Final Transcript

SUBURBAN PROPANE, LP: Fiscal 2020 Second Quarter Results

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SPEAKERS

Davin D'Ambrosio – Treasurer
Mike Sivala – President & Chief Executive Officer
Mike Kuglin – Chief Financial Officer and Chief Accounting Officer
Steve Boyd – Chief Operating Officer

ANALYSTS

Sharon Louie – Wells Fargo

PRESENTATION

Moderator: Ladies and gentlemen, thank you for standing by. Welcome to the Suburban Propane Partners LP Fiscal 2020 Second Quarter Results call. At this time, all participants are in a listen-only mode. Later, there will be a question and answer session and instructions will be given at that time. [Operator instructions]. As a reminder, this conference is being recorded.

This conference call contains forward-looking statements within the meaning of Section 21E of the Securities & Exchange Act of 1934 as amended relating to the partnerships' future business expectations and predictions and financial condition of operations. These forward-looking statements involve certain risks and uncertainties. The partnership has 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 its earnings press release, which can be viewed on the company's website. 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.

With that, I'll turn the call now to Mr. Davin D'Ambrosio, Vice President and Treasurer. Please go ahead, sir.

D. D'Ambrosio Thank you, John. Good morning, everyone. Thank you for joining us this morning for our Fiscal 2020 Second Quarter Earnings Conference call. Joining me this morning are Mike Stivala, President and Chief Executive Officer; Mike Kuglin, Chief Financial Officer and Chief Accounting 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. As usual, once we have concluded our prepared remarks, we will open the session to questions.

Our Annual Report on Form 10-K for the fiscal year ended September 28, 2019 and Form 10-Q for the period ended March 28, 2020 will be filed by the end of business today. Both 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 and our Form 8-K which was furnished to the SEC this morning. The Form 8-K will be available through a link in the Investor Relations section of our website at suburbanpropane.com.

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

M. Stivala Thanks, Davin. Good morning and thank you all for joining us today. Let me start by saying that I hope you and your families are safe and healthy, and coping well with the unprecedented environment that we have all faced over the past two months. Our hearts go out to those that have lost loved ones or are suffering as a result of the unprecedented health crisis that has plagued our entire nation. And to the frontline healthcare workers and first responders that are working tirelessly to help save lives, I thank you.

At Suburban Propane, we have adapted our business practices with the health and safety of our employees, our customers and local communities as our number one priority. Our business is considered an essential critical service in all the states in which we operate, and I am so proud of the resiliency and commitment of the more than 3,400 employees of Suburban Propane for their efforts to continue serving customers in local communities throughout this crisis.

And in particular, there have been countless proud moments for Team Suburban Propane in which our employees have been called upon to support frontline activities by providing vital temporary heat and power generation for makeshift testing tents, hospital sites, shelters and food

distribution centers through our operating territory, including taking extraordinary steps to meet a request by FEMA to make propane deliveries into New York City at the Jacob Javits Center and at the USNS Comfort to provide power to the RV's that housed FEMA workers as they worked around the clock.

This unprecedented health crisis has obviously had a profound impact on jobs and the economy as a whole as federal, state and local governments have all instituted dramatic measures to help control the spread of COVID-19. Our business is certainly not immune to the challenges presented by this dramatic economic shutdown. At this time, the areas that may be the most susceptible to the effects include: the temporary suspension of business operations by certain of our commercial and industrial customers, which has already resulted in lower demand in these customer segments; and we could see additional demand softness from businesses that are unable to recover or that experienced generally lower activity levels for a prolonged period of time.

We could see customer conservation efforts across all customer types if there is prolonged economic softness or a recession. We may experience a slowdown in the rate of cash collections or a higher amount of write-offs

which could affect earnings and cash flows. And the industry may experience disruptions in the propane supply chain resulting from the challenges in the crude market that are impacting production, storage and logistics. This would likely be limited to regional constraints and highly dependent on the severity of weather in next year's heating season. For Suburban Propane, given our infrastructure, supplier relationship and long history of success, and managing our supply through many different challenging times, we are not concerned at the surety [ph] of supply.

