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DPM - Q4 2016 DCP Midstream LP Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the Q4 2016 DCP Midstream LP earnings conference call. (Operator Instructions). As a reminder, this conference call is being recorded. I would now like to turn the conference over to Ms. Andrea Attel. Ma'am, you may begin.

Andrea Attel - *DCP Midstream LP - IR*

Thank you, Andrew. Good morning, everyone and welcome to the DCP Midstream fourth-quarter 2016 earnings call. Today's call is being webcast and the supporting slides can be accessed under our Investors section of our website at dcpmidstream.com.

Before we begin, I'd like to point at 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 risk factors, please refer to the partnership's latest SEC filings and the 10-K that will be filed this week.

We will also use non-GAAP measures such as distributable cash flow, adjusted EBITDA and adjusted segment EBITDA, which are reconciled to the nearest GAAP measure in the schedules in the appendix section of the slides. Wouter van Kempen, CEO and Sean O'Brien, CFO, will be our speakers today and after their remarks, we will take your questions. With that, I will turn the call over to Wouter.

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Thanks, Andrea. Good morning and thanks for joining us today. On this call, I will review the 2016 highlights for legacy DPM and tee up our 2017 path forward for the new DCP. Sean will briefly discuss 2016 financial results and then pivot towards our 2017 outlook. We will expand upon our operating philosophy and provide additional information for the newly combined DCP.

With that, let's start with the 2016 highlights. In a very challenging industry environment, the partnership had a strong year, achieving both our 2016 adjusted EBITDA and distributable cash flow target ranges. We honored our commitment to pay distributions of $3.12 per unit annualized and we generated strong coverage of 1.11 times for the year, which was well above our 1.0 times 2016 guidance.

We started 2017 with our announcement of the newly combined DCP Midstream, making the partnership the largest integrated NGL producer and natural gas processor in the United States with an $11 billion enterprise value. I'm excited to share with you our 2017 path forward, which is founded upon a strong track record of execution, combined with a strategy focused on unitholder value creation in a strengthening industry environment.

The new DCP has an unparalleled footprint with access to the premier regions and key product-producing basins including the DJ, the Delaware and Midland areas of the Permian, the SCOOP and STACK areas in Oklahoma, as well as the Sand and Southern Hills NGL pipelines. This footprint provides DCP with line of sight to multiple growth opportunities and these, combined with industry recovery, provide as a clear path to future distribution growth. We've already announced $900 million of growth projects with strong multiples, which I will cover in greater detail later.

And before I turn it over to Sean, I want to focus on another one of our continued commitments to you. We heard how much you valued DPM's disclosure and our emphasis on transparency. Our goal is to continue to provide you the same level or better disclosures for combined DCP, giving you the relevant information you need to better understand the very large asset portfolio that came into the MLP.

You will see that we have included in our appendix a significant amount of information, such as regional overviews, including volumes, operating data, plans and customers and we will continue to evolve these disclosures as we begin reporting the results of the newly combined DCP.

So with that tee-up, Sean will review our financials and then I will return to talk more about our strategy for 2017 and beyond.

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

Thanks, Wouter and good morning. I'm going to quickly hit the 2016 results and then focus most of my time on 2017 forward. On slide 5, we show the partnership's Q4 and full-year results prior to the transaction. As you can see, the partnership generated strong full-year 2016 results with $594 million of adjusted EBITDA and $537 million of distributable cash flow, both exceeding the high end of our target ranges. This resulted in a strong distribution coverage ratio of 1.11 times for the year, which was above the 1 time we forecasted at the beginning of 2016. And the partnership's standalone leverage was 3.5 times for the year.

During the fourth quarter, the partnership generated adjusted EBITDA of $151 million and DCF of $120 million, resulting in distribution coverage of 1 time for the quarter. The key drivers for both the fourth quarter and the full-year 2016 were relatively consistent and were largely impacted by volumes, which we provide on the next slide.

Overall, our strong 2016 results were driven by growth in our NGL logistics segment, primarily due to higher volumes on Sand Hills, Southern Hills and Front Range pipelines.

Sand Hills and Southern Hills volumes and results dipped slightly during the fourth quarter due to pipeline maintenance. The growth in our NGL logistics segment helped offset declines in our natural gas services and wholesale propane logistics segments. As expected, the natural gas service segment is lower compared to the fourth quarter and full-year 2015 due to the roll-off of expired hedges at the beginning of 2016, coupled with volume declines in our Eagle Ford and East Texas regions.

The Eagle Ford declines were larger than our projections; however, our diversified asset portfolio partially mitigated volume declines with growth in the DJ Basin and execution of our DCP 2020 strategy. This is evidenced by significant operating and maintenance cost savings and improved reliability.

On the positive side, we are starting to see increased activity in the Eagle Ford and we have a large inventory of drilled and uncompleted wells around the footprint, which are signposts to future volume growth in the region. As we look forward, we anticipate volumes to stabilize by midyear with the potential for slight growth in the second half of 2017. With the Eagle Ford's advantage, geographic proximity to the market hub, it should offer us upside as the industry continues its recovery.

Now on slide 8 to review our estimated 2017 key metrics. I would first like to highlight that we have updated our adjusted EBITDA definition and guidance range to include distributions in excess of earnings from our unconsolidated affiliates, which includes distributions from Sand Hills, Southern Hills, Discovery and our other equity investments. This is similar to how we calculate adjusted EBITDA for our bank covenant metrics and with many of our peers. The update does not impact our DCF guidance range.

Additionally, I would like to give clarity on DPM's 2017 standalone EBITDA. Since our call in early January, many of you have asked for a breakdown between Midstream and DPM's 2017 adjusted EBITDA, which are shown on slide 9. On a standalone basis, DPM's 2017 adjusted EBITDA under our updated definition would have been around $575 million at the midpoint and standalone Midstream would have been around approximately $450 million.

