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EnLink Midstream LLC (ENLC)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to the EnLink Midstream 2Q 2023 Earnings Conference Call and Webcast. [Operator Instructions] As a reminder, this conference is being recorded.

It's now my pleasure to turn the call over to Brian Brungardt, Director of Investor Relations. Please go ahead, Brian.

Brian Joseph Brungardt
Director-Investor Relations, EnLink Midstream LLC

Thank you and good morning, everyone. Welcome to EnLink's Second Quarter of 2023 Earnings Call. Participating on the call today are Jesse Arenivas, Chief Executive Officer; and Ben Lamb, Executive Vice President and Chief Financial Officer. Walter Pinto, Executive Vice President and Chief Operating Officer, is also in the room to answer any questions during the Q&A session. We issued our earnings release and presentation after the market closed yesterday and those materials are on our website. A replay of today's call will also be made available on our website at investors.enlink.com.

Today's discussion will include forward-looking statements, including expectations and predictions within the meaning of the federal securities laws. The forward-looking statements speak only as of the date of this call, and we undertake no obligation to update or revise. Actual results may differ materially from our projections and a discussion of factors that could cause actual results to differ can be found in our press release, presentation, and SEC files.

This call also includes discussions pertaining to certain non-GAAP financial measures. Definitions of these measures, as well as reconciliation of comparable GAAP measures, are available in our press release and the appendix of our presentation. We encourage you to review the cautionary statements and other disclosures made in our press release and our SEC filings, including those under the heading, Risk Factors. We'll start today's call with a set of brief prepared remarks by Jesse and Ben, and then leave the remainder of the call open for questions-and-answers.

With that, I would now like to turn the call over to Jesse Arenivas.

Jesse Arenivas

Chief Executive Officer & Director, EnLink Midstream LLC

Thank you, Brian, and good morning, everyone. Thank you for joining us today to discuss our second quarter 2023 results. We're in an exciting time at EnLink as we are on pace to report another record year of adjusted EBITDA and have a unique position to grow through the ongoing energy transformation. We consider this an energy transformation, not a transition, as we believe the world energy mix will continue to include hydrocarbons, while adding cleaner synthetic sources like hydrogen as well as renewables.

EnLink has what it takes to achieve sustainable growth through this transformation because of the combined strength of our traditional midstream business with our new carbon transportation business. This enables us to provide energy products critical to modern society and America's energy independence, while offering solutions to reduce greenhouse gas emissions across the industries that utilize these products. This is the future of midstream.

We are seeing robust demand for traditional midstream service today as exhibited by our strong second quarter results. For the quarter, we generated $334 million of adjusted EBITDA, which represents 11% growth over the prior year. That's despite volatility in the commodity prices. These strong results place EnLink on pace to achieve the midpoint of our 2023 adjusted EBITDA guidance of just over $1.35 billion. EnLink is well-positioned for sustainable growth through the energy transformation. We expect the transformation include a continued and growing need for traditional energy services – sources and midstream services. For example, solar and wind power represent the majority of new investments in power generation. However, natural gas-fired generation continues to be the largest component of the fuel mix during the warm winter, summer months in Texas, in which ERCOT recently experienced a record power demand.

According to the EIA, its latest annual report, the agency projects natural gas generating capacity will increase depending on the scenario between 20% and 87% through 2050. This outlook includes significant expansion of renewable sources that could see solar increase by as much as over 1,000% by 2050. Said simply, the US will need additional energy from all sources to power our development for decades to come. The EIA recently highlighted that natural gas demand increased 43% or over 34 billion cubic foot per day over the last 10 years. Demand in the Gulf States of Louisiana and Texas grew by 110% or 16 billion cubic feet a day, with the largest driver being LNG export activity.

This robust demand for natural gas is expected to continue to grow as another wave of export LNG projects comes online through 2030. Along the Gulf Coast alone, there's approximately 12 billion cubic feet a day in operation today, with nearly 9 billion cubic feet per day of capacity under construction and an incremental 15 billion cubic feet per day approved but pre-FID. Our assets are well-positioned to benefit from the energy transformation. We have three large natural gas oriented G&P systems that are well-positioned that meet the needs of our diverse customer base. In addition, we have an extensive network of natural gas pipelines in Louisiana that can meet the increased end user demand through attractive expansion projects.

