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DPM - Q1 2014 DCP Midstream Partners, LP Earnings Conference Call

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PRESENTATION

Operator

Welcome to the DCP Midstream Partners first quarter 2014 earnings call. My name is Lorraine and I'll be your operator for today's call.

(Operator Instructions)

Please note that this conference is being recorded. I will now turn the call over to Ms. Andrea Attel. Ms. Attel, you may begin.

Andrea Attel - *DCP Midstream Partners, LP - IR*

Thank you, Lorraine. Good morning, everyone, and welcome to the DCP Midstream Partners, or DPM's, first-quarter 2014 earnings call. Our speakers today are Wouter van Kempen, Chairman and CEO of both DCP Midstream and the Partnership; Bill Waldheim, President; and Sean O'Brien, CFO of both DCP Midstream and the Partnership. As always we'd like to thank you for your interest in our Company.

This call is being webcast and the slides used for today's call are available on our website at DCPpartners.com. During our call today we'll be making forward-looking statements. Please review the second slide in the deck noting that our business is subject to a variety of risks and uncertainties that could materially impact our actual results.

For a complete listing of these and other risk factors, please refer to the Partnership's most recently filed 10-K and 10-Q. We will also be using various non-GAAP measures which are reconciled to the nearest GAAP measure in the section -- in the appendix section of the earnings slide. With that I'll turn the call out over to Wouter.

Wouter van Kempen - *DCP Midstream Partners, LP - CEO*

Thanks, Andrea, and good morning, everyone.

I'm really excited to begin today by teeing up the highlights of the first quarter and to showcase how we're executing on our strategy. This was a quarter of strong results, driven primarily by our Gas Services segment, and in particular our Eagle Ford system.

First, the results. Adjusted EBITDA is up 38% to $138 million. DCF is up 58% to $122 million. And for those of you who are keeping count, this is our 14th consecutive quarterly distribution increase, now standing at $2.98 per unit annualized, and that's our focus: long-term sustainable growth.

The year has begun strong for us, and it's all about executing on our successful growth for growth strategy. At the end of March, we closed on the largest dropdown in the Partnership's history, a $1.15 billion immediately accretive dropdown. This transaction included the one-third interest in Sand Hills and Southern Hills, the remaining 20% of our of Eagle Ford business, and the Lucerne 1 plant in the DJ Basin.

All together, this expands the scope of our fee-based business, and further diversifies DPM's footprint into the rapidly expanding Permian Basin and the Granite Wash and SCOOP areas of the Midcontinent. We also began construction on Lucerne 2, a 200 million-a-day (sic - see press release, "200 MMcf/d") plant in the prolific DJ Basin, and we expect this plant will come online next year.

And to support funding this growth, we were successful on the capital Markets, executing on the largest debt and equity transactions in DPM's history. Additionally, the first quarter saw a lot of organic growth projects placed into service -- our Goliad plant, the 50 million-a-day (sic - see press release, "50 MMcf/d") O'Connor expansion, and the Front Range Pipeline. And these organic projects provide great returns to the Partnership, in the 5 times to 7 times multiple range. And they support our goal of providing long-term sustainable value to our unitholders.

And, finally, I'd like to call your eye to the bottom section of the slide, where you can really see the contribution of the organic growth in our Gas Services segment and highlighting our strong focus on capital efficiency. Not only are we very effective in bringing incremental capacity online, we are filling our plants up faster than we originally planned. Of over 500 million a day of new capacity placed into service in the past year, approximately 70% to 80% is already utilized, and that is a perfect example of capital efficiency.

And why is that? First, you need to be in the right location, and we are in the prime areas of the DJ and the Eagle Ford. Secondly, our integrated system strategy gives us the opportunity to run gas through our different plants. And, lastly, we have long-term contracts with large and dependable producers who have significant acreage at that location.

So, overall, the strategy is clearly paying off as you can see from our results in the Eagle Ford, where volumes are up 22% year over year. So, in summary, our growth-for-growth strategy continues to serve us very well, doubling our size over the past few years, and we're looking to double it again in the next couple of years.

