(TH) Target Hospitality Corp.
Year-End 2023 Earnings Call
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Officers and Speakers
Mark Schuck, Senior Vice President of Investor Relations and Financial Planning
Brad Archer, President and Chief Executive Officer
Jason Vlacich, Chief Financial Officer and Chief Accounting Officer

Analysts
Scott Schneeberger, Oppenheimer
Alec Scatielhoffer, Stifel
Greg Gibas, Northland Securities

Presentation

Operator: Good morning, ladies and gentlemen, and welcome to the Target Hospitality Year-end 2023 Earnings Conference Call. [Operator Instructions] This call is being recorded on Wednesday, March 13, 2024.

I would now like to turn the conference over to Mr. Mark Schuck. Please go ahead.

Mark Schuck: Thank you. Good morning, everyone, and welcome to Target Hospitality's fourth quarter and full year 2023 earnings call.

The press release we issued this morning, outlining our fourth quarter and full year results can be found in the Investors section of our website. In addition, a replay of this call will be archived on our website for a limited time.

Please note the cautionary language regarding forward-looking statements contained in the press release. This same language applies to statements made on today's conference call. This call will contain time-sensitive information as well as forward-looking statements which are only accurate as of today, March 13, 2024.

Target Hospitality expressly disclaims any obligation to update or amend the information contained in this conference call to reflect events or circumstances that may arise after today's date except as required by applicable law. For a complete list of risks and uncertainties that may affect future performance, please refer to Target Hospitality's periodic filings with the SEC.

We will discuss non-GAAP financial measures on today's call. Please refer to the tables in our earnings release posted in the Investors section of our website to find a reconciliation of non-GAAP financial measures referenced in today's call and their corresponding GAAP measures.

Leading the call today will be Brad Archer, President and Chief Executive Officer; followed by Jason Vlacich, Chief Financial Officer and Chief Accounting Officer. After their prepared remarks, we will open the call for questions.

I'll now turn the call over to our Chief Executive Officer, Brad Archer.

Brad Archer: Thanks, Mark. Good morning, everyone, and thank you for joining us on the call today.

Our strong 2023 results continue to illustrate the benefits of our strategic accomplishments over the last several years. These accomplishments have supported an enhanced operating platform, which allows us to efficiently align network capabilities with changes in customer demand while consistently achieving our financial goals. This efficient operating structure and network scale allows us to provide our world-class customers with the premium service offerings they demand while simultaneously continuing to pursue strategic growth opportunities.

This scale and flexibility enable Target to quickly respond to a strategic growth initiative, which ultimately resulted in a materially expanded presence providing critical humanitarian solutions to the U.S. government. We continue to benefit from this expanded presence with 72% of 2023 revenue being derived from committed contracts backed by the U.S. government. This benefit is illustrated in the success of our PCC community, which is entering its fourth year of operations as an established component of the U.S. government's domestic humanitarian aid mission.

It is important to remember that since 2021, this facility has evolved through multiple contract renewals and community expansions to be the longest serving influx care facility in the United States. Additionally, as the government sought to ensure the longevity of this critical solution, they initiated a comprehensive and competitive bidding process which took nearly a year to complete. This process was conducted under an indefinite delivery, indefinite quantity, or IDIQ, contracting vehicle. The IDIQ allows the government to appropriately establish a required funding vehicle to support long-term contracts and ensure continuity of central multiyear service offerings.

As we announced in December of last year, Target and our nonprofit partner were successfully awarded this multiyear IDIQ contract. The successful outcome of this competitive process coupled with Target's longstanding reputation as a proven provider of these critical humanitarian solutions to the U.S. government supports our belief that the PCC community is well positioned to remain a critical component of the government's influx care facility solutions through 2028 and beyond.

Further, Target remains actively engaged and continues to build strategic partnerships to jointly pursue the creation of new ICF sites not currently in the government's portfolio. In addition, our South Texas Family Residential Center is entering its 10th year of operations, a testament to the operational success of that community. The longevity of these established communities and critical solutions they provide will continue to support a high degree of revenue visibility and strong cash generation for years to come.