As part of the energy transformation, the energy sector has an opportunity to help decarbonize other industries. We view this as a significant growth prospect for EnLink, given our unique position, leveraging our existing pipeline network in Louisiana to provide CO_2 transportation. Last year, we executed the first of its kind definitive

CO2 transportation agreement with ExxonMobil. This is a 25-year ship or pay agreement with attractive project returns that at a minimum compete with traditional midstream projects. We are excited about ExxonMobil's continued commercial success as they recently signed up a second industrial CO2 emitter, Nucor, along the Mississippi River Industrial Corridor. Combined with the initial customer, CF Industries, they have signed up approximately 2.8 million metric tonnes per year of CO2 emissions that are being emitted into the atmosphere today. We look forward to continue working with ExxonMobil and others to help make a meaningful impact in reducing industrial CO2 emissions while generating attractive economic returns.

To sum it up, EnLink offers investors a compelling opportunity. We are seeing another record year of adjusted EBITDA, driven by solid demand for natural gas and NGL products. This attractive growth and strong cash flow generation is driving attractive valuations that compare favorably in many instances to the top quartile of the S&P 500 constituents. In addition, EnLink offers investors a unique opportunity to participate in the energy transformation due to our CO2 transportation business.

With that, I'll turn it over to Ben to provide an overview of our operations and our financial results.

Benjamin D. Lamb

Executive Vice President & Chief Financial Officer, EnLink Midstream LLC

Thanks, Jesse, and good morning, everyone. Let's start with the Permian, where segment profit for the second quarter of 2023 came in at $91.8 million. Segment profit in the quarter included approximately $0.9 million of operating expenses tied to plant relocations and $7.9 million of unrealized derivative losses. Excluding plant relocation OpEx and unrealized derivative activity, segment profit in the second quarter of 2023 grew 12% sequentially and decreased 8% from the prior year quarter. Producer activity behind our systems remained robust, driving a record quarter for gathered volumes with average natural gas gathering volumes approximately 3% higher compared to the first quarter of 2023 and 16% higher than the prior year quarter.

Turning now to Louisiana. We experienced another quarter of solid performance in the gas segment, along with strong results in the NGL segment despite normal seasonal effects. Segment profit for the second quarter of 2023 came in at $104.5 million. Segment profit included $18.2 million of unrealized derivative gains. Excluding the impact of unrealized derivative activity, segment profit in the second quarter of 2023 decreased approximately 18% sequentially and grew 12% from the prior year quarter.

Moving up to Oklahoma. We delivered segment profit of $110.7 million for the second quarter of 2023. Segment profit included $2 million of unrealized derivative gains. Excluding plant relocation OpEx and unrealized derivative activity, segment profit in the second quarter of 2023 grew 13% sequentially and grew 18% from the prior year quarter.

Producer activity remained resilient during the quarter, driving average natural gas gathering volumes 6% higher sequentially and 23% higher compared to the prior year quarter. We continue to be impressed with the resilience we're seeing in Oklahoma despite the headwinds in near-term commodity prices. Operators remain active as we continue to see six to eight rigs behind our system. That said, we are seeing some completion activity being deferred for a few months in the summer and fall and moved into late 2023 and early 2024. Despite this temporary deferral of completion activity, we are seeing double-digit growth in gathered volumes compared to 2022 and we have accounted for the financial impact in our adjusted EBITDA guidance.

Wrapping up with North Texas, segment profit for the quarter was $67.3 million. Segment profit included $7 million of unrealized derivative losses. Excluding unrealized derivative activity, segment profit in the second quarter of 2023 grew 1% sequentially and grew 16% from the prior year quarter. The improvement over the prior year was driven in part by the acquisition that closed in the third quarter of 2022. Natural gas gathering volumes were 1% lower sequentially, but were 11% higher compared to the prior year quarter. Separately, we continue to make solid progress to reduce our CO2 emissions intensity. The previously announced project with our largest customer in North Texas, BKV, to capture and permanently store CO2 from our Bridgeport facility is progressing with an in-service date in the fourth quarter of this year.

