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USAC.N - Q1 2024 USA Compression Partners LP Earnings Call

EVENT DATE/TIME: MAY 07, 2024 / 3:00PM GMT

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PRESENTATION

Operator

Good morning. Welcome to the USA Compression Partners' first quarter 2024 earnings conference call. During today's call, all parties will be in a listen-only mode. At the conclusion of management's prepared remarks, the call will be opened for Q&A. (Operator Instructions) This conference is being recorded today, May 7, 2024.

I now would like to turn the call over to Chris Porter, Vice President, General Counsel and Secretary. Please go ahead.

Christopher Porter - *USA Compression Partners LP - Vice President, General Counsel, Secretary*

Good morning, everyone, and thank you for joining us. This morning we released our operational and financial results for the quarter ending March 31, 2024. You can find a copy of our earnings release as well as a recording of this call in the Investor Relations' section of our website at usacompression.com.

During this call, our management will reference certain non-GAAP measures. You will find definitions and reconciliations of these non-GAAP measures to the most comparable US GAAP measures in our earnings release.

As a reminder, our conference call will include forward-looking statements. These statements are based on management's current beliefs and include projections and expectations regarding our future performance and other forward-looking matters.

Actual results may differ materially from these statements. Please review the risk factors included in this morning's earnings release and in other public filings. Please note that information provided on this call speaks only to management's views as of today, May 7, 2024, and may no longer be accurate at the time of a replay.

I will now turn the call over to Eric Long, President and CEO of USA Compression.

Eric Long - *USA Compression Partners LP - President, Chief Executive Officer*

Thank you, Chris. Good morning, everyone, and thanks for joining our call. I am joined on the call by Eric Scheller, our COO.

This morning, we released our first quarter 2024 results, which reflected another quarter of record results. Our first quarter results were driven by our strategy laid out during previous calls, focusing on prudent deployment of capital through return-based decision-making and demand-driven pricing, with extended contract tenors. By staying disciplined, we have continued to drive financial and operational performance to record levels, which we believe enhances and sustains unitholder value.

Of note, we saw another quarter of record revenues, adjusted gross margin, adjusted EBITDA, distributable cash flow, average revenue generating horsepower, and average revenue per revenue generating horsepower. Our utilization on both an average and period-end basis were also at record highs.

Consistent with my commentary during our last call, we addressed several important components of our capital stack during the first quarter. In March 2024, the partnership opportunistically issued $1 billion of 7.125% senior notes due 2029 and redeemed all of our $725 million 6.875% senior notes due 2026. We used the remaining net proceeds to reduce the revolving credit facility.

Our timing in the high-yield marketplace was virtually perfect with the spread to benchmark treasuries of 291 basis points close to the recent lows last seen in January 2022. The issue was substantially oversubscribed and our notes have performed well even in light of the recent pressure on interest rates. Additionally, this issuance received a credit rating upgrade from Moody's.

Further on April 1, 2024, the holders of the partnership's Series A preferred units elected to convert an aggregate of 280,000 preferred units into 13,991,954 common units, which were issued effective as of April 2, 2024. 2024 guidance for distributable cash flow has been updated to reflect the impact of this conversion.

The completion of these two activities sets us up well over the coming quarters to continue simplifying our capital structure, increase our public float of common units, as well as opportunistically work on the refinancing of our $750 million of senior notes due in 2027.

You may have noticed that our distributable cash flow coverage ratio, which was 1.41 times, was slightly lower than our prior quarter's 1.48 times coverage. Additionally, our leverage ratio of 4.27 times as calculated under our credit facility was slightly higher than our prior quarter's 4.1 times. Both of these changes were due to one-time events that we believe will potentially enhance unitholder returns over the long run.

Regarding our leverage ratio as we mentioned during our last call, we were expecting 52,500 horsepower of new large horsepower units to be delivered during the first half of 2024. These units represented the remainder of our late 2022 order. We are happy to report that 47,500 of the 52,500 horsepower was delivered during the first quarter and the remaining 5,000 horsepower was delivered in April. All have been deployed into the field under long-term contracts. The front-loaded purchase of these units led to the slightly higher leverage ratio for this quarter, but we believe our leverage ratio will begin to trend back towards 4.0 times.

