Superior Plus Corp (2023 Q4 Results)
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Corporate Speakers:

- Adam Kurnik; Superior Plus Corporation; Director Corporate Finance, Investor Relations
- Allan MacDonald; Superior Plus Corporation; President, Chief Executive Officer
- Grier Colter; Superior Plus Corporation; Chief Financial Officer
- Curtis Philippon; Superior Plus Corporation; EVP, President of Certarus

Participants:

- Gary Ho; Desjardins Capital Markets; Analyst
- Aaron MacNeil; TD Cowen; Analyst
- Robert Catellier; CIBC Capital Markets; Analyst
- Daryl Young; Stifel; Analyst
- Patrick Kenny; National Bank Financial; Analyst

PRESENTATION

Operator^ Good day. And thank you for standing by. Welcome to the Superior Plus Fourth Quarter 2023 Results Conference Call. (Operator instructions)

Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Adam Kurnik, Director Corporate Finance and Investor Relations. Please go ahead.

Adam Kurnik^ Thank you, Shannon. Good morning, everyone. And welcome to Superior Plus conference call and webcast to review our 2023 fourth quarter and full year results.

On the call today are Allan MacDonald, President and CEO; Grier Colter, CFO; and Curtis Philippon, EVP at Superior Plus and President of Certarus.

For this morning's call, Allan and Grier will begin with their prepared remarks, and then we will open up the call for questions.

Listeners are reminded that some of the comments made today may be forward-looking in nature and are based on Superior's current expectations, estimates, judgments, projections and risks.

Further, some of the information provided refers to non-GAAP measures. Please refer to Superior's continuous disclosure documents available on SEDAR+ and Superior's website for further details.

Dollar amounts discussed on today's call are expressed in Canadian dollars unless otherwise noted. I'll now turn the call over to Allan.

Allan MacDonald^ Thanks, Adam. Let me start by saying just how proud I am, to be speaking with all of you today about Superior Plus. Over the past three quarters, I've been speaking with you about our priorities and our vision for Superior Plus.

We stated categorically that we were transitioning away from growth through acquisition and towards organic growth through operational excellence. We spoke to you about the importance of having the right team in place to lead Superior Plus.

The team makes all the difference. Smart, skills and inspired leaders will always find a way to evolve to new models and deliver sustainable growth.

We told you, we value the relationships with our customers, and we would be focusing on building a bigger base of profitable customers, challenging traditional ways of doing business, delivering incremental growth and profitability from our existing businesses, all, while continuing to reduce our costs and improve returns from our capital investments.

Well, in Q4, I'm proud to say we made progress on all these fronts. The strength of our team, our focus on operational excellence and challenging ourselves to reduce costs. Transforming a company as complex as Superior, is a journey, and it takes time to see the fruits of our labor. But thanks to the hard work and commitment of the entire team, we're making progress every day.

And we believe we have a very sustainable strategy. As you'll see in our 2024 outlook, the propane division is capable of delivering very consistent returns.

With our renewed focus on operational excellence and have we put the right team in place, we're confident we'll deliver growth in propane while generating strong cash flow.

The addition of Certarus in 2023 created a new engine for growth for Superior Plus. And with the integration behind us, we are more focused than ever on building this business. As we look forward this 2024, we're optimistic that Certarus will continue to demonstrate its potential to become a significant competitor in an emerging and quickly growing segment.

With all that we accomplished in 2023, Superior Plus has undergone a significant transformation. And today, Superior stands as one of the best positioned companies in the industry. So, let me offer a few comments about our Q4 results before I hand things over to Grier.

The underlying strength of our propane business was seen in our strong Q4 results, despite record warm temperatures across North America, our propane divisions managed to post consistent financial returns.

This is a testament to the hard work and commitment of our local teams, the stability of our customer base, good management of customer churn and investing our resources wisely.

I'm very proud of our team, and I applaud their commitment to our focus to on operational excellence. In Q4, Certarus continued to execute well on its growth strategy with an impressive 21% growth in EBITDA versus Q4 '23.

Having reached a new high of 729 MSUs at the end of the quarter, Certarus is well positioned for a successful 2024. The team, very effectively, balanced demand and MSU utilization, while at the same time, staying on strategy, investing in new high-growth segments like RNG and expanding beyond the wellsite with capital investments.