These solid results were in line with our expectations and drove another robust quarter with $334 million in adjusted EBITDA, representing 11% growth over the prior year. We are reiterating our adjusted EBITDA guidance for 2023 and we remain on pace to achieve the midpoint of the range of approximately $1.355 billion. Capital expenditures and plant relocation expenses net to EnLink were $88 million in the second quarter of 2023. Free cash flow after distributions for the second quarter came in at approximately $96 million. Total CapEx spending, including growth CapEx net to EnLink, plant relocation costs, investment contributions, and maintenance CapEx, continues to track within our 2023 guidance of $485 million to $535 million.

On the balance sheet side, we continue to be in a very strong position with a leverage ratio of 3.4 times at the end of the second quarter and ample liquidity. We remain rated investment grade at Fitch and one notch below investment grade at S&P and Moody's with a positive outlook at S&P. Consistent with our capital allocation plan to return capital to investors, we maintained our common unit distribution of $0.125 per unit in the second quarter, which represents an 11% increase over the second quarter of 2022.

Additionally, we remain active with our common unit repurchase program with approximately $60 million spent in the second quarter. This puts us ahead of pace to complete our $200 million unit repurchase program for 2023. Over the last 18 months, we have now repurchased nearly $31 million common units. In summary, the EnLink team delivered solid results in the second quarter of 2023 and we expect the momentum to continue for the rest of the year.

With that, I'll turn it back over to Jesse.

Jesse Arenivas

Chief Executive Officer & Director, EnLink Midstream LLC

Thank you, Ben. The EnLink team delivered solid execution in the second quarter of 2023, placing us well on our way to achieve the midpoint of our 2023 adjusted EBITDA guidance, which would be another record year for EnLink.

With that, you may now open the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting a question-and-answer session. [Operator Instructions] Our first question is coming from Brian Reynolds from UBS. Your line is now live.

Brian Reynolds
Analyst, UBS Securities LLC

Q

Hi. Good morning, everyone. Maybe to touch on just the midpoint EBITDA guidance commentary from the prepared remarks. Can you just talk a little bit more about second half growth expectations, particularly in the Permian to help meet that midpoint? And then secondly, how should we think about Oklahoma into 2024, just given the rig dropped to three rigs from four in that region from – with the Dow-Devon JV. Thanks.

Benjamin D. Lamb
Executive Vice President & Chief Financial Officer, EnLink Midstream LLC

A

Yeah. Hey. Good morning, Brian. It's Ben. So on the way, the second half is shaping up. Yeah, a couple of things. One is big picture, I would remind you that we see a seasonal benefit in the NGL business in particular late in the year. And so we expect to have a, always expect to have a stronger fourth quarter than we have a third quarter. So don't be surprised if the third quarter looks a lot like the second quarter did. In the Permian specifically, we're expecting to see a pretty good ramp in the Midland Gas business in particular. If you look back into July, we had 23 rigs running on dedicated acreage in Midland Gas, operated by 10 different producers. And so we do expect to see a pretty healthy ramp there going into the end of the year.

As far as Oklahoma in 2024, I mean, listen, it's early to talk much about 2024 at all. But maybe to just expand on what I said in the prepared remarks, what we've seen is not so much a slowdown in drilling activity. We haven't seen producers dropping wells. What we've seen is producers delaying completions from the summer and the fall into the winter. I think, one, to manage capital budgets a little bit, but two, also to take advantage of the Contango that we're seeing in the natural gas market. I think broadly speaking, when you look at the commodity set up for 2024, it's a pretty constructive place to continue to see activity in Oklahoma.

Brian Reynolds
Analyst, UBS Securities LLC

Q

Great. Super helpful. And then maybe to switch just towards capital needs. As we look into 2024, you talked about really, really good growth, particularly in the Midland Basin. Can you just give us an update on potential needs for additional processing capacity and whether you have the ability to continue to move brownfield plants from other areas or whether there'll be potential for newbuild in the Midland Basin. Thanks.

Benjamin D. Lamb
Executive Vice President & Chief Financial Officer, EnLink Midstream LLC

A

Yeah, well, nothing to announce today on additional Permian capacity. We're focused on the Delaware side and getting Tiger plant 2 in-service in the second quarter of next year. That said, I don't think that that's the last capacity addition that we'll have in the Permian. I think it's likely that we'll have more and the good news is we do have additional plants that are good candidates for relocation to the Permian. So no decision at this point. But when we take that step, I think it's most likely to be another plant relocation.