Regarding our HFS segment, we continue to benefit from strong customer demand, which supported select asset acquisitions in 2023. This demand illustrates the value our world-class customers find in the premium hospitality solutions we provide. Coupled with continued

operational efficiency gains, we anticipate positive momentum across this segment over the coming quarters. These elements continue to support impressive operating income and industry-leading cash conversion, which has allowed us to achieve several strategic balance sheet objectives last year and established a highly flexible capital structure. We believe this is the ideal position to continue evaluating a robust pipeline of value-enhancing growth initiatives.

As we continue to pursue unique organic and inorganic opportunities, these initiatives remain centered on elements of our existing core competencies. We believe these naturally adjacent opportunities will complement our existing service offerings while establishing multiple avenues to expand Target's long-term growth opportunity set. As we evaluate these initiatives, we remain committed to achieving defined objectives of our growth strategy.

Our primary objective is to focus on diversifying our customer base and contract portfolio, which we believe is essential in broadening our long-term growth pipeline. By accomplishing this, we will establish a foundation to identify and consistently execute repeatable growth opportunities while remaining focused on generating strong operating income and industry-leading cash conversion.

In summary, we remain focused on sustaining the momentum we have created over the past several years. We have established a strong financial and operating platform to continue supporting our world-class customers while simultaneously pursuing the most robust growth pipeline we have seen in many years.

I'll now turn the call over to Jason to discuss our fourth quarter financial results, recent balance sheet initiatives and expanding capital allocation and growth opportunities in more detail.

Jason Vlacich: Thank you, Brad.

In the fourth quarter, we continued to benefit from our efficient operating platform and network scale, which allows us to seamlessly align with customer demand while consistently delivering strong financial results.

Fourth quarter 2023 total revenue was $126 million, and adjusted EBITDA was $68 million. Our government segment produced quarterly revenue of approximately $88 million. The sequential decrease in revenue was primarily driven by noncash, nonrecurring infrastructure enhancement revenue associated with the significant expansion that occurred at our PCC community in 2022, which was fully amortized as of November 2023.

As a reminder, this segment's revenue is centered around committed minimum revenue contracts backed by the U.S. government. These contracts inclusive of our new PCC contract, which we announced in December of last year, provide significant long-term revenue and cash flow visibility.

Our HFS and other segments delivered quarterly revenue of $39 million, compared to $37 million in the same period last year. This increase was driven by sustained momentum in customer demand for Target's premium service offerings, which supported select asset

acquisitions in 2023, further illustrating the value our customers find in our premier network flexibility and hospitality solutions.

Recurring corporate expenses for the quarter were approximately $10 million. And we anticipate these will remain around $9 million to $10 million per quarter for the remainder of the year. Total capital spending for the quarter was approximately $5 million, with the majority related to enhancing assets focused on supporting the government's humanitarian aid mission.

During the fourth quarter, we took deliberate steps to further strengthen our financial position, including the expansion of our credit facility and successful completion of the senior note exchange. These actions significantly increased our liquidity profile while simultaneously extending our senior note maturity timeline, which now extends to 2025.

We ended the quarter with $104 million in cash, $275 million of liquidity with 0 borrowings under our company's $175 million revolving credit facility and a net leverage ratio of 0.2x. These impressive financial results illustrate the strength of our operating platform and the sustained positive momentum we have created over the last several years. This optimized financial position supports our preliminary 2024 financial outlook, which consists of total revenue of between $410 million and $425 million and adjusted EBITDA between $195 million and $210 million. Excluding potential acquisitions, we anticipate capital expenditures of between $25 million and $30 million.