So, with that, let me turn things over to Grier to walk you through Q4 and provide some thoughts on 2024.

Grier Colter^ Thanks, Allan. And good morning, everyone. We were very pleased with the performance of the businesses in the fourth quarter.

The weather conditions were a bit challenging, but the results demonstrated great resilience despite this. As Allan mentioned, fourth quarter adjusted EBITDA of $213.6 million was a record Q4 for us and represents an increase of $31 million versus Q4 2022, primarily due to the contribution from Certarus, which had a great quarter.

Full year 2023 adjusted EBITDA was $552 million, $102 million higher than fiscal 2022 due to the addition of Certarus and an increase in EBITDA from our propane businesses year-over-year, partially offset by higher corporate costs and losses on foreign currency hedges.

Our fourth quarter net earnings of $78 million compared to net earnings of $63 million in the prior year quarter. Full year net earnings were $77 million compared to a net loss of $88 million in the prior year.

Similar to our growth in EBITDA year-over-year, the primary driver for the improvement here was the addition of Certarus. Earnings per share attributable to Superior was $0.23 in 2023 compared to a loss per share of $0.58 in the prior year.

The increase in earnings per share is due to higher net earnings in the period, partially offset by the increase in average shares outstanding.

Now, turning to the businesses. Certarus achieved record adjusted EBITDA in the fourth quarter of $47.2 million, growing 21% versus Q4 '22.

The growth is reflective of the larger available fleet in 2023, where the average number of MSUs increased to 661 in 2023 versus 580 in 2022. On a full year basis, adjusted

EBITDA was $187 million, which met our elevated guidance that we issued along with our Q2 results.

The U.S. propane business produced adjusted EBITDA for the fourth quarter of $113.8 million, which was a decrease of $2.9 million compared to the prior year quarter. The business saw lower volumes due to the impact of warmer weather, partially offset by higher average unit margins.

Average weather in the U.S. for Q4 was 9% warmer than the prior year quarter and 11% warmer than the 5-year average. Full year adjusted EBITDA in 2023 for U.S. propane was $302.5 million, an increase of $17.6 million compared to 2022, primarily due to the impact of acquisitions, higher unit margins and the impact of weaker Canadian currency on the translation of U.S. dollar EBITDA, partially offset by the impact of warmer weather on sales volumes.

The Canadian propane business produced $50.2 million of adjusted EBITDA in the fourth quarter, which was a decrease of $8.1 million compared to the prior year quarter. Similar to the U.S., the decrease was primarily due to lower volumes from warmer weather and to a lesser extent, the impact of divesting the Northern Ontario assets, which was partially offset by higher average unit margins to offset the impact of inflation.

You'll recall, as part of the closing of the Certarus transaction, we were required by the Canadian Competition Bureau to divest our various propane assets in Northern Ontario, which were sold in November 2023.

In Canada, average weather for Q4 was 13% warmer than the prior year and 13% warmer than the 5-year average.

Full year adjusted EBITDA in 2023 for Canadian propane was $133.9 million, a decrease of $10.9 million compared to 2022, primarily due to lower volumes due to the warmer weather, the impact of divesting the Northern Ontario business and the impact of inflation on expenses, which was offset by higher unit margins.

The wholesale propane business generated adjusted EBITDA of $16.3 million in the fourth quarter, a decrease of $6.4 million compared to the prior year quarter, which was primarily due to weaker market differentials compared to the prior year quarter.

Full year adjusted EBITDA in 2023 for wholesale propane was $63.4 million, an increase of $14.7 million compared to 2022, which was primarily due to the impact of the Keta acquisition and exceptionally strong market fundamentals compared to the prior year.

Turning to corporate results and leverage. Corporate administration costs for the fourth quarter were $8.0 million, which was a decrease of $3.0 million compared to the prior year quarter, primarily due to lower incentive plan costs with the lower share price and also lower insurance provisions.

Superior realized a higher loss on foreign currency hedging contracts of $5.9 million versus a loss of $4.1 million in the prior year quarter. Of course, these hedges offset favorability in our U.S. dollar cash flows.

On a full year basis, corporate administration costs were $34.3 million, an increase of $8.4 million compared to 2022, primarily due to costs related to the onboarding of new management.