Regarding our distributable cash flow coverage ratio, as I mentioned, our Series A preferred unitholders began converting their preferred units to common units in January. Then, in early April, they converted another $280 million of preferred units to common units prior to our record date attributable to the first quarter results. This resulted in approximately 14 million common units being issued, at least half of which we believe have been sold into the open markets as of today.

While the conversion of the preferred units has a very small impact on our distributable cash flow coverage ratio, the enhanced public float brought to our common units should be a positive. We believe that we will continue to increase our distributable cash flow coverage ratio and reduce our leverage ratio over time.

During the coming quarters, we will continue to focus on opportunistically improving and simplifying our capital structure. Through the first four months of the year, 320 million out of 500 million of Series A preferred units have been converted to common units. We have refinanced our 2026 senior notes at an attractive financing rate and firmed up the fixed interest rate for almost all of our debt through 2025.

As I mentioned, we used the proceeds from our March 2024 issuance of $1 billion of 7.125% senior notes due 2029 to redeem all of our 2026 senior notes and use the remainder of the proceeds to pay down our credit facility, resulting in $736 million borrowed under our credit facility at the end of the quarter.

If you recall, the notional amount of our floating to fixed interest rate swap is $700 million and extends through December 2025 at about 125 basis points below the current SOFR rate. As such, we essentially locked in $2.45 billion of our $2.49 billion of indebtedness as of March 31, 2024, at a weighted average interest rate of 6.86%.

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We were extremely pleased with this offering and believe that our ability to refinance our existing indebtedness at attractive rates in the current market reflects investor support for our underlying core business. While we still have work to do, we think we have made strong progress so far and we'll continue to be opportunistic in regards to maximizing our capital structure.

As a reminder, we believe focusing on our capital structure, including the eventual refinancing of our senior notes due 2027, renewing our credit facility and fully exiting our Series A preferred units is the prudent course of action before we consider changes to our distribution policy.

As we look forward to the rest of the year, we still believe the approach we laid out a few months ago during our previous earnings call remains the prudent path. We remain bullish on the long-term prospects of the natural gas industry but also see near-term uncertainty, which has only grown since our last call.

Inflation is turning out to be stickier than experts thought a mere three months ago, the Russia-Ukraine conflict is still ongoing and new tensions have arisen in the Middle East. We also have the upcoming election and interest rates that will be higher for longer, including the potential for stagflation according to the ever-insightful, Jamie Dimon.

As such, we believe 2024 is a year that we focus internally with reduced growth, enabling us to produce stable cash flows, reduced leverage and position USA Compression for long-term success. We will continue to improve internal operational efficiency, convert idle units to active status at attractive returns, pursue pricing improvements and strive to maximize return on growth capital through opportunistic purchasing of equipment.

As we said last quarter, we believe this strategy will allow us to maintain operational and financial flexibility to weather any storms created by current geopolitical or economic headwinds.

Before turning the call over to Eric Scheller to discuss first quarter results, I would like to make a few comments regarding safety. The most important thing we do is to ensure that our employees, contractors and customers return home safely each day. We are extremely proud of our tireless focus on safety that has resulted in a total recordable incident rate of zero during the first quarter. I'm very proud of this accomplishment and thank every USA Compression employee for their commitment and strict adherence to our safety policies and procedures.

With that, I will turn the call over to Eric Scheller, our COO, to discuss our first quarter highlights.

Eric Scheller - *USA Compression Partners LP - Chief Operating Officer, Vice President*

Thanks, Eric, and good morning all. As Eric noted, we were pleased to deliver our unit holders another excellent quarter of strong results. In addition to the record results Eric mentioned, we deployed approximately 63,000 additional horsepower during the quarter as we continue to deploy large horsepower units into the field.

As we mentioned last quarter, we are securing contracts with extended tenure and enhanced pricing that we think generates strong, stable base load cash flows, while providing opportunistic upside as market conditions evolve. Our revenue growth trend continued and was driven primarily by increasing utilization, exiting the quarter at an all-time high of 95% and pricing improvements also at an all-time high averaging $19.96 for the first quarter.