Much will depend on the length and depth of this economic slowdown across our operating territories or the possibility of a prolonged economic recession as a consequence of these actions. Nevertheless, while there is significant uncertainty related to the future impact of this unprecedented health and economic crisis, the fundamentals of our business remain strong. And our efficient and flexible business model leaves us well positioned to manage through this crisis and come out even stronger. In a moment, I will provide some additional thoughts on our outlook for the remainder of fiscal 2020 and share some steps we are taking to adapt to the current uncertainties and planning for a new heating season in fiscal 2021. But first, let me also provide some commentary on our results for the second quarter of fiscal 2020.

The unseasonably warm temperatures that started at the end of the first quarter, and in particular the month of December, continued throughout the entire second quarter in virtually every one of our operating territories. The warm temperatures in the fiscal 2020 heating season have been reported to be on par with the previous record warm winters of fiscal years 2017 and 2016, thus having an adverse effect on customer demand and our adjusted EBITDA for the quarter. Nonetheless, we're proud of the way our operating personnel have managed through the challenging environment, maintaining their focus on our high standards for safety and exceptional customer service, effectively managing costs, and importantly, continuing to execute on our customer base growth and retention initiatives. Not to mention the extraordinary efforts to adapt to the changing business circumstances resulting from COVID-19.

At this point, I'll turn it over to Mike Kuglin to take you through the details of our performance for the second quarter. Mike.

M. Kuglin Thanks, Mike. Good morning, everyone.

To be consistent with previous reporting, as I discuss our second quarter results, I'm excluding the impact of unrealized, non-cash, mark to market adjustments on derivative instruments used in risk management activities which resulted in an unrealized loss of $4.7 million in the second quarter of fiscal 2020 compared to an unrealized gain of $8.5 million in the prior year, as well as a $100,000 loss on debt extinguishment resulting from the refinancing of our revolving credit facility in the second quarter of fiscal 2020. Excluding these items, net income for the second quarter was $82.2 million or a $1.32 per common unit compared to net income of $112.5 million or $1.82 per common unit in the prior year.

Adjusted EBITDA for the second quarter amounted to $130.6 million compared to $163 million in the prior year. The decrease in earnings was essentially driven by the negative impact of extremely warm weather coming into the quarter and throughout the second quarter on heat related customer demand. While there's much uncertainty about the future impact of the economic slowdown that started in mid-March resulting from COVID-19, it did not have a material impact on our volumes or earnings for the second quarter.

Retail propane gallons sold in the second quarter were 145.1 million gallons, which is 12.2% lower than the prior year, and that percentage decrease was slightly better than the year-over-year percentage decrease in [indiscernible] days for the quarter. Average temperatures across all of our service territories for the second quarter were 16% warmer than normal and 13% warmer than the prior year.

As Mike mentioned, we had seasonably warm temperatures that started at the end of the first quarter as average temperatures for the month of December 2019 were 10% warmer than normal, resulting in a lack of momentum for customer demand and higher than expected customer tank levels coming into the second quarter. From there, warm temperatures continued across our service territories for the January through March period. Average temperatures during the most critical months for heat-related demand, which is December through February, were 14% warmer than normal, in line with the warmest temperatures on record for that period.

From a commodity perspective, wholesale propane prices declined throughout the quarter as the nation's propane inventory levels remained considerably above average levels. Overall, average wholesale prices for

the second quarter were $0.37 per gallon, [indiscernible] which was 44% lower than the prior year second quarter and 25% lower than the first quarter of fiscal 2020.

Total gross margins of $255.7 million for the second quarter decreased $38.7 million or 13.1% compared to the prior year primarily due to lower volume sold. Propane unit margins were roughly flat as the tailwind provided by lower wholesale costs was offset by an unfavorable volume mix for this time of year.

With respect to expenses, combined operating and G&A expenses of $124 million decreased $6.1 million or 4.7% compared to the prior year primarily due to lower volume related variable operating costs and lower variable compensation, partially offset by an increase in accruals for self-insured liabilities. Net interest expense of $19.2 million for the second quarter decreased $500,000 compared to the prior year primarily due to a decrease in benchmark interest rates and borrowings under our revolving credit facility.

Total capital spending for the second quarter of $7.4 million was $1.4 million lower than the prior year due to our lower level spending on vehicles and tanks.