For the full year, Superior realized losses on foreign currency hedging contracts of $9.2 million compared to $2.7 million in the prior year. Our leverage ratio for the trailing 12 months ended December 31, 2023, was 3.8x, an improvement from 4.1x a year earlier.

While this number will continue to move around somewhat from quarter-to-quarter due to the seasonal nature of the business, our objective is to continue to improve this metric with a long-term target of 3.0x.

Before I turn to the outlook for 2024, the Board has approved a quarterly dividend of $0.18 per share.

So, looking ahead to 2024, the company is expecting adjusted EBITDA growth in 2024 of approximately 5% compared to the 2023 pro forma adjusted EBITDA of $643.3 million or USD 475.5 million.

Included in the expected growth, we are assuming 15% to 20% EBITDA growth for Certarus and 1% to 5% EBITDA growth for each of our U.S., Canadian and wholesale propane businesses.

Note that, in the case of the Canadian propane business that we have normalized the sale of the Northern Ontario assets in the prior year comparative number to calculate the range and that's about USD 7 million. And in the case of the wholesale business, we have normalized the impact of the unusual market differentials experienced in 2023 to calculate the growth range and that's about USD 10 million.

Lastly, we are anticipating approximately USD 25 million of corporate operating costs and expect capital expenditures to be approximately USD 230 million, with Certarus making up just over half that amount.

Lastly, effective January 1, 2024, Superior will begin reporting results in U.S. dollars. Converting the reporting currency to U.S. dollars will reduce foreign exchange volatility as approximately two-thirds of our EBITDA and over half of our debt is denominated in U.S. dollars.

Historical comparative financial information in U.S. dollars can be found in our 2023 fourth quarter MD&A. And with that, I'd like to turn the call over to Q&A.

QUESTIONS AND ANSWERS

Operator^ (Operator instructions) Our first question comes from the line of Gary Ho with Desjardins Capital Markets.

Gary Ho^ Maybe just on the first question, you had pretty strong margins this quarter. Just wondering if you can share the competitive landscape just on the ground. Are your competitors also maintaining higher prices still a rational market? Maybe talk about the different regions.

And Allan, you mentioned in your prepared remarks, your team is managing churn pretty well. Maybe you can elaborate on this?

And how are your attrition rates looking versus previous years?

Allan MacDonald^ Hi, Gary. I want to be careful about giving out too much specificity or specific data when it comes to our customer numbers. But I'll tell you, we're managing our margins with a view to the impact it has on customer acquisitions, so, our ability to grow our customer base and then, of course, how well we're managing our churn.

So, we're not going to the well on margin and driving customers away. And I can say, overall, I'm really pleased. And in pricing optimization as we look at making sure that we're capturing the impact of inflation, prices sometimes go up.

But when you're managing it with a view to acquiring customers and not turning them you know you're in the right spot.

So, by default, we're doing really well competitively. So, I'm feeling pretty good about where we are.

Gary Ho^ And then Curtis, couple of questions. for you. Just first on the MSU Ad, it seems like pretty healthy growth for 2024. How does your backlog look? Do you anticipate any delays putting those MSUs to work?And then second, last year, you guys benefited a bit from an early '23 due to lower net gas prices.

It seems like we're going through that again. Just wanted to get your views on that.

Curtis Philippon^ Yes. Thanks, Gary. From an MSU Ad perspective, you'll see us adding MSUs correlated with the 15% to 20% growth that Grier talked about. So, expecting consistent profitability after the notes are adding.

The team is pretty confident on getting those deployed. We've got a backlog of projects waiting for us right now, and it's more a factor of the timing of getting them from the suppliers.

We're in a sold-out situation here right now and just looking forward to getting these back into the fleet.

One comment I'd make on the additions of the MSU this year is, we had a fairly back-end year loaded for adding MSUs last year that we came in at the back end of the year, partly due to the timing of getting the deal closed and things like that in 2024, I expect a more even add of MSU for the year.

Gary Ho^ And Curtis, can you maybe talk about the lower net gas prices? Is that going to benefit kind of Q1 results?

Curtis Philippon^ Yes. It's good. So, most of our net gas prices are effectively a pass through with our customers. And so, whether or somewhat indifferent on ups and downs, there are a few unique situations where there's some margin opportunity with low net gas prices.

