Participants

Barry Davis, CEO of EnLink Midstream (ENLC)

Nate Abercrombie, The Stock Podcast

Interview Transcript

Nate: Thank you very much for joining me on this show and taking the time to talk to me.

Barry: Yeah Nate, it's great to be with you.

Nate: I start off all these interviews with my guests background, so could you just tell the listeners just a little bit about yourself?

Barry: Yeah, my name is Barry Davis. I'm chairman and CEO of EnLink Midstream. I have been with EnLink and the predecessor companies since the beginning, which is over 25 years ago when I led the founding of the previous company. And so a role that I'm very familiar with and a company that I'm very proud of and what we've been able to do over the last 25 plus years.

Nate: Yeah. And so what brought you back to the role of CEO? I know that you had left, I think it was two years ago?

Barry: Yeah, so great question, timely. I did leave the company in January of 2018, left the CEO position. I didn't leave the company. I was Executive Chairman for about 18 months. Felt like it was the exact right timing to do that, had a great successor, Mike Garberding who I had worked with for over a dozen years. We were at a very stable place from a company standpoint, had lots of good things going on in a very high growth period. Felt like the table was set and it was a great time for Mike to take over as CEO. As you know, and I'm sure many of the listeners know that we've seen dramatic change in the industry environment in the last 18 months and for us in particular, we've seen change with the Devon ownership change, which quite frankly started not long after I stepped out of the CEO position. Devon decided to sell its interest due to a need on its part to really accentuate just a few core areas and midstream investment was no longer something that they wanted to have as part of their company. And so they ultimately sold in the middle of 2018 their position to Global Infrastructure Partners or GIP as I will refer to them frequently, I'm sure throughout the call here. And that really began a series of changes that ultimately led to about 90 days ago. My being asked to rejoin the company as CEO and help navigate through something that certainly we've seen before. This is a cyclical industry. And so since the beginning of EnLink and its predecessors, we've probably seen four or five dramatic cycles. And this one is no less than the challenge that we've seen before, that's something that we have seen before and we're optimistic that we'll navigate through it. And I think you'll hear me say several times that we have a path to the other side of this cycle and today our focus is on executing through it and I'm glad to be leading from the CEO position.

Nate: Yeah, I would really like to get your thoughts on just the overall macro environment within energy right now. But before we get to that, could you talk a little bit about just the origin story for EnLink?

Barry: Yeah, for sure. So again, we started from scratch. We started a handful of relationships that we were a consulting for in the early days, building projects, building infrastructure for producer customers. That was all around just getting broader from the wellhead to the burner tip and and so that's how we started. The very earliest days started in 1992 and in 1996 we formed Crosstex Energy and many of our folks will know us as Crosstex Energy before we became EnLink in 2014. So with our beginnings really on the upstream end of the pipe, we are still highly concentrated, 75% of our business is what you would characterize as gathering and processing and about 25% of our business is downstream or delivery market facing infrastructure.

Barry: So to step through that a little bit, today we are in four core areas. Our G&P focus is first of all in the Central Oklahoma STACK play. We are the leading infrastructure provider midstream player in that basin with significant volume of over one BCF, about 1.2 BCF a day of services provided from a gathering and processing standpoint. So the number one position in Central Oklahoma. Secondly, we are the leading infrastructure midstream company in the Barnett Shale or North Texas as we call it, again, having about a BCF a day of throughput across our system in the North Texas area, but the number one position by far in that flight.

Barry: Thirdly, on a G&P basis, we are a significant player in the Permian Basin with gathering and processing in both the Midland Basin and the Delaware Basin. We continuously are growing that position rapidly today and it really is a great source of growth for us going forward. Lastly, our fourth core area we're the second largest midstream company in Louisiana serving the Gulf Coast of Louisiana on gas, crude oil, natural gas liquids and fractionation services that we provide in Louisiana. One thing that I would like to highlight when you look at the company today and where we are, we've grown dramatically over the last six years. We've grown from just over $200 million a year of earnings to this year will almost be $1.1 billion, so more than a fourfold growth over the last five or six years. And so it's been a very heavy growth and in a fast pace several years for us.

Nate: Could, could you talk just a little bit about your corporate structure and how it differs from a lot of other midstream companies out there today?

