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DPM - Q3 2013 DCP Midstream Partners, LP Earnings Conference Call

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PRESENTATION

Operator

Welcome to the DCP Midstream Partners third-quarter 2013 earnings call. My name is Christine and I will be the operator for today's call.

(Operator Instructions)

Please note that this conference is being recorded. I would now like to turn the call over to Ms. Andrea Attel. You may begin.

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

Good morning, everyone, and welcome to the DCP Midstream Partners third-quarter 2013 earnings call. As always, we want to thank you for your interest in DPM. This call is being webcast and the slide views for today's call are available on our website at DCPpartners.com.

Before I turn it over to Bill, I want to remind you that, in the course of our discussion today and in the subsequent Q&A session, we may be making forward-looking statements. Please review the second slide in the presentation regarding forward-looking statements, noting that our business is subject to a variety of risks and uncertainties that may affect our actual results.

For a complete listing of these and other risk factors that may impact our business results, please review the Partnership's most recently filed 10-K and 10-Q. Also, during our discussion, we will use various non-GAAP measures which are reconciled to the nearest GAAP measure and scheduled to the Appendix section of the earnings slide.

With that, I'll turn the call over to DPM's President, Bill Waldheim.

Bill Waldheim - *DCP Midstream Partners LP - President*

Thanks, Andrea. Good morning, everyone, and thanks for joining us today for a discussion of our third-quarter results. I'm also here with Rose Robeson, our CFO.

As you saw on our press release last night, we had a great third quarter. DPM reported strong third-quarter earnings where we achieved solid DCF of $72 million, double our distributable cash flow from third quarter of last year. We also delivered our 12th consecutive distribution increase, which now stands at $2.88 per share annually.

Our third quarter was very active. We closed on the drop-downs of the O'Connor plant, which was formerly known as LaSalle, and a one-third interest in the Front Range Pipeline. We successfully accessed the equity capital markets. And with the O'Connor plant now in service, volumes are ramping up nicely. In fact, recently we've been running at about 100 million a day, or 90% of capacity.

As we bring new compression on, we believe the O'Connor plant will be full by year end. And expansion is underway to reach 160 million a day early next year. We are also pleased with the performance of our Eagle Ford system, which continues to ramp up and perform according to plan. These impressive quarterly results are underpinned by the Partnership's fee-based earnings and attractive hedge-book positions.

So here's a recap of our year so far. We've exceeded our $1 billion of drop-downs and are well on our way to deploying over $1.5 billion of capital via drop-downs and organic growth. We feel very confident that our distributable cash flow forecast -- about our distributable cash flow forecast. And assuming our assets continue to run well, we expect DCF to be at or above the high end of the $260 million to $280 million range for the full year.

We have significantly increased the scale and scope of DPM by expanding both our gathering and processing, and downstream logistics businesses. And as we continue on this high-growth trajectory, DPM as a standalone is well on its way to becoming one of the largest GMP and NGL producing MLPs.

Slide 4 shows our historical capital spend over the past couple of years and our 2014 capital forecast. This is the second year in a row that we have exceeded $1 billion of targeted drop-downs. As you look back, you can clearly see that the growth in drop-downs have continued and we are delivering on our plan, as promised. We achieved our distribution growth target in 2013 and believe sustainable distribution growth will continue, looking forward.

As mentioned in my opening, we expect to achieve $1.5 billion of growth in 2013. I'll talk more about the progress of our organic projects in just a minute. Keep in mind, DPM continues to be the funding vehicle for the capital needs of the DCP enterprise.

So, looking forward, our targeted $1 billion of drop-downs in 2014 may be conservative. Additionally, subject to the approvals of both the DCP Midstream and DPM Boards, 2014 would include the expected drop-downs of DCP Midstream's one-third interest in the Southern Hills and Sand Hills pipelines.

Now, starting on slide 5, I'll provide a brief operational update on our three business segments, all of which performed well this quarter. Our Natural Gas Services segment continues to experience substantial growth, with the completion of the Eagle Ford and O'Connor drop-downs. These assets will continue to be a major source of growth in the coming years.