And so, we have seen some of that. In particular on West Texas while pricing when it gets quite low, there's some interesting opportunities for margin on that.

But I'd say in the overall impact of it is not really material overall. It's a pretty small part of the number.

Gary Ho^ And then just my last question, Grier, just on your point to turns to leveraging target for '24. Maybe walk me through kind of the components to get there. Any debt repayment there at all or driven or is this primarily driven by your projected EBITDA growth? And are you assuming any buybacks in that leverage reduction?

Grier Colter^ Yes. So, I think that the de-levering, Gary, is the most part, it will be driven by EBITDA growth from the business of the last from outright that production.

We're also looking into managing the working capital of the business very carefully and maybe some of that will come from that. With regards to buyback, I would say that our priority here is to make sure that the businesses have the right amount of capital to grow and to maximize medium in a long-term value. And obviously, we've got our deleveraging as a very high priority.

And I think those really said really high for us in terms of our priorities. And so, the reality is buybacks, if any, will be pretty minimal because from a prioritization standpoint, they come after those things, if that makes sense.

Operator^ Our next question comes from the line of Aaron MacNeil with TD Cowen.

Aaron MacNeil^ Allan, this one is similar to Gary's question. You obviously made a big change at the top of the propane division this quarter. You've spoken about the optimization. So, where exactly are you in this process? I mean, are you just at the stage where you're getting the right people in the right place?

Is Q4 or Q4 margins an indication of things you've already done? Or is there something specific you can point to that you've changed that we'll see flow through in the next few quarters?Did you guys hear the question? Do you want me to repeat it?

Allan MacDonald^ We didn't hear. Sorry, our line drop down, could you repeat it?

Aaron MacNeil^ Yes, no problem. So, this one is for Allan focused on the propane division. You've obviously made some changes there. You've spoken about optimization in the past. So, could you just give us a bit of a sense of where you're at in the process?

I mean, is the focus so far on getting the right team in place?Is Q4 an indication of improving margins from optimization efforts? Or is there something specific that you can point to that Superior's changed to improve profitability that we'll see flow through in the next few quarters?

Allan MacDonald^ Hi, Aaron I would say that Q4 is really our starting point. I mean, we've been focused on understanding what the opportunities are in the business and the best way to get at them. And then having the right team in place to make that possible. So, early days, what we've done really now is set ourselves up to say we know what our priorities are, and they're going to be very straightforward and I talked about it in the call.

We've got a great team run propane organization, great team. And what they need from us is a clarity around what our priorities are and the resources to help to extract the value that we are almost there.

And that's just really doing the basic blocking and tackling really well, acquiring customers, optimizing the pricing and managing your churn all while you're keeping an eye to really good decisions around capital investment and managing your costs.

So, with the work that we did in Q4, I would say that the business is very, very stable.

The team is really engaged, which is really good news. We've got line of sight into where those opportunities lie. And now it's just about blocking and tackling, just getting in there and doing the work.

So, what you're going to see, I think, is first, stability, then improvement and then a continued new level of performance expectation for us. We think this business has a lot of legs. There's lots and lots of opportunities.

So, it's incumbent upon us to execute well, we really focused, be mindful of not having too many things to do and investing wisely.

So, no big bangs but also, I'd say this is the starting point, certainly not the finish line.

Aaron MacNeil^ The next one is for Curtis. Maybe just ignoring demand, which seems pretty robust. What do you see as the governors to your growth from an internal perspective? Like is it supply chain, people, infrastructure?And I can appreciate that you've grown more in percentage terms in the past. It sounds like you're pretty confident that all the growth this year will go to work at good economics.

But do you start to worry that you'll see inefficiencies in the business, either through utilization or profitability just given how large the growth is in absolute terms this year?

Curtis Philippon^ Thanks, Aaron. From an overall growth percentage, this is not one of the bigger growth years for Superior. We've had bigger percentage increases than previous years. And so, the organization is quite used to a growth mindset.

When I look at what we've got in part of us and where is the opportunity and where is the challenge is, the biggest bottleneck to growth is just the time it takes to build up the teams to go support the equipment.

So, we have a highly engaged differentiated workforce that they'll deliver CNG and RNG and hydrogen for us. And it takes time to build up those teams in different regions and to scale up to support the new equipment coming out.