Barry: Yeah, so we really got our start as a classic MLP, Master Limited Partnership. We came public in 2002 as a Master Limited Partnership. Our General Partner was originally held as a C Corp that came public. It was actually the first pure General Partner IPO that was done in January of 2004 so kind of leading into if you will, the MLP and the General Partner structure, we operated as that until 2018 subsequent to GIP buying in the Devon interest, we move forward with a process to do what we call a simplification transaction, which is simply merging the General Partner in a Master Limited Partnership. In that transaction we eliminated our incentive distribution rights. So today we are a very simple LLC structure with a check the box C Corp tax treatment. And so a very straightforward, a normal corporation structure today.

Nate: Yeah. And what are some of the benefits of the C Corp structure as compared to MLPs?

Barry: Yeah, so again, the simplified structure creates efficiencies, reduces overhead associated with operating the two different companies, the elimination of the IDRs, the Incentive Distribution Rights is certainly something that the market wanted to see happen, in the last several years. That allows us to have a lower cost of capital and really return more value back to the shareholder or the common shareholders. So more efficient structure, I would say better returns to our shareholders. And lastly, we are index eligible on a number of indexes that we were not able to participate in as a Master Limited Partnership.

Barry: And then for those who are historical MLP investors, we always had to deal with the K1 and in our structure today that is no longer necessary. And so that's really helpful for a retail investor not having to deal with a K1 from a tax standpoint.

Nate: Yeah, thanks. You mentioned being eligible for an index, and I find this component really interesting within midstream today, just given the amount of passive investing going on. And from your perspective, do you think just the midstream space as a whole has been really hurt in terms of, investor interest by being ineligible for indexing?

Barry: Yeah, I certainly think that has been an issue, but I don't think it's as great of an issue as the general investor sentiment around the energy space. I think that's been a bigger issue than the index eligibility and so we just haven't been in favor. There's a lot of different ways to explain it, but I would say in the last five years, maybe even longer, energy has been out of favor. And so we're all having to try to regain, if you will, the interest of the investor, whether that's retail investors, institutional investors, and especially the generalist investors. We're really trying to market ourselves and try to do the thing, that would bring them back to the midstream and energy space in general.

Nate: Yeah. And what do you think is the biggest hurdle in getting generalist investors, retail investors back into midstream?

Barry: Nate, I'm going to say, first of all, we have to create returns and value creation. And I think that's been challenged in the last several years. I think we've been through a period of such heavy growth and competitiveness for opportunities in our business that we haven't had real return to the extent that really is attracting the investors. So we've got to do a better job with that. We've got to run our companies more efficiently, we've got to make better investments and we've got to show real return to our shareholders. The second thing is I think the other industries have done so well over the last five to 10 years. Many people have felt like they didn't need the energy exposure. And so as a result, and you know this, we've seen the share of the S&P a decline from over 10% to I think somewhere in the range of 4% today for the energy industry. And so there's just been a lost interest and I think in time we will be able to get that back. But there are certain things that we need to do also and the way that we run our companies.

Nate: No, I can really appreciate that. The firm that I used to work for, we were benchmarks. Most of the funds were benchmarked off of the Russell 1000 growth index. And I think when I first started it was close to 5% maybe. I think it was close to 7% of the index energy that is. And when I left it was less than 1% which is just absolutely ludicrous. So could you talk a little bit about, you mentioned energy being out of favor and in your most recent presentation I see that, you have listed there occurrent headwind being just the evolving E&P landscape. Could you talk just a little bit more about what you're seeing right now?

Barry: Sort of the investor demand has been for our industry to provide free cashflow. That is after we pay our dividends, after we pay our CapEx or our invest in our CapEx to have free cash flow that is actually building value in the company. And I think that demand, that drumbeat it's being getting louder and louder over the last two or three years. I think it was first on the upstream side where investors demanding that producers in best within their own cashflow as opposed to within their access to capital markets. And so as we saw that occurring, we started to see producers rethink the way that they were budgeting for their drilling and their CapEx plans.

Barry: And so naturally that led to less activity with less capital, less activity results in less volumes of natural gas and crude oil than they used to be moved across the infrastructure that we own. So really has ultimately resulted in where we are today, which is in a lower growth environment than we were in the past. Now that we know that we can adjust, we are making adjustments. We have recently, and with me coming back into the CEO position, we've established very clearly what our execution priorities are and our first and foremost focus is to increase the profitability on the existing assets that we have today. We think that there is lazy capacity, there is lazy profitability across all of our assets. And so we are asking our folks every day to do with a sense of urgency, everything we can to drive more profitability across our assets. And so I think that's the appropriate and first execution priority that we have.