In October, the O'Connor plant, serving the rapidly expanding DJ Basin, went into service. We recently renamed this plant in honor of Tom O'Connor, DPM's Chairman and former CEO. It was Tom's leadership that prevailed not only -- propelled not only DPM, but the DCP enterprise into expanding both the Gas Services and Logistics businesses.

We must have the luck of the Irish, as the 110-million-a-day O'Connor plant had a smooth startup, continues to steadily ramp up, and has had several days at over 100 million a day of gas throughput. While system balancing still needs to occur, it looks like we'll be ready for the incremental 50-million-a-day expansion in Q1 of 2014. The DJ Basin is an exceptional growth area where we see volume growth and infrastructure needs as EMP capital spending continues to increase in this prolific area.

Now turning to the Eagle Ford, our 200-million-a-day Eagle plant is currently running at about 85% full, so we are pleased with the ongoing volume ramp-up to date. And our goal at that plant continues to progress on time and on budget, scheduled to meet the expected in-service date in early Q1 of 2014. This capacity will certainly be needed as we just saw a 4.5% quarter-over-quarter increase in our overall volumes in this area.

Finally, the Keathley Canyon pipeline project at our Discovery joint venture has now begun laying the shallow water portion of the pipeline. Williams, the operator, is now targeting an in-service date of Q4 of 2014.

As you see on slide 6, our NGL Logistics segment continues to maintain a high growth rate. As we announced last week, the Texas Express Pipeline, operated by Enterprise and owned 10% by DPM, has been placed into service. This means the take-or-pay agreements associated with this pipeline are now active, with revenues commencing in November of 2013.

This 580-mile pipeline is supported by long-term contracts and has an initial capacity of approximately 280,000 barrels per day, and readily expandable to approximately 400,000 barrels per day. NGL volumes from the DJ Basin will be transported to Texas Express mainline via the Front Range Pipeline. This asset was dropped down in August of this year, so now DPM has ownership interest in both these pipelines.

So when we talk about Front Range Pipeline, with the announcement of additional DJ plants not anticipated when this project was originally approved, we believe there are significant upside opportunities. The operator now expects Front Range Pipeline to be in service in the first quarter of 2014. This pipeline is a great long-term asset that is predominantly fee-based and is anchored by ship-or-pay commitments from DCP Midstream and Anadarko.

Turning to our storage asset, our Marysville ethane storage expansion is nearing completion and is expected to be in service in the fourth quarter. As demand for storage in the northeast region continues to grow, engineering and commercial work is underway for additional Marysville storage expansions. Looking forward, we expect our NGL Logistics segment to continue to have significant growth in 2014, with the targeted drop-downs of the one-third interest in both Southern and Sand Hills pipelines.

On slide 7, in our Wholesale Propane segment, we are experiencing a better-than-usual start to the winter heating season, with recent propane demand being fairly robust. Additionally, Phase I of our Chesapeake export project to de-bottleneck distribution into and out of the facility is progressing nicely and is expected to be completed in the first quarter.

This is the first of a two-phase project where Phase II will allow us to export either propane or butane from this facility. We are pleased with our progress to date and would expect to be able to export in 2014.

With that, let me turn it over to Rose to review our financial results.

Rose Robeson - *DCP Midstream Partners LP - SVP, CFO*

Thanks, Bill, and thanks, everyone, for joining us this morning. As Bill summarized earlier, we had a very strong third quarter. First, our third-quarter adjusted EBITDA was up approximately $41 million versus third quarter of last year. These results reflect growth from drop-downs as well as continued solid performance in our base business.

Second, we generated DCF of $72 million in the third quarter of 2013, more than double the third quarter of 2012. And lastly, our cash distribution coverage for the quarter was approximately 1 times, and for the trailing 12 months was 1.1 times. So, we are very pleased with these results and we continue to deliver on our forecast.

And as a reminder, as I walk through our results this morning, I'll discuss 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, even though, for GAAP accounting purposes, our prior-year results are shown as if we owned the 80% interest in Eagle Ford during the third quarter of 2012.

Let me start with the Natural Gas Services segment on the next slide. Our adjusted EBITDA in this segment increased $39 million compared to the prior year. These results reflect growth from the Eagle Ford drop-down as well as the operation of our Eagle plant that started up in March of this year.

