

# **Suburban Propane Partners, L.P. Common Units (SPH) Q2 2024 Earnings Call Transcript**

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**Body**

Suburban Propane Partners, L.P. Common Units (SPH)

Q2 2024 Earnings Conference Call

May 9, 2024 09:00 ET

Company Participants

Davin D'Ambrosio - Vice President and Treasurer

Mike Stivala - President and Chief Executive Officer

Mike Kuglin - Chief Financial Officer

Steve Boyd - Chief Operating Officer

Conference Call Participants

Christopher Jeffrey - Mizuho Securities

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the Suburban Propane Partners Second Quarter Earnings Conference Call. [Operator Instructions] This call is being recorded on Thursday, May 9, 2024. And I would now like to turn the conference over to Mr. Davin D'Ambrosio, Vice President and Treasurer. Thank you. Please go ahead.

Davin D'Ambrosio

Great. Thank you. Good morning, everyone. Thank you for joining us this morning for our fiscal 2024 second quarter earnings conference call. Joining me this morning are Mike Stivala, our President and Chief Executive Officer; Mike Kuglin, our Chief Financial Officer; and Steve Boyd, our Chief Operating Officer.

This morning, we will review our second quarter financial results, along with our current outlook for the business. Once we have concluded our prepared remarks, we will open the session to questions.

Our conference call contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 as amended, relating to the partnership's future business expectations, predictions, financial condition and results of operations. These forward-looking statements involve certain risks and uncertainties. We have listed some of the important factors that could cause actual results to differ materially from those discussed in such forward-looking statements, which are referred to as cautionary statements in our earnings press release, which can be viewed on our website at suburbanpropane.com. All subsequent written and oral forward-looking statements attributable to the partnership or persons acting on its behalf are expressly qualified in their entirety by such cautionary statements.

Our annual report on Form 10-K for the fiscal year ended September 30, 2023, and Form 10-Q for the period ended March 30, 2024, which will be filed at the end of business today, contain additional disclosures regarding forward-looking statements and risk factors. Copies may be obtained by contacting the partnership or the SEC. Certain non-GAAP measures will be discussed on this call. We have provided a description of those measures as well as a discussion of why we believe this information to be useful in our Form 8-K, which was furnished to the SEC this morning. Form 8-K will be available through a link in the Investor Relations section of our website.

At this point, I will turn the call over to Mike Stivala for some opening remarks. Mike?

Mike Stivala

Great. Thanks, Davin, and good morning. Thank you all for joining us today. The fiscal 2024 heating season presented widespread unseasonably warm weather across the vast majority of our operating territories, with the exception of a 2-week period of extreme cold temperatures in mid-January, during which reported heating degree days were 33% colder than the prior year.

For the fiscal 2024 second quarter, average temperatures were 8% warmer than normal, which followed a first quarter that was also 9% warmer than normal. While the warm weather negatively impacted customer demand for heating purposes, we were once again able to leverage our experience in managing our business through a challenging heating season, and our operating personnel did an outstanding job managing the things they can control, namely keeping safety as their highest priority, providing exceptional service to our customers, managing selling prices and controlling expenses.

In addition, the recent and continued favorable trends in our customer base helped to offset some of the shortfall in heat-related demand. As a result, volumes for the second quarter of fiscal 2024 were just 2.7% below the prior year. Adjusted EBITDA for the quarter was $147 million, down $2 million or 1.3% compared to the prior year second quarter.

In our renewable natural gas operations, we are continuing to install an operational excellence mindset that has made us a leader in the propane industry, including driving efficiencies, modifying our manure collection practices to increase the amount of volatile solids to be processed and identifying additional local dairies in the Stanfield, Arizona area to increase manure intake. As a result, we are continuing to improve the amount of average daily pipeline injected RNG at the Stanfield facility with an average of 1,139 MMBTUs injected per day during the second quarter of fiscal 2024, an improvement of 8.4% compared to the first quarter of fiscal 2024. And with the continued enhancements that we are making, we have additional opportunities to increase production levels even further.

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We're also continuing to advance our capital improvement plans for the installation of RNG upgrade equipment at our Columbus, Ohio facility and the construction of our anaerobic digester facility at Adirondack Farms in Upstate New York. We expect both facilities to be completed in the second half of calendar 2025. Finally, subsequent to the end of the second quarter, we closed on two small propane acquisitions in strategic markets in Florida and Nevada, investing a total of approximately $13 million.

