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DPM - Q3 2017 DCP Midstream LP Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Third Quarter 2017 DCP Midstream, LP Earnings Conference Call. (Operator Instructions) And as a reminder, this conference is being recorded.

I would now like to introduce your host for today's conference, Ms. Irene Lofland, VP of Investor Relations. Ma'am, you may begin.

Irene Lofland

Thank you, Amanda. Good morning, and welcome to the DCP Midstream Third Quarter 2017 Earnings Call. Today's call is being webcast, and the supporting slides can be accessed under the Investors Section of 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 measures, which are reconciled to the nearest GAAP measures in schedules in the appendix section of the slide. Wouter van Kempen, CEO; and Sean O'Brien, CFO, will be our speakers today. And after their remarks, we will take your questions.

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

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

Thank you, Irene, and thanks, everyone, for joining us. On our call today, we'll address the quarterly results, our response to Hurricane Harvey, provide an update on our growth projects and talk to you about the strength of our integrated business model.

Start with highlights. We had outstanding Q3 DCF of $187 million, which puts us at $467 million of DCF year-to-date. This translates to a distribution coverage ratio of 1.21x for the third quarter and 1.01x year-to-date with no IDR giveback.

We're delivering on our commitment to delever the company, with our leverage ratio improving to 4.3x as of the end of the quarter, and our Q3 adjusted EBITDA was $276 million and $737 million year-to-date.

Turning to Hurricane Harvey. I could not be more proud of the above and beyond response by our employees. I believe companies show their true character in times of crisis. And in reflecting on our team's response, we were very proactive in taking care of our people, our customers and our assets and quickly returning operations to service.

We did a controlled shutdown in the Eagle Ford, which allowed us to come back up quickly with minimal interruptions and no surprises to our customers. Given our integrated logistics portfolio, and it's one of the largest marketers of NGLs in this country, we were able to divert NGLs and redirect product into available markets and storage, which allowed us to minimize Hurricane Harvey's impact, demonstrating a premier position and strong execution.

Shifting to our project portfolio. Let me first talk about our strategic logistics growth projects in the Permian. Our 2017 Sand Hills expansion to 365,000 barrels per day is making excellent progress with 2 pump stations that went into service in Q3. We're all well -- we're well on our way to completing this expansion and expect to be at the full capacity by late fourth quarter 2017 or early fourth -- first quarter 2018. Volumes are running at record levels in Sand Hills, and we expect them to continue to ramp, as the additional capacity goes into service. Our 2018 expansion will further increase capacity to 450,000 barrels per day by the third quarter of next year. And all of this is a really, really exciting story for DCP.

We've also had an active quarter of furthering momentum on the Gulf Coast Express project, where we recently announced a collaboration with strong industry players that draws upon our combined capabilities to provide a competitive solution for needed gas takeaway out of the Permian. The 1.92 Bcf per day Gulf Coast Express Pipeline is a fee-based project and is currently in advanced stages of contracting firm transport agreement with core shippers. Gulf Coast Express is an important step-up for our logistics business, adding residue gas takeaway to our integrated value chain.

On the G&P side of the house, we are advancing our Mewbourn 3 and O'Connor 2 processing plants in the DJ Basin. We continue to set volume records in the DJ with Q3 as our highest volume quarter ever. Specifically, our 200 million a day Mewbourn 3 plant and Grand Parkway gathering expansion are moving forward and scheduled to be in service in the fourth quarter of 2018. We are doing everything in our power to accelerate this time line to enable continued production growth by our customers in the basin.

The next expansion in our fleet is our 200 million a day O'Connor plant scheduled to be in service by the middle of 2019. And both of these projects are underpinned by life-of-lease contracts with minimum volume and margin commitments.

We have clear line of sight to earnings growth across our project portfolio. We continue to be focused on capital discipline and strong returns and on accretive projects that do not rely on higher commodity prices.

I want to step back and remind you of the DCP 2020 strategy we began sharing a few years ago. We focused on taking cost out of the business. We recontracted. We exercised diligent capital discipline. We have been strategically transforming DCP's operating model and have evolved from a gathering and processing-only company to an integrated powerhouse with a significant logistics business that now makes up 40% of our adjusted EBITDA and continues to grow.

Our outstanding Q3 results in our response to Hurricane Harvey are a testament to the operating leverage in our business model. I'm extremely proud of our team for what they accomplished this quarter and for the journey that we've been on to become the most reliable, safe, low-cost midstream service provider. And with that, I'll turn over to Sean to provide a financial update.

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

Thanks, Wouter, and good morning, everyone. I'm very excited to take you through our outstanding third quarter results. We delivered very strong Q3 DCF of $187 million. Based on the strength of the quarter, we are very comfortable with the guidance ranges we provided for the year despite the lower commodity environment.

