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DCP Midstream Partners LP *(DPM)*

Q1 2012 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the First Quarter 2012 DCP Midstream Partners Earnings Call and Webcast. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Jonni Anwar, Director, Investor Relations. Please go ahead.

Jonni Anwar
Director-Investor Relations, DCP Midstream Partners LP

Thanks, Denise. Good morning and welcome to the DCP Midstream Partners First Quarter 2012 Earnings Release Conference Call. As always, we want to thank you for your interest in the Partnership. Today, you will hear from Mark Borer, President and CEO; and Angela Minas, Vice President and CFO.

Before turning it over to Mark, I will mention a couple of items. First, all of the slides we will be talking from today are available on Investor Page of our website at www.dcppartners.com.

Next, I would like to remind you that our discussions today may contain 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 lists some of the risk factors that may affect our actual results. For a complete listing of the risk factors that may impact our business results, please review our most recent Form 10-K and Form 10-Qs, as filed with the SEC. In addition, during our discussion, we will use various non-GAAP measures including distributable cash flow, adjusted EBITDA and adjusted segment EBITDA. These measures are reconciled to the nearest GAAP measures in schedules provided on our website. We ask that you review that information as well.

And finally, a note about the presentation of our earnings. In March 2012, the Partnership completed the acquisition of the remaining 2/3 interest in DCP Southeast Texas Holdings GP, or Southeast Texas, from DCP Midstream LLC. The results of operations presented today include the historical consolidated results of Southeast

Texas for all periods presented. For comparison purposes, we have also included our 2011 historical results, as reported in 2011 prior to the transaction.

And now, I will turn it over to Mark Borer. Mark?

Mark A. Borer

President, Chief Executive Officer & Director, DCP Midstream Partners LP

Thanks, Jonni. Good morning, everyone, and thanks for joining us today for a discussion of our first quarter results. We're off to a good start in 2012. As you saw in our press release last evening, we reported solid first quarter results, which were in line with our 2012 DCF guidance.

In addition to meeting our financial goals, you will see as we walk through the quarter that we continue to diligently execute on our growth strategy. On Slide 3, you will see our agenda. I will begin with some highlights for the quarter and an operational update. Angela will follow with a financial overview of the quarter. I will then close with an update on our growth outlook, including the continuing positive momentum for DCP Enterprise growth opportunities.

We'll start on Slide 4 with some highlights for the quarter. We generated distributable cash flow of $55 million for the quarter, in line with our 2012 forecast, providing a distribution coverage ratio of 1.3 times for the quarter and 1.1 times over the trailing four quarters. We raised our distribution again this quarter, representing a 1.5% sequential quarter increase, in line with our forecast of 6% to 8% distribution growth in 2012. We continue to execute on our growth objectives with an eye toward increasing our asset and business diversity, as well as our fee-based margins. To this end, we completed the previously-announced contribution by our general partner, DCP Midstream, of the remaining 2/3 interest in the Southeast Texas joint venture into the Partnership.

In mid-April, we announced the acquisition of a 10% ownership interest in the Texas Express NGL pipeline joint venture project, consistent with our strategy of transformational growth with an emphasis on fee-based NGL infrastructure. Both transactions continue our co-investment strategy with our general partner and are complementary to the growth opportunities we executed this past year.

A key element of our growth strategy is our financial positioning. On that front, we are pleased to have received an investment grade rating from Moody's, as well as our continued strong capital markets execution. Angela will provide some additional color in a few moments.

In summary, we had a strong first quarter and are progressing well in terms delivering on our 2012 business plan and three-year outlook commitments.

