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The Williams Cos., Inc. (WMB)

Q2 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to The Williams and Williams Partners Second Quarter 2016 Earnings Conference Call. As a reminder, today's conference is being recorded.

At this time for opening remarks and introductions, I would like to turn the call over to Mr. John Porter, Head of Investor Relations. Please go ahead, sir.

John D. Porter
Head-Investor Relations

Yeah. Thanks, Keith. Good morning and thank you for your interest in Williams and Williams Partners. Yesterday afternoon, we released our financial results and posted several important items on our website. These items include yesterday's press releases and related investor materials, including the slide deck that our President and CEO, Alan Armstrong, will speak to momentarily.

Our CFO, Don Chappel, is available to respond to questions, and we also have the five leaders of Williams' operating areas with us: Walter Bennett leads the West; John Dearborn leads NGL & Petchem Services; Rory Miller leads Atlantic-Gulf; Bob Purgason leads Central; and Jim Scheel leads the Northeast Gathering & Processing area.

In our presentation materials, you will find an important disclaimer related to forward-looking statements. This disclaimer is important and integral to all of our remarks and you should review it. Also included in our presentation materials are various non-GAAP measures that we reconcile to generally accepted accounting principles. These reconciliation schedules appear at the back of the presentation materials.

There are a lot of calls today. So we're planning on keeping our call to about an hour. If we miss any of your questions, feel free to follow up with Investor Relations later on today.

And with that, I'll turn it over to Alan Armstrong.

Alan S. Armstrong

President and Chief Executive Officer

Great. Thank you, John, and good morning, everyone. We're certainly glad to have you here this morning. And we've got quite a bit of information to go through, and we do have a tight timeline. So I'll try to move through this pretty quickly and then turn it over to Don for some comments, and I'll come back and close.

So I'd like to start off today just telling you something I'm very proud of relative to Williams, and really that is how this organization has stuck together and despite a lot of the upstairs issues and a lot of the distractions has remained very focused on executing our strategy, which our entire team is very excited about and just couldn't be more proud of the way the organization has really rallied and is absolutely all in on executing what we think is by far the best strategy in the industry. And so this focus that we've had certainly showed up here in the second quarter and we continue to see some great execution on all these projects that we have coming to fruition and tremendous amount of work going on up and down the system right now, particularly, on the Transco system, as we expand that out to meet all the growing demands there.

So I would tell you that as well in addition to the employee base, I would tell you very thankful for the board and their commitment and very active engaged board right now, working very hard, overseeing the execution of our plan and our strategy and very much appreciate their engagement as well.

So the plan for today's call is to walk you through our strong second quarter results and then discuss our execution on key initiatives and growth projects. Don Chappel will discuss the immediate measures that we're implementing to enhance value, strengthen the WPZ credit profile and fund a significant portfolio of really big large scale fee-based projects and all while maintaining flexibility to review financial and operational plans.

So we're going to – these measures, you'll see as we go through the DRIP program for Williams Partners. And as you've seen in our earnings release, we're also announcing a dividend reduction at Williams and the new level of our dividend will allow Williams to retain about $1.3 billion annually and that will be reinvested back into Williams Partners. So really think this is a great answer for bringing us the right cost of capital to go invest against all these great growth projects that we have as the natural gas market and the demand side continues to expand out.

Moving on to slide two here, we'll talk about the quarter. As you'll recall, in the first quarter of the year, we launched several actions to address the realities that we had as we saw a lot slower growth going on in the key supply areas as the demand side was building out, but the production side really was starting to see some pretty reduced activity even in the best basins here in the nation.

So, as a result of that, we really focused on two things that we talked about in the first quarter. One was our asset sales, and we talked about getting our asset sales done with in excess of $1 billion in asset sales, and we also talked about cost reductions. We made great progress on both of those in the quarter. First of all, we expect here in the third quarter now to finalize an agreement to sell the Canadian business, and the expected proceeds on that in excess of $1 billion, as we told you, and in addition to that, Williams Partners' share of that sale is expected to be in excess of $800 million.

On the cost side, really terrific execution on the team's part here, and we went after those costs right at the end of the first quarter. We took some action. We continue to take action across the organization and showing up here pretty dramatically, here in the second quarter, with $55 million lower O&M and G&A expenses than we had in the second quarter of 2015. And I would tell you that's even on top of the growth in our business. And so we've certainly been adding assets and growing the business, and despite that we were able to bring our costs in. We continue to find opportunities to reduce costs further and so we're really excited about the way the organization has responded and the great progress on this front.

And more importantly for our investors, we're pleased to deliver the adjusted EBITDA at WPZ of $1.065 billion. And this was about a 6% increase over the second quarter of last year, and this is the now fifth quarter in a row delivering adjusted EBITDA of more than $1 billion. And so, certainly, despite the challenging market conditions, our business of moving natural gas continues to expand, and we continue to take advantage of that.

We also had strong quarterly performance in our distributable cash flow at WPZ, which came in at $737 million, which was up 5% from the same quarter last year. And very importantly, our cash distribution coverage was 1.02 here in the second quarter, which is exactly what it was in the first quarter of 2016 as well.

So I mentioned back in May that Williams has delivered a strong – a long string of quarters with year-over-year increases in what we now refer to as adjusted EBITDA. We used to call it segment profit plus DD&A. But if you look to that and compare it into the prior year's quarter, we now have 11 consecutive quarters where we've shown improvement in that. And that, of course, is despite a pretty significant decline in unit commodity margins over this period. Of course, that's been driven by our fee-based revenue growth and our ability to continue to control cost in this environment.