We view 2017 as a year of transition for the industry and DCP. We are fairly bullish on the industry looking forward; however, we have not forgotten that we just came through one of the toughest cycles this industry has seen and that about 12 short months ago, crude hit $26 per barrel and NGLs fell to below $0.30 a gallon.

As we started preparing our 2017 budget about six months ago, commodity prices were closer to the lower end of our range. As we sit here today, the environment has strengthened with crude hovering around $53, NGLs well above $0.60 and gas around $3. This places us at the middle to high end of our range. And while our 2017 forecast does not assume any volume or commodity uplift from ethane recovery, we are well-positioned to take advantage of this uplift and overall industry improvement.

Through our DCP 2020 strategy, we have grown our 2017 fee-based and hedge margin to 72% and with our new growth projects we just announced and others in development, we believe 2018 and beyond will be even stronger than 2017.

Now moving to slide 9, we put together this graph to show the breakdown of our 2017 adjusted EBITDA contribution by region for both the standalone and the newly combined companies. With the contribution of Midstream's positions in the DJ, Permian, Mid-Continent, Sand and Southern Hills, DCP's combined portfolio continues to be well-balanced.

On a combined basis, our logistics business contributes roughly 40% of adjusted EBITDA with the remaining 60% distributed across our gathering and processing assets. And growth from great low investment, low multiple opportunities across these regions will continue to add to this balanced portfolio.

Slide 10 shows our current hedge position and margin profile. The table has been updated with recently executed hedges and shows our percentage hedged by commodity. With our focus on risk, we will continue to manage commodity exposures, stabilizing cash flows and providing downside protection through our proactive multiyear strategy, which targets 80% fee-based and hedge margin in 2017. And our portfolio continues to have strong upside in a rising commodity environment.

Now on slide 11, I'll review our liquidity and show how we calculate our combined DCP leverage ratio. We currently have a $1.25 billion undrawn credit facility. We used a portion of the $424 million proceeds from the transaction to repay $195 million of outstanding borrowings on our facility. The remainder is available to fund growth and/or repay a portion of our December 2017 $500 million debt maturity and we do not have any other debt maturities until 2019.

Our credit ratings shown here have been updated by the rating agencies post-transaction and I would like to highlight that all three have a stable outlook.

Now I will ground you on our bank leverage calculation. The table on the right shows our debt profile immediately after we close the transaction. Our bank covenant excludes $550 million of hybrid debt that is treated as equity and in this example, we have netted the $424 million of cash received from the transaction against the December 31, 2016 debt balances and if you apply the midpoint of our updated adjusted EBITDA range to the leverage cap, we achieve a levered ratio below 4.5 times.

With that overview of our 2017 financial metrics, I'm going to hand it back over to Wouter.

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Thanks, Sean. Over the next couple of slides, I'm going to describe for you our pathway to distribution growth and the operating and financial strategy that will guide us grounded on a proven track record of delivering on our commitments.

So looking to slide 13, you can see the cumulative effect of our DCP 2020 strategy. I'm very proud to say that our team of 2700 employees has been squarely aligned on exceeding our expectations. We believe that you should never let a good crisis go to waste and clearly, we haven't. So let me give you an overview on how we've repositioned the Company over the past two years to take advantage of industry recovery.

Back in February of 2015, we told you we had embarked on a journey to add about $200 million of margin by the end of 2017 through contract realignment. I am very pleased to say that we have exceeded our target, reaching $235 million of annual margin this year, almost a full year ahead of schedule.

Also, through this downturn, we've gained massive cost efficiencies and have actively managed and reduced our cost base by about $200 million, back to pre-growth levels while operating an asset base that grew almost $7 billion. We've optimized and rationalized systems using $330 million from non-core asset sales to strengthen our balance sheet and consolidated or idled underutilized plants and compressors.

With a strong reliability focus, we have prioritized maintenance and lowered our unplanned downtime more than 60% with our assets running better now than in the past several years and we did this while maintaining our strong safety performance. And through these efforts, coupled with the $3 billion owner contribution in 2015, we have significantly strengthened the balance sheet by reducing our debt levels over $2 billion since we peaked in mid-2015. We've realigned our organization; we've delivered on our commitments; and we've set DCP up for continued success.

Slide 14 lays out our philosophy on how we intend to manage DCP to achieve sustainable distribution growth. Our philosophy is founded upon maximizing operating leverage and capital efficiency, managing commodity exposure and strengthening the balance sheet. We have set clear expectations for financial targets that underscore a strategy and operating philosophy. We are targeting distribution coverage of 1.2 times or better and bank leverage of 3 to 4 times.

We will manage our commodity exposure utilizing a combination of fee-based contracting with our multiyear hedging program to target 80% fee-based and hedged margin in the current environment to protect our distributable cash flow. Our strong portfolio and footprint gives us the opportunity to execute growth projects at 5 to 7X multiples and we have massive operating leverage around our footprint with capital-efficient growth that will contribute to strengthening our balance sheet and provides us with a pathway to achieve a sustainable distribution growth target of 4% to 5%.

On slide 15, let's talk about our path forward with a visible pipeline of $1 billion to $1.5 billion of growth opportunities around our footprint over the next few years in the DJ, the Permian, the Delaware, the SCOOP and STACK areas and on our Sand Hills NGL pipeline. We've already provided you line of sight into $900 million of projects that are in execution or in development. This includes multiple investments in the premier DJ Basin in Colorado such as our $200 million a day Mewbourn 3 plant, incremental capacity of $40 million a day this summer via a bypass project and another $200 million a day plant in the DJ currently in the planning phase for 2019.

In the Permian, the recently announced 85,000 barrel per day Sand Hills expansion project is underway and expected to be ready by the end of this year.