Nate: Yeah. I'd love to get your perspective on just the regulatory situation today and how you're thinking about it going forward with, elections on the horizon and at a high level, are you concerned?

Barry: Well, certainly we have to pay attention to what's happening in the political environment and there's a lot of rhetoric right now around the oil and gas industry in particular, what might happen with certain administrations. Where they to occur around fracking and even a potential ban on fracking. We hear that. We think the reality of that is far, far away from where we are today. But we all have to think about that and we have to think about the implications. And what I would say is our expectation is more along the lines of scrutiny around the regulatory process, the permitting process so we could see things slow down as a result of the permitting process being more arduous or more difficult. And so we're having to plan for that. I think producers are making plans for that. I think they're building an inventory of drillable locations that they would be able to do even if things were to slow down in a new administration.

Barry: But look, here's what happens. If you slow it down, then that means you probably end up with a shift of activity into areas that are not on federal land that could serve us EnLink very well. We have a high concentration on privately owned lands and in particular our two basins of, Oklahoma and North Texas would benefit from that as we think activity could come back to those areas. Ultimately, I think the thing that the world needs to be concerned about is if you saw any kind of slowdown that would change the supply-demand balance. We could see commodity prices respond and I think many are predicting that we would see much higher commodity prices and that's not good for the economy. And I don't think at the end of the day there are many people that will want to see that happen.

Nate: Yeah. So we talked a little bit about investor sentiment and you've been out at a conference recently and I'm kind of curious whether or not these are the same types of questions that I just asked, that you're out there or you did hear out there in Dallas or is there something else that's top of mind from the investors that you're meeting with right now?

Barry: Yeah, I think the investor today certainly is discouraged. We've been in a lengthy cycle of where we've not seen share prices go up. People may create more value as a result investing in the space. And so not many people are in a good mood, it's a pretty tough environment today. But I think the demand is that we all look at this business differently and many people refer to it as midstream 2.0 or midstream 3.0 if you will, depending on where you think we've been. If we've been in 2.0 or 1.0 in recent days. But what that means is a greater focus on the balance sheet, making sure that we've got room to navigate, we've got less debt relative to our earnings, we've got more coverage, we're actually paying out less dollars as a percentage of our cashflow generated. We think the fed has dividend or distribution coverage and so the market wants to see more coverage. So the less leverage, lower growth.

Barry: We are in an environment where people don't really want to talk about 20% growth per year or they want to talk about something that is more manageable, which is probably a mid-single digit type growth with a solid distribution. And so I think people are asking for all of us to focus on delivering return to shareholders. And a combination of dividends and moderate growth and so that's what we're doing. We, we've communicated a plan, our plan again starts with increasing the profitability of our existing business. Secondly, we think down cycles and the cycle that we're in is going to create opportunities that we haven't seen in a while. There's going to be less competition because I think there're going to be fewer companies when this thing works its way through. Thirdly is really what I just pointed to, which is taking care of our balance sheet, making sure that we have the flexibility to operate in whatever the environment provides.

Barry: Lastly, I think we're on the very beginning of something that we're seeing across the midstream space and I think we're a leader in this and that is to drive organizational efficiencies, by finding ways to do things we've always done with more technology, more efficiency, which will drive costs out of the business and allow us to see more profitability. An example of that, we used this example yesterday in our conference discussion, but we've created what we call a center of excellence here in our Dallas headquarters. We have put some of our best and brightest in center of excellence. What we're doing is taking a look at everything we do across the business from earth, the way we operate our plants to the way we account to our producers. And we're running Six Sigma process and Lean process approaches across those core operations and finding ways to use technology, use data and drive down the cost and efficiency associated with those activities. So we're excited about the early returns, we are seeing real profit, we're seeing better margins, the results that will shake better runtime and real profitability being derived from the efforts that we have in that area.

Nate: Yeah. So you mentioned the balance sheet a couple of times. Could you just talk about what metrics you are currently targeting?

Barry: Yeah, so always, it starts with maintaining the strength from a debt to EBITDA, our debt to earnings. And so we do target a sub four times debt to EBITDA ratio and today we're operating at about four times debt to EBITDA. So we want to drive that down. We want to drive down the leverage in the business, so that it creates more flexibility for us. Secondly, we want to drive our payout percentage down as well or our distribution coverage higher. Today we are distributing at a coverage of about a dollar and 30 cents for every dollar that we pay out. So that's a 1.3 times coverage and we would like for that to go up and we are targeting that to go up to 1.5 or even greater if appropriate in the future. That's the first two metrics that we looked at. Obviously, we're always focused on returns. We think today returns are going up as a result of just the need to higher cost of capital. Our dollars are costing us more today and so we need to see more return for our investment for EnLink. That means investing more right around our existing assets, looking at ways to expand the existing assets and what we would call brown field type of growth as opposed to going into a white space and starting with a new asset. So higher returns, lower leverage, higher coverage. I mean all of that is giving us more operating flexibility and we think that's what you want to do in a cycle where we are today.