Turning to our balance sheet, during the second quarter we repaid $29.4 million of borrowings under the revolver. We funded the debt repayment, along with our seasonal working capital needs and capital expenditures, with cash flows from operating activities. With the debt repayment, our total debt outstanding as of March 2020 was roughly flat compared to March 2019. However, as a result of the impact of the warm weather on current year earnings, our consolidated leverage ratio for the trailing 12 month period ended March 2020 increased to 5.22 times. Despite the weather-driven elevated levels we are well within our maximum permitted leverage ratio of 5.75 times as provided under the recently amended revolving credit facility.

As we previously reported, during the second quarter we took steps to further strengthen our liquidity position and extend debt maturities with financing of our $500 million revolver which was scheduled to mature in March 2021. We received excellent support from our bank group as the syndication was well oversubscribed despite the challenging additions in

the credit markets. We were very pleased with the outcome of the opportunistic refinancing.

Back to you, Mike.

M. Stivala Thanks, Mike.

As announced in our April 23rd press release, our board of supervisors declared our quarterly distribution of $0.60 per common unit in respect of our second quarter of fiscal 2020, which equates to an annualized rate of $2.40 per common unit. The quarterly distribution will be paid May 12th to our unit holders of record as of May 5th.

Regarding our outlook, on the heels of a challenging heating season due to near record warm temperatures, like so many other companies we are obviously now dealing with uncertainties resulting from this unprecedented health crisis, and in particular the potential implications on customer demand from the impact on jobs and the economy. We are developing alternative operational plans and sensitivities under multiple customer demand scenarios, and evaluating the potential impact on earnings, cash flows and access to adequate liquidity as we progress

through the remainder of fiscal 2020 and plan for a new heating season in fiscal 2021.

As Mike indicated, we ended March with an elevated leverage ratio due to lower earnings through the first half of the year, yet maintained coverage rate of one times based on maintenance capex and borrowing capacity of approximately $130 million under our new revolver. In the early part of the fiscal third quarter, our residential volumes have benefited from a welcomed burst of colder average temperatures at a time when so many Americans are staying home. Yet, demand from our non-residential customers has suffered as a result of the number of businesses that we serve that have been forced to shut down or have experienced significantly reduced activity levels. As we gain more visibility at the potential short term and longer term impacts on customer demand, we may take proactive steps in the third quarter to work with our bank group to gain added financial flexibility and additional liquidity to manage through this period of uncertainty.

In doing so, we will also evaluated other levers to help strengthen our balance sheet, manage cash requirements and ensure adequate liquidity to fund working capital and continue investing in our long-term growth

initiatives. This may include reevaluating manpower plans, capex spending and the level of our quarterly distributions in the future.

These are truly unprecedented times for our country. I'm very proud of the steps we have taken to protect our employees and adapt our business practices to the ever changing circumstances. As I've said, our business fundamentals remain strong. Despite the challenging winter and the uncertainties associated with the COVID-19 pandemic, we will continue to make decisions and manage this business for the long term. Having the financial strength, flexibility and access to adequate capital at an attractive cost to support long term growth plans are all key to our long term success.

Lastly, I would like to express my sincere gratitude and appreciation for the more than 3,400 employees of Suburban Propane. I am truly inspired by the incredible stories of their efforts to provide support to their local communities in this time of crisis. And as always, we appreciate your support and attention this morning and we'd be happy to take any questions that you have. John, if you wouldn't mind helping us with that.

Moderator Certainly. [Operator instructions]. We have a question from the line of Sharon Louie with Wells Fargo.

S. Louie Hi, good morning. Just wondering if you could maybe walk through the changes in demand that you've seen from your customers from the March timeframe through April, and now as some of the businesses are thinking about restarting.

M. Stivala If you think about it this way, our business mix shifts dramatically as we exit the heating season to a more counter seasonal demand, which is obviously the primarily non-residential business. So to put that into a little perspective, on a full year basis non-residential volumes account for about 50% to 55% of overall volumes, and in the second half it's almost 2/3 of the volume performance. That's really very unique for every single one of our locations out there. Their demand is going to be dependent on the exact makeup of their customer base. Every location is different depending on whether you're in California, Florida, New York. But we're definitely seeing the impact on small businesses, as well as some larger businesses that we serve that have been forced to shut down.