So now let's turn to operating leverage around our portfolio. By operating leverage, I mean our ability to use existing assets and our current cost structure to process additional volumes, transport additional NGLs and grow earnings in a very capital-efficient way by utilizing our current asset base. Let me give you some examples on the G&P side of the ledger.

Starting in the Mid-Continent, we are positioned to utilize excess processing capacity to capture SCOOP and STACK growth. In the Eagle Ford, to mitigate volume declines, we have idled underutilized plants to reduce costs while maintaining flexibility to ramp up quickly once producer activity increases. We have very efficient plants in the Eagle Ford and a large inventory of drilled and uncompleted wells in our dedicated footprint.

We've also seen constructive activity with smaller, more targeted players. So we believe that the Eagle Ford will come back as the environment continues to improve and our assets are very well-positioned to capture that opportunity.

Now let's shift to our integrated NGL logistics business. Southern Hills has line of sight to continued growth from SCOOP and STACK. The DJ Basin is growing significantly, which benefits Front Range and Texas Express and in the Permian and Delaware, we are driving value through our Sand Hills pipeline. The Permian has seen tremendous growth and Sand Hills has been an unbelievable success story.

We set it up to be a producer-friendly pipe that allows our customers the option to take their NGLs to fractionators or other destinations of their choice and with continued third-party plant connections, NGL volumes on Sand Hills have grown without ethane recovery and all of this is why we are investing $70 million to expand it to its full 365,000 barrel per day of capacity by the end of this year.

With our current outlook, which includes announced growth and new third-party plant connections, we expect this 365,000 barrel per day of capacity to ramp up quickly. When we first provided you with our ethane upside about a year ago, Sand Hills capacity was 250,000 barrels per day. We assumed incremental ethane recovery volumes would fill Sand Hills and our other NGL pipelines to their full capacity. However, with all of the growth that we have seen around our pipes in the Permian, the DJ, the SCOOP and the STACK, volumes are increasing even before we get to ethane recovery.

In the Permian and Delaware, Sand Hills as already been expanded once and continues to ramp via new plant connections and growth and we expect the remaining capacity to fill from continued development in these basins without ethane recovery. So with the growing NGL volumes in the region, there's a good chance we will need to further expand Sand Hills even above the 365,000 barrels per day to accommodate ethane recovery and growth. We are exploring multiple options to significantly increase that capacity. So a great story even became better.

All of these are some great examples of how we maximize our operating leverage and capital efficiency with prudent growth projects, which will create value and strengthen the balance sheet through increased cash flow supporting the pathway to grow our distribution in as early as 2018.

Sean has already covered how we manage commodity exposure and create cash flow stability from fee-based asset growth and strategic hedging, so I won't spend a lot of time on slide 16, but I do want to highlight that this is an integral part of our strategy as evidenced by our contract realignment efforts and our hedge portfolio. Our fee-based and hedged margin has more than doubled since 2010 to 72% and we are targeting to grow that to 80% in the current environment.

As we just talked about, we have a visible line of sight to new fee-based asset growth and our goal is to protect our DCF through contracting and hedging while retaining upside in a rising commodity price environment.

Moving on to slide 17, another component of our financial strategy is strengthening the balance sheet. Since our debt reached its peak in June of 2015, we have delevered more than $2 billion and grown EBITDA through our strong DCP 2020 strategy execution. We've added fee-based margin through our contract realignment efforts. We've reduced costs and I'm proud to say that we did this while operating safely and more reliably.

In 2018 and beyond, we are targeting 3 to 4 times bank leverage, which will be accomplished through our continued focus on accretive growth, capital efficiency and operating leverage and an improvement in the overall industry.

On slide 18, let me summarize. It's all about the three areas of how we intend to manage our business. First, operating leverage and capital efficiency, our premier footprint affords us tremendous low risk, high return growth and optimization opportunities around one of the strongest portfolios in our industry.

Second, we are well-positioned to capture significant upside from both ethane and overall industry recovery, as we have said many, many times before. We were the first to experience the effects of the industry downturn and as the largest NGL producer and natural gas processor, we will be the first to realize the upside.

And third is a strong balance sheet. We will continue to delever and strengthen our bank leverage metrics and build strong distribution coverage of 1.2 times or better.

With that, I'd like to thank you for your interest in DCP and now, Andrew, please open the line for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). Jeremy Tonet, JPMorgan.

Jeremy Tonet - *JPMorgan Chase - Analyst*

Just wanted to start off with a question on the quarter with the nat gas services. Was wondering if you might be able to dive a little bit more as far as the Q4 versus Q3 uplift this year. There was a nice uptick there. Just wondering if you could provide some of the drivers.

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

Clearly, the DJ and if you think about the nat gas services, we definitely saw some really good results out of the DJ. We continue to see massive growth coming out of that region and they had a phenomenal Q4.

Same thing in the Permian. We continue to see very strong results out of some of the investments we've made in areas like Southeast New Mexico and in the Delaware. So Permian had a very good quarter as well. Those are probably the primary drivers, but I will tell you, as you think beyond even the margin and the volume side of the equation, the cost side of the equation was really focused on a lot of those areas as well. We continue to drive strong cost efficiencies. Those continued through the quarters as we continue to get full benefits from those types of transactions, but a couple of the regions doing very, very well and had really good Q4s.

Jeremy Tonet - *JPMorgan Chase - Analyst*

Got you. So were there any one-time events here or is this a run rate type of thing?

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

Yes, there were no one-time events that drove earnings. I think it is definitely driving towards a run rate. If you think about the growth areas that Wouter alluded to in his comments, areas like the DJ, we continue to see the need to add volumes, to add capacity and we are going to do some of that this year. The bigger chunks will come in 2018 and 2019.

Same thing in the Permian. It's just an area where we are getting full. We still have some capacity there and we are looking for ways to fill that up. So nothing that stands out in terms of, hey, we had a one-time or this is a good run rate (technical difficulty).