Q3 included strong execution from both of our segments driving positive trends and momentum to close out 2017 and pivot towards 2018. This quarter also included some unique drivers that I will cover in a minute. On our last earnings call, we said that we expected the second half of this year would outperform the first half. Costs would be lower, and volume would increase in key areas, resulting in higher margins. I'm proud to say that we are delivering on these commitments. Our assets are performing well and improved reliability, strong volumes in key areas and continued execution on efficiencies and optimization. Additionally, we stronger commodity prices, as we continue to see the environment stabilize and become more constructive. We are uniquely positioned, as demonstrated by our Q3 results.

As mentioned earlier, I want to highlight several unique Q3 drivers that impacted our strong results. You heard Wouter discussed the team's incredible response to Hurricane Harvey. DCP had minimal financial impact related to G&P downtime and property damage. These were offset by favorable pricing, marketing results and deferred maintenance, as we managed diligently through this challenging event. We are proud of how quickly we were able to return to service in the affected areas with a focus on minimizing customer interruptions, rerouting our product flows and benefiting from strong pricing as we took product out of storage post Harvey.

In our base business drivers, our costs were $13 million lower than second quarter, as we continue our laser focused on cost management. We expect Q4 costs to be in line with the third quarter.

Let's move to the next slide, where I'll provide further details on volumes and other drivers by segment. The G&P segment is up significantly in the third quarter, reflecting the strong performance of our assets, where we saw improved recoveries, strong reliability and lower cost. In addition to the DJ and Eagle Ford strong margins, we saw the Midcontinent perform well this quarter with improved reliability, efficiency and recoveries. The rig count uptick continues, significantly increasing in all the areas we operate in. We continue to see volume growth in the DJ Basin where we have records in July, August and September. And in the Permian, Q3 volumes would've been flat to Q2 levels, if you net out the impacts from Hurricane Harvey and a significant scheduled turnaround that occurred during the quarter. In the South, adjusting for Harvey impact, Q3 volumes would've been slightly above Q2, showing continued production growth in the Eagle Ford.

Last quarter, we mentioned that we expect our Discovery investment to be negatively impacted by about $10 million in the second half of this year. This has come to bear in Q3 results, which reflected reduced Discovery equity earnings and distribution due to lower production volumes from wells feeding the Keathley Canyon gathering system. We expect our Discovery investment continue to experience headwinds in 2018. Our latest estimate is a negative impact of $30 million to $40 million to equity earnings and distributions as compared to 2017. This is primarily due to continued production and operational challenges from 2 large producing wells that flow into the Discovery system. We will continue to monitor the situation closely with our Discovery joint venture partner. Regardless, we feel we will be able to more than offset this negative impact with the solid outlook on base volumes, strong cost management and earnings growth from projects that will become online next year.

Turning to our logistics and marketing segment. Sand Hills is setting record throughput volumes and continues to ramp up, filling capacity as it gets added. Our marketing business also had an outstanding quarter, as I previously mentioned. To recap, the third quarter reflected outstanding asset margin performance. And continuing this trajectory, we're looking forward to closing out the year strong.

Moving to the next slide. I want to underscore that we have ample liquidity and financial flexibility. We are focused on delevering and have made good progress with our bank leverage ratio improving to 4.3x as of September 30. At the end of the third quarter, we had significant cash on hand of $312 million and a fully undrawn $1.4 billion bank facility. Additionally, there are multiple financing alternatives that we continually evaluate, and we're confident in our ability to manage and fund growth. All in all, we have a lot of flexibility, and we continue to focus on strengthening our balance sheet and building coverage.

Touching on hedging on Slide 6. We are actively reducing our commodity exposure via our hedging program. We reached about 75% fee and hedged for the full year 2017 and are about 78% in the fourth quarter. We're turning our sights to 2018, which is currently about 70% fee and hedged. We will look to market opportunities to layer on additional hedges with a target of getting to 80%. The 2018 percentage of fee versus commodity margin will be updated when we roll out our 2018 guidance in commodity activities. We are encouraged by the strengthening of the NGL accrued relationship, driven by increased demand from petchem facilities and the development of the export market.

And with that, I'll turn it over to Wouter to discuss our growth projects and summarize key takeaways.

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

Thanks, Sean. On Slide 8, I want to spend some time reviewing our capital growth strategy. We have a terrific integrated and diversified footprint, which provides great choices on where we get to allocate our capital. It allows us to select the best projects, which are lower risk and higher return. The Permian DJ Basin are 2 areas where we have a tremendous opportunity to continue to grow and where we're providing offerings across the energy value chain. Our G&P position in the Permian is very strong and very important to us and is foundational to providing connectivity to our downstream logistics business. Leveraging our gathering and processing position, we see the greatest opportunity to allocate capital on the Permian to our integrated logistics business. And we're doing that both on the NGL side, with Sand Hills as well as via Gulf Coast Express, our first major residue gas pipeline strategic step-up, which further integrates our value chain.

As I mentioned last quarter, our Sand Hills expansions are underpinned by existing contracts with strong dedications from plants that are built or under construction, supporting growing NGL volumes well into the next decade. And this does not take into account any growth from ethane recovery, which would be upside over and above what we already have.