So with that, let me highlight some of the strong performance delivered from the operating areas this quarter. I'd note that all five of our areas are showing year-to-date improvement and, however, here just starting with the quarter, you can see Atlantic Gulf actually came in a little bit lower than the second quarter of last year. But I would tell you this is really for good reason and according to plans as we had a month-long shutdown of the Gulfstar tie facility, which allowed us to get the Gunflint tieback made.

That tieback was made – done very safely. We had over 1 million hour, man-hours of work, making that tie-in, and we had zero reportable incidents on that effort. So great job by the team getting that work done safely. And here, as we look into the third quarter, we're going to enjoy both the Tubular Bells facility coming back or Tubular Bells Field coming back on Gulfstar as well as Gunflint, and we also enjoyed Kodiak a bit for the quarter, but we'll see that come back here as well.

Moving onto the Central and Northeast and West, really going to combine all three of these because it's really kind of the same story. Steady as she goes business and the improvements were primarily driven by the team's ability to go after costs during the period. So continued very, very well positioned as the natural gas market start to pull on these areas, but nice to see the growth at 5%, 8%, and 2% better in the Central, Northeast, and West, again, driven mostly by lower cost and volumes holding up very well despite the pressures on gas prices. So a great job of the teams continuing to operate low cost and in a safe manner.

In the NGL & Petchem area, our second quarter GAAP results were affected by a held-for-sale non-cash impairment related to our Canadian assets, and we reported $419 million decrease in segment performance as measured by modified EBITDA.

But as we look at the adjusted EBITDA, that actually increased by $47 million or a 142%, which reflected the higher fee-based revenues. That was a lot driven by the Horizon project coming on up in Canada, olefins margins and lower operating costs in this segment as well. Geismar actually saw a very strong operational production levels and we did have a little bit of lower ethylene prices during the quarter, but our sales volumes, you'll know, were quite a bit lower or lower than our production volumes if you get into the details there.

And so we did hold back some inventory during the quarter as we expected the ethylene prices to improve in the third quarter due to a number of extended outages on turnarounds from a lot of the competing plants in the Gulf Coast. And we're fortunate enough to have called that right and we have seen a price improvement here in the third quarter. And of course, that benefit will show up here as we sell off some of that inventory from 2Q in 3Q.

Moving on to slide four, every quarter we review a list of our key milestones and, for me and the leadership team as well, it's an opportunity to highlight how the teams across Williams are executing. And if you're a regular participant on these calls, you know we just keep adding milestones quarter-after-quarter. So let's take a quick look at the 2Q list. And I would tell you this list, as I said, just keeps expanding in terms of the number of opportunities off Transco.

We did receive FERC approval for the Garden State Project and so this is to increase some new demand in New Jersey, the New York Bay Expansion, and that's an expansion right on top of our Rockaway Lateral last year, another expansion on that for $115 million a day, and we did receive FERC approval for that as well. Virginia Southside II which is serving a major new gas-fired power generation complex there in Virginia, and Virginia Southside I is in service. This is another expansion on that project as well already and we received FERC approval for that during the quarter.

The Northeast Supply Enhancement, really exciting project, really big investment for us, and that's $400 million a day expansion that's going to continue to take on new gas demands up in the very far northern reaches of our system. And so, we did close a binding open season on that. That project's moving ahead, again a very large investment for us.

And then in addition to that, we have a lot of projects that are ongoing. We have the Gulf Trace project that is under construction, and construction is going very well on that. That's mostly a Louisiana area project. We also expect here in the very near future FERC approval for the Dalton lateral. So that's a big lateral that goes from the southern part of Atlanta up to the very northern reaches of Georgia, and we expect to begin construction on that in the fourth quarter. So lots of new things going on here in terms of construction across all of these projects. And our cost reductions are ahead of plan as I mentioned earlier, and we're continuing to find even more ways to increase those cost savings.

In terms of coming soon, things that will drive us here in the near term, happy to report that our Rock Springs facility, another expansion off of Transco to a power plant in Maryland. That was brought in service August 1. Most of that work was done, completed back in the second quarter, but per the contract, ready to go in service here now August 1 and is in service.

On the Gunflint tieback as I mentioned, that's – really will drive our third quarter pretty substantially, and so we're excited about that. And so we also have, I would tell you, some other drivers here for the third quarter. We'll get a full quarter of Kodiak up and flowing. We also are enjoying the – some additional incremental volumes that came onto our system as a result of the Pascagoula plant outage, and so we'll see a nice improvement on influx of volumes into our Mobile Bay systems as well for that period. So a lot of great things that are coming together here for the third quarter.

Moving on to slide five, this is just a look now at really the – some of the big investments that we've got going on and you can kind of see by year how those pile up. So a lot of what I just mentioned, but this kind of shows what it looks like in terms of cumulative capital that will be placed in service.

And so, I think the really big takeaway that investors should have here is this is very clear and identifiable growth in our business that's coming from all these fully-contracted projects. So we've got a couple of billion dollars this year, a little over $3 billion next year, and about two-thirds, a little more than two-thirds of that is coming from these big regulated projects and they are going to really drive growth well beyond 2017.

So, next I'm going to turn it over here to Don to talk about the new program, the new financing plans. But before I do, I just want to remind you, it really is important that our investors understand how critical the expansion of natural gas markets are to our strategy, and we are very confident that that's occurring, certainly all the projects that we've listed on Transco. But we think those are going to continue to come and are going to come on the backs of low-price natural gas and, ultimately, all of that demand pull is going to pull out of the great basins that we're exposed to on the supply side. So I would say for the next couple of years the growth is going to be coming largely from the demand side, but when that demand shows up the volumes have to flow behind that and we're extremely well positioned to capture that on the back end.

So with that, I'll turn it over to Don to talk about our new financing plan.