Moving on to our capital allocation initiatives and continued focus on strategic growth opportunities. The strength of our balance sheet, high degree of revenue visibility and continued strong cash conversion provides the ability to simultaneously consider multiple value-enhancing capital allocation initiatives. Included in these initiatives is our previously announced $100 million share repurchase program, which allows the company to evaluate a holistic opportunity set focused on maximizing value creation through all available means.

This focus supported our decision to execute a series of share repurchases beginning in January of this year. As a result, through March 8, 2024, we have returned approximately $18 million to our shareholders by repurchasing 1.9 million shares of common stock. This illustrates our focus on utilizing a broad range of initiatives to pursue value-enhancing opportunities for our shareholders.

In addition, we continue to actively evaluate and pursue an expanding pipeline of strategic growth initiatives, including both organic and inorganic opportunities. These opportunities are designed to jointly leverage Target's operating expertise and existing core competencies to establish a robust service offering across various U.S. government agencies and commercial applications. These initiatives encompass Target's existing full turnkey hospitality solutions while also focusing on opportunities to broaden Target's contract and service offering portfolio through individual elements of our existing core competencies.

We are focused on establishing a platform to continue diversifying our revenue streams while simultaneously creating repeatable growth vectors to continue expanding our customer base and

service offerings. We view these opportunities as a seamless extension of our existing portfolio, providing greater confidence in consistently achieving our desired returns.

As previously stated, Target is prepared to allocate over $500 million of net growth capital to these high-return opportunities over the next several years. Importantly, as we evaluate these initiatives, we will remain focused on ensuring these opportunities to meet our return criteria, including maintaining a high level of continued discretionary cash flow conversion.

We are pleased with the breadth of these opportunities and look forward to providing additional updates in the coming quarters as these initiatives continue progressing.

With that, I'll turn the call back over to Brad for closing comments.

Brad Archer: Thanks, Jason.

Our impressive 2023 results are a testament to the operational efficiencies and scale we have created, which has enabled us to consistently exceed our financial goals and continue to strengthen our financial position. Over the past three years, we have taken deliberate actions to diversify the business while strategically positioning the company to pursue value-enhancing growth opportunities. We have significantly high-graded our contract structure and materially enhanced our long-term revenue visibility while prudently strengthening our balance sheet. These accomplishments have optimized our financial position and established a highly flexible capital structure.

With this foundation, we are evaluating and pursuing the strongest pipeline of growth opportunities we have seen in many years. We are excited about the future and believe the foundation we have established supports our capital allocation initiatives focused on continuing to create value for our shareholders.

I appreciate everyone joining us on the call today, and thank you again for your interest in Target Hospitality.

I will now turn the call back over to the operator.

Questions and Answers

Operator: Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] Our first question comes from the line of Scott Schneeberger from Oppenheimer.

Scott Schneeberger: I guess, Jason, probably the first question is for you. This is, I believe, the first public conference call since late December when the finalized terms of the updated PCC contract were completed, which will be a big part of this question of mine, which is, I was hoping you could bridge for us the 2023 EBITDA of $344 million. Just give us the top three to five components of the bridge getting us to, say, the midpoint of the 2024 EBITDA guidance of $202 million.

Jason Vlacich: Yes. Sure. Appreciate the question. So primary item right off the bat is the amortization of the upfront payment, the construction expansion payment that we received in August of 2022. So that's about $118 million of that. And then the other component is the fixed minimum revenue commitment, otherwise known as the cold status, which we reduced a bit on the new contract as we switched over from the old, which had a $196 million minimum revenue component. And now we've switched to $178 million. So those are the primary drivers of the difference between the 2023 adjusted EBITDA number in 2024. Does that answer your question?

Scott Schneeberger: Thanks. That's helpful. Just a follow-up there, Jason. What is the implied -- at the high end and the low end of the guidance range, what is the implied contribution for variable occupancy revenue?

Jason Vlacich: Yes. Sure. So it's important to note at the lower end of the range, it's primarily driven by the fixed minimum revenue commitments that are part of that contract structure. And so there's very little, if any, variable revenue contribution embedded in that low end of the range.