Moving to the DJ Basin. I'm excited to talk about the DJ, as this region provides some of the strongest returns and lowest breakevens in the country for producers. We have an integrated system with approximately 850 million a day of processing and bypass capacity. We've continued growing supply. We are on track to increase this total capacity by approximately 50% to about 1.2 Bcf a day over the next 2 years. These new plant are supported by very strong producer partnership and commitments and underscore the strength of our footprint and our focus on capital discipline. It provides strong returns with 5 to 7x multiples, have life-of-lease acreage, full value chain economics and are supported by minimum volume commitments.

In summary, first, we generated very strong results in Q3, which lays the foundation for the rest of this year in 2018. We delivered strong 1.21x coverage and lowered leverage to 4.3x during the third quarter. We will remain disciplined with our financial priorities, including strengthening our balance sheet, reducing leverage to 3 to 4x and targeting distribution coverage of 1.2x or better. And as this quarter demonstrate, our strategy has been successful in accretively growing earnings while increasing reliability and operational efficiencies in our base business.

The second key point. We have clear line of sight to lower risk, high return and predominantly fee-based growth opportunities that further extend our value change and integrate our gathering and processing and logistics businesses. We're differentiated by our ability to choose the best projects in the best areas and leverage our integrated portfolio. And finally, we are seeing great momentum from our multiyear DCP 2020 strategy in transforming DCP Midstream. We expect to close this year strong. And as we shift towards 2018, we see positive signposts for a more constructive environment. Our goal has never wavered: to be sustainable in any market environment, not founded on optimistic commodity prices, but instead on flawless execution of our strategy.

And with that, I'd like to thank you for your interest in DCP. And now, Amanda, we're ready to take some questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Shneur Gershuni of UBS.

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

I guess I wanted to start off on funding. Kind of wondering how you're thinking about funding, going forward. Hopefully, Gulf Coast Express gets across the finish line, which would mean that you would have to fund your portion as well, too, in addition to Sand Hills and the 2 new plants. Lately, the market has been rewarding, no equity pledges by management teams. And at the time of your restructuring earlier this year, instead of lowering the distribution, the GP put in place the coverage waiver -- trigger for $100 million. You've had strong results. You haven't triggered it. You probably won't because results continue to improve. But at the same time, you do have a sizable CapEx spend next year, I would imagine. Has the GP considered formally waiving the $100 million, even though you don't need it from a coverage perspective but because of your CapEx? Do you look at potentially deferring the $100 million and accrued its liability until the plants come online? Just kind of wondering, how you sort of just manage the bulge of the CapEx spend next year, cash flowing and trying not to issue equity while maintaining the distribution.

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

Okay. Shneur, It's Wouter. Sean and I will tag team to that question. Let me go -- start with the IDR waivers. And like, at this moment, and like, there's no discussions about do we permanently waive that or not. I think you made a couple of interesting comments around, hey, there is some good growth. There's very strong execution that you're seeing on our side. Like many others, we did not lower our distribution. We strongly believe a promise made is a promise kept. And we continue to run our business more on a strategy in a way where we deliver on our promises. We believe there is very significant flexibility that we continue to have in the business model, also around funding growth. As you know, we haven't gone into the equity markets. I think the last time we went into the equity markets was in 2015. People came in this year, thinking about, okay, is there a significant equity issue that need to be done for 2017. And we found many different other ways to fund our growth and not issue equity. So we believe there's a tremendous amount of flexibility that we continue to have within the portfolio within structure that we have and within the various capital markets that we see. So we're very comfortable with continuing to execute the way we've executed here in 2016 and 2017.

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

Shneur, the only thing -- this is Sean. The only thing I'd add, we're sitting on over $300 million of cash. We've got nothing drawn on the $1.4 billion facility. So we've got a lot of liquidity. Obviously, as you know, we've divested some assets through the year and raised cash that way. You mentioned it, our cash flows from our core businesses are performing quite well. So we have a lot of flexibility, as Wouter said. The other thing I'd point out is, since we are growing organically in a very disciplined way, that gives us a nice line of sight of the timing of the capital. It doesn't all come on in one big full swoop. We have great line of sight. We know when it's going to come online. So again, that's tying into the flexibility theme. So we feel really good about our ability to fund the growth, going forward.

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

So just to paraphrase, outside of some crazy event that's really unanticipated, you don't see yourself issuing equity at all this year or through '18?

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

You know, I don't -- well, we're not talking about -- you're sitting through '18, so that's obviously, you just made time period very lengthy. And like, we're not commenting on 2018, because we haven't given guidance around 2018. But we said this before, and we don't believe that we will issue common equity in 2017.

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

Okay, great. Just 2 more follow-ups. Rigs have been down in the DJ. Some of DMPs have attributed to midstream bottlenecks. Your plants don't come online until later next year, which would, obviously, help alleviate some of the bottlenecks. I'm not attributing it all to DCP at all. But is there any concern that the step-down in rigs, and therefore, we're not building an inventory of ducks, that you run into a scenario where there isn't enough activity to bring the plant on full when you actually bring it online? Could there, potentially, be a timing type of issue? Or do you feel there's enough activity to make sure that the plants come online in fall?

