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SPP - Q3 2015 Sanchez Production Partners LP Earnings Call

EVENT DATE/TIME: NOVEMBER 13, 2015 / 4:00PM GMT

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PRESENTATION

Operator

Good morning and welcome to Sanchez Production Partners' third quarter 2015 earnings conference. My name is Bob and I will be moderating today's call. (Operator Instructions)

As a reminder, today's call is being recorded, and if you object to such recording, you may disconnect at this time.

I would now like to turn the call over to Chuck Ward, Chief Financial Officer of Sanchez Production Partners. Mr. Ward, you may begin.

Chuck Ward - *Sanchez Production Partners LP - CFO*

Good morning and thanks for joining us. With me this morning is Gerry Willinger, our Interim Chief Executive Officer; Pat Sanchez, our Chief Operating Officer; and Tony Sanchez, III, Executive Chairman of the Board of Directors of our general partner.

Just a few quick notes before we get started. First, we released our third quarter 2015 earnings report yesterday evening and this morning updated the investor presentation on our website, www.sanchezpp.com. We have made the slide deck available as part of today's webcast and may make references to specific slides during the course of this morning's presentation. We encourage everyone to take a look at that material as we believe it provides a good overview of SPP and the transformation of our partnership.

We anticipate that our Form 10-Q will be filed with the SEC today.

Second, our slides and the discussion this morning will include forward-looking statements, which are subject to certain risks and uncertainties. These are described more fully in our documents on file with the SEC, which are also available on our website.

And finally, we will use non-GAAP financial measures in this morning's discussion to help our unitholders and the investment community better understand our operating performance. The investor presentation available on our website includes an appendix that reconciles these non-GAAP financial measures to GAAP measures.

And with that, I would now like to turn the call over to Gerry Willinger.

Gerry Willinger - *Sanchez Production Partners LP - Interim CEO*

Thanks, Chuck. Before we look at our third quarter results, let me first say that we were pleased to declare a distribution on our common units earlier this week. Initially, we have set the distribution at an annualized rate of $1.60 per unit. We believe a distribution at this level provides an attractive yield at the current market price of our common units and enhances our ability to pursue our growth strategy.

Our primary focus during the third quarter of 2015 was the execution and closing of the Western Catarina Midstream Transaction. This was our second transaction with Sanchez Energy this year and our first acquisition of gathering and processing assets. The Catarina transaction represents the culmination of over two years of work to refocus and improve the Partnership's strategic direction and financial outlook and serves as the cornerstone to our midstream business. With the Catarina transaction, we believe we have successfully repositioned the Partnership to provide enhanced visibility for future growth.

We also believe the Catarina transaction provides a solid foundation for next year's business activity. Our base-case forecast currently shows our adjusted EBITDA ranging from $54 million to $60 million in 2016. Based on this forecast, we currently anticipate distributable cash flow of between $14.4 million and $20.4 million in 2016, which would provide a coverage on projected distributions to our common unitholders of approximately 2.2 times at the midpoint of our forecast. Additional information on our 2016 forecast can be found on page 5 of the slide deck we posted this morning.

Our 2016 forecast represents a base case assuming divestiture of our Mid-Continent operated assets this year with no additional acquisitions or divestiture activity. However, with the recent disruptions in the energy markets and line of sight to over $1 billion in midstream and production assets, managed under the Sanchez Oil & Gas Corporation operating platform, we see significant opportunities for growth. As a result, we currently target a 15% compound annual growth rate in our distribution per unit through 2019.

While we are excited about the Partnership's progress and prospects, we recognize that current conditions in the energy markets have created an environment in which energy companies generally, and master limited partnerships in particular, have fallen out of favor in the investment community. As a result, we believe we currently trade at an implied yield that does not fully reflect the Partnership's value proposition.

We view this as a near-term opportunity and yesterday announced a unit repurchase program of up to $10 million. The plan, which was approved by the Board of Directors of our General Partner earlier this week, reflects our ongoing commitment to return value to our unitholders.

With that overview of our progress, 2016 forecast, and other plans, I'd now like to turn to call back to Chuck for a brief overview of our third quarter 2015 results.

