room on propane. We've been able to get some of those hedges on. Obviously, with the heavier end of the barrel, we've been able to get some hedges on as well. But a lot of room still left if propane is to run.

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

Okay, helpful. And just to make sure, and if you can provide it, just trying to compare that $0.74 a gallon hedge position in 2022 for propane. Is there a similar number you can provide for 2021, kind of where you are hedged right now?

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

For propane specifically? Yes. We'll shoot back an answer to that to you.

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

That's perfect, we'll follow up on that later. And then just on ethane, I understand you don't really have the ability to obviously recover or reject, make that decision each time, but it sounds like commercial team is working hard there to incent more recovery. I guess what would it take to grab more out of the stream from here? Is it simply a function of lowering the tariff downstream to make it more economic? I suspect it's more complicated than that. And have you been able to quantify at all kind of what the upside is, if you ever get to a full recovery scenario, what that could mean from an earnings perspective?

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

So a couple of things. The big lever is, obviously, you're incentivizing people by lowering the rate. The frac spread, the good news is, I know the frac spread hasn't been conducive to recovery, but let's -- the positive is that's because gas is running, so has NGL. Gas just happens to have run more than ethane. In terms of the upside for the company, I don't know if we've ever given a number, Spiro, but I can tell you it's tens of millions of dollars for the remainder of the year if we can get into full recovery. That's the benefit of having a very stout value stream, right? Having the pipeline, getting to be able to make money in various chunks of the value stream. So it could be a couple of tens of millions of upside for us if we were to go into full recovery for the remainder of the year.

Operator

(Operator Instructions) Our next question comes from Tristan Richardson with Truist Securities.

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

Just appreciate all the comments sort of on what you're seeing near-term and even looking out into 2022. Just thinking maybe a bit longer term, once you've kind of achieved some of those medium-term targets, getting the balance sheet to that 3 handle, just thinking about CapEx. You've noted on past calls there's some niche capital opportunities here and there out there. But I guess, just thinking about '22 and beyond, as we kind of go in and out of potential commodity cycles, sort of does DCP have everything it needs from an earnings engine perspective to sustain multiple

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commodity cycles and keep the balance sheet exactly where you'd like it? Or are there project opportunities expanding the downstream business further, etc., that you're thinking about longer term?

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

Yes, Tristan, let me take that one. I think what's first and foremost, the most important thing as a commodity business to go through commodity cycles, is get that balance sheet fortified. So we're running, internally, we're running obviously a lot of different decks and models. But where I look at most of that is kind of a downside model and say, okay, if we get into a prolonged low commodity environment, are we comfortable running the company, having the balance sheet to get through that, continuing to generate excess free cash flow and continuing to, obviously, pay the distribution? And the answers to all of those are yes, which is a great, great thing.

If you think about this industry over the last 10-plus years, and the cycles we have seen, for many companies, including ours, that answer was fairly often, unfortunately, no. Because the industry was levered fairly highly. So getting to that is absolutely, first and foremost, the most important thing for us. Because after that, you've got enormous flexibility. If you talk about, hey, what are the different kind of pieces of the puzzle that you would like to have? I think we've made a tremendous improvement to the business model over the last decade. If you think about where we were as a 90-plus percent gathering and processing business, massively commodity exposed, now we're a much more vertically integrated company. But would we like to have more of that? The answer is absolutely yes.

I do believe, and we believe as a management team, that having a wellhead to water type of business is going to be important call it for the next 10-plus years, kind of the longer-term that you're looking at. So we made good improvement there, but could there more be done? The answer is probably yes. So those are things that we continue to look at and say, are there opportunities around that? And so then I think the other piece that you have is there will be some investment opportunities where we believe you can make a return, like around CCS and some other business models that we're pursuing. But yes, it's a great question. It's something that we're looking at spending a lot of time on. Short answer, get the balance sheet really, really strong. We have line of sight to that. Now you have massive flexibility and see what you can do to move the business further downstream.

Operator

Our next question is from James Carreker with U.S. Capital Advisors.

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

Just wondering if you can expound any on some of the working capital tie up that you've seen year-to-date and the confidence in that reversing? Is any of that related to disputes relating to Uri? And could some of that drag into 2022?

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

Yes, James, this is Sean. Yes. Yes, yes, and yes, but I'll give you some clarity. Because the price movement has been so strong, since we do have hedges in place for '21, '22 and a little bit of '23, there is collateral requirements on those hedges. Obviously, price run-ups are good things for DCP and the industry. But it does put some temporary collateral requirements on the company. 60% of that particular collateral requirement rolls off by the end of the year. So yes, we do see that one obviously improving. And that's assuming prices stay really strong. But 60% of that will be gone because we'll have realized those hedges and again realized a pretty strong environment.