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

Shneur, there's many things that keep me up at night. This definitely would not make the list. We are very comfortable around what we're seeing in the DJ Basin. Yes, we're at a place today where we wish there was processing capacity available, and that we could bring it online, and like we spoke of the last earnings call about this. But hey, there was a mismatch between our timing and the producers' timing. And when the producers weren't ready to sign up for new processing capacity in 2015 and 2016. And it takes a long time for us to get permits and build things. But at the same time, we've done tremendous activity between ourselves and the producers to optimize the system, to bring kind of new bypass capacity, small other chunks of capacity online. We continue to work that, and probably bring some little pieces of capacity online until the Mewbourn 3 plant comes in. I really am not worried at all about what the rig activity is. And like rig activity used to be a really good way of looking at things, obviously, the efficiencies that producers have, they can get so much more volumes with less rigs. I think this plant is going to fill up really quickly, the Mewbourn 3 plant. I mentioned in my prepared remarks that we're doing anything and everything in our power to get this plant online faster and make sure that we can fill it up. I think this plant is going to fill up really quickly. And that's why we are also working on the O'Connor 2 plant for 2019 and trying to get that plant online as quickly as possible. The DJ Basin, it doesn't get that much attention compared to some of the other areas in this country. But you talked to the producers, it is one of the best-producing regions in this country, very low breakevens. Between ourselves and the producers, I think we have tremendous partnership on making sure that we continue to develop that area. And I'm very confident that we're filling up Mewbourn 3 tremendously quickly.

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

Great. Final question. When I looked at your midpoint of NGL guidance for 2017, you sort of gave us a sensitivity out. If I remember the time you were in the mid to high 50s, NGLs are over $0.70 now. At the time, you said $5 million per $0.01 change. Has that sensitivity changed, given, I think, you just said 70% hedge for next year? If I do my math correctly, depending on what number you use, it could be anywhere from $65 million to $80 million as a step-up in 2018 versus 2017. Does that sound right? Is that accurate? Has there been any changes in the sensitivity? Or is there a more of a sensitivity? I was wondering if you can talk about it a little bit, given the strength of NGLs.

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

What -- you're right. The midpoint was about $0.58, Shneur, and we're already 60 year-to-date, and to point, in the spot, we're a bit higher. In terms of sensitivities, we'll give you the '18 -- you're kind of -- '17 sensitivities, we think are still very reasonable to utilize that you're trying to model the rest of the year. I think we have $5 million on NGL. As you think about '18, as a positive, we are set, we gave you the 70% already for your hedged and with the constructed environment, I would hope to see that continue to climb. But we'll give you that guidance here when we roll out '18. I'll give you the sensitivity guidance there as well. I can tell you that, over time, our sensitivities around, really, all commodities but NGL in particular, has gone down. And that's partially because of the growth in our fee-based business and obviously, the more aggressive hedging program that we put into place. So I don't think your logic is out of place. I can't give you exact numbers for '18 yet. We'll roll that out here in a little bit it. But very good signs that we're 70% fee or hedged going into the year already. And obviously, we -- as we've mentioned, pretty constructive commodity environment going into '18.

Operator

Our next question is from the line of Jeremy Tonet of JPMorgan.

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

I wanted to pick up on the Mewbourn plant here. Just wondering, how much sooner could you possibly have it online? And when we get a clear picture on that, what are the gating items here?

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

Jeremy, it's Wouter. I'm not going to talk about how much sooner we can get it online. I mean, these are very complex machines. They're a couple of hundred million dollars. They're not easy, obviously, to build. But I can tell you that we are doing anything and everything in our power from adding additional manpower, trying to accelerate things, to get this plant on -- as quickly as we can. There's a couple of things that are outside of what we can control. And like we're going into a winter here in Colorado. If we're seeing a lot of snow, a lot of bad weather in Weld County, that, obviously, has an impact. If we see a little bit of a warmer winter here in Weld County, that means people can have less weather days, less snow days, and they continue to make progress. But I can tell you, we're talking to the producers here in the basin every day, and we're all very aligned on trying to get this plant up as quickly as possible.

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

That make sense. In the release, you talked about increased gas marketing settlements contributing to the quarter, I was wondering if you could provide -- if you could quantify that a bit and give us some insight as far as how marketing compared, kind of, quarter-over-quarter?