Chuck Ward - *Sanchez Production Partners LP - CFO*

Thanks, Gerry. Now I would refer everyone joining us today to turn to page 14 of the slide deck we posted this morning for this portion of the discussion.

The Partnership produced 367 MBOE during the third quarter 2015, which is down from 402 MBOE in the second quarter 2015. Lower level of production is primarily a function of the expected decline in our production assets, which is somewhat impacted by the continuing suspension of drilling in the Mid-Continent during the sales process. Regarding the decline, I'd also like to note that our working interest on the Eagle Ford asset acquired earlier this year will step up on January 1st, so we would expect some positive benefits in our future results from the structure of that transaction.

Our average net production of 3,991 BOE per day was about 33% oil and liquids and 67% natural gas. Our total revenue of $25.6 million for the third quarter of 2015 includes revenues from sales of $7.9 million, of which approximately 62% was oil and liquids sales and 38% was natural gas sales, revenue from hedge settlements of $5 million and revenue from services provided to third parties of $400,000.

Also included in the Partnership's total revenue was a $12.3 million gain on mark-to-market activities, a non-cash item that is excluded from our results in arriving at Adjusted EBITDA.

Our operating costs, which include lease operating expenses, production taxes, and general and administrative expenses, net of certain non-cash items and adjusted for nonrecurring items of $3.4 million, averaged $25.96 per BOE in the third quarter 2015. This compares to $23.13 per BOE in the second quarter 2015 and $25.76 per BOE in the third quarter 2014.

For the first nine months of 2015, operating costs averaged $24.10 per BOE, as compared to $25.45 per BOE for the same nine-month period of 2014, in each case after adjustments for nonrecurring items.

We reported third quarter 2015 Adjusted EBITDA of $300,000, which compares to Adjusted EBITDA of $5.2 million in the second quarter 2015. Removing the nonrecurring items from our results, our Adjusted EBITDA would have been about $3.7 million.

We had no new wells or recompletions during the quarter and we continue to evaluate opportunities to divest our Mid-Continent assets and currently anticipate very little in the way of drilling activity and capital expenditures in our asset base. For the quarter, our capital expenditures totaled about $800,000, with total capital spending of about $1.8 million for the first nine months of the year.

As of today, we have $106 million in debt outstanding under our credit facility, which since closing the Catarina transaction last month has a borrowing base of $200 million. We reported cash and cash equivalents totaling $8.9 million as of September 30, 2015, which is an increase of approximately $3.7 million over the prior quarter. The next redetermination on our borrowing base is currently scheduled for the second quarter of next year.

For the period October 1, 2015, through December 31, 2015, we have hedges in place that cover approximately 1.1 BCF of natural gas production at an effective price of $4.17 per MCF and 109,000 barrels of crude oil production at an effective price of $75.64 per barrel. Additional information on our hedge positions can be found in our investor presentation and in our information on file with the SEC.

As noted in our press release, we have approximately 3 million common units issued and outstanding as of yesterday's close. At our current distribution rate of $0.40 per unit, this translates to a $1.2 million use of cash at the end of this month for our initial distribution on common units.

Looking ahead, we anticipate increasing our unit count of about $1.2 million on March 31, 2016, the date we have elected to convert the Class A preferred units to common units.

And with that overview of our third quarter 2015 results, we would now like for the moderator to now open the line for some questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Our first question is from Gregg Abella. Your line is open sir.

Gregg Abella - *Investment Partners Asset Management - Analyst*

Good morning, guys.

Chuck Ward - *Sanchez Production Partners LP - CFO*

Good morning, Gregg.

Gregg Abella - *Investment Partners Asset Management - Analyst*

So let me start by -- we've been among the first to criticize when we think things are going wrong, so I want to be the first to congratulate you when things are going right. In a really horrible environment, this is really excellent execution, so I want to commend all of you, and as a fellow unitholder, I'm very much looking forward to receiving my first distribution after a long, long wait.

So the first question (multiple speakers) I have has to do with the distributions. I want to make sure I have this math right. If we start at $1.60 annualized, is this math correct that by 2019 you are projecting you'll have almost $2.45 or so of distribution?

Chuck Ward - *Sanchez Production Partners LP - CFO*

Our forecast potential is about a 15% annual growth rate.

