DCP Midstream Partners
"Second Quarter 2010 Earnings Conference Call"

Friday, August 06, 2010, 9:00am ET
Mike Richards
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OPERATOR: Good morning and welcome to the DCP Midstream Partners Second Quarter of 2010 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing "*" then "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on your touchtone phone, to withdraw your question, please press "*" then "2." Please note this event is being recorded.

I would now like to turn the conference over to Mike Richards, Vice President and General Counsel. Please go ahead, sir.

MIKE RICHARDS: Thank you, Andrea. Good morning and welcome to the DCP Midstream Partners second quarter 2010 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 Chief Executive Officer and Angela Minas, Vice President and Chief Financial Officer.

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 our website at www.dcppartners.com in PDF format. You may access to them by clicking on the Investor page and then the webcast icon.

Next, I would like to remind you that our discussion 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 actual results. For a complete listing of the risk factors that may impact our business results, please review our Form 10-K for the year ended December 31, 2009 as filed with the SEC on March 11, 2010 and updated through our subsequent SEC filings.

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 measure and schedules provided on our website. We ask that you review that information as well.

And now I will turn it over to Mark Borer.

MARK BORER: Thanks Mike. Good morning everyone and thanks for joining us today for a discussion of our second quarter results. As you saw in our press release last evening we reported second quarter results which were in line with our 2010 DCF forecast. In addition to meeting our financial goals, we have been diligently executing our growth opportunities and related business objectives which we will also discuss today.

On Slide 3, you will see our agenda for this morning. I will begin with some highlights of the quarter, and will then provide an operational update including execution of growth opportunities across all three of our business segments. Angela will follow with the financial overview of the quarter. We will close with our outlook and summary. We are pleased with the progress we have made thus far this year. We are optimistic about the

future and believe we are favorably positioned to continue executing our growth strategy as we move through 2010 and beyond.

Turning to Slide 4, let's discuss some highlights for the quarter. Second quarter financial results are on track to achieve our 2010 DCF forecast. We generated distributable cash flow of $24.9 million for the quarter and $56.6 million year-to-date providing a distribution coverage ratio of 1.14 times year-to-date and 1.2 times over the trailing four quarters.

In our year end earnings call, we introduced the resumption of distribution growth, as a 2010 objective. We declared a cash distribution of $0.61 per unit for the second quarter which is a 1.7% increase. The increase in our distribution speaks to our solid and sustainable business results, as well as our recent execution on growth opportunities. We are pleased to now have delivered on that important 2010 objective.

Improvements in the business environment along with opportunities in the market have enabled us to continue to execute on our growth objective through a series of fee based acquisitions and capital projects around our existing footprint.

Last week, we closed on an acquisition which expanded our existing wholesale propane business into the Mid-Atlantic region through the addition of a marine import terminal and storage facility in Chesapeake, Virginia. We also acquired this past week the remaining 55% interest in our Black Lake fee-based NGL pipeline.

In conjunction with our general partner, DCP Midstream, we announced in May plans to create an NGL joint venture with EQT Corporation, in the Appalachian Basin. Under the letter of intent EQT and the DCP Enterprise would pursue gas processing and related NGL infrastructure opportunities in the Marcellus and Huron Shale areas. I will discuss more of the details around each of these exciting growth opportunities as I go through the segments.

2010 is an integration year for the November 2009 Michigan acquisition as well as our January 2010 Wattenberg pipeline acquisitions. Both projects are progressing on plan and will drive incremental cash flows in 2011. Another key element of our growth strategy is our financial positioning. On that front, we have continued to execute on our financial objectives, having received our second investment grade rating from Fitch in May. In summary, we are progressing well in terms of delivering on our 2010 business plan commitments.

Turning to Slide 5, I will provide a brief operational update. Starting first with our Natural Gas Services Segment. As is the case again this quarter, we view our diverse geographic footprint as a strong positive, as it will provide us with access to multiple resource place, contract types end customers.