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

Yes. So quarter-over-quarter marketing was up, round numbers, about $20 million. I will point out, that didn't just come -- when we started our M&L business, and we remember that includes the pipeline, they were up a couple of million dollars quarter-over-quarter. That includes our storage business, gas and NGL storage, those were up for the quarter. Propane was also included in the segment. It was not huge number on an absolute basis. But in a -- from a Q3 to Q2 perspective, it was up a couple of million dollars. So you're thinking about that $20 million. You have drivers in our pipeline business. You have drivers in our storage business. I'll mention that costs were down. We had a very good laser focus on cost, getting the company back online. Some of that was reflected a couple of million dollars in our NGL business. Now we talked about the marketing business itself. It clearly had a very good quarter. It's not a huge portion of our overall M&L business. If you think about it, it makes up only about 5% to 10% depending on the year. But they had a phenomenal quarter. Some of the drivers were -- the movement in basis. This is a business that optimizes our product flow, and it was up, considerably. I think it was about $10 million. So about half of that increase you can attribute to that business. The other half you can attribute to the other things that I mentioned. But as you think about modeling our business long term, it is not a huge portion. Again, great quarter for the business, Q3 versus Q2, but not a big -- a driver long term. Our pipeline business is going to be much big driver.

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

And as you think about, Jeremy, about our trading business, it's probably the bookends in that business is $20 million, $25 million in a bad year, $50 million in an unbelievably good year, and normal year is probably sitting around $30 million or so. The trading business is obviously a bit opportunistic. And you note, as things in the market are available, that's when people are getting -- are going to be able to make their margin there. And here in the third quarter, I'll give you a good example about what the team was able to do. It's diverting in our marketing business. After Hurricane Harvey, obviously, Bellevue was not good, and prices were not there. And you couldn't direct your product to Bellevue. But we were able to put all of our project or a lot of our project into Conway where there were very, very strong prices and optimized, really, our business model.

And there's very few people in the country who have that capability and that connectivity and that integrated value chain that can do that. We are one of those, and that's why you saw a pretty nice offset out of this business where we made some significant dollars offsetting what we saw on the gathering and the processing side of the house.

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

That's helpful. So for modeling purposes, are there other things besides like the Conway, Bellevue spread that we could monitor to kind of determine how marketing makes money, or any other examples you can share there?

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

Yes. Yes, go ahead, Sean.

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

Yes, I mean, it's opportunistic. The other thing I think we mentioned in our written remarks or spoken remarks was that we were able to take some product into stores. This is related to the hurricane. Obviously, with some of the downstream bottlenecks, we were able to pull that product out of storage at -- and prices had moved up. So that's another indicator. I mean, obviously, you don't always see that. That was related to one specific incident. But that also benefited the marketing business.

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

I think the key takeaway point, Jeremy, is that the trading business, it's not a huge business, okay? I gave you the bookends of what does it look in a bad year and what does it look in a stellar year and kind of what look -- does it look like on a normalized basis, and the normalized basis is probably what you want to model. And like in the end, if you're talking about $30 million on a normalized basis, it is less than 5% of our overall DCF. So it's really not that material.

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

Got you. And Sean, I was just wondering if you could provide an update and where leverage stood on an agency business at the end of the quarter and kind of how you think about next year as far as trying to balance everything as far as 1 0 coverage, having some excess DCF there, but looking to bring down leverage a bit, over time, and getting good projects, great projects like GCX are nice, but just kind of balancing these different items as far as deleveraging and trying to minimize equity market needs in funding this CapEx?

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

Yes. So Jeremy, leverages -- you think about the list on our focus, it's at the top of the list for this company, obviously. And you mentioned, there's a lot of ways we're going to improve leverage. We have continued to improve leverage. The 4 3, I know that's a bank ratio. So the pure rating -- and obviously, there's multiple ways the 3 rating agencies calculate it. But we've made massive progress in our bank ratio. We have made very strong progress as well lowering that pure rating agency, if you will, ratings-type metric. Our goal is to get to 3 to 4x and to get below 5x on the rating agency metrics. We're approaching those levels on both sides of the equation. So we don't just focus on the bank. In terms of how we're going to get there, you mentioned one driver is, we've got a lot of, really, really accretive projects, and we talked about the first -- some of the Sand Hills stuff that's come online. That's a 2x EBITDA multiple. That's incredibly credit accretive. We talked about the 5 to 7x multiples on the expansion that are going to come online next year, some that are coming on line late this year. Those are incredibly credit accretive. So we're driving, obviously, the EBIT side of the equation. We have done a really -- we've lowered our debt levels by over $2 billion over the last few years with -- be it at the

$1.5 billion from Phillips and things of that nature. We continue to focus on that side of the question as well. So good progress. We've hit the lowest levels on our debt metrics in quite a while here in Q3. And our goal is to continue that trajectory and continue to push both the ratings metrics and the bank metrics down into '18 and throughout '18.

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

And Jeremy, maybe to add to that. We have multiple arrows in the quiver. And we've shown that, I think, over the last couple of years, and like we've done noncore asset sales close to $0.5 billion. And those were very small assets that we sold at mid-teens type of multiples, and then you take that money to invest in 2 to 3x Sand Hills expansions or 5 to 6 or 7x plans in the DJ Basin. Obviously, that equations works really, really well. And I think we have continued opportunities to optimize this portfolio. So I think we have a lot of different ways that we can go at this. The team has made unbelievable progress on delivering this company. And I can tell you, we'll continue to have the front and center. That is the #1 thing that we're focused on in the company.