Nate: And what types of returns have you sort of thought about as being appropriate for EnLink?

Barry: Yeah, so I think the way we think of our returns is a real return above our cost of capital and also a risk adjusted return. So there's not a magic number, but generally I would say we are looking for high teams returns and in some cases even North of that get into the 20% return on our projects.

Nate: Yeah. So you mentioned your cost of capital and one thing that really stands out to me personally is just your coverage ratio or your distribution coverage is high, but your yield is also really high, which I'm curious how you addressed investor questions around, the stability of the distribution or how do you allay investor fears when they look at your yield and know nothing about you?

Barry: Well, I'll tell you what the market is saying is that our distribution is not sustainable and we've heard that loud and clear. What we have communicated, and we did many times yesterday at the conference, is that we believe that it is a sustainable distribution based on the projections that we have for the business. And here's the way I would say it. We can sustain distribution. I think the appropriate question and what the question the market is asking is should we or should we do reduce the distribution to create more flexibility in our operation and our balance sheet? And I think it's a valid question and certainly something that we will continue to evaluate. But today as we've made decision to hold our distribution where it is today, we pay out about $1.13 on a roughly $5 stock price. And so as you've said, just over 20% and we will continue to add value there.

Nate: Yeah. Now that you're back in the CEO seat, has your vision for the company changed apart from, making it more efficient and targeting higher returns? Are there priorities that you have now apart from those that are different from when you were previously CEO?

Barry: Yeah, I think we are in a very different environment than we were 24 months ago and that environment was in a fast infrastructure build period to serve the growing basins. At that time we had obviously Oklahoma position was growing rapidly. The Permian's growing rapidly. The Eagle Ford's growing, the Haynesville is growing, everything is in a growth mode and so we as a midstream companies were running as fast as we could to keep up and we did a terrific job of last. The service level that we provided through that high growth period has been fantastic, but as I stepped back into the CEO position today we see a different environment. We see one with lower activity and so we're now mining for opportunities to increase the efficiencies, we're driving out costs.

Barry: One of the things we communicate is recently was on a same store basis. You take our assets and the way they operated in 2019 we believe there is $75 million that can be added to the profitability of that business in 2020 that is a combination of cost reductions and that's across the entire system from overhead to our field operations and then secondly, higher utilization, so more margin, more revenue. And lastly, just again, driving efficiencies to the point where we reach our full utilization in an expanding the capacity of those facilities in a very efficient way. And so that's what's different today. I think that cycle has at least another year in it and that will be our focus. What we also have to do is be prepared for what happens beyond that and that is to take advantage of some opportunities that you see in a down cycle to really grow your business. We've been a leader in that. There hasn't been a cycle that we've been through yet in the last 20 years that we didn't come out the other side better than we went in and so that's our focus and kind of what I see is I've stepped back into position here.

Nate: Yeah, thanks for that. I'd like to get your thoughts on whether or not you think there are misconceptions the market has about either your company's investment story or the industry as a whole.

Barry: Yeah, so there are four things that we think the industry is really focused on as it relates to our story and our future. Number one, the market is demanding to know more about what's going to happen in our Oklahoma gathering and processing business. Again, we're moving about 1.2 billion cubic feet a day, which is a very large complex. Generating over 400 million of segment profits from that business or about 35% of our overall segment profit. The market simply wants to know if that basin is going to continue to grow. Are we going to be flat or are we going to see a decline with the lower activity levels? That is something that we are not in a position to be able to say today because we're waiting for producers to find their plans for 2020. So that's number one. I think in an environment where there is something that's unknown, people fill the blank with kind of a worst case and that's what we've seen people do. We've seen people projected there will be little or no activity in Oklahoma which would result in our case in a bid type volume decline and a high single digit margin decline in that business. And so I think people are searching for just what is Oklahoma going to do.