So while warm weather weighed on customer demand in the fiscal 2024 heating season, our operational personnel delivered solid results, and we remain steadfast in our commitment to our long-term strategic growth objectives of fostering the growth of our core propane business while making strategic investments in lower carbon renewable energy alternatives. In a moment, I'll come back for some closing remarks.

However, at this point, I'll turn it over to Mike Kuglin to discuss the second quarter in more detail. Mike?

Mike Kuglin

Thanks, Mike and good morning, everyone. To be consistent with previous reporting, as I discuss our second quarter results, I'm excluding the impact of unrealized mark-to-market adjustments on our commodity hedges, which resulted in an unrealized gain of $5.9 million for the second quarter compared to an unrealized loss of $4.5 million in the prior year. Excluding these items as well as the non-cash equity and losses of our unconsolidated subsidiaries accounted for under the equity method as well as a loss on debt extinguishment resulting from the refinancing of our credit agreement and acquisition-related transaction costs in the prior year, net income for the second quarter was $110.3 million or $1.71 per common unit compared to net income of $112.8 million or $1.76 per common unit in the prior year.

Adjusted EBITDA for the second quarter was $147 million compared to $149 million in the prior year. As Mike mentioned, our earnings for the quarter were impacted by lower heat-related demand resulting from warm weather during most of the quarter but benefited from organic growth in our customer base, unit margin expansion and greater contribution from our R&D facilities.

Retail propane gallons sold in the second quarter were 140.2 million gallons, which was 2.7% lower than the prior year, primarily due to the impact of widespread warm weather throughout much of the second quarter, except for a 2-week period of extreme cold temperatures in mid-January. According to NOAA, average temperatures for the quarter, as measured in heating degree days, were 8% warmer than normal and 4% cooler than the prior year second quarter. Although we experienced an increase in heating degree days compared to the prior year, the increase was heavily influenced by mid-January heating degree days that were 33% colder than the same period last year. Notwithstanding the short-lived blast of cold weather, average temperatures for the month of January were 4% warmer than normal. For the month of February, average temperatures were 12% warmer than normal and 1% warmer than the prior year. And for March, average temperatures were 10% warmer than normal and 7% warmer than the prior year.

From a commodity perspective, propane inventory levels in the U.S. experienced a seasonal decline during the quarter, but remained elevated relative to historical levels for this time of the year. At the end of the second quarter, U.S. propane inventories were at 51.8 million barrels, which was 7% lower than March 2023 levels, yet 8% higher than the 5-year average for March. Given the decline in inventory relative to the prior year and other factors, wholesale propane prices for the second quarter of $0.84 per gallon, basis Mont Belvieu, increased 3% compared to the prior year.

Excluding the impact of the mark-to-market adjustments on our commodity hedges that I mentioned earlier, total gross margin of $302.1 million for the second quarter increased $2.7 million or 1% compared to the prior year, primarily due to higher propane unit margins and higher margin contribution from the RNG assets, offset to an extent by lower propane volumes sold. Propane unit margins for the second quarter increased $0.08 per gallon or 4.2% compared to the prior year.

With respect to expenses, combined operating and G&A expenses of $154.4 million for the second quarter increased $1.2 million or 0.8% compared to the prior year primarily due to higher payroll and benefit-related expenses, partially offset by lower fuel costs and other volume-related variable operating costs. The year-over-year comparison of our expenses was also impacted by acquisition-related costs of $3.4 million in the prior year, which was reported in G&A and excluded from adjusted EBITDA.

Net interest expense of $19.9 million for the second quarter was essentially flat compared to the prior year as savings from a lower level of average outstanding borrowings under our revolving credit facility was offset by higher benchmark interest rates for borrowings under the revolver. Total capital spending for the quarter of $14.5 million was $1.3 million higher than the prior year primarily due to growth capital associated with improving operating performance and RNG production at our facility in Stanfield, Arizona and from advancing construction efforts at our Columbus and Adirondack facilities, partial offset by a lower level of spending on propane tanks and cylinders as we leveraged and refurbished the inventory on hand.