Turning to Slide 5, I will provide a brief operational update, beginning first with the Natural Gas Services segment. We continue to view our diverse geographic footprint as a strong positive as it provides us with access to multiple resource plays, contract types and customers with our ongoing Eagle Ford expansion continuing to further enhance that [indiscernible] (05:57). That diversification has continued to serve us well as we look at volume and margin trends over time. On a sequential quarter basis, gas throughput and NGL production volumes in the aggregate were flat to modestly increasing on our volumetric-based margin systems. We have continued to see a shift by producers into the liquids-rich areas as a result of sustainable, favorable crude oil and NGL prices. In our Wyoming and East Texas Systems, we saw higher volumes as a result of new dedications and liquids-rich drilling activities. Additionally, we are optimistic regarding new organic growth opportunities at a number of our assets.

Our dry gas exposure is relatively limited, and where we are in dry gas basins, we generally have contract structures that mitigate volume exposure, such as the substantial shipper pay commitments in the Piceance Basin.

Our Eagle plant construction is on plan for a fourth quarter startup. The Eagle plant will add additional needed capacity as DCP Midstream nears full utilization later this year at its five existing South Texas and Eagle Ford plants.

Our Keathley Canyon expansion continues to proceed on plan for a mid-2014 startup. We've committed to the pipe order during the first quarter and completed the major geotechnical surveys. Overall engineering and procurement activities continue to progress as planned. We continue to expand our scale and scope in this segment with the January closing of the East Texas dropdown and the late March closing of the South East Texas dropdown, both of which provide immediately-accretive cash flows.

Moving to Slide 6 for our NGL Logistics segment, this segment, which generates predominately fee-based margins and is complementary to our gathering and processing business, has been and will continue to be a key focus area for us as we grow the Partnership. We are very pleased with the significant growth in scale and scope of this business over a relatively short period of time.

Our assets are well-positioned in strong, growing markets. We had another quarter of strong volume growth. Our Wattenberg pipeline, which connects to DJ Basin to the Conway hub, is running near full capacity, which is sooner than we originally planned due to rapidly-increasing volumes in the DJ Basin.

Additionally, our Seabreeze and Wilbreeze pipeline volumes have ramped up by approximately 80% over the past year with the dramatic growth from the Eagle Ford shale. Given the strong fundamental of liquids-rich drilling and the need for the additional takeaway capacity, we continue to find attractive opportunities to expand our footprint in this business. We are excited about our recent investment in the Texas Express NGL pipeline, which is detailed on Slide 7.

On April 12, we acquired a 10% ownership interest in the Texas Express pipeline joint venture from the operator, Enterprise Products Partners, representing a total planned investment of $85 million for the Partnership. The NGL pipeline infrastructure project will provide much-needed takeaway capacity from the Rockies, Permian Basin and Mid-Continent to the Gulf Coast providing producers an opportunity to access the largest NGL market in the U.S. and maximize the value of their NGLs.

Originating near Skellytown in Carson County, Texas, the 20-inch diameter NGL pipeline will extend approximately 580 miles to Enterprise's NGL fractionation and storage complex at Mont Belvieu and will provide access to other third-party facilities in the area. There are numerous compelling attributes to this investment. It further diversifies our asset portfolio and enhances our scale and strategic positioning in the NGL infrastructure business.

The long-term shipper pay agreements of 252,000 barrels per day underpinning the project will provide fee-based margins with minimal volume exposure. The size and timing of capital spending and cash flows of this organic build project also fit well within our overall capital and distribution growth outlook. Texas Express is also integral to DCP Midstream's assets and strategic positioning, including synergies with its recent investment in the Front Range NGL pipeline joint venture project, which will connect the DJ Basin to Skellytown and Texas Express.

As DCP Midstream is one of the largest gatherers and processers in the DJ Basin and Mid-Continent, Texas Express will help provide Midstream and its customers with reliable takeaway capacity to [indiscernible] (11:10). In conjunction with our investment in Texas Express, a DCP Midstream affiliate committed 20,000 barrels per day to the pipeline. This pipeline is expected to be completed by the second quarter of 2013. This is another prime example of how we are co-investing and effectively partnering with our general partner and is also in line with our strategy of utilizing the MLP as a growth vehicle for the DCP Enterprise.