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

Last thing, Jeremy, because this is so important to us, and it's something that Wouter and I are very proud for the quarter. If you really think about the results, and we saw a lot of hey, price had to help these guys a bunch. And yes, the price environment got more constructive in Q3. But when you really look at the improvements in our M&L business, you look at the improvements in our G&P business, the majority, 70% of the improvement in the G&P business was nonprice related. That's just -- us being laser focused on our cost. Us continuing to drive reliability and see growth in volumes. So those -- as I think about our leverage metrics, when you're not deploying any capital, and you're adding earnings and margin and DCF through just running our assets better and continuing to drive better efficiencies, that can be pretty powerful. And you saw that in Q3.

Operator

Your next question comes from the line of Michael Blum of Wells Fargo.

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

I just wanted to stay on the topic of returns. So on your Slide 8, when you talk about the 5 to 7x multiples on projects, so I understand the NGL expansions are far better multiples than that. But in terms of all the other projects on this page and just generally, is that, kind of, what you expect to earn on each of these discrete project? Or is that more of a blended number for the total portfolio?

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

No, I think that it is -- Michael, Wouter here, and like the pump expansions that we currently do. So the 2017 Sand Hills expansion, that is kind of a 2x multiple. But I wish we could do those all day. But those are -- unfortunately, other ones are a little bit higher than that. So I think that one is massively good project. It is out at about a 2x multiple. But you look at the 2018 Sand Hills expansion, that is somewhere in that 5 to 7x range. The plans are in the 5 to 7x range. So really, all of the projects that we're targeting throughout the portfolio are in that 5 to 7x range. Sand Hills 2017 expansion is significantly lower, because it's just pump stations, which is relevantly low capital, and you get very significant volume.

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

Would that also be true of the gas pipeline projects?

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

Yes, so those would be true of the gas pipeline projects, both the projects in the Permian Gulf Coast Express as well as the Cheyenne Connector that we have an option on in the DJ Basin.

James Spicer - *Wells Fargo & Company - Executive VP, Group Executive and Chief Information Officer of Wells Fargo Corporate Technology*

Okay. And then just one follow-up on to that. In terms of processing contracts and the returns, you mentioned that on your new processing plant you have some level of MVC or take-or-pay type contract. But I assume, these are basically acreage dedications. And I guess the question is, does the MVC get you that return? Or do you need a certain amount of volume up -- above and beyond that to hit those multiple numbers?

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

So on the new plant that we're talking about, Mewbourn 3 and O'Connor 2, yes, we do have life-of-lease acreage dedication. But on top of that, we have minimum volume commitments. And on top of that, we have minimum margin commitments. So there's multiple layers of protection for us to ensure that we're going to get our returns. Between the minimum margins, the minimum volumes that we have and the time periods that we have, we are very comfortable on getting the returns that we need to.

Operator

Our next question is from the line of Faisel Khan of Citigroup.

Faisel Hussain Khan - *Citigroup Inc, Research Division - MD*

It's Faisel from Citi. Just on the cost structure that you guys -- on the cost that you guys reported in the quarter you did talk about, I think, deferring some maintenance. Because I think in the previous call, you guys talked about, sort of, going through a decent maintenance cycle in 3Q. It looks like that got deferred because of the hurricane. So if you could just kind of -- just -- so I understand what's going on here. Is it -- is this the cost structure I could use going forward into the fourth quarter, or is there something else I need to take into account?

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

Yes. So Faisel, what we -- I think what we're thinking through is, Q1 was relatively light, we're talking about maintenance capital. Q2 is much stronger, and we thought -- between Q2 and Q3 is when we do a lot of our turnarounds, a lot of our engine overhauls and things of that nature, which affect maintenance capital. Harvey did delay that a little bit. It wasn't huge, but it was couple of million dollars, but Harvey did have some impact. That's why we felt we wanted to mention that we had to defer some stuff into Q4. But I would see Q4 similar to Q3 levels. Maybe slightly higher, but somewhere in that range, as we catch up and just get on a normal cycle. So I think we spent $20 million in Q3, $29 million in Q2.

Faisel Hussain Khan - *Citigroup Inc, Research Division - MD*

Okay, okay. Got it. It makes sense. And just -- going back to the capital being spend on the expansion on the processing plants, the $395 million and $350 million. I just want to make sure that I have it right. Is it right to say that half the plant is basically the processing and half the plant is the gathering facilities? Is that the right way to look at it?

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

Yes, that's a good rule of thumb. So yes, it's not that we're spending $395 million just to put a $200 million a day [cryo in]. We have very significant infrastructure that we're putting into the fields. Like extensions in the Grand Parkway systems, very large turbine systems in the field and things alike. So yes, about 50-50 is a good way of looking at it.