Those are the headlines I wanted to call out for you. Now, Bill is going to talk specifically about each of our business segments and project development. Bill?

Bill Waldheim - *DCP Midstream Partners, LP - President*

Thanks, Wouter, and thanks everyone for listening in today.

On slide 4, let me provide you a brief update on how we are executing on our 2014 guidance that was provided during our last earnings call. First, as Wouter mentioned, we completed the previously announced $1.15 billion dropdown in the first quarter, which puts us well on our way to achieving our 2014 drop-down forecast. Also during the first quarter, our Goliad plant, our O'Connor plant expansion, and the Front Range Pipelines were all placed into service.

So, if you add these to our Keathley Canyon project, the Lucerne 2 plant, and other organic bolt-on projects coming online this year and next, we are on track to meet our 2014 organic growth forecast of about $500 million. Our first-quarter DCF of $122 million is in line with our 2014 DCF target range of $400 million to $420 million.

And, with our first-quarter distribution increase, we are also on track to reach our 2014 distribution growth target of 7%. As in past years, we have good line of sight into delivering on our plan, so we are confident we'll continue to achieve our goal, providing sustainable distribution growth and long-term value to our unitholders.

Starting on slide 5, I'll provide a brief operational update of our three business segments. Starting with our largest segment, Natural Gas services, you can see we got off to an exceptional start in 2014. In Q1, this segment comprised about 80% of DPM's adjusted segment EBITDA.

It is important to note that about half of this business segment's earnings are fee-based. Again, in the past year, we placed three plants into service, two of these within the past six months, and they are currently averaging between 70% and 80% capacity utilization, which underscores our disciplined focus on capital efficiency.

Let me touch on some important facts regarding the Eagle Ford system. This is a terrific shale play where we continue to build out our infrastructure. As the first mover, we are one of the largest gatherers and processors in the Eagle Ford, and our strong project execution is paying dividends.

We now own 100% of the Eagle Ford system, and it is the primary driver of our strong results and growth in this business segment. This system continues to grow, with volumes steadily climbing, up 22% over the first quarter of last year, now at about 85% of the 1.2 Bcf of processing capacity.

Our 200 million a day (sic - see slide 5, "200 MMcf/d") Goliad plant, which we just placed into service in February, is already running over 130 million a day and climbing. The Eagle Ford is a prime example of how we've leveraged the dropdown, added an organic project with line of sight growth, and are achieving our targeted dropdown multiples of 7 times to 9 times.

Turning to the DJ Basin, we are also experiencing growth from our recently expanded O'Connor plant. The O'Connor plant came into service in the fourth quarter, filled up quickly, and, in fact, ran above 110 million a day plant capacity during the first quarter. And, and having added a 50 million-a-day (sic - see slide 5, "50 MMcf/d") plant expansion startup in March, the now 160 million-a-day (sic - see slide 5, "160 MMcf/d") plant is running at approximately 80% of capacity.

The DJ Basin is an exceptional growth area, with Lucerne 1 operating and in our portfolio, and Lucerne 2 under construction, we continue to see growth, volume growth, and infrastructure needs as the [MP] companies deploy large amounts of capital into drilling programs in this prolific area. And don't forget our 14 Bcf Spindletop gas-storage facility made a strong contribution to Gas Services segment in the first quarter as well. Sean will touch on that in a minute. So, things are going very well in our Gas Services business unit.

Turning to NGL Logistics, on slide 6, during the first quarter we completed the long weighted drop-downs of the one-third interest in the Sand and Southern Hills pipelines. And Front Range Pipeline was also placed into service, with the associated ship-or-pay contracts now active. As we look ahead, NGL Logistics segment will continue to have significant volume in fee-based earnings growth, as we continue to ramp up our NGL pipelines and we execute on the many bolt-on opportunities to connect additional volumes.

We are more than encouraged by our volume ramp on both Sand and Southern Hills. In fact, our throughput for the combined pipelines is about 200,000 barrels per day, or another way to look at it, we are 85% of the way to our 2014 forecasted exit rate of 230,000 barrels per day for both pipes.