Scott Schneeberger: Okay. Thanks. And then just curious, a lot of the -- you guys are in great shape on the balance sheet. So this is for all of you. There are opportunities that you've been pursuing for a long time, National Defense projects, Rare Earth et cetera. Could you just give us an update and also a -- that third ICF contract that the government has been contemplating. Could you give us an update on all of the above? And just how ripe are these potential opportunities? And has the pipeline expanded from last time we touched base?

Brad Archer: Yes. Scott, this is Brad. Let me take that. And if you don't mind, what I'll do is holistically give you some feedback on the organic opportunities. But also, I think it's important we touch on the inorganic and some of the things we're doing there. But I'll start with the third ICF that we've been talking about.

We continue to be in pursuit of that project. We're doing all types of design work, working on numbers. The biggest thing we're waiting for, and we've been in discussions with the government, is the final bid to be worked out. We expect that to hit the market sometime in the middle of 2024, is what they're telling us right now with an award on the back half of the year. I don't know if that's going to be towards the end of the year, the middle of the third quarter. We don't know. We'll update you as we get more information. But it's active discussions. We look for that bid to come out. So we have a team working on that as we speak.

And then let me just -- more holistically on the organic opportunities. And I'll break this into two buckets, one being the government and then one being all things nongovernment, if you will. And on this government piece, we'll set ICF to the side.

In the past few months, you can imagine with all of the border issues, there's definitely much more conversations happening with our team around support around the border issues, so discussions with multiple different agencies, and some we've actually provided bids to, for services that we already do at PCC and other locations.

So they're coming to us knowing they're going to need something to help with this border issue. I can't give you a date or time on that. What I would tell you is that part of our government business has ramped up considerably as far as the calls, the discussions, the meetings. So we're encouraged by that.

On the other organic opportunities, nongovernment, very active pipeline consisting, as you mentioned, large industrial projects throughout the U.S., high tech, infrastructure et cetera, natural resource projects, the steel industries for one that we're dealing with right now. Oil and gas, still a big part of our business. There's some really large customers that we're in discussions with. We'll see where that goes. It would be selective on that long-term type in oil and gas. Carbon capture is another one that's out there that's really starting to take hold in some areas.

And then I think the more exciting piece is the critical minerals, the copper, the lithium, rare earth, just to name a few, that we're in active discussions with. And some of these, as you know, have very long gestation periods. What I would say is the pipeline has gotten stronger. And this will eventually produce some really nice wins for us. If you look at our history, we continue to take down some large contracts. The problem is not very programmable. It's the peaks and valleys.

And then let me just touch really quickly on the inorganic opportunity. And we discussed inorganic opportunities many times in the past. And with our balance sheet being stronger than any time in the company history, we begin to lean even further into this. To help with this, we're continuing to build out the strategy and corporate development team. And we'll add more human capital to this department. This department reports directly to me. I'm leading that charge. I think it's very important as we continue to move to diversify the company.

But our goal with any inorganic opportunity we do in the future is to broaden our customer base, further diversify the revenue streams and create a platform for revenue growth and doing all of this while maintaining a strong cash flow profile with good visibility on future revenues.

So we'll be very thoughtful in this in terms of fit and kind of financial profile when assessing any potential inorganic deal, but we feel very strongly the growth through inorganic opportunities can help us deliver the goals I mentioned. We think it's very important to continue to diversify the revenue stream and derisk the business. So we're all over that. There's even more focus to get that done quicker. But we're not going to do something that's not right for all the investors. So I think where we sit with the capital we have available, we're set up pretty nicely over the next few years on the organic-inorganic side of the business.

Scott Schneeberger: Thanks, Brad. Just real quick, a follow-up to that. On the inorganic, should we be thinking something core to what you do already? Or will it be more the path of the diversification that you speak to?