Faisel Hussain Khan - *Citigroup Inc, Research Division - MD*

Okay. And then just looking at the volumes coming in across the different regions for the quarter, but the well had volumes. So in the Permian, it looks like volumes have been sort of trending down since the -- for a year now. And so when -- at what point, does this volume sort of turn around? So I mean -- I know that North, you guys are growing because it's clear where the investment is going. And then Midcontinent, it looks like volumes have stabilized, and are you still seeing decline in the south? I guess, it was unclear if that's a function of the hurricane or not. So just trying to understand, where we see these volumes sort of hit bottom.

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

So to hit a couple of your direct. When we normalized, and I think that's part of the equation here, Faisel. When we normalized the Permian, the Permian did see, because of the downstream, some of the constraints around the hurricane we had to obviously limit some of the volumes out of the Permian in particular, and we did. It was temporary. It wasn't -- it didn't have huge impacts, but it did affect the volumes. So when we normalize for that, it was pretty flat overall to Q2. So not down. The Permian was relatively flat. And in the areas where we are -- where we have invested money, you see strong volumes. There are still some areas outside of the Delaware that are declining. But as a whole, we're relatively flat in the Permian and hopefully, we'll see that trend continue up, as we move into the next year. On the Eagle Ford, we said a few things around normalizing for Harvey, which Eagle Ford did get impacted quite a bit, obviously being right there. But we would have been up, actually, Q3 versus Q2. From the lows, if you think about the Eagle Ford as a whole, we're up over 100 a day. When you think about the low that we hit in that area versus where we're trending right now, we're over 100 a day higher. That's pretty impressive. We see that holding and continuing as we close out the year and move on. So a little bit of noise from the hurricane in Q3, but we actually like the trends we're seeing in the Permian and definitely, the Eagle Ford.

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

And Faisel, let me add to that, it's probably one of the very large volume driver is our NGL business. Unlike our marketing and logistics business, Sand Hills volumes are up significantly. And I want to make sure that I remind people, this is not a gathering and processing company only. This is a highly integrated, full value chain company that we have really transformed this company over the last couple of years. 40% of the margins and the earnings out of this company are coming out of that marketing and logistics business. So the volumes there are continue to be very strong and continue to grow significantly.

Faisel Hussain Khan - *Citigroup Inc, Research Division - MD*

Yes. Sure, I definitely understand. I'm just trying to understand if the trend is, sort of -- where we're seeing the trends in these volumes. It sounds like the trend is up. So that's all I'm trying to get at.

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

Yes. No. Yes, and I think that's a good way of saying it. I think trend is up. And there is very strong operating leverage in this portfolio, and that's a good thing.

Operator

(Operator Instructions) Our next question is from the line of Chris Sighinolfi of Jefferies.

Christopher Paul Sighinolfi - *Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships*

And thanks to Irene and Andrea for the slide presentation. It's always really helpful, particularly the segment walks. I guess, if I could begin with those. I was hoping to refine my understanding of the G&P segment disclosure on Page 5 or Slide 5. You quantified, Sean, $21 million of benefit from 2Q due to margin and volume benefits. If I look at the volume numbers you put on Slide 11, they look like they're basically flat quarter-on-quarter. So I'm assuming most of this is driven by the composition of those volumes in the higher margin areas? Is that a right interpretation? Or did you also have an advancement in the fee portion? I know that's been a focus in the past quarters, raising the fee up.

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

Let me give you a couple. Because there's a number of components here. And I want to take you back to what we have been trying to work on around our DCP 2020 strategy from multiple years. It was about recontracting. So you're seeing that benefit in here. It was about some volumes, you're seeing that benefit in here. Obviously, it was about continuing to reduce our costs for the company. So you're seeing that benefit in here. You're talking about reliability. There's a lot of questions about maintenance CapEx over the last couple of years. So guys, you guys have gotten a lot lower on maintenance CapEx. Well, it was deliberate. Why? Because we're trying to kind of be much smarter about where we do our maintenance, how we do our maintenance? [And whether as a result at the end], which, I think, is a great think over the last couple of years of significantly reduce our overall maintenance spending, but our reliability is actually up, very significantly. So that's kind of, you get a 2x benefit, because you don't spend the money and you're getting better reliability, better recoveries and that fall straight to the bottom line. So that's all about the operating leverage that we've been talking about quite a lot and you really saw it come here into the third quarter.

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

And Chris, maybe just to give you a little color, we talked about regions that drove that increase on that slide on the volumes and margin. But a lot of that -- the north clearly, so you talked about higher price, that was an element of it, we saw volume increases in a very high -- a solid margin area. But we also mentioned the Midcontinent, in to Wouter's point, all those things Wouter just mentioned around better efficiencies, better reliability, better recoveries, which are not pure volume issues, there -- the more dollar per Mcf issues. That was a lot of benefit we saw from a lot of things that we were working on in areas like the Midcontinent. And then of course, you had the South, with just improving volumes in the Eagle Ford that were driving that as well.