And, lastly, business development across both pipelines continues. We've identified over $200 million on a 100% basis of opportunities to connect DCP Midstream and other third-party plants. So, needless to say, we're excited about the future earnings potential of both Sand and Southern Hills.

In our Wholesale Propane segment, on slide 7, the heating season for this segment exceeded our expectations in the base business but was challenged in several respects. We hit our first-quarter budget but couldn't top the strong Q1 2013 results we posted last year, which was an exceptional year for our Wholesale Propane business.

Sean will go into greater detail on the results, but the bottom line is the strong margins in last year's heating season were driven by favorable inventory values and hedges, which drove up unit margins, and the opportunistic exporting of propane at very favorable prices from our Chesapeake facility. To the extent we supplied our customers spot volumes this winter heating season, the margins were significantly lower than our base-business contracts.

And, finally, we continue to work to finalize an agreement with a third party to begin exporting at our Chesapeake terminal. We expect to have a signed document soon and to be exporting butane in 2014. And with that, I'll turn it over to Sean to review our financial results.

Sean O'Brien - *DCP Midstream Partners, LP - CFO*

Thanks, Bill, and thanks to everyone for joining us today.

I want to start off by saying that I'm very excited to discuss the strong performance that we delivered in the first quarter of 2014, driven primarily by our Natural Gas Services segment. We came into 2014 with strong momentum, and we continue to see great growth from dropdowns in organic projects placed into the service. As a quick reminder for GAAP accounting purposes, our prior-year results are presented as if we owned an additional

47% interest in the Eagle Ford during Q1 of 2013, even though we only owned 33% of the Eagle Ford system and 100% of the Lucerne 1 plant during the first quarter of 2013 and 2014, even though it was just acquired.

I'll be referring to the quarter-over-quarter variances for the assets actually owned by the Partnership, as shown in the shaded box on this and the next slide. So, we generated $122 million of DCF in the first quarter of 2014, up 58%. And our first-quarter adjusted EBITDA was up an impressive $48 million, to $138 million.

These strong results were driven largely by growth from the Eagle Ford and O'Connor plant dropdowns and included a one-time favorable producer settlement of about $11 million related to a prior-period measurement adjusted. Adjusting for this item, first-quarter results were in line with our 2014 DCF target range of $400 million to $420 million.

Maintenance CapEx during the first quarter was about $6 million. Timing of maintenance CapEx is not linear throughout the year, and we continue to forecast between $35 million and $45 million of maintenance CapEx in 2014.

Generally, we time our maintenance capital projects with turnarounds during the middle of the year to minimize down times. In the second quarter, we have three plant turnarounds planned.

Lastly, our cash distribution coverage for the quarter was 1.4 times and 1.1 times for the trailing 12 months. Keep in mind, our first and fourth quarters are typically our strongest quarters, due to seasonality in our gas storage and Wholesale Propane business.

Now, on slide 9, I'll highlight the key earnings drivers from each of our business segments. In our largest business segment, Natural Gas Services, adjusted EBITDA increased $67 million. Results in this segment were driven primarily by our Eagle Ford dropdown, as well as the operation of our fee-based O'Connor plant that started up at the end of October 2013.

Our natural gas throughput volumes were up 2% compared to the first quarter of last year, with volumes up over 20% from our Eagle Ford system and new incremental volumes from our O'Connor plant, partially offset by declines on lower-margin assets. So, I'll underline that not all natural gas volumes are created equal, as shown by the 18% increase in NGL production volumes, liquids-rich higher margins gas is growing, while some of our lower-margin dry gas is declining.

Volumes and improved recoveries from plants in our liquids-rich areas, such as the Eagle Ford and DJ Basin, are driving higher natural gas throughput and NGL production volumes from what we saw a just a year ago. And, as a quick reminder, our hedging program continues to provide earnings stability with very little exposure to commodity prices for this segment.

Now, looking at the lower left graph of this slide, our NGL Logistics segment adjusted EBITDA was $17 million, down about $6 million compared to the prior year. Overall, Marysville storage contracting remains solid, yet physical volume fill is down slightly due to the strong demand this winter, resulting in lower throughput volumes and related fees.