Now moving to Slide 8 for our Wholesale Propane segment. We are pleased to report record financial results for the latest fiscal year. These results were achieved despite near-record warm winter weather and recent challenges in the retail propane sector.

Our Wholesale business model with its fee-like margins and diversity of supply has been a consistent performer and provided attractive growth. We do see some pressure on margins but remain very pleased with the returns of this business. We're also pleased with our expansion last season into the Mid-Atlantic with our acquisition of the Chesapeake, Virginia terminal. We continue to seek opportunities to grow this segment through acquisitions and active evaluations of organic build opportunities.

With that, I will turn it over to Angela to review the financial results.

Angela A. Minas

Chief Financial Officer & Vice President, DCP Midstream Partners LP

Thanks, Mark, and thank you for joining us today. Beginning on Slide 9, distributable cash flow of $55 million for the quarter was in line with the 2012 DCF forecast that we introduced on our earnings call last quarter. Although our business is substantially fee-based or commodity-hedged, we do provide our forecast in the context of the commodity pricing environment. If you take into account the commodity prices year-to-date and the forward curve for the balance of 2012, the table would indicate DCF between approximately $165 million and approximately $180 million.

Given the seasonality of our Wholesale Propane business and our Natural Gas Storage business going forward, we would generally expect lighter second and third quarters. Also, as introduced in our last earnings call, we are targeting distribution growth of 6% to 8% in 2012.

Embedded in our 2012 forecast at the 6% is the $0.01 increase we made this quarter and the assumption that we would continue to increase the distribution an additional $0.01 every quarter at a minimum. So our first quarter distribution is in line with our forecast. As a reminder, our 2012 forecast did include the impact of the Southeast Texas dropdown, which was closed March 30. Consistent with past practice, it does not include the impact of potential future acquisition or co-investment opportunities or any unannounced organic expansion projects.

As we indicated previously, we believe we can achieve our targeted distribution growth through our existing asset base in combination with identified and targeted co-investment capital of $600 million in 2012.

Now turning to Slide 10 for further details. As a reminder, consolidated financial results are adjusted to remove the impact of non-cash mark-to-market activities of our commodity hedges, which are outlined in the Appendix, as well as the non-controlling interest in our joint ventures.

In addition to the consolidated results, which are required to be recast for both the first quarter of 2011 and the first quarter of 2012 as if we always owned our now 100% interest in Southeast Texas, we also show the results as reported in 2011, which better reflect the trends and results achieved over time. As such, I will be discussing the results as reported in 2011 as the basis for comparison.

Distributable cash flow, which is the most relevant comparison of the Partnership's performance since it removed [indiscernible] (15:33) size impact of pooling on 2012 results, increased to $55 million for the quarter compared to $46.4 million in the prior year. Distributable cash flow for the quarter is the highest since inception of the Partnership. Our distribution coverage ratio of 1.3 times is based on distributions declared. When adjusting for the timing of actual cash distributions paid, the cash coverage ratio would be 1.5 times.

For more detail on our results, let me move to the segments. Starting on Slide 11 with Natural Gas Services, adjusted EBITDA for the quarter increased to $66.6 million from $36.4 million, reflecting the dropdowns of the 50% interest in East Texas on January 1, 2012, and the 2/3 interest in Southeast Texas for pooling purposes as if it also occurred January 1, 2012. Also positively impacting adjusted EBITDA for this quarter were lower operating expenses, which was largely the timing of expenditures.

A good estimate of our annual operating expense run rate, given our existing asset base, would be approximately $90 million to $95 million. As a reminder, on the accounting treatment, given that the East Texas joint venture was consolidated for accounting purposes, figures for gross margin and operating expense were previously shown on 100% basis with the minority interest netted to get to adjusted EBITDA for our 50% ownership.

Our 33% interest in Southeast Texas would have previously been shown as earnings from unconsolidated affiliates with its operating expense netted to get to earnings rather than included in the operating expense line.