And then on Uri, I mentioned in Q1 that we've done a pretty good job of coming out right out of Uri, about 90% of our collections in hand. We've been able to improve on that. I think we've picked up another roughly $20 million since Q1. There are some disputes still outstanding. Those probably, I think you're thinking about it right, those could be longer term. But we definitely see the working capital situation improving significantly between now and the end of the year. But I think some of those Uri disputes, look, we're very confident in the revenues we booked. But obviously,

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some of those are going to get held up and maybe have to get litigated over time. But we'll keep you in the loop on that, but not a big driver, and I think some of that helps itself by the time we get to the end of the year, a little bit of carryover into 2022.

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

Okay. And then maybe just a clarification. I guess, I think your year-to-date working capital usage has been around $200 million. So if it's not Uri, is there any item or set of items that's driving the big use of capital, temporarily?

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

Yes, it would be -- it's the collateral on the hedges is the biggest driver on that working capital.

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

Right. But I guess I thought I saw that the collateral is about $200 million. And then separately, working capital is about $200 million.

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

Yes. Oh, so you've got some normal timing. This was a heavy payout period for the company. So that's just going to happen normally. But the big, I would call it, temporary drivers are going to be the collateral and the hedges and the Uri collections.

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

Got you. If I could follow-up with one more, I think I saw one of your parents announced resumption of a frac 4 at Sweeny. And I know you guys previously had that option for Fracs 2 and 3. Does the resumption of that construction bring potential ownership of some of those fracs back on the table, now that your balance sheet is in better shape? Any opportunities around that, that you see?

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

Well, we obviously know Phillips 66 fairly well, as you alluded to. We used to have an ownership option for Fracs 2 and 3 and decided last year during kind of massive COVID time not to exercise that. We haven't had any conversations since. Again, as I said earlier, our real focus is around getting the balance sheet right. Could that come back to the table at some moment? As I said, we know Phillips 66 fairly well, they know us fairly well. And if there's something that makes sense, then that probably could come back or we just keep it where it is right now. So I would say there's no active conversations around it.

Operator

Our next question comes from Chris Jeffrey with Mizuho Securities.

Chris Jeffrey - *Mizuho Securities USA LLC, Research Division - Equity Reseaerch Associate*

This is Chris on for Gabe. I was just wondering as your kind of thoughts on the consolidation in the DJ Basin as far as the producers. And I know that they also have some midstream capabilities. Just kind of wondering how that impacts the outlook for the DJ.

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

You know, I think it's not that big of an impact for us. If you think about it, the three companies that are coming together, they're all in various ways, shapes, or forms, we have customer relationships with them. At the same time, even combined, they will be one of our smaller overall customers. So there are still the focus on some of the main customers that we're having there that are larger than them. At the same time, we do see it as a good thing when producers come together, kind of focuses their effort, take costs out so they can direct, in the end, more of their dollars not to G&A or overhead or corporate functions, but to the drill bit. With all of those, where we have contracts in the DJ Basin, they are life of lease dedicated acreage. So there really is not a competitive issue. If someone has a small midstream business themselves, and they say, hey, we can take stuff off our dead acreage and direct it somewhere else. Contractually that is not allowed, that's not possible. So net-net, I look at it as probably a small positive for us.

Chris Jeffrey - *Mizuho Securities USA LLC, Research Division - Equity Reseaerch Associate*

And then just as far as cost expenditures, the cadence for the rest of the year, should we expect more deferred costs from Q1, some chunkier kind of timing at the end? Or was that mostly it?

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

No, yes, Chris, there's definitely still some catch up. Obviously, Q2 was higher than Q1, but the run rates that we've had so far this year are just very, very, very low. So the good news is, you may recall back when we gave guidance, we took $120 million plus out of our cost base in 2020, and we said we were going to hold on to all of that. And we still are on par, and feel confident about that. But there is still some dollars to catch up on. Uri was a big event. It really set some of our projects back, and we're in catch-up mode, and you'll see that continue through the second half of the year. That will also impact sustaining capital.

Operator

Thank you. And I'm currently showing no further questions at this time. I'd like to turn the call back over to Mike Fullman for closing remarks.

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

Thank you all for joining us today. If you have any other follow-up questions, feel free to reach out and give me a call. And with that, have a good day.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

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