We also had favorable operating expense in our base business. So, overall you can see our throughput volume decreased about 3%; however, our NGL production increased 12%. And these volumes do include the 80% interest in Eagle Ford.

We are seeing very strong volume growth in Eagle Ford, as you would expect. We are also seeing a nice ramp-up in NGL production in Eagle Ford and other assets due to higher volumes and improving recoveries from what we saw a year ago. These improvements are offsetting some volume declines in certain of our lower margin areas. And lastly, our hedging program continues to provide earnings stability with very low exposure to commodities prices for this segment.

Turning to our NGL Logistics segment, DPM's third-quarter adjusted EBITDA was up $5 million, a 31% increase from last year. This increase was primarily due to higher volumes and margins at the Mont Belvieu fractionators. We also saw about a 20% increase on pipeline throughput volumes, due primarily to increased volumes on [Wilburys] with the start up of Sand Hills Pipelines.

Slide 11 shows the results of our Wholesale Propane segment. Our adjusted EBITDA was about breakeven for the quarter, reflecting our normal seasonality. Propane sales volumes were up over 10% compared to last year, reflecting the industry's excess inventory build up in 2012. So, on the next slide, let me recap our sensitivities and our DCF targets.

So, as a reminder, about 95% of our margin is fee-based or hedged and, as shown on this slide, for 2013, we are neutral to changes in natural gas and crude prices and our sensitivity to the NGL-to-crude relationship is about a $1-million impact for a 1% change. So, we have very limited exposure to commodity prices in 2013.

Our third-quarter DCF of $72 million is ahead of plan, but does reflect some discretionary maintenance capital carrying into 2014. Our current maintenance capital run rate is about $20 million to $25 million in 2013, lower than our original forecast of $30 million to $35 million.

And as Bill mentioned earlier, in terms of our full-year forecast, with the start up of the O'Connor plan in October, we expect to be at or above the high end of our DCF forecast range of $260 million to $280 million. And lastly, we achieved 6% distribution growth on a cash-paid basis in 2013.

Slide 13 outlines our financial position at the end of the quarter. We continued to maintain a strong capital structure and a competitive cost to capital. Our average cost of debt was 3.6% and we had approximately $790 million available under our revolver at the end of the quarter. We completed a $450-million equity offering in August, so our balance sheet is in great shape.

Our debt to EBITDA at the end of the quarter was 3.6 times after adjusting for acquisition and project credits. This is around the midpoint of our target range of 3 to 4 times. We also recently launched a commercial paper program for DPM which should lower our short-term borrowing costs. So, we continue to be well positioned to serve as a significant source of funding for growth capital for the DCP enterprise.

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

Bill Waldheim - *DCP Midstream Partners LP - President*

Thanks, Rose. I would like to close this morning by leaving you with the following. We had a great third quarter and are looking forward to a strong finish in 2013.

We have doubled our third-quarter DCF, and our unit holders have enjoyed 12 consecutive quarterly distribution increases, now at $2.88 annually. We are very excited about our Eagle Ford system; and it is performing well and is a large contributor to our strong third-quarter results.

So, as the O'Connor plant ramps up faster than expected, and the Front Range Pipeline comes online in the first quarter of next year, we are looking forward to sustainable distribution growth and continued value creation for our unit holders. So, again, thank you for your interest in DPM. And I'll turn it back to Christine, our operator, for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Gabe Moreen from Bank of America Merrill Lynch. Please go ahead.

Gabe Moreen - *BofA Merrill Lynch - Analyst*

Good morning, everyone. Couple part question on the Chesapeake terminal. Just wondering if -- what Cap Ex in that $200 million guidance for next year, what Cap Ex is baked in from Chesapeake in that $200 million number for 2014? And also, what you're status is in terms of contracting, potentially, Phase II and then would you need additional permits that you think you'd need for Phase II?

Bill Waldheim - *DCP Midstream Partners LP - President*

Yes. The Chesapeake project's been ongoing for a while now. And we've been working, as I said, on phasing it in with Phase I being really the transportation into and out of the facility. The overall project is, probably, in total, maybe, a $25 million to $35 million type project. But, Phase II, as we get through with that a lot of the engineering has been done and, really, we're just, hopefully, flanging up some of the commercial aspects of the business arrangement so we can be ready to export in 2014. We are primarily looking to be more of a service provider and really working on a fee-based arrangement for those services. So, overall, the project's moving well and we hope to be exporting next year.