Donald R. Chappel
Chief Financial Officer & Director

Thanks, Alan, and good morning. I'll just run through the slide six fairly quickly. It hits a number of the points included in our press release. And again, these actions were designed to enhance value at both WPZ and WMB and strengthen the credit profile and maintain investment grade ratings at WPZ as well as fund the significant portfolio of fee-based growth projects at Williams Partners.

It totals about $5 billion in the 2016-2017 timeframe with the vast majority of that being Transco related. So first, Williams announced that it planned to reinvest $1.7 billion in WPZ through 2017. That reinvestment is funded by retaining cash flow that was previously paid out in the form of a dividend.

The dividend reduction totals $1.3 billion annually, a 69% reduction, and the new dividend level at $0.80 represents about a 3.5% yield in terms of where we've been trading here the last couple of days and we think that's a level we'll continue to attract investors that are interested in a meaningful dividend. WPZ will maintain its current $0.85 per quarter, or $3.40 annual, dividend through 2017 and then expect to resume some level of distribution growth in 2018.

As I mentioned, we expect our actions to significantly improve the credit profile, again, with $1.3 billion of cash being retained by Williams and reinvested into WPZ. That is a very strong credit positive that we think the agencies and debt investors will take note of.

The estimated growth capital – let me back up here a second, again, that will reduce the external funding needs for WPZ. It will enable deleveraging at both WMB and WPZ and really targeting having WPZ below 4.5 times by 2018 and, again, with a commitment to maintain those investment grade ratings at WPZ.

And, again, I mentioned the $5 billion of growth capital, which is $1.9 billion in 2016 and about $3.1 billion in 2017, with 68% and 77% in 2016 and 2017 respectively, related to Transco. So we're delighted to have the ability to grow our Transco franchise anchored with demand payments with strong counterparties and we think that will add a lot of value over time.

WPZ intends to fund the growth by a number of means here, as Alan mentioned. We plan to sell the Canadian assets during 2016, plan to sign and announce in the third quarter and close the transaction in the second half of this year with combined proceeds to PZ and MB totaling more than $1 billion and PZ share being more than $800 million. We're establishing a distribution reinvestment program, or DRIP program, that will be available for all common unitholders, and we're hopeful that we get some public participation in that. And Williams does plan to reinvest $1.7 billion into WPZ through 2017.

The third quarter distribution that Williams receives will be reinvested in WPZ via a private placement transaction because the DRIP program is not going to be available quickly enough, and then the contributions or the reinvestment thereafter will be through the DRIP program.

WPZ would also plan to access the public equity market to the extent it has a need through its ATM program or other means as well as access to public debt market, also as needed. And, again, to the extent that we get public participation in the DRIP program, that would reduce the need for ATM or other equity.

I'll pause there and turn it back to Alan.

Alan S. Armstrong

President and Chief Executive Officer

Okay. Great. Thank you, Don. And so just a few things to wrap up here real quick before we go to questions. Certainly, I don't think there's any argument around the industry that we hold the premier natural gas asset base in the nation and we see that continuing to deliver growing fee-based revenues. The fee-based revenues now is about 93% of WPZ's gross margin, and you're going to continue to see that grow. And so we're excited to see that, again, first on the demand side and then pulling the supply basins along with it.

With the financial measures that we've announced, we'll be driving significant reinvestment at WPZ, and that's going to stabilize the investment grade ratings and improve the coverage at PZ as well. And so we certainly are on a path to continue delivering steady growing result for our investors. And I want to say once again before we close here just how pleased I am with our organization.

I'd tell you the team really does understand our strategy, they understand what's critical to us, and really lots of energy around the organization right now excited about showing what we're made of and showing how we can deliver against this exciting strategy and plan and execute on this multi-billion-dollar project backlog that's going to continue to drive our growth, especially along our big interstate pipelines here for the next couple of years. And we believe that our natural gas focused strategy has positioned Williams as the company for long-term steady growth.

And so with that, thank you again for joining us, and we'll move on to questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We'll go first to Christine Cho with Barclays. Please go ahead.

Christine Cho
Barclays Capital, Inc.

Q

Good morning, everyone. Thanks for all the detail today. I wanted to start with the $250 million that MB will be buying. How should we think about the price at which WMB will be buying that and the private placement of the common unit? And is the parent primarily funding this with the $200 million, give or take, of proceeds, of its portion from the Canadian asset sale?

Alan S. Armstrong
President and Chief Executive Officer

A

Christine, good morning. The discount is something we're not prepared to speak to today, but I would say it will be in the range of customary discounts. We think it will be attractive to WPZ. We're unable to talk about the DRIP program today because we would be getting ahead of our registration statement. So we'll have to be patient on that. And our intention would be to have a discount that is consistent with the discount that would be available to the public once the registration statement and the DRIP program are activated. As to the $250 million of cash, or the $200 million of cash in the current quarter, that would be funded from the WPZ distribution or the Canadian asset proceeds.

Christine Cho
Barclays Capital, Inc.

Q

Okay. And then the DRIP program, like you guys say, goes through 2017, how confident are you that this won't have to be extended, especially in the event Atlantic Sunrise is delayed from the late 2017 in-service date? Is this generally something you're comfortable with because the CapEx generally drops off in 2018? Just some thoughts there would be helpful.

Alan S. Armstrong
President and Chief Executive Officer

A

Yeah, Christine. First, I'll just say that, again, Atlantic Sunrise is currently moving along as planned, but if there were a delay, that would also significantly reduce the capital spend in those periods as well. So you'd see some reduction in DRIP program requirements or equity requirements just generally. As to 2018, we're not providing any kind of guidance on 2018 today, so again I'll ask that you be somewhat patient on that.

Christine Cho
Barclays Capital, Inc.