Our revenue increased 2% sequential quarters and 16% compared to the year ago period. The first quarter also saw our sector-leading margins over 67%, in line with historical averages since our initial public offering, reflecting the stability of our steady determination to offset increased inflationary costs through both productivity improvements and contractual pass-through pricing adjustments, which we expect to continue supporting our margins in line with our current levels, should inflation remain high or increase in the near-term.

Regarding financial results, our first quarter 2024 net income was $23.6 million. Operating income was $66.9 million. Net cash provided by operating activities was $65.9 million and cash interest expense net was $44.7 million. Cash interest expense increased by approximately $1.7 million on a sequential quarter basis, primarily due to higher average outstanding borrowings.

However, higher cash interest expense was mitigated by $2.4 million of cash payments received under our $700 million notional principal fixed rate interest rate swap, which locks in 30 days SOFR until December 2025 at 3.9725% compared to current 30-day SOFR that exceeds 5.25%. Under our current leverage ratio, this resulted in an interest rate at 6.47% on $700 million of our credit facility borrowings.

Turning to operational results. Our total fleet horsepower at the end of the quarter increased by 2% to approximately 3.8 million horsepower as we accepted delivery of 47,500 horsepower of new large horsepower units during the quarter. Our revenue generating horsepower increased by 2% on a sequential quarter basis, primarily due to the addition of these new large horsepower units, as we had secured customer contracts prior to the delivery of the new units.

First quarter 2024 expansion capital expenditures were $104.8 million and our maintenance capital expenditures were $5.8 million. Expansion capital spending continues to consist of reconfiguration and make ready of idle units along with the aforementioned delivery of 47,500 horsepower of new large horsepower units and the opportunistic acquisition of other large horsepower units in the market.

We accepted delivery of an additional 5,000 horsepower of new, large horsepower units during April, which completed the remainder of our late 2022 order. We also expect additional and ongoing conversion of current fleet idle units to active status and throughout the remainder of 2024, we anticipate the deployment of between 85,000 and 115,000 horsepower of existing uncontracted fleet assets at capital costs substantially below those of new organic growth equipment builds.

Finally, I am pleased to share that on May 3, we made our 45th consecutive quarterly distribution payment. The $0.525 per unit distribution was flat to previous quarter's distribution.

And with that I'll turn the call back to Eric Long for concluding remarks.

Eric Long - *USA Compression Partners LP - President, Chief Executive Officer*

Thank you, Eric. We are extremely proud of our first quarter results and the progress we have made in a mere four months on the optimization of our capital structure. While we remain bullish on the long-term prospects of the natural gas industry, we are all facing some general economic and political uncertainty in the near-term.

We believe we are well positioned to weather this uncertainty, continue improving our financial metrics and opportunistically address our capital structure over time. Once we have addressed our capital structure, we will then be in a better position to consider future potential distribution policy changes.

To conclude, we are extremely pleased with our first quarter 2024 results, highlighted again by record quarterly revenues, adjusted EBITDA, distributable cash flow and utilization. We expect to file our Form 10-Q with the SEC as early as this afternoon.

And with that, we will open the call to questions.

QUESTIONS AND ANSWERS

Operator

We will now begin the question-and-answer session. (Operator Instructions) Jim Rollyson, Raymond James.

Jim Rollyson - *Raymond James Financial, Inc. - Analyst*

Eric, just if you kind of take a step back from the kind of short-term caution you provided, it seems like the outlook as we go into next year and frankly the next few years on the gas side driven by LNG that we've all read about in some of the data center growth from AI and impact there on electric demand and gas, bodes well for this cycle to play out over a period of time.

And I'm curious, given the planning cycles that you all need with lead times and all that, I realize this year you've taken a step back from just new units and focusing on some of the internal fleet upgrades and bring it back. But curious just how your conversations with customers are going and plan -- how far out are they planning and just maybe how you're thinking about visibility going out here over the next handful of years?