Gabe Moreen - *BofA Merrill Lynch - Analyst*

Is there going to be an official open season for that, Bill? And is that also something that your parent company would help, potentially, base load with export volumes, or is it just that their NGL barrels are too far away from that project to actually help out there?

Bill Waldheim - *DCP Midstream Partners LP - President*

Yes. I think, right now, we're primarily working with the producers out of the [Utica], Marcellus area, because that's the logical sourcing of product for the facility. So, again, I think not necessarily an open season. I think we're working directly with several customers to be our customers at this facility. So, again, we believe things are moving well on the front of negotiating our arrangements. And you'll know more as we know more.

Gabe Moreen - *BofA Merrill Lynch - Analyst*

Okay. And then shifting gears to the billion in drops in 2014 in Southern Hills and Sand Hills, could you talk about timing on when you'd contemplate doing those drop-downs in 2014? And also, in that billion dollar figure is that just Southern Hills and Sand Hills? Or do you of other stuff in there too?

Bill Waldheim - *DCP Midstream Partners LP - President*

Well, again, we've had a great quarter and looking forward to finishing the year real strong. When we look at the DCP Enterprise they've got a lot of projects that they're still working on in the Permian and the DJ Basin of Colorado. So, we are the funding vehicle for the DCP Enterprise and as we look to 2014, we can't say specifically how and when, but we certainly have communicated that Southern and Sand Hills pipelines, at some point, will be part of the drops. And I think as we look at the level of guidance for 2014, at this point, I think we're conservative at this point.

Gabe Moreen - *BofA Merrill Lynch - Analyst*

Got it. And then, last question from me, just in terms of the 6% to 10% growth being laid out for next year, can you talk about some of the variables that would cause you to be at the lower or the higher end of that range? How you're thinking about distribution coverage for next year as well?

Bill Waldheim - *DCP Midstream Partners LP - President*

Sure. Again, as you look at this year, we are having a good year and I think our coverage has been improving. As an enterprise we are -- or as DPM is, we are funding a lot of organic growth projects. And so those are generally good to be doing for continuing the longer term sustainability of our dividend growth. We really -- at this point are looking at threading the needle, if you will, on keeping a good coverage ratio along with funding organic projects. And so, right now, I think we're -- at one point we'd guided 6% to 10%. I don't think we'll be at the very high end of that range, but I think we'll certainly be in the wheelhouse as we look into 2014.

Operator

Our next question comes from Ross Payne from Wells Fargo. Please go ahead.

Ross Payne - *Wells Fargo Securities, LLC - Analyst*

Bill, you guys have had some nice drop-downs from DCP Mid. Given the commodity nature of many of the assets, do you expect future drop-downs to be hedged by DCP Midstream, or are you getting to the size where you can shoulder some of that? And then lastly, how do we think about the kind of size that we might see in the next couple years out of DCP Mid moving down towards you?

Bill Waldheim - *DCP Midstream Partners LP - President*

Ross, over the years we've done drops in several different ways. We have received a direct commodity price hedges from our owners when we did the Eagle Ford drop-down. More recently, when we did the LaSalle facility, we actually converted a commodity sensitive type asset more towards fee. So, I think, as an enterprise we do understand that it's important to the MLP to have fee-based type earnings. As we look forward, and we look at the pipeline of organic projects that are in the mill, we have a lot of fee aspects associated with many of the assets. Southern and Sand Hills pipelines, for instance, are all fee. The Keathley Canyon project is 90% fee-based and even the O'Connor plant is a lot of fee as well, which is just now ramping up.

So, again, I think as we look at DPM, currently at 50% fee, I think that trend might be on an increase as far as moving higher from 50%. I think we'll always have some form of commodity exposure and we do hedge that. And whether it be with the owners, or in the third-party markets, we do look forward and hedge those commodity exposures. It's hard to say what would be coming to us from the owners. I can't say there would or wouldn't be fees associated with it, but, overall, I think we manage our commodity exposure very well looking forward.