Gregg Abella - *Investment Partners Asset Management - Analyst*

That's phenomenal. So tell me how we get to that. I'm expecting sort of through acquisitions or -- it's not on this current asset mix?

Gerry Willinger - *Sanchez Production Partners LP - Interim CEO*

No. It's driven by the line of sight that we mentioned to a $1 billion worth of potential acquisitions via the Sanchez Oil & Gas Corporation operating platform, which includes obviously midstream assets and some production assets as well. We think this environment is one where we feel we are comfortable with our balance sheet to get deals done and look forward to executing over 2016 as we move through the volatility in the market.

Gregg Abella - *Investment Partners Asset Management - Analyst*

Do you sort of have a targeted mix between midstream and upstream assets? I think right now it's, what, about 60/40 or so midstream. Is it going to stay like that or does it just depend?

Gerry Willinger - *Sanchez Production Partners LP - Interim CEO*

This is Gerry again. It depends, but our current focus is to lead with midstream transactions. We do view our producing assets more midstream like and more royalty interest like. So we really like those assets as well but at the present time we view ourselves as leading with midstream assets going into 2016.

Chuck Ward - *Sanchez Production Partners LP - CFO*

And (multiple speakers) to note there, you mentioned upstream assets. We really think of the escalating working interest as not being the traditional definition of an upstream asset, where you are using drilling capital and you are taking geology risk and you are hoping to grow through the drill bit. Ours is still that low G&A, low infrastructure, escalating working interest at mature wells with resetting ownership interest to provide kind of a five-year flat production profile.

Gregg Abella - *Investment Partners Asset Management - Analyst*

Are you confident you can get rid of those legacy assets where there is higher SG&A so you can just concentrate on the plan you are talking about?

Chuck Ward - *Sanchez Production Partners LP - CFO*

Yes, we are. Of course, the fall in commodity markets, so I tend to make it in the hedge book, but don't get helped on asset value, that's for sure.

Gregg Abella - *Investment Partners Asset Management - Analyst*

Fair enough. With your new private equity partner in Stonepeak, are there any of their infrastructure assets or energy assets that might be a good fit as drop-downs here?

Gerry Willinger - *Sanchez Production Partners LP - Interim CEO*

There's certainly potential as we talk and continue to develop our relationship. There's nothing identified specifically as of yet, but we plan to have conversations on an ongoing basis with Stonepeak about opportunities that we see in the midstream space and not just in their current portfolio, but in the future acquisitive nature, and we look to continue to partner with them going forward.

Gregg Abella - *Investment Partners Asset Management - Analyst*

Sounds good. Last question, or really a comment that now you've got really a great story to tell. I'm pleased to see you are going to RBC and I would just encourage you to continue to do things like that because there, maybe, in the past hasn't been as much to boast about, but now there's a lot to talk about.

Gerry Willinger - *Sanchez Production Partners LP - Interim CEO*

Thank you, Gregg.

Gregg Abella - *Investment Partners Asset Management - Analyst*

So can you talk about what sort of efforts you are going to have on the IR front going forward?

Gerry Willinger - *Sanchez Production Partners LP - Interim CEO*

We plan to be at as many conferences as humanly possible -- this is Gerry again -- and we plan to be talking to as many of the banks as possible. We think obviously the growth story will need to be communicated, and in this environment, it'll need to be overly communicated. So we plan to have constant conversations with the investor base.

Gregg Abella - *Investment Partners Asset Management - Analyst*

I'm just pleased at how this has taken shape. It's been a while, but I'm glad we are here. Thanks again.

Operator

Thank you. Our next question is from Lin Shen. Your line is open.

James Jampel - *HITE Hedge Asset Management - Analyst*

Hi, it's actually James Jampel, from HITE Hedge. Could you talk a little bit more about the repurchase program? How long do you think it will take you to complete that and what's your goal there?

Chuck Ward - *Sanchez Production Partners LP - CFO*

Our goal is to really buy back equity at a rate that we think reflects not a bad return on equity, number one, but also to us shows the General Partner's kind of support for what their view is on the valuation.

The other is that we do look forward, and we look at the $1.60 obligation and look at the unit price and say that's not a bad payback on -- if you are yielding 16%. We've got a lot of growth with the midstream asset that we've got. We like the rest of the portfolio opportunities that we see as we're starting to kick off the distribution.