Eric Long - *USA Compression Partners LP - President, Chief Executive Officer*

Jim, all great questions. Obviously, I appreciate you're digging into our industry. You've recently published some research which by the way I think some of the best I've seen in a long time with the deep dive that you've done.

The fundamentals of the compression industry are probably the best they've been in the last two decades. If you think about when we formed USA Compression 25 years ago, domestically, we produced and consumed little over 50 Bcf of gas a day and today, we're north of 100 Bcf. With permitted and under construction LNG facilities, we're going to see a substantial increase in the next two or three or four years related to demand increases for natural gas.

The electrification drive, the decarbonization drive has legs. I don't think people fully appreciate the magnitude of how far behind the electric grid is, what has to happen to stabilize the grid and expand the grid. As we all know, when the wind doesn't blow and the sun doesn't shine at night, the renewable sources of electric generation don't make electricity.

Backup batteries are extremely expensive at the industrial and the utility scale. We've had a meeting with the Chairman of the Public Utility Commission recently in Texas, who indicated that looking at peaking gas plants versus looking at using battery backups for some of the renewables that the renewables with batteries are 10 times the cost of a conventional gas peaking type of unit.

So when the light bulb comes on to the people of the State of Texas as an example or other states across the US, this is going to be an extremely costly effort to expand the grid, stabilize the grid. And that's -- now you're at the point in time of starting to bring on AI data centers, which have massive more electrical requirements than a conventional file server type data center or even Bitcoin mining or whatever it may be, continued population growth, warming of the environment, meaning more air conditioning load, it just goes on and on and on and on.

So natural gas compression will fit in the middle of feeding gas in the pipelines to get into LNG facilities, feeding gas in the pipelines that will end up getting into facilities to provide and create electricity, we're getting a lot of legs. The reason we're a little on the conservative side right now cautious is more the uncertainty coming out of Washington right now.

We have two very, very different approaches to how you deal with the electrification that's required in the grid. We've got very different approaches between the two dominant parties in Congress right now relating environmental cleanup and environmental perspective going forward. The US is a large provider of energy. Are we going to provide energy to our allies to help deal with geopolitical risk? There's a lot of things that are going on.

So we want to be cautious and not commit hundreds of millions of dollars to equipment with the stroke of a pen, could have significant regulatory risk. We'd rather let kind of the decks clear a little bit, continue to focus on our internal efforts on long-term modification of our fleet assets to dual drive, to looking at distributed generation opportunities, utilizing our existing assets. So we're trying to optimize our as is case into the to be case when we have regulatory certainty and we've got some clarity of the economy and the markets, et cetera.

So simplistically, to get back on your question, I think the fundamentals of compression, as I noted, are probably the best I've seen them in two decades. There are ancillary activities that will come off of that. As far as forward visibility with our customers, we're already talking about 2025 activities. As we all know, there is a lot of integration going on with major acquisitions and consolidations of the upstream industry. So people are starting to rationalize their acreage holdings, rationalize their drilling and developmental plans over the coming year or two or three. Exxon and Pioneer just got their deal approved by the DoJ last week.

So as these things are promulgated and processed, people will start to get better clarity. And until these things clear regulatory oversight, that's a little bit of a jump ball right now. So a little bit of caution. I'd say, our industry has tailwinds, but in -- we have always been believers and unless there's a very clear-cut path and course of action, let's wait a quarter or two or three and just see what the marketplace holds in store for us.

So I think right now, we've got firm hand on the tiller. You got a little bit of choppy seas. We're just trying to weather through a little bit of a storm, but we see very clear sailing ahead of us.

Jim Rollyson - *Raymond James Financial, Inc. - Analyst*

That's very helpful and thank you for the detail commentary. And maybe circling just back to the balance sheet. You said a lot of things. Obviously, you guys made the move on refi-ing and congrats on that. It was certainly a good print on the coupon.

From a going-forward perspective, we think about -- obviously, you mentioned -- at some point, you tackle the 2027, which I presume is going to be opportunistically driven based on the markets. But kind of bigger picture with where the balance sheet is today, the leverage is today, maybe remind us just where you want leverage to go? And kind of where does that need to be, either leverage or distribution coverage or maybe a combination of both, before you would actually think about doing something on distributions here down the road?