Q

Okay. And then, I guess if I was to go by what you said and continue to operate under the assumption that Atlantic Sunrise does come in on time, then it does look like you guys may have to rely on the ATM just given the big CapEx next year. And the WPZ cost of equity is still pretty high. A lot of your peers have gotten rid of the GP in some way, shape, or form, whether it's the parent buying in the LP or the LP buying in GP. Can we just get some updated thoughts from you guys on this trend and whether or not at some point you will have to evaluate the same in order to be competitive with these peers?

Alan S. Armstrong
President and Chief Executive Officer
A

You know what I would say today that I think we announced a series of actions today, but in terms of other potential actions, we always are looking at other possibilities, structure change or otherwise, and you've seen us take a number of actions in the past and we'll continue to evaluate the possibilities again as we continue to move forward. So I wouldn't rule anything out, but at the current time I'd focus on the actions we've taken and we really don't have any commentary really on anything else that we're looking at.

Christine Cho
Barclays Capital, Inc.
Q

Great. Thank you for the color.

Alan S. Armstrong
President and Chief Executive Officer
A

Thank you.

Donald R. Chappel
Chief Financial Officer & Director
A

Thanks, Christine.

Operator: We'll go next to Jean Salisbury with Bernstein. Please go ahead.

Jean Ann Salisbury
Sanford C. Bernstein & Co. LLC
Q

Hi, guys. Just a couple of quick ones. Can you provide an estimate of the EBITDA from the Canadian assets for sale? I know it's very sensitive to NGL prices, but a range would be helpful.

Alan S. Armstrong
President and Chief Executive Officer
A

Yeah, Jean, I don't think we have disclosed that. I can tell you that in the current environment that there's not a tremendous amount of cash flow there in the current environment with propane being so heavily depressed there in Canada. Of course, that was the purpose of the PDH project, was to take advantage of that, but it's not a meaningful amount of EBITDA here in 2016.

Jean Ann Salisbury
Sanford C. Bernstein & Co. LLC
Q

Okay. And can you say how much CapEx you've put into the PDH plant so far?

Donald R. Chappel
Chief Financial Officer & Director
A

I don't think we've singled that out yet.

Alan S. Armstrong
President and Chief Executive Officer
A

Yeah, I'm sorry, Jean, I don't think we've disclosed that, and we're right in the middle of that sales process or getting that finalized. So I'd prefer not to disclose that. Thank you.

Jean Ann Salisbury
Sanford C. Bernstein & Co. LLC

Q

Okay. No, no problem. And then, as a follow-up, a number of news reports have come out that Chesapeake is close to selling their Barnett assets. Have you had any discussions with them about what it would mean for their midstream agreements there?

Alan S. Armstrong
President and Chief Executive Officer

A

I would just say we're always working with Chesapeake on ways to improve our relationship with them, and certainly we're interested in trying to get the drill bit to work there in the Barnett, which would improve volume today we have those MVCs that protect our cash flows there, but certainly would like to see the drilling activity and development activity increase there. So we are working with Chesapeake, we always are working with Chesapeake on ways to improve that, but we're not in position to be able to disclose anything on that today.

Jean Ann Salisbury
Sanford C. Bernstein & Co. LLC

Q

Okay, great. That's all for me. Thank you.

Alan S. Armstrong
President and Chief Executive Officer

A

Thank you.

Operator: We'll go next to Danilo Juvane with BMO Capital Markets.

Danilo Juvane
BMO Capital Markets (United States)

Q

Thanks and good morning. As you guys sort of think about the dividend in 2018, should we think about the potential rebasing as something that is gradual off of the $0.80 number or will you sort of have a hard rebasing at that point?

Donald R. Chappel
Chief Financial Officer & Director

A

Danilo, I don't think we have much in the way of guidance there, but certainly several factors. WPZ expects to increase its distribution somewhat by 2018. Obviously, we're not quantifying that today. And then, secondly, over time we would expect the reinvestment to diminish or be eliminated and a combination of factors will be considered as Williams determines what its dividend will look like. So, again, really not in a position to provide any guidance on that today, but I think it'll be something that we look at all the factors and make a decision as we got closer to that time period.

Danilo Juvane
BMO Capital Markets (United States)

Q

Thanks. And just to clarify on your Canadian asset sales, are those proceeds after-tax?

Donald R. Chappel
Chief Financial Officer & Director

A

Those are pre-tax proceeds. We do not expect a tax burden in light of the high tax basis on those assets.

Danilo Juvane
BMO Capital Markets (United States)

Q

Okay. Last question for me. You guys realized a lot of cost savings during the quarter. Can you quantify how much you expect to realize here for the balance of the year and maybe also even through 2017?

Alan S. Armstrong
President and Chief Executive Officer

A

Yeah, sure. Thank you for the question. We do think that the level that we have now is sustainable. These are not kind of one-time, these are more systemic kind of cost reductions. Our head count from the first of the year is down about 12% and our team has done a really great job on the supply chain side of things of lowering our costs there as well. So these are things we've worked hard to not just – not as simple as just head count reduction, but also process improvements across the organization. And we do think that we're reducing costs in a way that's sustainable. And we are looking for some things to simplify the organization looking forward as well. And so we're hopeful to continue to improve on the cost savings beyond what we have today as we get into 2017.

Danilo Juvane
BMO Capital Markets (United States)

Q

Okay. That's it for me. Thank you.

Alan S. Armstrong
President and Chief Executive Officer

A

Thank you.

Operator: We'll go next to Shneur Gershuni with UBS. Please go ahead.

Shneur Z. Gershuni
UBS Securities LLC

Q

Hi. Good morning, guys.

Alan S. Armstrong
President and Chief Executive Officer

A

Good morning.