As you know, people think about it in terms of yield plus growth potential. To the degree that we can lower the number of actual units on that base kickoff amount on distribution going forward, the more of the, I would say, excess or the surplus distributable cash flow we are able to share with the remaining unitholders as we grow.

James Jampel - *HITE Hedge Asset Management - Analyst*

Great. So when do you think you might conclude the $10 million? How long do you think this will take?

Chuck Ward - *Sanchez Production Partners LP - CFO*

We'll be limited by volume to kind of 25% of the average volume over the prior period. So that's going to shape how long it can take to execute.

It's highly variable, depending upon whether we average 20,000 or 25,000 or 30,000 a day. It can move around over many months, depending upon which of those volumes become the average, and that's still assuming kind of perfect execution of taking out 25% at any one time.

James Jampel - *HITE Hedge Asset Management - Analyst*

But the idea is to begin now and proceed at the most rapid pace you can?

Chuck Ward - *Sanchez Production Partners LP - CFO*

Yes.

James Jampel - *HITE Hedge Asset Management - Analyst*

Okay. Thank you.

Operator

Jay Abella.

Jay Abella - *Investment Partners Asset Management - Analyst*

Hi, guys. Let me be the second Abella to congratulate you guys on some excellent execution here in a very tough market. So, we appreciate it, immensely.

Having said that, I think my brother actually asked all my questions, but I would like some color on the statement that you have possibly $1 billion worth of either drop-downs or opportunities through Sanchez Corporation. Do you mean SN, the parent? Or do you mean entities within Sanchez? And if you could comment and provide some color, I would appreciate it. Thanks.

Chuck Ward - *Sanchez Production Partners LP - CFO*

You will see our comment on that is always through kind of the Sanchez Oil & Gas operating platform. As you know, Sanchez Oil & Gas is the private operating platform that provides essentially all the employees for Sanchez Production Partners, as well as Sanchez Energy.

They are certainly separate public entities, not under common control, not under anything other than having this commonality of a private entity that provides employees that works on opportunities. So there's -- we will always have the public separation. We will always exercise to be very careful about that relative to governance and obviously relative to the GAAP procedures on related parties, but I think what it gives us is that there is opportunities we see in there where perhaps the ROFO that we had as part of the midstream transaction, and some other activities that other parts of the organization are undertaking that we see assets that more properly fit, we believe, in our risk bucket and it's up to Gerry and I and the team at SPP to propose and try to execute transactions on those assets.

Jay Abella - *Investment Partners Asset Management - Analyst*

Okay. Well thank you, fellows, again. That's all I had.

Operator

Our next question is from Mr. Tristan Richardson. Your line is open.

Tristan Richardson - *SunTrust Robinson Humphrey - Analyst*

Good morning, guys. Just one from me. I'm curious. You guys talked a little bit about third-party opportunities longer term. Could you expand on that a little bit, whether it's timing or timing of agreements and when you'd see cash flow from that, and then maybe just kind of longer-term plans for a general split of the third-party business?

Gerry Willinger - *Sanchez Production Partners LP - Interim CEO*

As we go forward, certainly with the volatility in the market we will ramp up and continue to look at a very robust pipeline of third-party opportunities. So what I would say is in a very general fashion is as we move through 2016 with a very clean balance sheet and opportunities come to us or we get aggressive in a specific basin, we will look at third parties as a way to continue to ramp our business and to continually grow into a fairly unlevered balance sheet.

So, we will be opportunistic. We look at a lot of third-party opportunities here. I believe we've looked at somewhere in the neighborhood of 100 over the last two years and we will continue to be opportunistic in 2016 as well.

Tristan Richardson - *SunTrust Robinson Humphrey - Analyst*

Is it fair to say a little bit early at this point to have necessarily a targeted split or anything at this point?

Gerry Willinger - *Sanchez Production Partners LP - Interim CEO*

Yes, it's early -- this is Gerry again. I would say it is opportunistic because it's one of those situations that it's not necessarily easy in the environment that we are traveling through right now to have acquisitions be done in a timely manner because you would typically have a bid/ask difference and you have balance sheets that are upside down and you have to work through all that.