On Slide 12, our NGL Logistics adjusted EBITDA increased by 84% to $11.8 million from $6.4 million the prior year, delivering record adjusted EBITDA results for the quarter. Higher EBITDA reflects the completion of Wattenberg capital expansion project, increased throughput on our pipelines, in particular the strong ramp-up in the DJ Basin and Eagle Ford, and our acquisition of the DJ Basin NGL fractionators. The numbers reflect our growth focused on this segment and the resultant increase in size.

Slide 13 indicates the results from our Wholesale Propane segment. As a reminder, this business has considerable seasonality with the majority of its earnings coming during the fourth and first quarters. Timing of winter weather and other factors may also impact earnings recognition across those quarters, so calendar year comparisons can be misleading. As such, we view the fiscal year or heating season April 1 to March 31 as a more relevant comparison. For the heating season just completed with the first quarter of 2012, this business delivered record adjusted EBITDA of $34.2 million. The graph on this slide illustrates the steady growth trend since we acquired business in 2006. Strong heating season results were driven by favorable unit margins, partially offset by a modest 3% decline in volumes primarily resulting from the near-record warm winter weather.

Turning now to Slide 14 for our financial positioning, which is a key element of our growth strategy. We had an active quarter in terms of financing activity and our accomplishments continue to position us well in terms of both liquidity and cost of capital to support our growth outlook. We are pleased to have received an investment grade rating of Baa3; stable from Moody's. The rating complements our investment grade ratings of BBB-; stable from S&P and Fitch and marks the final milestone in the successful execution of our investment grade plan. As only one in five MLPs are investment grade, we are committed to maintaining those ratings and believe that there are several benefits, including cost of capital, access to capital and competitive positioning.

Our investment grade plan has been a key part of our strategic and disciplined approach to long-term financing of growth and terming of debt on our credit facility. Our objectives have been to access the term public debt markets as an investment grade entity, and to do so when overall rates were favorable. As such, we successfully executed our first 10-year public debt offering through the issuance of $350 million of 4.95% of senior notes. This, in combination with our late 2010 inaugural investment grade public debt offering of 3.25% five-year seniors note, positions us with a highly-competitive current cost of debt.

Our track record also positions us well to continue to access the public debt market at a competitive cost to support future growth. On the equity side, we raised $234 million in capital through the successful execution of a public equity offering, which was sized to meet our current capital needs while also maintaining credit metrics and liquidity that provide us with some financial flexibility.

Turning to Slide 15 for the numbers behind our balance sheet and credit metrics. Our effective interest rate on our total debt position at quarter-end was 4.4%. Our credit facility leverage ratio was 3.2 times and our debt to capitalization ratio was 45%. Our public term debt as a percentage of our overall debt has increased to approximately 70% and our unutilized revolver capacity is increased to over $700 million.

In summary, we have solid capitalization, a competitive cost of capital, substantial dry powder on our revolver to support the execution of future growth opportunities, and credit metrics in line with our investment grade ratings.

Given these items, we believe that the Partnership is well positioned to serve as a significant source of funding for very sizable growth at the DCP Enterprise, both DCP Midstream and the Partnership, as outlined in our three-year growth outlook.

With that, I will turn it back over to Mark to talk about progress on our growth projects and opportunities.

Mark A. Borer

President, Chief Executive Officer & Director, DCP Midstream Partners LP

Thanks, Angela. We first introduced Slide 16 a couple quarters ago as a way to think about and track our co-investment activities as we begin to emphasize this element of our strategy. As a refresh, we have a three-pronged approach how we think about co-investment alternatives and the numerous forms that it can take, effectively utilizing the Partnership to finance growth for both ourselves, as well as DCP Midstream.

To summarize, the first alternative is direct investment or acquisition, in which we invest capital in assets with MLP-friendly characteristics where those assets are really part of the larger strategic investment for DCP Midstream. The second alternative is an organic build project, in which we provide the capital to construct all or part of an asset. A third alternative is a dropdown with the redeployment of the cash proceeds by Midstream into other capital projects.