Barry: Secondly, what the market wants to understand is in the broader overall company forecast, what would that mean? Are we going to continue to be able to grow our EBITDA from the 1.07 range that we've indicated for this year, $1.07 billion. And so that's the second thing. The third thing that the market really wants to understand is what we're going to do with our distribution and are we going to reset the distribution given that the market doesn't seem to be valuing it the way it is today. And then lastly, I think the market really wants to understand... Our large shareholder, Global Infrastructure Partner owns about 45% of our company and they really want to understand how supportive they are going to be in this cycle. And is that something that's going to be beneficial to our common shareholders. And so our focus is over the next month or so to deliver a definitive answer on all four of those things. The last one will be difficult.

Barry: Here's what we'd tell you. They're our largest common shareholder. They have aligned interests with all of our shareholders and me in particular, I think of them is being a great partner. I am a significant investor in this company, holds clearly a large position relative, anything else that I own. And so I feel good about GIP as a partner and they're doing everything they can to help us in this difficult cycle. And we'll be just as helpful when we get to a better part of the industry cycle. So those are the four things I think the market is having to try to work through. It is our job to help them work through it in a shorter time as possible and we hope to be able to fill those blanks on some of the unknown in the coming days.

Nate: Yeah. Because we have talked a little bit about headwinds. I'd love to hear what comes to mind? What comes to your mind when you think about tailwinds for the company?

Barry: Yeah. It always starts with commodity price in our industry. And so should we see an improvement in commodity price, and it doesn't take much. Today natural gas prices are just above $2.50 (mmbtu) and crude oil is in the mid-sixties and if we see any improvement, it can have a real difference in the cash flow to our producers and the activity levels. And so I think it always starts with commodity price. Secondly, I think that anything that would shift the general market sentiment towards wanting to invest, wanting more exposure in energy, it'd be a real tailwind from a stock performance standpoint. And I think it's possible. I think we've got to see some other things not performing as well as they have in recent days, caused people to really want to look for different ways to create value in their portfolio. And so there were a couple of things it could become tailwinds and who knows. I mean we seem to be in a very dynamic macro environment so we could see some things improve from a global economic situation that could be helpful as well.

Nate: And I know you spend a lot of time talking to investors even this week out of that conference. But from your perspective, what's the most important question about your company that never gets asked by investors?

Barry: Well, believe me, after as many meetings and as many questions as I had yesterday, it doesn't feel like there's any question that's been left unasked. But here's one thing I'm proud of data. Nate, I think that we never spent any time talking about our lack of performance relative to the operations in our business. We have the absolute best operating team across our assets. The service that we provide to our customers is second to none, and so I never go into a commercial negotiation with a producer or a downstream market and have to explain a lack of excellent performance because we have performance excellence across all of our business, so they're a little bit like the referee that never gets noticed. They're doing a great job and so I think it would be that we don't spend time talking about misses in terms of operations, cost overruns or construction timing. Our team does an excellent job in executing across the business.

Nate: Could you tell or share with listeners just what you think was most critical thing that's happened in your professional career that has impacted you as a CEO or helped you get to the CEO role or become a better CEO?

Barry: Yeah, clearly it's about the people, taking the right people to partner with, having the right team in place. I've been very fortunate throughout the last 25 plus years to be working with great people. And I think that's it. I think it trumps everything else. Love the phrase that you've always got to figure out, make sure you've got the right people on the bus before you can determine where you're going. And we've always done that extremely well and I think that served us and all of our stakeholders well today.

Nate: Yeah. And then final question, if you had to recommend only one book about oil and gas or midstream, what would it be?

Barry: Well that's an easy one today. I think there are many books I love to read, but there is no book that we need more people to read right now than The Moral Case for Fossil Fuels by Epstein, we need people to understand the truth about our industry and the forecast for the use of fossil fuels. It presents facts and really gives both sides of the story. But Nate, what he wants the world to understand is that fossil fuels aren't going away because of low cost energy that is derived from fossil fuels. We have a better way of life, and there are many people throughout the world, we can still benefit from that. So that would be it, in fact I intend to send that out to a few folks this year around the holidays. Because I think it makes a great gift and maybe gives people a different perspective than what they're hearing in the marketplace, which is that everything's going to turn into renewable energy. There's a lot left in the runway for fossil fuels. And so I'm glad to be part of it and excited for EnLink and the role that we play.

Nate: Yeah. Wait, Barry, I really do appreciate your time coming onto the program and it's been a pleasure talking to you, so thanks a ton.

Barry: You bet, Nate. Thank you. Appreciate you. Goodbye.

Nate: Yeah, good luck out there. Bye.