So I think it would be a little early to have a split laid out, but the way we look at it potentially in the first quarter, second quarter of next year, the opportunity set should be a little bit broader and we view ourselves a little bit more aggressive in that time period as we go through 2016.

Tristan Richardson - *SunTrust Robinson Humphrey - Analyst*

Great. And then, just to clarify, am I thinking about it right that it sounds like midstream drops may be more of a priority in terms of order of execution at this point, or you're just kind of looking at everything and not necessarily any particular side that you want to drop first?

Chuck Ward - *Sanchez Production Partners LP - CFO*

It seems if I think about the midstream transaction market versus the upstream transaction market, whether upstream is a -- to us would be a traditional escalating working interest, there seems to be a little bit better pricing discovery action on the midstream, and so when I think about the two tranches or types of transactions, it seems to me that a midstream transaction is more easy to execute, whether with a related associated party or with a complete independent party.

Tristan Richardson - *SunTrust Robinson Humphrey - Analyst*

And on the upstream side, you guys would like to see maybe a little bit more clarity in the market before --

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Chuck Ward - *Sanchez Production Partners LP - CFO*

I think that there's not seller capitulation on some guys who probably should sell, but are not interested in doing it yet, once I get to the third-party transaction level.

Tristan Richardson - *SunTrust Robinson Humphrey - Analyst*

Got you. Very helpful. Thanks, guys, very much.

Operator

Our next question is from William Adams. Your line is open.

William Adams - *Fiduciary Asset Management, LLC - Analyst*

Good morning. I just want to get a little more color on your guidance for 2016. Can you give us some details on what kind of interest expenses you are using and what kind of maintenance capital spending?

Chuck Ward - *Sanchez Production Partners LP - CFO*

Sure. We've given this level of guidance intentionally the first time. This is the first time we've given guidance in a bit, relative to making a distribution and a yield. I think when we finish out the year, we're probably going to break that into more pieces.

We do make some general underlying statements on slide 5 relative to the hedges in place and what we expect to happen relative to the balance sheet on a Mid-Continent asset sale. We do give a cash interest expense of $2.2 million and distributions on the Class Bs and a maintenance capital of $2.4 million.

William Adams - *Fiduciary Asset Management, LLC - Analyst*

You said $2.2 million on the cash interest and what did you say?

Chuck Ward - *Sanchez Production Partners LP - CFO*

$2.4 million on maintenance capital.

William Adams - *Fiduciary Asset Management, LLC - Analyst*

Oh, maintenance capital spending, okay. And then, what do you assume on the hedges for next year in terms of volume and price?

Chuck Ward - *Sanchez Production Partners LP - CFO*

We provide in the slide pack. I'd ask you to look through the slide pack and also on the SEC documents, and we provide -- our complete hedge book is there. (multiple speakers) few years to read out.

William Adams - *Fiduciary Asset Management, LLC - Analyst*

Okay. I guess I didn't see it on the slide deck.

Chuck Ward - *Sanchez Production Partners LP - CFO*

It's near the end, in the appendix.

William Adams - *Fiduciary Asset Management, LLC - Analyst*

Okay.

Chuck Ward - *Sanchez Production Partners LP - CFO*

On page 24.

William Adams - *Fiduciary Asset Management, LLC - Analyst*

Okay. I didn't quite make it that far. There we are. Okay, perfect. That's great. That's all I needed.

And then in terms of strategically, where else would you like to be besides the Eagle Ford area?

Gerry Willinger - *Sanchez Production Partners LP - Interim CEO*

I would say we are open to business in all basins, all major basins in the United States that provide an acceptable return in this environment. We obviously have operated in the past in most every major basin, and so I don't think we are limited to any one basin. We are purely return focused and anywhere we can keep costs down in this market and drive value is the basin we will be looking to go into.

William Adams - *Fiduciary Asset Management, LLC - Analyst*

Okay, great. Good luck to you and thanks so much.

Gerry Willinger - *Sanchez Production Partners LP - Interim CEO*

Thank you.

Operator

Thank you. At this time, we have no further questions. We would like to turn to call over back to Mr. Ward.

Chuck Ward - *Sanchez Production Partners LP - CFO*

Thanks again for joining us this morning. We look forward to speaking with you again very soon.

Operator

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