Results at our Mont Belvieu fracs were also affected by lower volumes as a result of maintenance and unfavorable location pricing. However, overall volumes in this segment are up, with the start-up of our Texas Express and Front Range Pipelines, with the associated ship-or-pay contracts in effect. Looking forward, we expect to see strong growth in this segment, with the completed dropdown of Sand and Southern Hills Pipelines. And with Front Range and Texas Express Pipelines just placed into service, we expect volumes and fees to grow.

And, finally, in the lower right-hand graph, we show our Wholesale Propane segment. Wholesale Propane adjusted segment EBITDA of $13 million was lower than last year by $9 million and included a $3-million unfavorable, lower of cost or market adjustment during the quarter. Keep in mind that this segment contributes less than 10% of DPM's total adjusted segment EBITDA.

This winter was strong, yet challenging, as we expected our base-contracted volumes to be lower than last year and anticipated fewer imports of higher-priced foreign propane. So you can see, results for the quarter were lower than prior year due to lower unit margins, the LCM, and lower volumes. This was partially offset by a prior-year project write off. As a reminder, our Wholesale Propane business is seasonal, with most of the earnings generated in the first and fourth quarters.

Moving on to slide 10, we've shown this slide before. It really hasn't changed, so I'll hit the highlights quickly. These exposures and sensitivities are inclusive of our completed dropdown. I would emphasize, we manage our commodity sensitivities on a portfolio basis, with a multi-year hedging program with 95% of our margins either fee based or hedged. So, we have very limited exposure to commodity prices in 2014.

Slide 11 shows our financial position at the end of the quarter. We continue to maintain a strong capital structure and a competitive cost of capital. In the first quarter, we demonstrated strong access to the capital markets, with the execution of the largest debt and equity transactions in the Partnership's history.

Our average cost of debt was about 4%, and we had approximately $980 million of capacity available under our $1-billion revolver at the end of the quarter. We continue to maintain strong liquidity. In fact, we just upsized and extended our credit facility from $1 billion, to $1.25 billion, and extended our maturity to May 2019.

Our debt to EBITDA at the end of the quarter was 3.6 times, well within our target range of 3 times to 4 times, and our coverage ratio for the quarter was 1.4 times and 1.1 times for the trailing 12 months. So, with strong investment grade credit metrics, we are well positioned to service a significant source of funding for growth capital for the DCP enterprise. And, with that, I'll turn it back to Wouter for some summary remarks.

Wouter van Kempen - *DCP Midstream Partners, LP - CEO*

Thanks, Sean. I'll close out by reiterating the highlights of this quarter.

We are delivering on our promises, and we're successfully executing on our growth for growth strategy. We checked a lot of boxes in this first quarter. We placed into service our Goliad plant, our 50 million-a-day (sic - see press release, "50 MMcf/d") O'Connor plant expansion and the Front Range Pipeline.

We completed $1.15 billion of dropdown. We're also on track to deploy $500 million of high-return organic growth projects. And with strong first quarter DCF and adjusted EBITDA, we expect to be within our 2014 DCF target range. And, finally, we are successfully executing on our strategy and delivering strong results. And we will continue to be disciplined in our approach, with a focus on capital efficiency and effectively bringing incremental capacity online, as is needed. So, we are very confident that we'll continue to deliver on our promises and providing sustainable, long-term value to our investors.

And I'll leave you with a commercial for DPM's 2014 Investor Day. We're on the way in planning it for October 7 in New York, so we hope you'll pencil in that morning to join us.

So, again I'd like to thank you for your interest in the Partnership. Bill, Sean, and I are now available to take your questions. And, with that, Lorraine, please open the line for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Bill Waldheim - *DCP Midstream Partners, LP - President*

Okay, well, I want to thank everybody for their interest in the Partnership. And if there are any further questions, you can contact Andrea or Sean or myself at a later time. So, thank you very much.

Operator

Thank you. And thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.
