



PAA/PAGP Fireside Chat: Capital Allocation, Permian in Focus

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Summary

- The midstream business model has transitioned from capital-intensive growth mode to capital-light efficiency mode, with Plains and others emphasizing free cash flow generation.
- Management noted the potential for buybacks and/or distribution increases to take greater precedence in capital allocation decisions as debt is reduced. The same can likely be said for others in the midstream space.
- The outlook for the Permian remains positive with recent rig additions trending above management's expectations. Plains' footprint in the Permian will be enhanced by its joint venture with Oryx, which is expected to close in 4Q21.

Last week, the management team from [Plains All American](#) (PAA/PAGP), including Willie Chiang, Chairman and CEO, and Al Swanson, EVP and CFO, participated in a fireside chat call series co-hosted by Morgan Stanley and Alerian. Today's note discusses key takeaways from the conversation, covering topics from capital allocation to the Permian, with both company-specific insights and read-through for the broader midstream space.

Growth focus replaced by emphasis on capital discipline and efficiency.

The management team emphasized the positive changes to the midstream business model that have taken place broadly, including at Plains. Prior to 2020, the midstream industry was in a capital-intensive growth mode, which was arguably necessary to facilitate the tremendous increase in US energy production. Now, the industry is operating in a capital-light, efficiency mode. Capital discipline is the priority, and the focus is on optimizing existing assets – potentially in concert with others – instead of building new pipelines. Plains has exemplified this optimization through its joint venture with Oryx (discussed below) and in reversing the [Capline](#) oil pipeline with its partners, which is slated for completion this year. Capline reinforces the value proposition of existing pipelines, but pipelines can be used for more than moving hydrocarbons. While discussions on repurposing pipelines tend to focus on transporting captured carbon or hydrogen, management noted that they have had conversations with utilities and telecom companies about using idle pipelines for power lines or broadband wires as it can be challenging to secure new rights of way today. The value of existing pipelines often seems underappreciated, but these examples from Plains' asset base highlights the value of having steel in the ground.

Free cash flow provides optionality for capital allocation.

The combination of cash flows from completed projects and lower capital spending is resulting in significant free cash flow generation across midstream, even after accounting for dividend payments. Specifically, Plains forecasts 2021 free cash flow after distributions of \$1.35 billion including asset sales (or \$450 million excluding sale proceeds). The company's objective is to maximize free cash flow, reduce debt, and return cash to shareholders. As highlighted last week, the prospect for free cash flow has led to a proliferation of buyback programs ([read more](#)). Plains announced a \$500 million buyback authorization in November 2020 and had approximately \$400 million remaining on the authorization at the end of 2Q21. Management noted the potential for buybacks and/or distribution increases to take greater precedence in capital allocation decisions as debt is reduced. The same can likely be said for others in the midstream space who are prioritizing debt reduction in the near term but may look to be more active with buybacks (or dividend increases) as leverage improves. More broadly, midstream's transformation from issuing equity in its capital-intensive days to now buying back equity represents a positive shift for investors.

Positive Permian outlook with positioning enhanced by Oryx JV.

From an operational standpoint, the Permian was a natural focus of the conversation given Plains' significant footprint in the basin in terms of gathering assets and long-haul takeaway capacity to both the Gulf Coast and Cushing. Permian rig counts have been trending above management's expectations. As of Friday, the Permian rig count was up 88 rigs (+50.2%) year to date per [Baker Hughes](#). Oil production from the basin is currently [4.8 million barrels per day](#) (MMBpd), and management expects production to eventually grow to 6-7 MMBpd. The company's existing asset base provides significant operating leverage as volumes increase, allowing PAA to grow its business with minimal spending. The company's Permian gathering footprint will be enhanced by its [joint venture](#) with Oryx, which is expected to close in 4Q21. The JV will have 4 million in acreage dedications, a weighted average remaining contract life of seven years, and an average inventory life of 30 years based on upstream activity levels at the time of the announcement in July. Within 12 months, the JV is expected to capture \$50 million in synergies with the potential for that number to exceed \$100 million in the long run. Importantly, the deal allows for synergy benefits and increased optionality and flexibility for customers without any capital outlay.

Bottom line

In many ways, Plains exemplifies a number of the positive developments underway in the midstream space, including emphasizing asset optimization and free cash flow after distributions with a focus on capital discipline.

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