Christopher Paul Sighinolfi - *Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships*

Okay, that's very helpful. I guess, maybe a sub-question to that. Wouter, you had mentioned the presence of minimum margin, minimum volume protections in your earlier dialogue with Mike Blum. I'm just wondering, if there was any influence of those mechanisms on the margin we see in G&P in the quarter tax. I guess what I'm trying to figure out is, if I see volume growth here, are there sort of ceilings that need to be [pierced on any of those before we see incremental margin generator]?

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

No, Chris. And like -- and those minimum margins and minimum volumes really come to bear on the next 400 million of capacity that we're putting in place with Mewbourn 3 and O'Connor 2. So those are downside protections on those projects, but the upside is wide open.

Christopher Paul Sighinolfi - *Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships*

Okay. Okay. Switching gears, if I -- just 2 more questions, if I could. They're both related to the hedging disclosure. I saw -- I guess, first, I saw that the estimate of percentage hedged by products was removed from prior presentations. I'm just wondering, if that's something you're willing to provide, or if it's in the Q, I can hunt for it there. Just trying to calibrate to -- from the aggregate percentage number you leverage on down to component product.

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

Yes. So Chris, we took them off. But the numbers, I think we gave them in Q2. Those numbers didn't change that much for '17, and we'll be back with you on '18. I think what we want to do, obviously, as you can tell, we're putting -- we put the 70% number out there for '18. We continue -- the environment is pretty strong. So we didn't want to get a preliminary number out yet for '18 until we give our guidance a year later. So '17 numbers, we did take them off, but you can use the numbers from Q2. They're materially right in line, and then more to come on those hedging percentages in '18 as we roll out guidance.

Christopher Paul Sighinolfi - *Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships*

Okay. And I guess one follow-up question, Sean, the 2018 hedge stepped up, looks like about 5,000 barrels a day, pricing came down just $0.01. So like -- so wondering, is that mostly ethane hedges you put there? Or was it earlier in the quarter? Was it [steep in Contango] into next year? Any help in just seeing what was added there would be helpful.

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

What we predominantly have been able to add in '18 is actually -- and around that slide has been that butane and propane, and a little bit of crude. Crude, the NGL curves are unfortunately still quite a bit backward dated. I'd love to be able to get the prices. Next year, that we're seeing in the spots. Gas is backward dated. Crude is relatively -- we're seeing some benefits in crude. It was relatively flat maybe and given us some opportunities as that has moved up. But it's really -- ethane, we haven't really seen that much. It's quite a bit Contango, Chris, and we haven't seen a lot of opportunities to get a lot of ethane on. That's something we'll look real hard at the rest of the year. And obviously continuing to put on additional butane and propane.

Operator

And our next question is from the line of Selman Akyol of Stifel.

Selman Akyol - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Two quick ones. In terms of the Cheyenne Connector and your option there, can you talk about when you will decide and how long you have, et cetera?

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

Yes. Selman, on Cheyenne Connector, basically, what we need to do is we need to go through FERC approval. That's probably going to take 12-plus months. And basically, our option to decide, if we want to be an equity owner in the project is kind of commensurate when we get the FERC approval. So we got time for that.

Selman Akyol - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Got you. And can you just remind us in terms of just ethane recovery scenario. How much that could impact you?

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

So with ethane, I think we've given previously, and I'll point out that we don't have any baked in, obviously, to our forecast. But we have, in the past, Selman, talked about $75 million to $100 million of uplift. That includes, obviously, a big uplift on transporting the barrels on things like Sand Hills and Southern Hills and so forth. We still have ethane uplift. You're still -- you're seeing slight movements, meaning decreasing a little more less rejection, that's in our numbers. It's not substantial at this point. So we're getting those barrels today. I think on a positive side, that analysis and those discussions happened very early in the year. We've been able to through a lot of the growth projects that we've had outside of rejection, increased the volumes on Sand and Southern Hills, obviously just via growth. I think if I had to put a number out there for next year or for going forward on what the potential upside, I think we've been using around $40 million. And that's not because it's diminished, that's because we're getting more, we're filling up our pipelines via other methods. So there's still definitely upside. Wouter always talked about the Concentrix circles. We think our pipelines and our assets are much closer to the market standards that gives us a big advantage if and when we go back into recovery. But we've been able to maximize some of that value just through volume growth in areas like the Permian. So if I had to give a number, I'd say somewhere in that $40 million range, based on what we know today. That -- the additional value that we gave could still be there, but it would require us to invest some capital to expand Sand and Southern Hills more.

Operator

And that does conclude our Q&A session for today. I'd like to turn the conference back over to Wouter van Kempen for closing remarks.

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

Thank you, Amanda. And first, I want to thank every employee at DCP Midstream for really, really great quarter. Great performance, safe performances. Thanks for that. For everyone on the phone today, I want to thank you for joining us. If you have any follow-up question, obviously, between myself, Sean, Irene and Andrea, are available for any discussions. So have a terrific day. Thanks.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program. You may now disconnect. Everyone, have a great day.