Gas throughput volumes held firm and were virtually flat on a sequential quarter basis. Since the second quarter of 2009, gas throughput volumes have been down a modest 2%. We are continuing to experience a modest rig count recovery from the lows we experienced in the second quarter of 2009.

NGL production was up 3% on a sequential quarter basis, plant turnarounds in East Texas in discovery had a modest unfavorable volume impact during the quarter. Integration efforts related to our bolt-on acquisition of fee based assets in Michigan are proceeding according to plan, on time, and on budget. We have rationalized some of the treating plant infrastructure and have begun to realize some of the targeted synergies.

We continue to see growth opportunities in this segment. We believe the emerging shale plays will continue to provide infrastructure development opportunities. Our recent announcement around the Marcellus is an example of this type of opportunity.

On the next slide, I will discuss this opportunity in more detail. Joint ventures between DCP which is collectively the partnership and our general partner DCP Midstream, as well as EQT Corporation. As contemplated by the letter of intent, DCP and EQT would each initially own a 50% interest in the JV. The JV is intended to serve EQT as well as third party producers in the Marcellus and Huron Shale areas of the Appalachian Basin.

Regarding the formation and the initial investment in the JV, DCP would contribute approximately $200 million in cash in exchange for its 50% interest in the JV and would operate the new JV. EQT would contribute to the JV an equivalent value in existing assets consisting of its 170 million cubic feet per day natural gas processing plant and related NGL pipeline located in Southeast Kentucky.

Terms and conditions of the JV agreement are being finalized, and signing is expected in the third quarter of 2010. We believe this is a strong partnership with both parties bringing complementary strengths and capabilities to the table. DCP has an industry leading position in natural gas processing and NGL marketing and is one of the largest NGL producers in the United States.

EQT has an industry leading exploration and production position in the Appalachian Basin with over 3 million of firmly held acres. We believe the JV will facilitate additional investment opportunities to meet the rapidly growing needs of EQT and other producers for processing capacity and NGL infrastructure.

Indeed, the cash we contribute to the JV will be targeted for expansion of existing and development of new facilities. In summary, this represents a strategic entry point into an attractive shale play. It strengthens the diversity of our asset portfolio and provides us with significant potential growth opportunity over a multi-year time horizon.

Now moving to Slide 7 for our wholesale propane segment. Timing of sales in winter weather tend to vary somewhat each year, while we experienced early cold this winter, we also had an early spring and warmer weather, which is reflected in lower demand in propane sales volumes in the quarter. This year’s winter season was in marked contrast to last year where winter weather and high spot sales volumes occurred later in the season.

Lower sales volumes also reflect a planned outage related to our Providence terminal inspection which is required once every 20 years. Additionally related to Providence, we amended a supply agreement to shorten the term of the agreement. The amendment provides us with additional flexibility in sourcing future supply.

In our Northeast market area, we continued to see strong demand from the residential service providers for next season. Through our successful contracting efforts, we are well positioned for this upcoming fiscal year. As the past several years have shown, this business model with its fee like nature has provided attractive growth. We have been targeting opportunities to expand into new markets. As such, we are pleased to expand our position into the Mid-Atlantic through the acquisition of Chesapeake terminal detailed on the next slide.

Last week, we closed on the acquisition of Atlantic Energy, a subsidiary of UGI Corporation for 49 million plus propane inventories and other working capital. Atlantic Energy owns and operates a marine import terminal with 20 million gallons of above ground storage in the Port of Chesapeake, Virginia. The asset serves as an important

supply point for propane customers in the Mid-Atlantic region. The transaction expands upon our existing position as one of the largest wholesale propane suppliers in the Northeast by extending into the Mid-Atlantic.

One of the keys to our success and competitive positioning in the wholesale propane business has been our supply and logistics capabilities. So this broadens our reach and enhances the reliability of our service to customers.

Consistent with our existing business in the Northeast, we plan on deploying a business model in the Mid-Atlantic that provides our customers access to rail, truck, pipeline and barge deliveries. By applying our business model, we believe that there are substantial synergies that also can be achieved with our existing business. We expect this transaction to be immediately accretive to distributable cash flow.