When you think about the customers that we serve, is the restaurants, it's the hotels, it's the tourist attractions, the ports, the laundry mats you name it. These are local, many times small businesses that we have the pleasure to serve and that are struggling from the efforts to mitigate the spread of this virus.

So what have we seen? So far in the third quarter, I guess through April, I would say we've seen upwards of 20% to 25% demand destruction in those sectors. As I said in my opening remarks, though, or towards the end of our remarks, the good thing has been the cold weather that never really showed up in the heating season showed up in April and we were extremely pleased with the residential side of our performance so far in the third quarter here. It's actually been able to mask some of the impact of the commercial industrial side of the business.

So, we have seen a slightly improvement in the first part of May here in the commercial industrial volume performance, but I don't want to get too excited about that yet; it's just a couple of days. Frankly, we haven't seen enough states truly open up the kind of businesses that we serve to say that we expect to see that activity level to start normalizing.

In a perfect world, if we could get the economy back up and running and the weather continues to stay unseasonably cold, and the residential volume can continue to prop up the overall performance, well that could certainly help us get through the crisis if things can normalize. I think the uncertainties that we're talking about is really around how long does the economy take to recover, which starts with when do the businesses that we serve open; how many of them suffer so much that they perhaps may not be able to open and this ultimately forces them to close permanently; and even once open, what is the activity level start to look like relative to historical delivery trends. So that's the caution that we have to start thinking about our business and preparing the business in the event that that demand softens for an extended period of time.

So those are the things that we're seeing. Those are the things that we believe there's tremendous uncertainty about. That's why we're being cautious about how we think about the next several months and make sure that we, like everybody else, ensure that we have the right amount of liquidity. But also, not just liquidity to run the business. We still want to invest in growth and we don't want to take this period of time and not be able to seize on opportunities that may be in front of us because, as I've said numerous times, our business fundamentals are strong. We've been

through warm heating seasons before. In fact, when you look at this performance versus 2017, aside from COVID-19, I think we were tracking very nicely towards a similar performance that we had the last time we had a record warm winter. So, that tells me that the fundamentals are continuing to be strong. And when we start to see April respond the way it did with weather, it also is a testament to the readiness of our platform.

So, it's hard to totally quantify it for you, Sharon, because the reality is the story is about uncertainty.

S. Louie Okay. Thanks for that color. I guess just also thinking about the longer term impacts of perhaps a recession and how that would impact your business, are you at all seeing any changes in payments from either residential or non-residential customers? What are the payment programs that are currently in place for these customers? I know that there are certain government protections around utility services as well.

M. Stivala So look, we are members of the local communities that we serve and our number one priority is to ensure that our customers are safe and healthy, and we help serve their needs. And we are very empathetic to the situation that they're all in, so we are working very closely with all of our

customers, whether it's businesses or the residential customer that may be strapped for cash as a result of job losses, and we've instituted a period of not taking some of the steps that we would otherwise take to ensure collection for a period of time. We are working very closely with customers to make sure that we're helping them get through this time, but also being cognizant of the fact that we have a business to run and we need to collect cash.

We are seeing a slowdown in typical cash collections that you would see for this time of year. One of the things in the operating expenses that contributed to some slightly elevated expenses year-over-year was the fact that we did put aside a little bit of extra in the bad debt reserve just in case we start to see that deterioration in the aging profile of our receivables and we start to see slower collections.

The good thing is we're looking at it every single day, we are here for our customers. We want to help them get through this crisis and at the same time we need to get paid. I think our sign of sympathy for them is going to ultimately benefit us in the long term and we are going to continue to manage those receivables very, very tightly.

S. Louie Thank you.

M. Stivala Thank you. Stay safe.

Moderator [Operator instructions]. No further questions coming in.

M. Stivala Okay, well thank you, John, for your help today. Again, thank you all. I hope you stay safe and healthy for you and your families. We look forward to catching up with you again as we get more clarity and we report our third quarter results sometime in early August. So, thank you all.

Moderator Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation. You may now disconnect.