Eric Long - *USA Compression Partners LP - President, Chief Executive Officer*

Again, great questions, Jim. And these are things we have discussions with our Board with routinely. Keep in mind that USA never cut our distribution. You look at the -- now, pushing $2 billion that we have distributed back to our unitholders since going public in 2013, we're one of the few who chose not to cut the distribution. I still believe that if you're going to be an MLP, distribution is one of the -- should be sacrosanct. And before you cut a distribution, you need to have exhausted each and every other alternative that you had.

So before we induce then an increase in distribution, we want to make sure that going forward regardless of volatility in the cycle that we will be able to maintain and the increased level of distribution over time. So you can see we're building our distribution coverage to the 1.4, 1.5 range coming up. We think that that will continue to improve. You look at our leverage which right now is running in the 4x or so range, we do have a different -- somewhat different definition for our ABL purpose versus the way some other people look at your all-in balance sheet. And I think that this conversion of our preferred to common units over time continues to simplify and get the convergence of kind of how people look at the balance sheet with and without the prep as total leverage coming down.

So we're going to get the leverage down. This conversion of the pref to common goes a long way to getting that accomplished. Slowing the growth like we've been doing allows us to continue to reduce our leverage ratio. Yes, the absolute leverage has picked up a little bit, but think again to what we pointed to on our cost of capital. Our debt capital blended basis was 6.84%, 6.86% something along that line.

We're constructing and deploying new assets or rebuilding used assets at costs that -- and returns that -- give us upper double digits, low 20% unlevered IRRs. So to the extent we can borrow money for sub-7% and deploy it into returns in the 20% and make 1,300 basis point type of returns, it seems like that is a pretty good way to create shareholder value.

So it's the balancing act, Jim, between absolute level of leverage. We, as a private company, ran substantially higher levels of debt and leverage. I am a believer that this industry and USA Compression in particular can readily support leverage in that 4.0x zip code range. Do we see ourselves wandering down a little bit below that? Potentially. Do we see at certain points of the cycle when things are a little bit tighter and utilization declines particularly with folks in our industry who focus on smaller wellhead equipment, it's a little more volatility, a little bit higher beta, your leverage ticks up.

So I think a good range long term is to look somewhere between 3.75 and 4.25 or so across different types of cycles. We're never going to be a 2x levered company. We're never going to be a 1x levered company, but we don't need to be because we are much more stable than industries that have lower leverage like an oilfield service company or like an upstream company who have different financial drivers and economic drivers than we do as a midstream company with take-or-pay demand type of contracts with de minimis commodity risk.

Operator

Brian DiRubbio, Baird.

Brian DiRubbio - *Robert W. Baird & Co. Incorporated. - Analyst*

Just was hoping a couple of follow-up questions. Can you let us know what you think CapEx spend is going to be this year in full?

Eric Long - *USA Compression Partners LP - President, Chief Executive Officer*

Yes, sir. So CapEx being growth CapEx, being growth and maintenance CapEx --

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Brian DiRubbio - *Robert W. Baird & Co. Incorporated. - Analyst*

Growth and maintenance.

Eric Long - *USA Compression Partners LP - President, Chief Executive Officer*

Growth and maintenance combined CapEx.

Eric Scheller - *USA Compression Partners LP - Chief Operating Officer, Vice President*

Yeah, I think what we're going to see is somewhere that -- we're going to be around $115 million, $125 million in expansion capital and probably somewhere between call it, $25 million and $35 million in maintenance CapEx.

Brian DiRubbio - *Robert W. Baird & Co. Incorporated. - Analyst*

Got it. And just as we think about you deploying some of the existing fleet back into the field as opposed to buying new equipment, is that included in the expansion or is that included in the maintenance CapEx?

Eric Scheller - *USA Compression Partners LP - Chief Operating Officer, Vice President*

No, that's included in the expansion capital.

Brian DiRubbio - *Robert W. Baird & Co. Incorporated. - Analyst*

Okay. And I know you're not looking to add more new equipment right now, but any thoughts on how long it would take if you order new piece of equipment? How long that would it take to get delivered, particularly with the Cat 3600 Series engines.