So, that's where we spend the majority of our time.

Operator^ (Operator instructions) Our next question comes from the line of Robert Catellier with CIBC Capital Markets.

Robert Catellier^ I just wanted to follow-up, Allan, on the propane business and how you plan to bring out more efficiencies there. You talked about the blocking and tackling. So, it sounds like there's a number of things we're after. But what are the measurable operating or financial metrics that you're most closely following to measure your success there?Does it really just come down to unit margins? Or is there something else that we should be tracking?

Allan MacDonald^ Hi, Rob, look, unit mergers are a funny indicator when it comes out because we need to be focused on profitable businesses and profitable customers, not necessarily volume.

And to be honest, volume is going to fluctuate obviously with the and the quality of the customers that we take on. Let's build a really strong customer base. When we talk about organic growth, what that really means is acquiring more customers, but doing it with an eye to profitability.

So, for us, if we can continue to build our base organically. And let's be clear, this is about taking care. It's a modestly growing segment, but we think with the right focus, really, really well positioned to take share from our competitors.

We've got great assets.

So, transformation from an M&A-focused organization, as you'd expect, means a lot of our expertise and our focus has been on integration, driving synergies and now that's got to shift to being about doing great marketing, being greater acquiring customers, being greater pricing effectively, making sure that our customers are profitable, managing churn.

So, it's a very long-winded way of saying the size and the health of the customer base is we're most concerned with, and that's going to translate into great financial results, effective use of capital and good margin management.

So, that's how I'm thinking about it.

Robert Catellier^ And I have a number of financial questions here, and I don't want to bog the call down too much. So, if we have to take some of these off-line, that's fine. Grier, I just wanted you to talk about the guidance. I assume your guidance is based on the 5-year average weather. Can you please confirm that?

Grier Colter^ Yes. Good question, Rob. So, it is based on the 5-year average weather. However, we did adjust it for year-to-date warmer weather that we've seen. So, we've obviously seen it warmer so far this year relative to the five years.

So, we adjusted that up to the release data essentially.

So, it's been kind of broca, but for the remainder of the year. So, from this point forward, yes, it would be based on a 5-year average.

Robert Catellier^ And then I just want you to talk about the plan to report in U.S. dollars. First of all, what are you going to do with your hedging? What's the plan there for currency hedges? And is there a possibility that you monetize some of the unrealized currency gains?

Grier Colter^ Yes, so, obviously, the exposure goes down pretty significantly. Looking up from the U.S. same obviously, you got exposure on the Canadian side. It's now kind of a third roughly of our EBITDA.

Of course, then we get into a conversation about whether you actually hedge EBITDA. So, if you actually look at our cash flows after debt costs and taxes, we actually don't have as significant an exposure, certainly if you look at it relative to EBITDA.

So, our thinking at this moment is our economic exposure is not that significant.

And we probably will not do hedging. I mean this may change, and we'll continue to evaluate it. But we're no longer thinking we'll hedge EBITDA, which was a previous practice. So, a, we got lower exposure, b, the concept of hedging EBITDA is probably not something we'll do. We'll be more focused on economic or cash flow hedging or balance sheet hedging if we do it at all.

But at this point, there's no hedging on, there's no positions on to hedge the Canadian exposure as we are sitting here.

So, we had some hedges on from the legacy U.S. dollar exposure when we are a Canadian dollar reporter.

We crystallized those the first of the year. And I don't have the number in front of me exactly its order of magnitude roughly $10 million of losses that were crystallized that would have been running through.

But obviously, these hedges were no longer relevant. So, we crystallize them and put that behind us.

Robert Catellier^ Last question, and I'm getting into the weeds here a bit. But what is the impact to adjusted EBITDA of no longer including the hedge contracts in adjusted EBITDA or segment profit? Presumably, you've already adjusted the guidance to take that into consideration?

Grier Colter^ So, if you look at the way we had it before kind of like in the last quarter is probably the best example, you've got hedge losses. But of course, there's higher earnings coming through the EBITDA in the business line.

And so, there's an offset going forward, we would there would not be hedges and then we're exposed, obviously, to now the Canadian dollars. So, obviously, Canadian dollar stronger than our results, all things equal, would be a little bit better in U.S. dollars.