Ross Payne - *Wells Fargo Securities, LLC - Analyst*

Okay. And, Bill, just absent organic projects. Any thought on the kind of volume of assets we may see heading your way just from DCP Mid, some legacy assets?

Bill Waldheim - *DCP Midstream Partners LP - President*

Yes. I think, as I said in my earlier comments, the enterprise -- DCP Enterprise continues to experience a lot of capital growth needs in and around its primary assets. And being the funding vehicle for the enterprise, I think, as we look to the billion dollars of drop-downs that we've said would be a 2014 number, I just think it's going to be conservative. But, beyond that I really can't comment too much.

Operator

Our next question comes from Michael Blum from Wells Fargo Please go ahead.

Michael Blum - *Wells Fargo Securities, LLC - Analyst*

Just a couple of questions, back to the Chesapeake terminal. Can you just remind us what would be the capacity to export? And what percent do you think you would need contracted of that capacity to move forward?

Bill Waldheim - *DCP Midstream Partners LP - President*

Michael, I don't know if we've ever actually mentioned the capacity. I think, as we are able to talk about it more fully, once we've flanged up all the arrangements. I think we'll be able to share what we're looking at as far as the ability to export. But there's really -- the only limiting factor is, really, how many railcar's we can offload and that's the work that's ongoing today, as far as adding towers and tracks. We can get a lot more volume through and into the facility. As far as actually exporting out of the tanks, themselves, it's a deep-water port and we can handle the small ships all the way up to the large VLGCs. I think we'll be more apt to talk about that once we get the -- and flange up our commercial arrangements.

Michael Blum - *Wells Fargo Securities, LLC - Analyst*

And then, have you -- any sense if you're going to be moving propane's, butanes or both? What that might look like?

Bill Waldheim - *DCP Midstream Partners LP - President*

I think, right now, we're actually looking at the terminal being able to handle both. I do know there's been more interest, recently, in butane, but I think the thought would be that we would be able to handle both. And so we're -- again we're working with our customers to determine what is the best use for that facility at this time.

Michael Blum - *Wells Fargo Securities, LLC - Analyst*

And then just one more macro-industry question. Since you guys are based in Colorado, you have the vote -- the four counties, that it looks like they're voting spending their moratorium on fracking, do see that as any real threat to drilling activity, longer-term, in Colorado in the areas that you have a pretty good presence as DCP?

Bill Waldheim - *DCP Midstream Partners LP - President*

You know, Mike, that was something that just occurred last night in the elections, themselves, and so that's fairly new news to us as well. I could tell you we've been working with the state and local governments around these types of initiatives and how we -- and what they might do as they affect our business, but it's a little too -- it's a little premature to comment just what impact something like this would have. I don't think it would be material, but I think it's something that we are following. And I know that the associations -- the E&P community and ourselves are all working together to understand what this means on a go-forward basis.

Operator

Our next question comes from Matt Niblack from HITE. Please go ahead.

Matt Niblack - *HITE Hedge Asset Management - Analyst*

Congratulations on the great quarter. Just a couple questions. It looked like the Eagle Ford was particularly strong for you. Could you comment on what drove that strength and whether this was a timing issue, as volumes coming quicker than you expected, or whether this is indicative of a larger overall ramp?

Bill Waldheim - *DCP Midstream Partners LP - President*

I'll take that question, but I might have Rose comment a little bit on that as well. As you look back at the Eagle Ford, we are a legacy company in this area. And so we got in early and I think we've got very strong producers and acreage positions behind our assets. We've been seeing a nice ramp-up in volumes from the producers that are behind our assets. You know, our Eagle Ford asset, or the asset in south-central Texas is comprised of not only the Eagle Ford vines, but some legacy vines as well. Overall, that total volume of gas has been increasing, as I mentioned earlier.

I think Eagle Ford gas in and of itself is growing faster than the overall pool. Again, we're seeing real good volume growth. What's really driving some of these results, and then I'll let Rose comment further, is our recovery efficiencies at the plants, themselves, are improving. As these plants come online, we line them out and then we get better at what we do. Our recovery efficiencies have really been improving and our earnings are reflecting that. Rose, you have some comments as well?