Shneur Z. Gershuni
UBS Securities LLC

Q

A couple of questions. I guess, the first one is kind of a multi-part question, but when you think about restarting the dividend in 2018, is there a net debt to EBITDA target on a consolidated basis that you have to achieve first, or do you just sort of think that the way you – if you're on the right glide path, that that would allow you to restart that?

And then, secondly, is it only going to be dividend increase, or are you thinking about share buybacks? And then, finally, would you be interested in calling some of the WMB debt, or would there be premium issues and so forth? I was wondering if you can sort of talk about that in context together?

Donald R. Chappel
Chief Financial Officer & Director

A

Yeah, a lot of questions there. I would say that we would like to, again, hold WPZ at investment grade stable levels. We would like Williams to be not more than two notches lower than that, and also have Williams credit profile strengthening as well such that Williams begins to come back to investment grade levels over a multi-year timeframe here as well.

Having said that, I think we would certainly be looking at all of our options, but at this point, I would say that we would look at all the options, whether it's dividend, share buyback or debt reduction. But again, I think we'll have to see exactly what the facts and circumstances look like, what's the best use of capital as we approach 2018. I think right now we've got a pretty clear path and plan through 2017. But 2018, I think we don't want to get ahead of ourselves and really start to lay out too much until we get a little further down the road.

Shneur Z. Gershuni
UBS Securities LLC

Q

Okay. And then as a follow-up, and I realize you guys have been very busy and announced a lot today, but when you think about Geismar in terms of the options that you have for it right now, what is the appetite in the marketplace right now for a tolling arrangement? When I think about the amount of M&A that we've seen in the chemical sector, some of them seem to be short ethylene capacity. Do you see yourself signing a potentially longer term tolling arrangement with one of those guys or when you think about the M&A appetite that's out there for chem assets, do you think about possibly selling Geismar as well, too?

Alan S. Armstrong
President and Chief Executive Officer

A

Yeah. I would say that we certainly are exploring what the tolling market looks like out there. We've kind of done that almost piecemeal in the past, kind of one customer at a time and we are looking at doing more of a process. Really if you think about, there's really two groups that would be the counterparties of those tolling agreements. One would be the market. So the parties that are selling the ethylene and have that supply, and that's a fairly consolidated group on the river.

And then on the other side of that you had a multitude of buyers that really are dependent on Williams as a merchant provider in that market. So that's the downstream derivative buyers. And so we really are trying to determine which party is the better counterparty for us on that between the supply side versus the market side of that. So I would say we've moved from doing that in a kind of – I wouldn't – in a piecemeal manner, one party at a time, to kind of looking at it in a more aggregated process, and so we will be pushing ahead on that for the balance of the year.

Shneur Z. Gershuni
UBS Securities LLC

Q

Okay. And then, finally, there was an earlier question about the Barnett and Chesapeake. It's my understanding that the recent activity in the Barnett is more about an oil target. Would that be a benefit to you longer term? I was wondering if you can sort of talk into context as to what the targets are there and why folks would be interested in potentially acquiring the asset?

Alan S. Armstrong
President and Chief Executive Officer
A

Yeah, I really couldn't help you too much. I think the window that's there is primarily a gas window that we're involved with, with Chesapeake and the acreage that we have. But there's just a lot of – if you think about how old a lot of those completions were versus modern technology today, there is a lot of improvements that don't require the kind of capital to drill, but just a lot of improvements that can be done with everything that the industry has learned about completions. And so we think there's some pretty low-cost incremental gas production to come out of the basin. And so we think putting ourselves in a position where we're helping encourage that is good for us long term. And so those are the kind of things that I think we would be looking for, for that basin.

Shneur Z. Gershuni
UBS Securities LLC
Q

Great. Thank you very much, guys.

Alan S. Armstrong
President and Chief Executive Officer
A

Thanks.

Operator: We'll go next to Ted Durbin with Goldman Sachs. Please go ahead.

Theodore Durbin
Goldman Sachs & Co.
Q

Thanks. Just on the CapEx guidance here, I just want to confirm, first of all, how much have you spent on Atlantic Sunrise, if anything? And then, do you have full completion of the project in your $3.1 billion through 2017?

Alan S. Armstrong
President and Chief Executive Officer
A

Yeah, let's see, on the capital, I don't think we've disclosed that. So we have spent money, it always takes a lot of money upfront on a project like that, and we've been very successful on the right-of-way acquisition piece of that. And so that's where the permitting and right-of-way acquisitions where majority of those dollars will go, but team's done a terrific job on that front and so we're doing very well on that.

In terms of the timing of the capital, certainly the $3 billion in 2017 includes Atlantic Sunrise. I will tell you that, as we've mentioned before, team is very focused on that 2017 in-service target. But I would tell from you a financial plan standpoint – I think this has perhaps brought some confusion, from a financial plan standpoint, we always give ourselves, on all of our projects, we give ourselves some room so that we're not expecting cash flows and we can absorb some delays if they do occur. So I would just say on the planning and the project management side, we are full bore into making that 17-date, and things are going well in that regard. But from a financial planning standpoint, we put a more conservative date in there for expected start-up.

Theodore Durbin
Goldman Sachs & Co.
Q

Okay. That makes sense. And then, I think, for Don, you had mentioned in your prepared remarks 4.5 times debt to EBITDA at WPZ in 2018. Can you just confirm does that have a full year of Atlantic Sunrise, is that sort of an exit rate type of metric, and do you think that's the number you need to get to, to stay IG with the agencies?

Donald R. Chappel
Chief Financial Officer & Director

A

I'd say – first, I'd say that I said less than 4.5 times. That would be an agency adjusted number, so it wouldn't be right off the books, but it'd be an agency adjusted number. It has a partial year of Atlantic Sunrise, I think as Alan mentioned. We build a contingency into our financial plan for potential delay in all of our projects. And we just wanted to be clear about that. So it's partial year that's included in our 2018 numbers.