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Maybe let me add a little bit on what Sean was talking about. If you take it looking forward, where are we looking from a volume point of view? If you go around to various areas, I think the DJ is going to be up low to mid-single digits. I think the Permian we see in 2017 volumes being up, I would say strong volume up in the Delaware offset by predominantly our [Zona] assets. If you go into the Mid-Continent, I think our volumes are going to be slightly down in 2017 really driven by Western Oklahoma, the old [Yucatan] Basin. They are on a slow, steady decline there and that's then being offset by growth that we are seeing in the STACK and the SCOOP area.

If you go to the Eagle Ford, Eagle Ford is a little bit of a wildcard. I'm cautiously optimistic around the Eagle Ford just due to the area where it is and the great infrastructure close to the market center. I do believe that our first and second quarters are continuing to go down, but then we start stabilizing in the summer and probably see some up in the back. So I would say Eagle Ford overall is probably flat or up for 2017.

And then when you go lastly to the NGL volumes, great strength there and we will see double-digit growth in NGL volumes. So you take that whole thing together and to your earlier question, you know what, can you take Q4 and how do you look at that as a base for the rest of the year? I feel pretty good about where we are growing from Q4.

Jeremy Tonet - *JPMorgan Chase - Analyst*

Great. And as far as the asset sales during the quarter, I was wondering if you could expand a bit more on that.

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

Yes, we had -- the North LA -- I'm sorry, Henshaw pipe -- North LA was Q2 -- we had the Henshaw pipe sale, relatively small pipeline, not a big pipeline, shows up in the Eagle Ford volumes, I believe. Not driving a lot of DCF, so it's just continued with our goal of optimizing and selling some assets that aren't driving a lot of value.

Jeremy Tonet - *JPMorgan Chase - Analyst*

Okay, great. Thanks. And just one last one from me. As far as the balance sheet, just wonder about any thoughts as far as eventually looking towards retaining -- getting investment-grade again. Is that something that you guys prioritize now or any other color that you could share would be great?

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

Yes, we definitely prioritize that. I think a couple things as you think about the investment-grade. Obviously, we've been there. I think we are clearly -- we've looked at how we compare to other investment-grade companies in our space. We think we line up fairly well there. Having said that, we came through one of the toughest downturns that the industry has been through and the RAs, obviously, will take you down quicker than they will take you up. But our goal is to get back there, Jeremy and I think we are doing all the things we need to do to get us back there.

Jeremy Tonet - *JPMorgan Chase - Analyst*

Great. Thanks.

Operator

James Spicer, Wells Fargo.

James Spicer - *Wells Fargo Securities - Analyst*

I appreciate you guys breaking out some of the data for DPM standalone versus the LLC. Wondering if you could share what EBITDA was from the LLC assets during the fourth quarter so we could just understand Q4 on a pro forma basis.

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

Yes, so I guess we gave you the ranges for 2017. What we could do is give you the breakout -- I think we have it -- we might have to give it to you offline -- you can see DPM obviously and you are trying to get LLC.

One thing I will tell you, James, if you take Q4, and Wouter alluded to it a little bit earlier, for the two combined companies and pro forma them together, you are going to get to a pretty strong run rate. If you just took that and said, hey, that's how the Company can deliver as it moves into 2017 on a quarterly basis, you are going to get to a 1.1 or better coverage ratio, but I can get you the exact number -- I don't have it in front of me -- for where LLC would have come in in Q4.

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

And maybe to add to this, James. Historically, there was some seasonality around our business and driven by the propane business. So some of you still continue to talk about that Q4 or Q1 is seasonally strong businesses. With the combination of this entity, that really is not there anymore.

Just to put it for you in perspective, our propane business that was driving that Q4/Q1 seasonality is less than 3% of the total EBITDA of the Company as a whole. So that's when again you go back to Q4, you start multiplying that times 4, you get to numbers as Sean alluded to that are pretty strong and are probably at or above 1.1 coverage for 2017.

James Spicer - *Wells Fargo Securities - Analyst*

Okay, great. Great. No, understand that you need to sort of understand the context when looking at it, but appreciate that. Then, secondly, I see your target leverage 3 times to 4 times. It sounds like you think you might be able to get there in and around 2018. Just wondering do you see yourselves getting to that level purely organically through cash flow growth, or is there anything external that you think you may need to do to get there?

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

A couple ways we are going to get there. Organic growth is a large -- significantly large portion of this. If you are thinking do we need an acquisition or something to get us there, that is not the case. We are not modeling that, James, in any of our models. So organic growth is going to be one element. I think continued -- we came into the year with a delevering event with the $424 million that I mentioned. We took out some short-term debt. Our goal, as you think about that $500 million maturity, is maybe to take that out, to re-up that at a lower level, again delevering a little more off of that.

And then I think to your point, it's going to be two things that drive the improvements in the debt metrics. It's not just organic growth; although we mentioned the $1.5 billion to $2 billion. We've given you a lot of line of sight to about $1 billion of that, but really it's the things that Wouter talked about around operating leverage. If you think about where the Company has come over the last two years, we've improved our debt metrics massively not by growing. If you think about the last two years, we didn't deploy an awful lot of growth capital. What we did is we really looked at running our assets better, controlling our costs, being more efficient, getting assets more full, idling plants that were not full.

So I think that's the three prongs. It's going to be a little bit of debt reduction going forward. It's going to be continue the success around operating leverage around our 2020 strategy and then, of course, you look at the $1.5 billion to $2 billion of growth projects and I will point out those are very strong multiple growth projects. If you think about the Sand Hills expansion we announced at 2X and you think about the expansion in the DJ and I think we gave 5X to 6X, 5X to 7X.

So those are the three things, not dependent upon having to go out and having to acquire something.

James Spicer - *Wells Fargo Securities - Analyst*

Okay, great. Understand. And then, finally, just curious here. You talked about how volumes are growing pretty substantially even without ethane recovery. I would be interested to hear your general thoughts on ethane recovery in general and timing and outlook there.