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Turning to our balance sheet. During the second quarter, we utilized cash flows from operating activities to repay $32.3 million in borrowings under the revolver. As a result of the debt repayment, our consolidated leverage ratio for the trailing 12-month period ended March 2024 improved to 4.61x compared to 4.72x at the end of the first quarter. Although the leverage metric has been elevated relative to our historical levels following the RNG acquisition, from the impact of the warm weather on earnings, we remain well within our debt covenant requirement of 5.75x and continue to make progress in strengthening the balance sheet with debt repayments from excess cash flows.

As we previously reported, during the second quarter, we took steps to further strengthen our liquidity position and extend debt maturities with the refinancing of our $500 million revolver, which was scheduled to mature in March 2025. This new 5-year facility further extends our debt maturities, maintains the interest rate pricing grid and financial ratio covenants and provides enhanced financial flexibility in support of our long-term strategic growth initiatives. We're very pleased with the outcome of this opportunistic refinancing and are appreciative of the continued support provided by our bank group.

With that, I'll turn the call back to Mike.

Mike Stivala

Thanks Mike. As announced on April 25, our Board of Supervisors declared our quarterly distribution of $0.325 per common unit in respect of our second quarter of fiscal 2024. That equates to an annualized rate of $1.30 per common unit. Our quarterly distribution will be paid on May 14 to our unitholders of record as of May 7. Our distribution coverage continues to remain healthy at 1.99x for the trailing 12-month period ended March 2024.

Looking ahead to the rest of fiscal 2024, now that we are beyond the critical period for heat-related demand, our operations personnel in the propane segment will turn to some of our initiatives to further enhance our operating model to continue executing on our customer base growth and retention initiatives and to support our market expansion efforts in several strategic markets throughout our national footprint.

In our RNG operations, while overall revenues have been influenced by lower California LCFS prices and, to a lesser extent, lower benchmark natural gas prices, the improvements we are making to the operating performance at our Stanfield facility are stabilizing and increasing the level of RNG production at that facility. We're also continuing to support our minority-owned subsidiaries, Oberon Fuels and Independence Hydrogen as they scale their platforms for the production and sale of ultra-low carbon renewable dimethyl ether and clean hydrogen, respectively.

The energy transition is still in the early stages, and we are positioning Suburban Propane for long-term growth and sustainability through our comprehensive growth strategy that builds on the low carbon attributes of propane and our investments in innovative renewable energy products and technologies through our Suburban Renewable Energy subsidiary. And from a balance sheet perspective, as Mike mentioned, we reduced our overall debt by more than $32 million during the second quarter using excess cash flow and successfully renewed and extended our revolving credit facility. As always, we are committed to maintaining a strong balance sheet to help support our long-term growth objectives.

Finally, I want to take this opportunity to thank the more than 3,200 employees at Suburban Propane for their hard work and unwavering focus on the safety and comfort of our customers and the communities we serve. I'm extremely proud of all of their efforts during another challenging heating season. And as always, we appreciate your support and attention this morning.

And we'll now open it up to questions. And Ina, if you can help us with that.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] And your first question comes from the line of Christopher Jeffrey from Mizuho Securities. Please go ahead.

Christopher Jeffrey

Hi, good morning, everyone. Thanks for taking my question. Maybe just on how you see the expectations for excess cash flow kind of in the long-term, maybe with normalized weather in the coming years? And then maybe talk about what the priorities are to do with those excess funds. You've talked about lowering the leverage, but it seems like also bolstering of propane and renewables businesses is quite important.

Mike Stivala

Yes. Thanks, Chris. I think if you look at the last several years, we've taken a very balanced approach towards utilizing our excess cash flow. We've done a fair amount of debt delevering. We've obviously invested in the build-out of our renewable energy platform, and we're also doing tuck-in propane acquisitions. I think you're going to see a bit more of the same. I mentioned in our opening remarks about the stage that we see the country and, frankly, the world in the energy transition. I think we're in the very early innings of that transition.