Theodore Durbin
Goldman Sachs & Co.

Q

Got it. That makes sense. And then just in Northeast G&P, the volumes there, it looks like they're down sequentially. You've spoken, I think about price related shut-ins. I'm just wondering if you're still seeing that, and is it more a northeast Pennsylvania or it is now more widespread across the basin, what you're seeing there?

Alan S. Armstrong
President and Chief Executive Officer

A

Yeah, I'll ask Jim Scheel to chime in on that, please.

James E. Scheel
Senior VP-Northeast Gathering & Processing

A

Yeah. So right now we have about 700 million a day shut-in. And you're correct, the majority of that is in northeast PA, specifically in and around the Bradford area. As you can recall, our volumes are down somewhat, but you've got to remember this is a shoulder month where we really haven't had much cooling impact until the last month of the quarter.

Theodore Durbin
Goldman Sachs & Co.

Q

Great. I'll leave it at that. Thank you.

Alan S. Armstrong
President and Chief Executive Officer

A

Thank you.

Operator: We'll go next to Craig Shere with Tuohy Brothers. Please go ahead.

Craig K. Shere
Tuohy Brothers Investment Research, Inc.

Q

Good morning, and congratulations.

Alan S. Armstrong
President and Chief Executive Officer

A

Good morning, Craig.

Craig K. Shere
Tuohy Brothers Investment Research, Inc.

Q

So, Don or Alan, can you comment on the updated cash tax outlook at WMB over time with this updated plan? Also, any prospects that you envision as far as cash flows for the size of excess coverage at WPZ through 2017? And any thoughts about the combined range of potential public DRIP and ATM proceeds that you might look for through the end of 2017?

Donald R. Chappel
Chief Financial Officer & Director

A

Craig, cash tax rate continues to be at or near zero for extended period of time in light of the heavy capital investment and significant NOL that we have. In terms of WPZ's cash flow and coverage, we've not put out a number on that. I think you can calculate that based off what we have put out. And, again, we've not defined the size of the public DRIP or ATM program. But again, I think given the data we have put out, I think you can probably come up with some pretty good estimates yourself.

Craig K. Shere
Tuohy Brothers Investment Research, Inc.

Q

Are we to anticipate some cash tax drag before the end of the decade?

Donald R. Chappel
Chief Financial Officer & Director

A

I think that's unlikely.

Craig K. Shere
Tuohy Brothers Investment Research, Inc.

Q

Okay. Thank you very much.

Operator: We'll go next to Faisel Khan with Citigroup. Please go ahead.

Faisel H. Khan
Citigroup Global Markets, Inc. (Broker)

Q

Hey. Good morning. It's Faisel from Citi. Just want to go back to some of the equity funding statements you made for WPZ. I understand that looks like it funds the equity portion of the capital program. I take it, Don, that the rest will be sort of funded with debt on the – incremental debt on the balance sheet?

Donald R. Chappel
Chief Financial Officer & Director

A

Well, Faisel, I'd say, we have a pretty limited amount of debt in this plan. As you know, Transco issued $1 billion of debt back in January of 2016 when the market was not very attractive. But the amount of debt being issued in this plan is pretty modest. There are some debt retirements that are coming up. So we'll obviously be issuing debt to fund debt retirements. But beyond that, it's pretty limited given that we're in the process of delevering.

Faisel H. Khan
Citigroup Global Markets, Inc. (Broker)

Q

Okay. And then, in terms of the distribution coverage, I know you're around one times. What do you think the right target for distribution coverage is? I mean, you still have some cyclical cash flows in the portfolio of assets and you've got some concentrated counterparty risk. I'm just wondering, what's the right coverage ratio at PZ and that is comfortable for you and the agencies?

Donald R. Chappel
Chief Financial Officer & Director
A

That's a great question. Again, I think it'll be a function of the amount of commodity price or other risk that we have in the portfolio. And I would say that it's somewhere going to be between 1 and 1.2 times. But these are general range of coverage that I would expect over time, again, depending on facts and circumstances, but obviously it could be a bit different from that.

Faisel H. Khan
Citigroup Global Markets, Inc. (Broker)
Q

Okay. And did the agencies get a chance to preview this plan, and does this take at least one or two of them off the negative watch do you think?

Donald R. Chappel
Chief Financial Officer & Director
A

Well, we did preview it with three agencies and it will be up to them to determine their point of view.

Faisel H. Khan
Citigroup Global Markets, Inc. (Broker)
Q

Okay. And then just on the – you guys used to publish your – sort of your sensitivity commodity prices. I just want to make sure that the historical sort of guidance you used to give us on the sensitivity is still sort of intact?

Donald R. Chappel
Chief Financial Officer & Director
A

I would say that – I don't know anything offhand that throws it off, but our volumes have changed somewhat since that date. So I wouldn't want to say that it's up-to-date, but I think directionally it's in the right direction. I think we'll look to provide some updates in the future date as to what those look like. But again, we've had some movement in volumes, so I wouldn't want to say that that's as precise as it used to be, but nonetheless I think it's still something that is useful.

Alan S. Armstrong
President and Chief Executive Officer
A

Yeah. I think probably the main delta looking forward, of course, would be the Canadian asset sales because those are very commodity sensitive and so that would probably be the big change in your model looking forward.

Faisel H. Khan
Citigroup Global Markets, Inc. (Broker)
Q

Okay. Understood. Now, Alan, last question from me. On the corporate governance plans, as you go into sort of, I guess, a November proxy, what's the plan in terms of number of board seats and the sort of independent Chairman role? I mean, what's the plan from a corporate governance and sort of corporate structure perspective?