Eric Long - *USA Compression Partners LP - President, Chief Executive Officer*

Caterpillar has brought in their -- their construction period was running as much as over a year, a quarter or two ago, it's been reigned back into, I'd say, roughly nine months or so ago. And it's not just Cat engines on the 3600 series, you've got fabrication capacity limitations, you've got other components that go into manufacturing, a compressor package from compressor frames and compressor cylinders.

One of the things I think people haven't quite picked up on yet is that Caterpillar also uses these types of engines to supply backup generation equipment for data centers. So you can envision that if you're Microsoft or Google or Facebook or Amazon, let alone before you move into the AI expansions that some of these folks are getting into, all of those data centers end up with backup electric generation equipment, because they can ill-afford to have any form of downtime. So as the number of data facilities are increased and spending billions and billions and billions of dollars to increase new capacity, these places all have Cat driven, some diesel, some natural gas type, backup generation equipment.

So I look at it as these facilities continue to be brought online, there's going to be continued tension and pressure on not just USA and our peers to access this equipment, but we'll be competing with sourcing this equipment from Caterpillar with the likes of the Amazons ,Googles, Facebooks and Microsoft to back up their expansions into AI and continued forays with data centers.

Brian DiRubbio - *Robert W. Baird & Co. Incorporated. - Analyst*

Understood. That's helpful there. And just as you think about the distribution policy post the simplification of the capital structure, how are you thinking about the distribution policy in context of the cycle?

Eric Long - *USA Compression Partners LP - President, Chief Executive Officer*

So again, that's something that our Board makes that decision. The management team will sit down and look at it and say, gents, here we are early stage of cycle, mid-stage of cycle, late stage of cycle. What's the outlook for interest rates? What's the outlook for demand for our equipment going forward? What's the regulatory environment? All of these things go into our gonkulator.

So I think it's fair to say that once we do get these 2027's refinanced, maturity extended with our ABL facility, we're able -- on both of these, we have several years of runway left. But at the point in time that we have some good clarity on just what our cost of capital is going to be, our cost of interest is going to be, what the regulatory environment is looking like, what's going on geopolitically worldwide, what's going on with OPEC, then we'll have a little bit better sense of what we need to recommend to the Board as far as distribution policy.

So I'm not prepared today to commit to next quarter or two quarters or a year from now, because there's a lot of stuff coming into an election year with basically two wars going on throughout the world. There's a lot of instability right now and I'm not prepared today to comment further on what the policies might look like in the future because today, sitting here, it's pretty uncertain.

Brian DiRubbio - *Robert W. Baird & Co. Incorporated. - Analyst*

Understood. And then final question for me, unless I missed this, are you still in the active CFO search at this point in time? And where does that stand?

Eric Long - *USA Compression Partners LP - President, Chief Executive Officer*

So as we've indicated to multiple people, multiple times, CFOs come in two categories, those who raise capital, i.e., you're actively in the equity markets growing your balance sheet, or the CFOs come in the form of more on the technical, accounting, compliance and support and optimization of running your day-to-day business.

Tracy Owens, our Chief Accounting Officer, comes from a long and stable background in the latter category. So we have made the conscious decision to not add a CFO at this stance. As you are aware, our Board is controlled by Energy Transfer. We do have -- our financials are consolidated underneath ET, and we do have adult supervision in the room. Tom Long, my boss, who's the Co-CEO of Energy Transfer is the former CFO of ET. Dylan Bramhall, who is the current CFO of Energy Transfer, sits on our Board. And to the extent, Tracy and his team need any further support or quote, adult supervision, they're more than willing and able to roll up their sleeves, if, it's needed at any point in the future.

So no, we do not intend to add a CFO currently. We're not actively entertaining M&A. We're not actively growing our balance sheet with the form of equity capital. We haven't raised any equity capital in over a decade, and we don't contemplating needing to at any time in the foreseeable future.

Operator

As there are no further questions at this time, that concludes today's call. Thank you everyone for joining. You may now disconnect.