Rose Robeson - *DCP Midstream Partners LP - SVP, CFO*

Yes. In terms of Eagle Ford, we were -- just this is the Eagle Ford joint venture, as well as the Eagle plant, we were up about 4% on a sequential-quarter basis in terms of throughput and about 12% of from last year. So, we are -- we are seeing very good volume growth. We did have one plant that had a turnaround last quarter, so there was some impact from that. But overall, we're seeing very robust volumes in the Eagle Ford.

Matt Niblack - *HITE Hedge Asset Management - Analyst*

And then, another question that's -- this would be the last one, it's a little more, I guess, conceptual or strategic in nature. But, the unit prices recently of DPM have been fairly weak despite your strong position overall in the market and strong backlog of growth projects. And it seems like that's caused, perhaps, by the high multiple of the recent drop-down and some of the communication that you're -- that may be taken that you're predominantly a funding vehicle and not viewed strategically by the parent. Could you comment -- is there a thought to trying to change that narrative so the marketplace does not unfairly punish the units relative to the fundamentals?

Bill Waldheim - *DCP Midstream Partners LP - President*

I'll try to answer the question. I mean, certainly the strategy has always been at DCP is to grow the partnership to size and scale. Where we are able to fund organic growth on our own. We can -- are big enough to acquire assets, or companies, for that matter, and help DCP Midstream in their capital needs. I think we are, certainly, accomplishing that. The size of DPM has doubled in the last few years and I think you'll probably see it double in the next several years looking forward.

As we get scale and size, I think, we aren't just a drop-down store. I think, we do see opportunities in the marketplace for acquisition. But more recently organic growth projects, when you've got a lot of them and they're good multiple -- good kind of return projects, I think we definitely want to be pursuing those types of opportunities.

Matt Niblack - *HITE Hedge Asset Management - Analyst*

Great, well, again, congratulations on the great quarter. And our hope is that the market continues -- starts appreciating what you have a little more than they have in the past, but we appreciate the strong execution.

Bill Waldheim - *DCP Midstream Partners LP - President*

We're with you on that one.

Operator

(Operator Instructions)

We have a question from Michael Del Papa from Castleton Commodities. Please go ahead.

Michael Del Papa - *Castleton Commodities - Analyst*

I hate to beat a dead horse, I know this has already been asked a couple times, but I was just wondering if I can ask a little bit more about your Chesapeake terminal? And regarding importing supplies for the winter, with all the growth in liquids production coming out of the Marcellus and the Utica, I guess I'm curious as to why there would be a need to bring in winter supply via imports as opposed to just sourcing it out of the Marcellus and Utica?

Bill Waldheim - *DCP Midstream Partners LP - President*

Generally speaking, our wholesale propane business is a business that really tries to source product from its most advantageous source. And over the years, we have imported a lot of propane into these facilities. More recently, I think, with, as you mentioned some of the growth and production in the Marcellus, you've seen our sourcing more turn towards rail supply, but, I think, we're always going to source the product at its most advantageous point.

We don't know what the markets are going to give us as we look forward, but I think the international price of propane has been a little higher than we would normally see. So, importing propane has not been the best use of that facility. But going forward, I don't know if several years from now that'll change and we'll be importing propane once again as more propane finds its way down potential pipelines that are being built.

Michael Del Papa - *Castleton Commodities - Analyst*

Okay. Fair enough. And, well, I must say I think the exporting of propane of Chesapeake sounds like a very needed capacity with on the reverse side of that growth is in liquids production out of the Marcellus and the Utica. They're looking for outlets for that. And I was just wondering, you know, when you said that you can support both VLGC, very large gas carriers in addition to your handi-size or smaller vessels. Are these going to be low ethane, propane exports headed for international markets? And if so, how do you plan to source that low ethane propane?

Bill Waldheim - *DCP Midstream Partners LP - President*

Again, I think our intent would be to take product out of the Marcellus and Utica and export it to Central and South America. That would be the logical market for this product. Again, there is interest from the producers in this market, so, I think, as you just said and I think is what we're seeing in the marketplace, there's an interest for export.

Operator

And we have no further questions at this time.

Bill Waldheim - *DCP Midstream Partners LP - President*

Well, thank you very much for your interest in DPM and if there are any other questions you have, please contact Andrea, Rose, or myself. Have a nice day.

Operator

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