Alan S. Armstrong
President and Chief Executive Officer
A

Yeah, sure. I would tell you we are out recruiting and going through the interview process. We've got Spencer Stuart helping us with that effort. And it's gone very well, very impressed with the kind of candidates that we've seen and that I'm very excited about, frankly.

And so we are looking to add a few really great candidates in that regard, and I would say stay tuned on that. It's moving ahead pretty quickly. But we are anxious to hear if there's any other candidates that surface as part of the – from outside of the board, the Spencer Stuart effort. We're always anxious to hear that feedback as well. So again, things are going well. We're excited about adding the board today is very stable, very engaged, but as always we're looking to add to the quality of our board.

Faisel H. Khan
Citigroup Global Markets, Inc. (Broker)
Q

Okay. Any independent Chairman spot?

Alan S. Armstrong
President and Chief Executive Officer
A

Today Kathleen Cooper is our Chairman, and would expect that to remain the case.

Faisel H. Khan
Citigroup Global Markets, Inc. (Broker)
Q

Okay. Thank you.

Alan S. Armstrong
President and Chief Executive Officer
A

Thanks.

Operator: We'll go next to Chris Sighinolfi with Jefferies. Please go ahead.

Christopher Paul Sighinolfi
Jefferies LLC
Q

Hey. Good morning, guys.

Alan S. Armstrong
President and Chief Executive Officer
A

Good morning.

Christopher Paul Sighinolfi
Jefferies LLC
Q

A lot's been hit here, so apologize if these are sort of second-tier type questions, but just curious on a couple of things, Alan. First, I guess, the time profile of your appeal process on Energy Transfer, if there's anything you can tell us as a guidepost for that, when we might put it sort of formally behind us?

Alan S. Armstrong
President and Chief Executive Officer
A

We're hoping to see that expedited, but would just say that it moves through the Delaware courts at a pace that – I would expect that it's going to drag out too terribly long, but I don't really have any specific dates for you on that. I would just remind people that the focus there is for the damages. And we certainly are – our outside counsel is certainly very focused on that. I would tell you the management team has got their head down to really execute on the plan before us, and so fully expect our outside legal team to be successful in going after those damages. But I would tell you the management team's focus is just head-on on the business before us.

Christopher Paul Sighinolfi
Jefferies LLC
Q

Understood. Thanks for that. And then, I guess, just a final question for me. With regard to the MVC accruals that you make, are you asking the counterparties to post collateral for those? How does that process, I guess, work? And then, as it relates, how does – in your conversations, Don, I guess, previewing with the rating agencies, how did they think about those cash flows as it pertains to your leverage and the defense of IG down at WPZ? Thanks.

Donald R. Chappel
Chief Financial Officer & Director
A

Chris, we do not get any credit support on those. They're contractually due, so the counterparties require to pay those. Obviously, in the event of a credit event, that's a different situation. But absent credit event, they're contractually due, and they have been paid timely every year. And we would expect those would continue to be paid to us in full and timely. So it's really not a worry, except in the event of a credit event. And in terms of the agencies, I think the agencies view it the same way so that they would view it as certain cash flows, except with an assumed credit event. So that would be some stress-testing around that.

Christopher Paul Sighinolfi
Jefferies LLC
Q

Okay. Great. Thanks for the color.

Donald R. Chappel
Chief Financial Officer & Director
A

Thank you.

Operator: We'll go next to Sharon Lui with Wells Fargo. Please go ahead.

Sharon Lui
Wells Fargo Securities LLC
Q

Hi. Good morning. I'm just wondering if you could provide some more details on your underlying assumptions for 2017 in your financial planning, especially when you think, I guess, targeting that debt leverage of 4.5 times and below? Just wondering what are you expecting for 2017 commodity prices, as well as is there any anticipated deterioration in the Chesapeake cash flows?

Donald R. Chappel
Chief Financial Officer & Director
A

Sharon, we're largely using strip prices, so I'd say something that's very much in line with where the current market is. And in terms of CHK cash flows, we're not expecting a significant amount of drilling activity from Chesapeake in light of the fact that they have a number of priorities for the use of their capital including some debt reduction. So again, I think we have what appears to be a fairly realistic plan at this point, and we'll see how things play out.

Sharon Lui
Wells Fargo Securities LLC
Q

Okay. But no change in terms of the gathering rate for the MVCs at this point?

Donald R. Chappel
Chief Financial Officer & Director
A

No.

Sharon Lui
Wells Fargo Securities LLC
Q

Okay. And then to achieve, I guess, the 4.5 times or below, are you assuming ATM equity or additional asset sales in 2017?

Donald R. Chappel
Chief Financial Officer & Director
A

We are assuming ATM equity, and the amount will be dependent upon the amount of public participation in the DRIP. But between public DRIP or public ATM equity, we are expecting to tap that. We are not planning any additional asset sales at this point, certainly to the extent that there were any, that certainly could reduce the needs in that area.

Sharon Lui
Wells Fargo Securities LLC
Q

Okay. And just a question about 2017 growth CapEx, you provided guidance of $3.1 billion. The bulk of it is Transco spending, but just wondering if you can give some color on the other areas of investment for the remaining balance.

Donald R. Chappel
Chief Financial Officer & Director
A

I'd say it's Gathering & Processing assets throughout our system. I would say with the Northeast as a factor there just to meet growing production needs, particularly as this new pipeline capacity comes online, there's some gathering expansions that have to occur as well to fill those pipelines. So I think that's probably the biggest portion of that.

Donald R. Chappel
Chief Financial Officer & Director
A

And we also have in that – other than interstate, we also have some investments going on out in the Permian as well. So in the joint ventures out there as well as in some of our operated facilities in the Permian, there's quite a bit of committed expansion and capital going on in that area as well.