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And we intend to ensure that we set the business up for the long-term by making good investments in renewable energy platforms that we see as real benefactors of the future of cleaner energy sources, and we want to leverage our 95-year history as trusted distributors of energy to local markets as those newer, cleaner energy sources develop and further advance in their maturity over the coming decades. So I think you're going to see a bit more of the same from us. As you know, we always maintain balance sheet strength as a core principle of ours, and that's we've done a good job of bringing leverage down following a bit of a leveraging event with the Equilibrium acquisition in December of 2022. And so I think that's what you could expect to see from us.

Obviously, as the investments we're making begin to mature and deliver the kind of expectations that we see in the coming years, we'll also be generating incremental EBITDA and cash flows that will give us opportunities to be strategic as well.

Christopher Jeffrey

Thank you, Mike. Maybe just going back to the first part of that question, is there any kind of ballpark of the excess cash flows, I think, or just cash flows generated? Like you kind of talked about $100 million in the past. Any updated thoughts around that number?

Mike Stivala

Yes, that's going to fluctuate with earnings. This year has been a warmer winter scenario. The first quarter, we were down – year-to-date, we're down about $17 million in year-over-year EBITDA. Second quarter was a great quarter in relation to what the weather was, but that followed a tough first quarter. So that decline in earnings is going to be a temporary impact on the level of excess cash flow that we have. But our cash flow post distributions, post debt service and post growth CapEx generally is going to range between $50 million and $100 million depending on the amount of growth CapEx and the level of earnings as the heating season continues to affect.

Christopher Jeffrey

Great. Thank you. And then maybe just an update on something brought up last quarter as far as interest in participating in the voluntary RNG market as compared to the transportation market. Just any update there or are there any particular gating items that you're waiting to see move?

Mike Stivala

Yes. I think, first of all, we hired a resource dedicated to the RNG commercial development. So we now have some dedicated commercial sales activities that are building relationships in the voluntary market. That is long-term the way we see the market for RNG developing. I'm sure you've seen California LCFS prices have been pretty depressed as of late. I think we're down this quarter about 6% from the average from the first quarter. So that does create some volatility and revenue opportunities in that market.

So I think for the longer-term, we do see – again, back to the concept of we're in the early innings, we do see the markets for RNG developing in a way where RNG demand is going to expand beyond just transportation I think as more and more of the demand for electricity grows from the adoption of electric vehicles and expanded AI with the need for enhanced computing and data centers, I think you're going to see a significant uptick in demand for RNG to be a good source of power generation for the electric grid because I think the reality of powering with pure renewable sources from wind and solar is never going to keep up with the amount of demand increase on the electric grid. So I think we see voluntary markets for RNG demanding or developing over the course of the next 5 to 10 years as the reality of the transition towards electrification sets in that we need additional cleaner energy alternatives. And that's, I think, the opportunities of the future that we see.

Christopher Jeffrey

Great. Understood. Maybe just a follow-up on that as well. Any kind of update on the Oberon Fuels and Independence Hydrogen should we kind of expect? In the past, there's been more like ratable capital fit into those businesses? Is that still kind of the expectation going forward?

Mike Stivala

Well, they're both advancing towards commercial scale. They're both going to be seeking capital to enhance their opportunity to grow their supply of the respective products. And we've been supporting those businesses as they get closer and closer to full-scale commercialization of their business models. And I think over the course of the next year, both of them will continue to advance towards bigger scale production of the products that they serve.

And we'll continue to pay attention to whether we should be continuing to put in additional capital to maintain our ownership stake or welcome in additional investors to continue to support that while we continue to support them from the perspective of, what I like to say, the weight of Suburban Propane behind us to support these start-up companies that need resources beyond just capital. And we've been a great source of capital, but we've been a bigger source of resources. And so I think that's – those two businesses are progressing nicely, frankly, and a lot is going to be determined over the next year.

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Christopher Jeffrey

Got it. Alright. Looking forward to it. Thank you very much. Have a great day.

Mike Stivala

Great. Thanks, Chris.

Operator

[Operator Instructions] There are no further questions at this time. I'd like to turn the conference back to Mr. Michael Stivala for closing remarks.

Mike Stivala

Okay. Great. Thanks for your support, Ina, and thank you all for your attention today. We look forward to catching up with you in August after our – the close of our third quarter. And I hope you all stay safe and healthy and enjoy the summer as it approaches.

Operator

Thank you. That concludes our conference for today. Thank you all for participating. You may all disconnect.

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