Brian Reynolds
Analyst, UBS Securities LLC

Q

Great. Super helpful. I'll leave it there. Thanks, guys.

Operator: Thank you. Next question is coming from Spiro Dounis from Citi. Your line is now live.

Spiro Dounis
Analyst, Citigroup Global Markets, Inc.

Q

Thanks, operator. Good morning, everybody. First question on CCS. Curious just to hear your latest thoughts on FID timing for the next project and to the extent you've seen any more interest beyond that incremental 20 million tonnes per annum.

Jesse Arenivas
Chief Executive Officer & Director, EnLink Midstream LLC

A

Yeah. Good morning, Spiro. It's Jesse. Yeah. Look, I think we, as we've said, robust activity discussions are progressing quite rapidly at the moment, so beyond the 20 million tonnes that we talked about in Investor Day, we are seeing incremental projects in discussions with multiple parties. Publicly, we've said we have the other three LOI's outside the Exxon deal. Those are progressing. Timing is just a tough part we don't control. But I would say we're very optimistic that these are being worked diligently and we expect some FID soon.

Spiro Dounis
Analyst, Citigroup Global Markets, Inc.

Q

Great. Helpful. Second question, maybe just turning to M&A. Back at the Analyst Day, you guys sort of highlighted the fact that that's kind of been a nice, useful tool for you. You've been able to get some pretty, pretty low multiple, high return deals. But it sounds like at least for a period of time, that market has cooled down. Just to maybe get some update on M&A landscape here and your latest thoughts.

Jesse Arenivas
Chief Executive Officer & Director, EnLink Midstream LLC

A

Yeah. Well, look, like we said, we'll be very disciplined in our approach. We like the last two M&A deals we did. They are low multiples with a lot of optionality in the right basins, the consolidation plays, we've done very well with. We've been able to cut cost out, relocate compression and options, future options on other facilities to relocate. So we like those. You're right. It's cooled off a bit. We don't feel like we need to do anything. We've got the CCS growth ahead of us. So we'll be very diligent, look for the right synergistic bolt-ons. And that's about all I've got.

Spiro Dounis
Analyst, Citigroup Global Markets, Inc.

Q

All right. That's it for me. Thanks for the time, guys.

Operator: Thank you. Next question is coming from Praneeth Satish from Wells Fargo. Your line is now live.

Praneeth Satish
Analyst, Wells Fargo Securities LLC

Q

Thanks. Good morning. So I see in the slide deck that there's – you're estimating a 5 times EBITDA multiple on CCS opportunities, I guess, beyond the initial Exxon agreement. Maybe if you could just kind of elaborate conceptually on how you came up with that multiple. Do you expect all deals to kind of at least be this good? How much of variability is there from deal to deal in terms of economics? And then is that kind of – is that a year one multiple or like the Exxon deal where it might take some time to get to peak returns?

Benjamin D. Lamb
Executive Vice President & Chief Financial Officer, EnLink Midstream LLC

A

Yeah. Hi, Praneeth. It's Ben. So first as to how we arrived at that multiple, we looked at the projects that we have in development today, not only with Exxon, but with all the other counterparties that we've talked about, and honestly, a couple of parties that we haven't been able to talk about publicly, and came up with a concrete business case that we showed our board of directors for how that business could develop. And the endpoint was a little above $300 million in EBITDA in 2030 at an average investment multiple of 5 times, right, which implies total capital of $1.5 billion. So they're real projects that have been scoped by our engineering team. They're not all the same. Some of them have more elements of brownfield repurposing, like the ExxonMobil project has, some have more elements of newbuild. And so they're not all each individually 5 times projects, but across the entire portfolio, that's the average that we expect to see. And it's not so much a year one multiple as the way we see the business evolving between now and 2030.

Praneeth Satish
Analyst, Wells Fargo Securities LLC

Q

Got it. That's helpful. And I wanted to just touch on CapEx, maybe this is nitpicking, but you reiterated the CapEx range for the year, but not the midpoint. Should we kind of assume that you're still tracking to be at the midpoint or are you trending towards the low or high end of the range? Just what are kind of the puts and takes that we should consider for the balance here on CapEx?