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Let me take that one, James. I'm just going to reiterate how we are looking at especially Sand Hills. It's a tremendously successful pipe. We got much more than probably our fair share of NGLs and it's because our producer customers and midstream customers really like this pipe and the flexibility that it gives them to delivering their product to wherever location they want it, whatever fractionator they want to push it through.

So we have gotten a tremendous amount of third-party plants that we have connected. There is a variety of ways where you can play a place like the Delaware. You can play it by the GMP side, you can play it by the NGL side. We are playing it tremendously hard, especially the Southern Delaware, via the NGL side that gives us very good operating leverage, very capital-efficient overall.

So we are thinking that we are sitting here at a place that's 365,000 barrels per day coming to Sand Hills. Before ethane recovery, we may get a very significant chunk of those barrels. We continue to think that ethane made a big move from January 31 to February 1. We are hovering somewhere around $0.26, $0.27 on ethane today. There are some plans that we have put into ethane recovery, especially in the Mid-Continent benefiting our Southern Hills plant.

I think ethane potentially still has a little bit of a rocky road here over the next couple of months. I think we're going to see some ups, some downs. Overall continue to be very bullish looking at the crackers that are going to come online here towards the end of the year that are going to just get very significant overall demand growth for ethane.

So net-net, I think this is a great story for us. It may mean that we have to do an additional expansion on Sand Hills and that is a great, great problem to have.

James Spicer - *Wells Fargo Securities - Analyst*

Thanks a lot, guys.

Operator

Selman Akyol, Stifel.

Selman Akyol - *Stifel Nicolaus - Analyst*

A couple quick ones for me. First of all, just going back to the contract realignment of the $235 million and I understand the recontracting is done, but I'm just wondering just on a run rate, was all that recognized in 2016 or could there still be any uplift going into 2017 on a year-over-year basis?

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

No, the number I gave you, the $235 million, is if you stopped contract realignment on December 31, 2016 and then obviously there are things that you did somewhere during the year, so that $235 million is an annualized number that will be realized here in 2017.

But remember what we have tried to work to when we rolled this out in February 2015 is to get to $200 million annualized by the end of 2017. So that would have been done into 2018. That's how we are a year overhead of where we wanted to be.

Is there more contract realignment opportunities? I think this now has become part of our daily business. So there is opportunities when contracts come up where we can go after things, try to redo the contract, maybe add some more fee-based to the contracts or add some other fees. But as a major call it initiative, it is something that is pretty much done for us.

Selman Akyol - *Stifel Nicolaus - Analyst*

Okay, thanks. In terms of the $900 million of investments here, are you guys primarily planning on doing that with equity?

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

I will let Sean go on this one. As you know, we are sitting on cash on the balance sheet today. We are talking about some pretty significant operating leverage that we have here in 2017. I think we have internal cash that we will generate that we can use to add some growth and then after that, there may be a combination of some debt or equity.

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

Wouter hit it. The only thing I would add, we are in a great spot sitting on some cash. The industry has continued to improve. So if you think about our forecast as we alluded to on the call, we are more towards the mid to higher end of our ranges. That is generating more cash flow and then you look at projects that we do have in slate, they are very low multiple, high return projects. So at the end of the day, it's very easy to finance those projects in a very creative way.

So in the short run, I don't see a lot of need for capital markets, but we will keep an eye. If the growth continues, we have a high end of that range of $2 billion. Obviously, we may need a little more, but in a good place to start with cash on hand and some increasing cash flows as the industry continues to improve.

Selman Akyol - *Stifel Nicolaus - Analyst*

Got it. And then on Sand Hills, you referenced one expansion, but you talk about that it could be larger. I guess if you started with a blank slate, how large do you think that pipe could be?

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Probably -- and we are in the early innings. The team is looking at a lot of different opportunities. We have been looking at that for a number of months, but you can probably go up to high 500s.

Selman Akyol - *Stifel Nicolaus - Analyst*

Okay.

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Very significant expansion that you potentially could do if we chose to go that route.

Selman Akyol - *Stifel Nicolaus - Analyst*

Got it. And then just the last one. And I know you talked a little bit about asset sales, but is there anything left to do there as well?

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

No, not really and I think the small sale that we did in Q4, it was fairly de minimis and immaterial. I think there's always opportunities around a portfolio where you do something, but I do not think you should expect anything at a material level.

Selman Akyol - *Stifel Nicolaus - Analyst*

All right. Thanks very much.

Operator

Elvira Scotto, RBC Capital Markets.

Elvira Scotto - *RBC Capital Markets - Analyst*

A couple of quick ones for me. I guess, one, when you talk about the potential ethane margin uplift on the NGL pipelines of $75 million to $100 million, how much incremental CapEx spend do you need to capture that full amount? I know -- I think you said that you can capture half of that on existing capacity.

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Yes, I think that is probably the right way. Half is probably uplift on our NGL pipelines that we use existing capacity. There will be some that comes out of the G&B side of the house. It really goes to the earlier words that I spoke and some of the answers I gave is what is next for Sand Hills after the full expansion to 365,000 barrels a day. And I think that is a tremendously good luxury problem to have.

So I think the probably rule of thumb, take half of the $75 million to $100 million that you can continue to add as is and then after that some additional, definitely additional capacity needed depending on how large you go on this pipe.

Elvira Scotto - *RBC Capital Markets - Analyst*

Okay. And if you were to scale up the Sand Hills pipeline, is the CapEx -- are you going to generate similar types of returns as this latest expansion that you've done or are working through?

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

No, that would be great, Elvira, but the last one was a -- I think if we rounded up, we got to 2X multiple and setting pumps is something that's tremendously capital-efficient. We have other pipelines where we can continue to set pumps and you may see, if there is growth that you see in the DJ Basin or other things where you set some additional pump stations and you get those types of multiples.