Moving to Slide 9 for our NGL Logistics Segment: Just to refresh, we are executing a project to spend approximately $18 million of expansion capital to connect and integrate the recently acquired Wattenberg Pipeline with DCP Midstream's facilities.

DCP Midstream, the largest gatherer and processor in the DJ Basin is investing capital to construct a new natural gas processing plant. It is expected to be completed by early 2011 at which time we also expect to begin receiving cash flow contributions from our investment.

Our integration efforts and capital expansion projects are progressing on plan. This segment generates a 100% fee based margins and is complementary to our gathering and processing business providing broader exposure to the NGL value chain. This is yet another area which we are pleased to have recently been able to execute on targeted expansion opportunities.

As I mentioned earlier, we've recently acquired the remaining 55% ownership interest in our Black Lake pipeline bringing our ownership interest to 100%. We did this through the acquisition of an additional 50% from BP for $15 million and an additional 5% interest in DCP Midstream for $1.5 million.

Given the equity earnings, we generate of approximately $2 million per year for our 45% interest. This was an attractive bolt-on opportunity that is an excellent fit with our asset portfolio and is immediately accretive to distributable cash flow.

Now, I'll turn it over to Angela to review the financial results.

ANGELA MINAS: Thanks Mark, and thank you for joining us today. On Slide 10, we begin with the consolidated financial results. Results are adjusted to remove the impact of non-cash mark-to-market activities of our commodity hedges, which were outlined in the appendix, as well as the non-controlling interest in our joint ventures.

Adjusted EBITDA was $26.2 million for the quarter, compared to $32.4 million for the prior year. Distributable cash flow of $24.9 million for the quarter resulted in a distribution coverage ratio of approximately 1.0 times similar to that for the same period last year.

Year-to-date distributable cash flow increased from $50.6 million to $56.6 million resulting in a 1.14 times distribution coverage ratio year-to-date. As a reminder, given the seasonality of our wholesale propane business with the majority of earnings coming during the first and fourth quarters we would expect a lighter second quarter.

As such, it's appropriate to look at our distribution coverage on an annual basis. For the last four quarters, our distribution coverage ratio was 1.2 times.

For more detail on our results, let's move to the segments. Starting on Slide 11 with natural gas services. Adjusted EBITDA was $33.1 million for the quarter, compared to $34.5 million for the prior year.

Results for the quarter were positively impacted by the addition of our Michigan acquisition and organic growth at the Piceance Basin asset offset by higher costs and downtime related to turnarounds at our Discovery in East Texas assets and lower throughput at certain of our natural gas assets.

Year-to-date adjusted EBITDA increased from $59 million in 2009 to $66.4 million in 2010. Year-to-date results were impacted by volume curtailments due to plant shutdowns and producer wellhead freeze offs as a result of the near record cold weather in the first quarter.

Results for 2009 include the impact of operational downtime at our Discovery, East Texas and Wyoming assets. Although not included in adjusted EBITDA, we did realize the cash flow synergy benefit from the rationalization of surplus equipment resulting from our Michigan integration efforts.

On Slide 12, our wholesale propane segment EBITDA was a loss of a $0.5 million for the quarter compared to $3.5 million for the first quarter of 2009. Results for the quarter reflect the planned outage related to our Providence terminal inspection and reduced demand as a result of an early spring and warmer weather, partially offset by an amendment to an existing propane supply contract.

Due to the timing of winter and propane demand, quarterly results often do not provide a meaningful comparison. As such, we view results of this business on a fiscal year or heating season basis, which is April 1st to March 31st .

Historically, this business has generally generated its cash flows in the fourth and first quarters and the second and third quarters providing breakeven or nominal cash flow. As such, this quarters results are somewhat lower, but still in line with historical trends. 2009 results reflected late winter weather and increased spot sales opportunities driven by a very favorable marketing environment.