A key element of our co-investment model is the cash flow profile and the ability to structure the investments to provide MLP-friendly characteristics. Co-investment opportunities have continued at a nice pace. As you can see, this quarter, with the addition of Texas Express, the cumulative amount of co-investments now stands at almost $800 million. As we have done in the past, the timeline on this slide is based on when the investments were announced, which is effectively when the commitments were made.

Last quarter, when we introduced our three-year co-investment outlook, we laid out identified opportunities of $600 million for 2012 and $1 billion per year, respectively, for 2013 and 2014. With respect to 2012, the $240 million commitment to Southeast Texas earlier this year leaves us with an expected $360 million of 2012 co-investment commitments remaining. We view the $85 million Texas Express commitment as incremental to the $600 million of previously-identified 2012 co-investment opportunities.

Turn to Slide 17; I will continue with an update of our growth outlook. The DCP Enterprise has $4 billion-plus related to projects in execution and another $2 billion-plus in potential opportunities. Midstream continues to see significant investment opportunities fueled by its ability to fully leverage its strong existing asset footprint in basins with growing liquids-rich production. Additionally, as the largest NGL producer in the lower 48, Midstream is leveraging that strength to reposition the company from being gathering- and processing-centric to a full NGL value chain Midstream service provider.

This repositioning has created NGL infrastructure opportunities under construction, such as the Southern Hills and Sand Hills NGL pipelines. These in turn have also created a platform for additional growth going forward, such as the recently-announced Front Range and Texas Express NGL Pipeline as the NGL Logistics needs of the industry and the DCP Enterprise continue to grow.

On our last earnings call, we indicated that subject to approvals of both the Midstream and Partners' Boards, we would expect the Southern Hills and Sand Hills NGL pipelines to ultimately reside within the Partnership in the 2013 to 2014 timeframe.

As a brief update, Southern Hills, which is the 150,000 barrel day project from the Mid-Continent to the Gulf Coast markets, is expected to be fully in service by mid-year 2013. Sand Hills, which will provide NGL transportation service from the Permian and Eagle Ford to the Gulf Coast markets, is also on time and on budget.

We expect to complete the project's first phase during the second half of this year for Eagle Ford service with Permian flows by the middle of 2013. Given the sources of growth opportunities at both Partnership and Midstream, our growth strategy continues to be multifaceted, including co-investment, third-party acquisitions and organic growth.

However, with the significant level of growth opportunities currently in Midstream's footprint, we would expect relatively more emphasis on co-investment over the next few years. Our co-investment commitments today in our identified future co-investment opportunities total approximately $3 billion. From a transformational standpoint, we believe these growth opportunities will support the evolution of the Partnership into a large-scale MLP possessing substantial fee-based assets, a diversified asset portfolio and significant NGL infrastructure assets.

Now if you turn to Slide 18, I would like to close with a few summary points. First, our results-to-date position us well and we are on track to deliver on our 2012 business plan and three-year outlook commitments. We are successfully executing on our multifaceted growth strategy. Our investment grade ratings, cost to capital and liquidity position us well to support the execution of the DCP Enterprise strategy to utilize the Partnership as a key growth-funding vehicle. The large-scale visible growth opportunities currently in our pipeline put us well on our way to becoming a large-scale, diversified Midstream MLP.

Our target continues to be top-quartile total shareholder return, which is underpinned by our visible growth opportunities and strong distribution growth outlook. Having the strong sponsorship of DCP Midstream, Spectra Energy and Phillips 66, which was the downstream entity recently spun out of ConocoPhillips, our former owner, is a significant benefit to us and our unit holders. As you know, the DCP Midstream is a 50-50 joint venture with Spectra and Philip 66, and we've recently had our first board meeting with the new Phillips 66 members.