I think on the next phase of Sand Hills, if we would go that route, I think you get to a little bit more in that 5X type of multiple, but still very strong fee-based returns that you look at.

Elvira Scotto - *RBC Capital Markets - Analyst*

Okay, thanks. And then can you talk a little bit about your hedging strategy in general? So when you look at the immediate year, how hedged do you want to be and then one year out, what is your hedged target, etc.? How to think about the hedging beyond the immediate year?

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

Elvira, the simplest way to think about it is we like to be 80% fee or hedged. As you can see, we are hovering in that 60%, 60% to 70% fee range, so we've got to do the delta via hedging. So this year, we are 72% with the current hedges we have in place and 60% fee. So our target for the remainder of this year obviously sitting here in February with market strengthening is to go out -- and I think we had it on that slide -- and get another 8%, which would get us to 80%. So that's the target we are going for.

As you think about 2018, we will go for the same range. We'd like to be around 80%. And we are looking, I can tell you right now, at rolling into 2018 hedges. We are looking for opportunities there and I think the market I am hopeful will give us some of that to start layering on some of those.

So to close out, we think at 80% fee and hedged gives us a lot of stability, but also, as we have noted a couple of times in our remarks, that it gives us some really good recovery opportunity to benefit from the upside as well. But 80% is the number I think you want to keep in your head.

Elvira Scotto - *RBC Capital Markets - Analyst*

Okay, great. And then just the last one from me. Of the fee-based earnings, what percent of those are underpinned by take-or-pay type contracts?

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

There's probably not a ton of that. A lot of our fee-based comes from our pipelines. Obviously our pipelines are a combination of some of that type of activity, as well as plant commitments, if you will, or plant dedications. So I can get you the percentage, but I don't think it's an incredibly high percentage that are tied to take-or-pay.

Elvira Scotto - *RBC Capital Markets - Analyst*

Okay, great. Thanks. That's all for me.

Operator

Derek Walker, Bank of America.

Derek Walker - *Bank of America Merrill Lynch - Analyst*

Most of my questions have been answered, but just a quick one on the Eagle Ford. I think in your formal remarks you mentioned some stabilization mid-year with some slight growth in the back half of the year. Just given where the utilization is today around 75%, how should we think about that utilization towards the end of the year?

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

I think it's a little bit too early to tell. I think there are -- when you are looking overall, we are seeing a large number of drilled and uncompleted wells around our footprint, more than 1000. We are seeing increased activity. Volumes I think are stabilizing, as I said, in the summer and hopefully an uptick in the second half.

I think it's too early to say what is the utilization going to be. What our hope is and when I talk a lot about operating leverage is how do you get more through plants and if you think about that, we have very efficient plants there. We have volumes that go into the Sand Hills pipeline as well, so you get paid twice for the activity and that will throw a lot of dollars to the bottom line versus having to go out and do new greenfield plant-building or other things like that.

So I think it's a little bit too early. I think over the next couple of months, if we see how the Eagle Ford here plays out, I can probably give you a better answer.

Derek Walker - *Bank of America Merrill Lynch - Analyst*

Got it. I appreciate that. I guess just a clarification question on the leverage front. It seems to include some EBITDA credits I guess as you look at the 2018 leverage of the 3 to 4 times. Does that include the 200 a day plant in the DJ that's expected to go in in 4Q of 2018? Is there any EBITDA credit from that?

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

Yes, they are not huge, obviously, the EBITDA credit -- the answer is yes. As we do projects, growth projects on your bank calculation, you do bring credits in. I would tell you they ramp up over time. It is not like you get the full value day one, so they are very small initially and then they grow obviously as you approach the in-service date and start realizing real cash flow from the plants.

But, right now, we are in the position where it's not driving much value. More to come. Obviously, as we get forward, if growth continues, again if we start to see more projects get closer to that $2 billion, it will become a larger part.

But I can tell you, we went through -- if you think about the last five to seven years with this Company, we had the EBITDA credit concept in there. We had a very large capital program and it actually -- actual results in the credits panned out very well for us in the long run.

Derek Walker - *Bank of America Merrill Lynch - Analyst*

Got it. Appreciate it, guys. That's it for me.

Operator

Chris Sighinolfi, Jefferies.

Chris Sighinolfi - *Jefferies & Co. - Analyst*

First, just a quick note to Andrea and the team for the new presentation. Very much appreciate the added color. Super helpful to us. So thank you for that.

I guess starting first question and this maybe dovetails on something Jeremy was asking about earlier. I think he was noticing some of the seasonality or whatnot in the natural gas services segment, but just curious as it pertains to MVC, are those -- I think, Sean, correct me if I'm wrong -- but there was a realization probably $13 million to $15 million this year. Is that principally in natural gas services or is that -- can you help us understand the composition of where that falls?

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

That is -- the MVC has been there. It's related to the Cobra assets and it's not a -- if you think about it, it's a difference in DCF and when you -- accounting recognition. I think you get the cash through the year, but the MVC pops out. Accounting recognizes it all in Q4. It's been that way for quite some time. I think, Chris, if you look at it, you are looking at an absolute number for a quarter, but I think that delta on that MVC versus last year was de minimis. So meaning it was there last year as well. So not a big driver. It's with Cobra. It's not someone that's not meeting their requirements. We do get the cash flow.

Chris Sighinolfi - *Jefferies & Co. - Analyst*

Right. Okay. I note -- we've been noticing that, obviously, you've been adding it on a ratable basis to the DCF, but I figured it was providing maybe a bit of that segment pop on the EBITDA level in 4Q.

And then I guess as it pertains for 2017, now that you have the LLC assets in there, what is the expectation around MVCs for 2017 in the budget?