Benjamin D. Lamb
Executive Vice President & Chief Financial Officer, EnLink Midstream LLC

A

Yeah. We're trending toward the higher end of the range and we talked about that in the second quarter call. We've had a little bit of pull forward in the Permian in particular into the fourth quarter out of early next year. That's not even new for the quarter. That was the case in 2Q. So we're going to be a little bit on the high end of the range on CapEx, at the midpoint, is our current expectation for adjusted EBITDA, which lands is within the range on FCFAD.

Praneeth Satish
Analyst, Wells Fargo Securities LLC

Q

Got it. Thank you.

Operator: Thank you. [Operator Instructions] Our next question is coming from Gabe Moreen from Mizuho Securities. Your line is now live.

Gabriel Moreen
Analyst, Mizuho Securities USA LLC

Q

Hey, good morning, everyone. I think you noted getting aggressive with 2024 hedges at this juncture. Can you just speak to kind of how much you've hedged, maybe the levels and how they might compare to hedging levels for this year in 2023?

Benjamin D. Lamb
Executive Vice President & Chief Financial Officer, EnLink Midstream LLC

A

Yeah. Gabe, there'll be some detail on that in the notes in the 10-Q that will get filed later today that you can go take a look at. And I don't want to get too deep here, but let me say our normal practice is to start hedging four quarters in advance. And so over a four quarter period, we end up being fully hedged for the top quarter. What we did for 2023 is we were almost fully hedged on natural gas before the year 2022 even ended. And that has obviously served as well this year. And our observation on the gas market is we like the price that's available to us in the market today. For 2024 natural gas, it's price that works well for our business. And so in the ordinary course, we would have done fairly little for 2024. But at this point, we've been more aggressive, not to the same extent that we were in 2022, coming into 2023, but been fairly aggressive in managing the risk for next year.

Gabriel Moreen
Analyst, Mizuho Securities USA LLC

Q

Thanks, Ben. And then maybe if I can talk about capital return and can I get a little bit more than the $50 million per quarter cadence this quarter, just to what extent you might be willing to go above the stated $200 million for this year, if you feel you have the flexibility, particularly if there's more volatility out there in the market?

Benjamin D. Lamb
Executive Vice President & Chief Financial Officer, EnLink Midstream LLC

A

Well, I think there's two parts to that. What we did this quarter was to use the flexibility to lean in a bit when the stock is under pressure. And the repurchases we did in the second quarter came at an average price of $9.94, which we felt like was a good opportunity for us to step in and support the stock. But that doesn't change the fact that our authorization today, the $200 million authorization. Now, as the year progresses and we see how the FCFAD picture is shaping up as we get closer to the year – end of the year, we can always go back to the board and look to expand that authorization a little bit. But right now, we're focused on getting through our $200 million authorization. We're just running a little bit ahead of pace.

Gabriel Moreen
Analyst, Mizuho Securities USA LLC

Q

Thanks, Ben. And maybe just a bigger picture question on CO2. Clearly, there's been a little bit of announcements out there over the last couple of weeks in terms of how different players are positioning themselves in the market. Do you see that as having any implications for EnLink's CCS business or the need to partner, get more integrated, or whether you're comfortable I guess with the current approach?

Jesse Arenivas
Chief Executive Officer & Director, EnLink Midstream LLC

A

Yeah, Gabe, good question. I think the way we look at it is we're very well-positioned. Our competitive advantage is having multiple pipes across the state of Louisiana, especially heavily weighted in the industrial emissions corridor there. We've proven we can work with ExxonMobil. So we think that transaction has opened more doors than it's closed. I think we – so we see the pie is growing beyond the $80 million. And I think it's going to take multiple parties to solve that up from a transportation perspective. But we feel like we're in – our position hasn't changed. If anything, we've just got more options today than we had prior to the transaction.

Gabriel Moreen
Analyst, Mizuho Securities USA LLC

Q

Thanks, Jesse.

Operator: Thank you. We reached end of our question-and-answer session. I'd like to turn the floor back over to management for any further or closing comments.

Jesse Arenivas

Chief Executive Officer & Director, EnLink Midstream LLC

Thanks, Kevin, for facilitating the call this morning and thank everyone for being on the call today and your continued support. As always, we appreciate the interest and investment in EnLink. We look forward to updating you with our third quarter results in November. And in the meantime, we wish you well. Stay healthy and have a great day.

Operator: Thank you. That does conclude today's teleconference and webcast. You may disconnect your line at this time and have a wonderful day. We thank you for your participation today.