Sharon Lui
Wells Fargo Securities LLC
Q

Great. And just I guess in terms of expected timing, when you would provide more details on 2017 guidance?

Donald R. Chappel
Chief Financial Officer & Director
A

Well, we haven't determined that yet, Sharon, in terms of when we would provide more detail. Certainly, you can see on slide five of the package that we produced today, you can see the projects and the amount of capital we expect to be placed in service in 2017. So that can give you some idea of the amount of growth that we expect for 2017. But we haven't determined exactly when we would lay out guidance for the 2017 period.

Sharon Lui
Wells Fargo Securities LLC

Q

Thank you.

Donald R. Chappel
Chief Financial Officer & Director

A

Thank you.

Operator: Next, we'll go to Darren Horowitz with Raymond James. Please go ahead.

Darren C. Horowitz
Raymond James & Associates, Inc.

Q

Good morning. A couple of quick ones. The first, Don, what's the average return threshold across the projects in the backlog for next year? And I'm just curious, when you look at the current cost of equity, where you think the cost of equity is going to be as well as the current cost of debt, any opportunities to high grade or defer that capital commitment in order to alleviate some of the financing burden next year?

Donald R. Chappel
Chief Financial Officer & Director

A

Darren, great question. Something we look at all the time. I'd say our pipes projects tend to be in the low-teens, un-levered returns. And we think the cost of capital for those is pretty low too from the standpoint if you were to really isolate that business and say what is the perfect cost of capital for that business. So I think you'd be looking at pretty low debt costs there and a pretty attractive equity cost as well I'd say. And I think that's exactly the kind of business that investors are pretty enthusiastic about and probably lowers our cost of capital overall.

So we think all of those Transco projects are just really right down the sweet spot. So while we could lay off some capital there, it's not desirable, I think, from our perspective. The rest of the returns on some of those investments tend to be fairly high because they're incremental returns on existing asset bases. So, again, we'll continue to look at those and see if there's capital that is not earning a sufficient return or otherwise can be deferred or laid off. But at this point, this is the plan, but we'll continue to focus on that in an effort to maximize value creation opportunities for both PZ and Williams.

Alan S. Armstrong
President and Chief Executive Officer

A

I would just add to that. As you think about the returns on projects like Atlantic Sunrise, great project, great returns, but in addition to the returns we get on a particular project, something like Atlantic Sunrise pulls all the way through the system. So you heard Jim talk about the 700 million a day that we have shut-in up there as – and that capital is already there, the gathering system is already there. So to the degree we unlock those constraints and systems like that, we get a very high increment in cash flows because we would see the gathering volumes pick up there as well. So, really, those projects are really important to us in terms of incremental cash flow.

Darren C. Horowitz
Raymond James & Associates, Inc.

Q

So, Alan, if you think about it in that context just meaning that those projects are sticky because they've got, if you will, more intrinsic returns, just based on how vertically integrated they are, if you balance that with your funding plan, how do you guys think about – and I know this is tough to answer, but how do you think about balancing the equity issuances that are needed through the ATM beyond WMB's investment in WPZ, and the headwind that leaning on that ATM could have on PZ's equity cost of capital, maybe challenging some of those returns?

Alan S. Armstrong
President and Chief Executive Officer

A

Yeah. No, we certainly look at it that way. And I think the way you are describing you should look at it, with just kind of on the incremental cost of capital is the right way to think about that, and that is the way we think about it. So I completely agree with that assessment. I would just tell you I think these projects are pretty powerful in terms of what they do for us going on the increment. And we have trimmed a lot of capital out of the plan. But I think as WPZ investors see the amount of coverage that we have and see the kind of growth that is out before WPZ with all those big capital investment, I think we'll see some very constructive positioning for the PZ units. And so I think that will be a positive. But, again, I think the kind of returns that we're talking about, are powerful and we'll overcome that over time.

Darren C. Horowitz
Raymond James & Associates, Inc.

Q

Okay. And then last question for me. Don, Alan, in your eyes, what's more net present value accretive? Is it a meaningful leverage reduction in the near term where you can return to a larger dividend reset with a de-risked cash flow profile, or is it a more moderate dividend restatement and greater operational cash flow being reinvested in the business for theoretically greater returns like you just talked about over the long term?

Donald R. Chappel
Chief Financial Officer & Director

A

Darren, I think we're comfortable with the plan that we laid out here today based on the facts and circumstances we have in front of us, and obviously we'll continue to look at the changing landscape, including how we're valued and the cost of capital and make decisions from that new baseline. But we're certainly very focused on the cost of capital, very interested in reducing spending where we don't see a good spread between the return on capital and cost of capital as well, but all consistent with supporting our franchises. So we'll continue to balance those points and try to find the path that we believe will create the greatest long-term value.

Darren C. Horowitz
Raymond James & Associates, Inc.

Q

Thank you.

Alan S. Armstrong
President and Chief Executive Officer

A

Thanks, Darren.

Operator: And, ladies and gentlemen, this will conclude the Q&A portion of the call today. I'd like to return the program to Alan Armstrong for closing comments.

Alan S. Armstrong
President and Chief Executive Officer

Okay. Well, great. Well, thank you all very much. Appreciate all the interest. We're really excited about the platform that we're sitting on here for growth and very excited about really moving this business to a much more predictable set of cash flows and continuing to execute on these projects that are just coming in one after another as we expand out the business, and then ultimately the pull-through that we'll get on our supply side. So we couldn't be more excited about strategy, very thankful for a very dedicated organization that's fired up about executing on the plan. And we appreciate your confidence and interest in Williams in the future. Thank you.

Operator: And this will conclude today's program. Thanks for your participation. You may now disconnect, and have a great day.