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

I think it would be very similar. The biggest driver is going to be that Cobra asset. There are some contracts, but most of that will be in 2018, Chris. Wouter has alluded to some of the growth -- we derisked some of the growth in the long run with some volume commitments. Obviously, as we are deploying capital in the short run, we want to make sure we have some of that. None of that is really going to come into play in a big way in 2017. That was tied to LLC assets. So I wouldn't expect a big rampup or anything. It's really still going to be driven by the DPM type of MVCs that you saw.

Chris Sighinolfi - *Jefferies & Co. - Analyst*

Okay, perfect. I just have a couple questions as it pertains to ethane. Really appreciate the depiction on slide 24 and it looks like, if I think about the present level of rejection and then the $75 million to $100 million margin uplift that's potential, it looks like that's about a $0.09 blended bundled rate on your recovery. Understanding the concentric circle nature of how this market is likely going to move from rejection to recovery, just wondering if there's any color you can provide on maybe how that rate structure changes for your assets as we move away from the Belvieu market center?

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Well, in the end, I think if you think about strict economics without any arbitrage, the way that would work is just the transportation is what needs to move up. So getting from the Eagle Ford to Belvieu is cheaper than getting from the Marcellus to Belvieu. So that is really what, on a marginal basis, should drive overall ethane prices.

At the same time, I think you are going to see different plants go into recovery for a variety of reasons. It's not just ethane by itself. Obviously this is a spread game, so it's where is ethane as it is relative to natural gas and we are seeing right now you are on the edge of where some of the plants make a little bit more sense from an ethane point of view and you start recovering and I think we are going to continue to see that in a little bit of a choppy fashion here over the next couple of quarters and then hopefully much more constructive towards the back end of the year.

Chris Sighinolfi - *Jefferies & Co. - Analyst*

Okay. On the TNF side, I think you guys have been offering an incentive ethane tariff rate on Southern Hills. I am just curious are there market signals we could look forward to to maybe gauge at what point you will start walking that back down to a normal either walk-up rate or contract it out?

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Obviously, if you are in the money and ethane would be fully in the money then that incentive rate is going to be gone. It's a rate that we would set and have set on a monthly basis. If you go back really when we had a little bit of an ethane spike in the summer of last year, June, July of 2016, we were right on the edge of -- you weren't completely in the money, but you were in this gray area. That's why we have that incentive rate to tell people, hey, why don't you start recovering and we can then transport net-net ourselves or a third-party midstream or a producer. They will benefit and DCP will benefit as well.

So we are going to continue to take a look at that. Those are rates that we are filing on a monthly basis and you know what, again, it all depends on the spread between ethane and gas. But this is not something that we would do -- if ethane gets deep in the money, there obviously is no reason to give an incentive rate.

Chris Sighinolfi - *Jefferies & Co. - Analyst*

Right, right. Understood that, okay. I guess final question on ethane is just what, if any, of that opportunity that you outlined on slide 24, the $75 million to $100 million, is in the guidance? If I were to look at midpoint EBITDA (multiple speakers)?

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

There is nothing in our guidance. We were very clear about that. We are constructive around ethane and we have good hopes, but we tend to believe in plan for the worst, hope for the best. So all that would be upside to the ranges that we've given today.

Chris Sighinolfi - *Jefferies & Co. - Analyst*

Okay. And if I could just ask one more. It's on a different topic. It follows up on Elvira's question around hedging. I used to always interpret NGL hedging marketplace comments through what Spectra was saying when they held -- when LLC had its own assets, but they would always bemoan the shallow nature and somewhat illiquid nature of that market.

I'm just wondering, Wouter, has hedging of the products improved? I know obviously you own all those assets now. Sean went through the plan to be 80% fee or hedged as you go into a year. Just wondering if that market is getting more liquid and if it is getting deeper.

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Yes. I think those comments are really comments that are probably a couple of years old, but, unlike the overall NGL products market, has absolutely become deeper. If you go back a number of years, people used to do dirty hedges and use NGLs with crude. Obviously, that didn't work out very well at times, but right now and what we are doing is we are doing direct hedges of the product. So it's a direct propane hedge and things alike. So they are very clean. The markets are deeper. The markets have a little bit better [center].

Chris Sighinolfi - *Jefferies & Co. - Analyst*

Wonderful. Thanks a lot for the time, guys. Appreciate it.

Operator

Jerren Holder, Goldman Sachs.

Jerren Holder - *Goldman Sachs - Analyst*

Just wanted to follow up again I guess maybe on the natural gas services EBITDA when you look at fourth quarter versus third quarter. So that was up about 20% even though volumes were down. How can we explain the increase in EBITDA from last quarter to the fourth quarter? What's the drivers, I guess, of that?

Sean O'Brien - *DCP Midstream LP - Group VP & CFO*

So a couple things we talked about and maybe got to the seasonality comment people were referring to the Cobra, so that's a fourth-quarter event, Jerren. The other thing I think to consider is -- and we've talked about it in the past -- volumes are not all considered equal. When you look at some of the areas where we are seeing volume declines, they tend to be our lower realization type areas. When you look at the areas where we are seeing volumes increase and grow, they are in our high -- we have said many times the DJ is our number one region and basin. We make very good returns there. The Permian we make very, very good returns there.

And I think, lastly, we spent some time earlier on the call talking about contract realignment. If you think about where those efforts were focused on, that was not a volume effort; that was more around, hey, how do we improve our margins, how do we improve our average volumes and again, those were in areas like the Permian and the portions of the Mid-Continent where we are not seeing massive volume declines.

So on average, our average returns are going up in the areas where we make more money. Obviously, we are seeing bigger declines in some of the areas where the returns are a little less and then you have a little bit of seasonality with the Cobra item that people have mentioned before.

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Maybe let me add, Jerren, a couple of quick things around this. And like we've talked about our DCP 2020 strategy that we've been working on over the last two years, all of that is about operational excellence and how do you translate that in the end into your models and how you look at this Company. Better reliability. I think people underestimate how much money you can generate and throw to the bottom line if you have better reliability.