On Slide 13, our NGL Logistics EBITDA for the quarter increased from $1.5 million in 2009 to $1.8 million in 2010. Year-to-date EBITDA increased from $2.9 million to $5.5 million in 2010. 2010 results reflect higher per unit margins as well as increased throughput volumes associated with an additional pipeline interconnect early in the year.

Slide 14 reflects our 2010 DCF forecast, which we provided on our year-end earnings call. Second quarter and year-to-date results were in line with our forecast. If you take into account the commodity prices year-to-date and general market views of prices with the balance of 2010, the highlighted section in the table would indicate 2010 DCF between a $105 million and a $115 million, provide a distribution coverage of 1.05 times to 1.15 times at our current $101 million distribution level. This forecast excluded the impact of future potential acquisitions or any unannounced organic expansion projects.

The Chesapeake and Black Lake acquisitions we just announced would add an estimated $3 million to 2010 DCF net of any transaction and integration costs. Beyond 2010, we would forecast additional cash flow contribution as the Wattenberg integration and expansion is completed in early 2011 and as we move beyond the integration of the Michigan acquisition and more fully realize the synergy benefits.

Key to our distributable cash flow performance, is the nature of our contracts and our commodity hedging program. We estimated that approximately 55% of our forecasted margin was fee based. Given the fee based nature of our growth, this percentage would be expected to increase.

Of our commodity based margins, we have hedged over 80% of our equity position in natural gas liquids, condensate and natural gas. This results in 90% of our 2010 margins being fee based or supported by commodity hedges. Our 2010 position is part of a multi-year hedging program that extends into 2015.

As cited by S&P and Fitch with our recent investment grade ratings announcements, our sizeable fee based revenues and multi-year hedging policy are key strengths in our financial position which I will discuss on Slide 15.

We've continued to execute on our investment grade plan, which was accelerated from our original objective of obtaining an investment grade rating prior to the maturity of our credit facility in June 2012. We believe there are certainly benefits to doing so with respect to cost of capital, access to capital and competitive positions. We are pleased to have been able to achieve our S&P and Fitch BBB-stable ratings well ahead of our targeted timetable.

We are committed to a financing strategy that maintains a strong capital structure and significant liquidity to enable us to execute our growth strategy. We believe that our sources of capital are more than adequate to support our 2010 forecast and planned capital spending. Our successful November equity offering demonstrates our ability to access the equity markets and our investment grade plan positions us well to access the public debt markets.

We have an excellent $850 million credit facility that extends through June 2012. At the end of the second quarter, we had drawn $615 million resulting in available capacity of $235 million. More recently, we financed the Chesapeake and Black Lake transaction with borrowings under our credit facility.

You will note that the credit facility commitment is $25 million higher than we indicated in the previous quarter. This reflects the reinstatement of $25 million of available capacity through the transfer of the former Lehman Commitment to another global financial institution added to our bank group.

With respect to long-term financing of growth and debt under our existing credit facility, we will continue to take a strategic and disciplined approach. We have maintained liquidity and credit metrics consistent with our investment grade rating and plan to continue to do so in the future. And now, I will turn it back over to Mark.

MARK BORER: Thanks Angela. Please turn to Slide 16. I spoke briefly about each of the recent growth opportunities that we have executed on or have in progress this year. Not only are we pleased with each of the opportunities individually, but we are also very pleased with the strategic and disciplined executions of our overall growth plan.

On our year-end earnings call, I provided you some insights into how we are thinking about future growth opportunities. Although a very broad potential opportunity set, we have now checked the box, at least initially, on a number of opportunities as we continue to execute our plan.

In summary, our growth opportunities have continued to enhance the diversity of our asset portfolio. We have executed on growth across all of our business segments and are

in the process of extending our geographic footprint. Additionally, this growth will result in an increased percentage of fee-based margins.

As cited by both S&P and Fitch with our recent investment grade rating announcements, our sizable fee-based revenues and diverse asset base are key strengths in our financial position.