So, there will be no offset from the hedge, but it's not hedging.

Operator^ Our next question comes from the line of Daryl Young with Stifel.

Daryl Young^ Just a quick one around Certarus, and I'm just wondering if you can give us a bit of color on the customer mix and specifically, which end markets are absorbing the new incremental MS? And I guess the background would be wondering if the utilities are taking a bigger slug and if the cold snaps in January had any impact on utilities appetite for backup sources.

Allan MacDonald^ Yes. Thanks, Daryl. I think one of the big customer segments we look at is that utility space in LDCs right across Canada and the U.S. are facing challenges with infrastructure that they've got gaps in their infrastructure and one of the biggest growth areas for sugars helping the LDC fill those gaps in their infrastructure.

So, I wouldn't say that we necessarily had a specific weather impact, spike in the last few months related to that, but more just an ongoing challenge that all these LDCs face so that we're not building new infrastructure at the pace that's needed for energy demand than they're needing to find creative ways to bridge gaps in their infrastructure.

And increasing at Certarus gets to be more well known for that. We're being called to be brought in on a very large-scale projects that are high profile, but also just a lot of smaller situations that virtually every LDC in North America faces, whether they need some sort of reinforcing in their natural gas pipeline networks, either short term or long term to sort of make sure customers are getting their energy.

So, increasingly, that's a very significant part of our business, and it will be one of the biggest growth areas for us next year.

Operator^ Our next question comes from the line of Patrick Kenny with National Bank Financial.

Patrick Kenny^ Maybe just a follow-up on the customer mix question there for Certarus. But specifically, the Curtis, the 20% plus ROIC that you've been generating here. Wondering how you're thinking about potentially trading higher returns for, say, longer duration contracts with, for example, the LDCs and whether or not over the next couple of years, we might see a slight shift in your cash flow quality profile.

Curtis Philippon^ I think you'll see that over time as you get into more contracted product. I think the one prime example that would be the renewable natural gas space based on that typically those R&D projects that we're getting into, they're looking for long-term contract commitments. And that is a different economic structure for those types of contracts, and you have sort of 5-year and potentially longer than 5-year contract terms on those that they can be structured a little bit differently and ensure the returns we're looking for, but you obviously price them a little differently than you would say, a spot deal.

Patrick Kenny^ And sorry if I missed it, but the current percentage of customers that are oil and gas based and maybe where that's headed over the next, say, one to three years?

Curtis Philippon^ Yes. It's still the majority of our business is just over half is in the oil and gas drilling and completions activity, but we've seen significant growth in those other segments. And I like to always be providing people that over the last couple of years, we've been deploying the majority of our capital into the beyond wellpad applications just to make sure we're continuing to diversify the business and expect to see that again in 2024 with the majority of the capital going into the beyond well site applications.

In saying that, our oil and gas business is a great business. It will continue to grow. We just know long term that there is a real benefit early got a very diversified portfolio.

Patrick Kenny^ And then maybe just for Grier, on the leverage target, achieving your 3x ratio mainly from growing the EBITDA. But wondering your thoughts around asset sales as potentially being part of the plan to accelerate that timeline to reach your target level?

Grier Colter^ Yes. Thanks, Patrick. So, currently, our target is to get to 3x. We think we can do this in roughly three years. And we wouldn't need to rely on asset sales, I think.

So, there are no plans. I think we like the businesses we have. We like the footprint. There's nothing that we're actively looking to sell.

Obviously, like at certain prices, anything is for sale, which kind of goes without saying. But as I said, there's nothing that we have on the path and don't need to do that to achieve our objectives.

Operator^ I'm currently showing no further questions at this time. I'd like to hand the call back over to Allan MacDonald for closing remarks.

Allan MacDonald^ Well, thanks very much, everybody. We appreciate, obviously, your time and engagement on our business here. And I'd like to take the opportunity to thank all of our employees at Superior for their continued contribution to our success, their focus on safety and reliably serving our customers.

If it wasn't for our employees and none of this would be possible. Thanks for your participation, and I look forward to speaking with you all through the course of the next quarter. Have a great day, everyone.

Over to you, Operator.

Operator^ This concludes today's conference call. Thank you for your participation.

You may now disconnect.