If you are the largest NGL producer, the largest gas processor in this country, you take an awful amount of gas through your system. You transport a lot of NGLs. If somehow you can get 1% more run time out of your assets, that throws a lot to the bottom line. So that's why that piece is so, so critical.

The same around sustainable cost reductions. $200 million of costs that came out of this asset base over the last two years while growing the asset base by $7 billion, that creates a tremendous amount of leverage and we are running the assets better.

So those are the things that I think you've got to look at. It's not always volume-driven. It's not all about, hey, how much more money do I spend to build something new. If you have a large entity like this entity is, there is a tremendous amount of operational leverage that you have.

Jerren Holder - *Goldman Sachs - Analyst*

Thanks. I guess as a follow-up question, we've obviously seen some deals in particular in the Permian clear. How active do you want to be in terms of third-party M&A in any of your basins?

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

We have spoken about this, I think, a lot with all of you on the call here individually or in larger forums. We are not a company that goes out and does the high multiple, large, large acquisition. That's historically not what we have done. Can we do it at some time? Absolutely, but we are very cautious about buying someone else's dream and hoping that it's all going to work out. We are very, very prudent around this.

You talk about the Permian. I think that's a great example. If you think about the Southern Delaware, there's obviously a lot of things that are happening out there. So you can play in the Southern Delaware via doing a big acquisition and buying someone else, or you can play in the Southern Delaware with your NGL business and you are not betting on one producer. You are not betting on just limited acreage. What you are betting on is on an entire basin, like the Permian Basin, like we are doing with the Sand Hills and our NGL business.

So Jerren, we continue to look at anything and everything, but the great high price, blue sky, high multiple acquisitions that we will go into over a number of years, I think it's unlikely that you will see us do any of those.

Jerren Holder - *Goldman Sachs - Analyst*

Okay. And last question from me, what about the potential for joint ventures? Obviously, you guys have excess capacity in certain regions. For example, in the STACK, there are other companies that can't build persistent capacity quick enough and then you guys have some excess capacity. Have you guys looked at potential arrangements where you could do some JVs around some of those?

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Yes, absolutely. And I think we are very comfortable around doing joint ventures. Obviously, our Company is a joint venture. And joint ventures are not for everyone, but we like the construct, the governance and how to operate in a joint venture. So if there is something to do where you can create capital efficiency between us and someone else, we are definitely very open to those and there's discussions that we have going on all the time.

Jerren Holder - *Goldman Sachs - Analyst*

Okay. Great. Thank you.

Operator

James Carreker, US Capital Advisors.

James Carreker - *US Capital Advisors - Analyst*

I missed the beginning, but don't know if you touched on it. Eagle Ford volumes sequentially were down fairly substantially. Is there anything unusual going on there in the fourth quarter?

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Yes, we spoke a little bit about that. We did see some steeper declines in the second half of last year and the real driver of that was one producer that had a fairly large shortfall in volume throughput commitment that really was driving that Eagle Ford overall volume.

I want to turn you to why our transaction that we did is also such a good transaction when it comes to just mentioning the Eagle Ford. Historically, the South or the Eagle Ford was probably about a third of the old legacy DPM, so it was a very big driver of the overall volumes and the profitability of legacy DPM.

If you look at the new entity, the combined DCP, new DCP, it's probably about 15%, 1-5, of the entire portfolio, so it is absolutely smaller and I think it's being offset by some other areas that continue to see some really nice and robust growth.

And as I said earlier on some of the questions and in my words was that we are cautiously optimistic around the Eagle Ford. I think the Eagle Ford has the potential to surprise us somewhere in the second half of this year.

James Carreker - *US Capital Advisors - Analyst*

Thanks. And in your slides, you also put forward 2018-plus targets of a 4% to 5% DPU growth. I just wanted to clarify. You are saying potentially in 2018, but not necessarily? Is that what you want to put forth?

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Yes, what we have given you is we have given you a strategy of these are the various things that need to come together. So we want to have 1.2X of DCF coverage or larger. We are working towards a balance sheet that has 3 to 4 times leverage on it and if you are in that place, then you can do a distribution growth, call it 4% to 5% in 2018, then everything comes together. And if we start looking at our internal numbers; we are looking at where is the industry going, we are pretty comfortable that we can make that kind of trifecta work and get to a place where in 2018 we can get to sustainable distribution growth.

James Carreker - *US Capital Advisors - Analyst*

Fair enough. And then I guess just being as you guys do have so much -- do produce so many NGLs, we have seen a really nice pickup in NGL prices, especially considering crude has been somewhat flattish. Just wondering if you guys have any thoughts about what's driving that and where your internal thoughts are about NGL pricing going forward and in relation to crude too. Would appreciate it.

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Yes. I think there's a couple of things that obviously here in February predominantly have gone up. Ethane has gone up so rolling from January to February months, ethane probably went up $0.08, $0.09, $0.10. I think propane continues to be pretty strong. So overall, I think we see good overall demand growth on the NGL side. As I said earlier in some of the questions, I think it's probably going to be a bit choppy here over the next number of months, but I think the overall trend feels very constructive.

James Carreker - *US Capital Advisors - Analyst*

Okay. Thank you. That's all I have.

Operator

I would now like to turn the call back to Mr. Wouter van Kempen for any further remarks.

Wouter van Kempen - *DCP Midstream LP - Chairman, President & CEO*

Thanks, Andrew and thank you all again for joining us today. If you have any follow-up questions, please give Andrea or Irene a call. Irene Lofland recently joined the IR team as our VP of Investor Relations, so she would be absolutely available to talk to as well and we look forward to introducing her to you in person soon and have a great day and thanks for your time.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program. You may all disconnect. Everyone, have a great day.