Moving to the next slide, I'd like to close this morning with our outlook and a few summary points. First, our results today position us well. We are on track to achieve our 2010 business plan commitments and DCF forecasts. Resuming distribution growth has been an important 2010 objective. We are pleased to have delivered on that commitment. Our target continues to be top quartile, total shareholder return and we believe that is achievable given the breadth of the DCP Enterprise.

As we continue to grow the partnership having the strong sponsorship of DCP Midstream, Spectra Energy and ConocoPhillips is a significant benefit to us and our unit holders.

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

Q&A

OPERATOR: Thank you. We will now begin the question and answer session. To ask a question, you may press "*" then "1" on your touchtone phone. If you are using a speakerphone please pick up handset before pressing the keys, to withdraw your question, please press "*" then "2." At this time, we will pause momentarily to assemble our roster.

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

MICHAEL BLUM: Thanks. Good morning, everybody.

ANGELA MINAS: Good morning.

MICHAEL BLUM: Can you hear me [inaudible] a couple of questions I guess. The first one under the guise of what have you done for me lately, what's the thought, you've now raised the distribution and, you know your slide says you delivered on that. Does that mean that we are done for the year or is it possible that there could be additional increases this year?

MARK BORER: Michael, this is Mark. Good morning and thanks for the question. Relative to distribution growth that's obviously a continuing objective of ours to achieve the…what we've set out as far as our objectives on total shareholder return. We realize that we will need to grow our distribution on a consistent basis. Having said that, that is a quarterly decision as we look at our overall portfolio and our coverage and where we are at the business cycle and where we are executing on growth. But clearly it's our objective and plan to grow our distribution on a sustained basis.

MICHAEL BLUM: Okay and the next question is for Angela. Given that the investment grade ratings you have, is there the possibility that you…could you redo your revolver and realize a better lower cost pricing grid basically or are you pretty much happy with where you are at?

ANGELA MINAS: Given our relationship with Midstream at the time that we had put together the initial revolver. We do have investment grade terms and conditions, so we are at LIBOR plus 44 basis points in our credit facility which is probably better than an investment grade could get in the market place today.

MICHAEL BLUM: Okay. If you did…if you did a public debt offering, what sort of pricing do you think you could get in let's say 10 year type of money?

ANGELA MINAS: Well, that seems to be a moving target depending on rates, we are by both of the agencies at BBB-stable, so we would probably price given that we have two ratings with a small discount, just we had three ratings, so let's call that somewhere in the range of 10 to 25 basis points from where a BBB- would issue.

MICHAEL BLUM: Okay. Thank you.

MARK BORER: Thank you Michael.

OPERATOR: Thank you. Our next question comes from Gabe Moreen of Bank of America. Please go ahead.

GABE MOREEN: Hey, good morning everyone.

MARK BORER: Hi, Gabe.

GABE MOREEN: A question on the Marcellus JV and maybe I didn't catch this on the call and it sounds like its still being finalized. I don't know if you can speak to whether part of the partnership's going to be contributing any upfront capital to the JV and longer term whether its contemplated that the partnership is going to, I guess, you know, participate in Greenfield early stage investments or is it something that the partnership would contribute capital on and perhaps there is more mature assets to acquire at the partnership level, at the JV level? Excuse me.

MARK BORER: Relative to your first part of your question, it is contemplated that we would…DCP the enterprise would contribute $200 million initially in cash and they would contribute assets with a corresponding value as we look forward, you know, we did another restructure and both Midstream Partners have signed the LOI. So the structure does provide us the flexibility for either Midstream or Partners to invest. There may be projects due to their size or lead time or development profile that are more suitable to Midstream to fund or maybe just some combination of Midstream and Partners, but we clearly have that flexibility. You know I think it's important to note that Partners is intended to be a primary growth capital deployment vehicle for the DCP Enterprise, but you know given the financial strength of the overall enterprise, it does give us a flexibility on how we fund and obviously putting projects in the MLP that are suitable from a growth view point and from an accretion view point.