We have been working with them throughout the transition and continue to be fully-aligned with a strong consensus view on the growth plans for DCP Midstream and the Partnership. We believe our structure is unique and provides benefits to all the key stakeholders of both Midstream and the Partnership. The Partnership's access to capital markets supports Midstream's execution on escalating growth opportunities, while balancing distributions to Spectra and Phillips 66.

The Partnership, in turn, will realize accelerating growth and is able to participate in very significant projects which otherwise might be difficult for the Partnership to execute on its own. We're excited about the future and look forward to delivering on this attractive value proposition.

In closing, I also want to express my appreciation to Angela Minas for her significant contributions over the last three-plus years. Angela's last day with the Partnership will be this Friday. She leaves the Partnership with a strong record of capital markets execution and we wish her best in all her future endeavors. I also want to welcome Rose Robeson as the new CFO of the Partnership. Many of you know Rose, as she brings a wealth of experience to Partnership having over 25 years of industry experience, including most recently as the Group Vice President and CFO of DCP Midstream.

That is the conclusion of our prepared remarks. As I turn it back over to Denise, the operator, for your questions, I just want to express my appreciation for your interest in the Partnership and joining the call today. Thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. We will now begin the question-and-answer session. [Operator Instructions] And our first question this morning will come from Ross Payne of Wells Fargo. Please go ahead.

S. Ross Payne
Analyst, Wells Fargo Advisors LLC

Q

How you doing, everybody? First question is in terms of financing some of these growth projects going forward, do you basically look at it as 50% debt, 50% equity? And second of all, if you look at the debt to EBITDA levels, what would your targets be for maintaining certain kind of ranges of leverage there? Thanks.

Angela A. Minas
Chief Financial Officer & Vice President, DCP Midstream Partners LP

A

Okay. In terms of leverage, we have always looked at a 3 to 4 times in terms of our credit facility leverage ratio calculation. You can see we're at the lower end of that right now at the 3.2 times. And then in terms of financing growth, probably a little bit more equity, say at 55% equity, 45% debt is how we'll typically view it.

S. Ross Payne
Analyst, Wells Fargo Advisors LLC

Q

Okay. And Mark for you, what opportunities do you perhaps see with Phillips 66 now?

Mark A. Borer
President, Chief Executive Officer & Director, DCP Midstream Partners LP

A

We think they'll continue to be a very supportive sponsor. I know that they're very pleased with the history of the joint venture. So we really don't see any change in strategy. So I think they'll continue to be a supportive parent, and obviously, they bring a number of commercial relationships and such to the business. So we're pleased to have them on board and really think that we'd stay pretty much the same track we've been.

S. Ross Payne
Analyst, Wells Fargo Advisors LLC

Q

Do you see many opportunities that they're going to bring to the table similar to what DCP has been able to do for you in general? Or maybe Spectra?

Mark A. Borer
President, Chief Executive Officer & Director, DCP Midstream Partners LP

A

We think there will be some good touch points. I mean, clearly, they have refined product systems, which are pretty core to their needs. We have other touch points obviously with the CP Cam joint venture, so they'll continue to be a large customer. I do think that there will be some things on the liquids side with the closer touch points with them and being more meaningful to Phillips 66, that can create some opportunities for us. Without being specific, we feel good about those opportunities.

S. Ross Payne
Analyst, Wells Fargo Advisors LLC

Q

Okay, great. Thank you.

Mark A. Borer
President, Chief Executive Officer & Director, DCP Midstream Partners LP

A

Thank you, Ross.

Operator: [Operator Instructions] And showing no additional questions in the queue, this will conclude our question-and-answer session. I would like to turn the conference back over to Mr. Mark Borer for any closing remarks. Please go ahead, sir.

Mark A. Borer
President, Chief Executive Officer & Director, DCP Midstream Partners LP

I just want to say thanks again for your interest in the Partnership. If you have any follow-up questions over the coming days, please feel free to contact Jonni Anwar and we can make ourselves available to visit. Thanks and have a good day.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.