GABE MOREEN: Got it and don't know if you can also speak Mark maybe to the commodity sensitivity at the JV both in terms of the existing assets and may be what the contract structures might look like going forward?

MARK BORER: We have not finalized the exact contract structure. I would anticipate that would be some combination of the fee and commodity sensitive.

GABE MOREEN: You covered both of them there. Okay, great. Thanks Mark. I appreciate it.

OPERATOR: Thank you. Our next question comes from Yves Siegel of Credit Suisse. Please go ahead.

YVES SIEGEL: Thanks and good morning.

MARK BORER: Good morning.

ANGELA MINAS: Good morning.

YVES SIEGEL: Just to follow up on, I guess both Mike and Gabe's questions. As it relates to long-term financing on the debt side, what's the fairway in terms of the amount that or the minimum amount that you have to do to get an investment grade, not an investment grade, but just get a bond deal done. In other words, could you come to the market with $250 million or is the fairway more in the $500 million range?

ANGELA MINAS: 250 is about the minimum and a good size that we could go to market with and certainly as we look at the timeframe between now and the maturity of our credit facility, we would likely plan to term out anything that's permanent financing prior to that.

YVES SIEGEL: Now, and I may be off base here too, but you know my sense is that an investment grade can come to market may be as low as you know, 4.5. So would you think that you would be able to get something if you decide to go to the market below 5% today?

ANGELA MINAS: Markets have been moving around I think, you know, on the five year certainly you are looking at, you know may be 4% or possibly even sub 4%, and you are looking in somewhere in the 5 percent-ish range, 5 and change I think for the 10-year…depends on market condition.

YVES SIEGEL: Do you have a number for where you think growth CapEx would be, if you combine the acquisitions that you closed on plus growth capital, what does that number look like for the final six months of the year and if you have any thoughts on what 2011 might look like?

MARK BORER: Yves we have not put anything up for 2011, I guess I would say, you know, over the last, you know if you take kind of the last six months including the Michigan transaction last fall, we've executed on about a $150 million to $160 million or so of transactions, you know I see a continued nice activity level through the balance of the year and would hope that we could make additional transactions that are accretive in that range. So we see a good activity level and would continue to execute our growth plan in that [unintelligible].

YVES SIEGEL: Okay, great. And if I could just push it to follow up on Gabe's questions and I'll say goodbye and good luck. As it relates to the EQT JV, do you have any sense of what the capital appetite for that JV; you know on an annual go forward basis, you know might look like?

MARK BORER: I think the…I think the JV will have a healthy capital appetite going forward, you know we are still finalizing plans with EQT, as well as, you know, looking at other, you know serving other producers, EQT has certainly put out a very robust drilling program to the tune of, you know $900 million or so for 2010. So you know we see definitely the need for expanding existing facilities and the need for grass root facilities. I think as we finalize the LOI and move into more of an execution phase, we can be more definitive on that as we move into 2011, but that's where things stand now.

YVES SIEGEL: So the Part B to that question is when you finalize the JV agreement with EQT, would you expect that within that document to delineate the relationship between DC Midstream and the partnership or it will be more between EQT and again the total enterprise?

MARK BORER: Well clearly the LOI document would delineate the relationship between the DCP Enterprise and EQT and we will be able to address the nature of our investment from the DPM view point so to speak, as we initially contribute monies to the JV.

YVES SIEGEL: Great, thanks guys.

MARK BORER: Thank you.

OPERATOR: Thank you. Again, if you would like to ask a question, please press "*" then "1" on your touchtone phone. Please hold while we pause for questions.

Gentlemen, at this time we are showing no further questions in the queue. Do you have any closing remarks?

MARK BORER: I guess, I just like to say if you have any follow up questions over the coming days, please feel free to contact Angela, and Angela and I can make ourselves available and once again thank you for your interest today and wish you a good day. Thank you.

OPERATOR: Thank you for joining. This does conclude the conference, if you would please disconnect your lines at this time.