Brad Archer: I think you can do both of what you just said, something we already are very good at that diversifies us. And I'm not going to get into specifics here, but I'd just tell you segments that were circling around. Specialty rental. We already do that, right? There's many different things in the specialty rental business that you can go and do that fits in our wheelhouse that

we're very good at, we have some expertise at. So that's one of the segments we're focused on. Government services is another one that we're focused on. So that's where we're leaning into. We're not going to not look at some others, but those are the two.

But to answer directly, we're not going to get so far out of our wheelhouse that we don't know what we're doing. We're going to stay within what we do really well. But it will -- the things on the inorganic side definitely need to hit those three buckets, broaden our customer base, further diversify the revenue streams and give us repeatable programmable growth.

There's no secret. The risk is our two contracts in the business. We think those are long term. They've proven they have been, so we're very comfortable with those. But we also realize we need to continue to diversify that strength.

Operator: [Operator Instructions] We have our next question coming from the line of Alec Scatielhoffer from Stifel.

Alec Scatielhoffer: So just to kick us off here, I was -- this is a three-part question. I was just wondering if you could provide some details on exactly how the variable piece of the government contract works. And if Trump wins the election, are you concerned about the utilization of the facility or the renewal of the one-year contracts? And the third part, can you just talk about the differences you see in under Trump's prior presidency versus Biden?

Jason Vlacich: Yes. So the variable revenue piece, again, as a reminder, is a small component of our outlook. We usually plan for very minimal amounts of that variable revenue contribution. As a matter of fact, our 2023 results include a minimum amount of that. It's primarily based on the fixed minimum revenue commitments.

Having said that, there is an element of occupancy-driven component associated with that. And there's the [bed band] allocation as well. So anyway, it's generally driven by occupancy levels, population fluctuations for the unaccompanied minors, which is always going to fluctuate over the year. So therefore, we plan for very minimal amounts of that variable revenue.

Brad Archer: Yes. And let me take your elections question. History tells us to expect very little change, if any, in our facilities. We have served many different administrations to date. And again, we just -- we don't see any or anticipate any changes. I would also add, based on the populations we serve and the regulations and laws surrounding that, this also provides us with some surety around long-term use.

Alec Scatielhoffer: Got it. That makes sense. And then just kind of shifting gears a little bit to your capital allocation framework in '24. You commenced some of the share repurchases, as you mentioned, thus far in 1Q '24. Just curious how we should think about your capital requirements should you secure that through the contract with the government and just some of the moving pieces behind some of the inorganic and organic growth that you're contemplating?

Jason Vlacich: Yes. Thanks for the question. So we're obviously focused on growth. But the share repurchase program is still in play. It's certainly something that's an important

consideration for us. We executed upon it. We'll continue to evaluate that as an accretive allocation of our capital. But we'll also continue to remain extremely focused on our growth initiatives, both inorganic and organic.

So we're not losing sight of the organic pipeline. It's very strong. We continue to focus on that. We're pleased with the breadth of opportunities there. But as Brad mentioned, we're definitely focused on our inorganic piece as well for the various reasons he's outlined and for the various reasons we outlined at the start of the call as well as in the earnings release and in past calls. So that's how we're thinking about it. Again, that share repurchase program is in play. And we executed upon it, and that will continue to be an option for us as we move forward.

Operator: Our next question comes from the line of Greg Gibas from Northland Securities.

Greg Gibas: I guess just a follow-up on another question. Jason, were you saying that the lower end of the EBITDA guidance range assumes that Target's only receiving that fixed component for the Pecos contract?

Jason Vlacich: No. Not necessarily. There are some elements of the variable revenue component in there, but it's minimal.

Greg Gibas: Got it. And curious, it seems like that maybe potentially drove some of the upside in Q4, the variable piece. And curious if you [guys saw] that continue into early 2024. And maybe what you're -- I mean is it fair to assume a midpoint of that guidance range, just given what we're seeing on the variable side thus far?

Jason Vlacich: So in Q4, I think you're referring maybe to the outperformance, which was primarily driven by cost efficiencies that we realized ahead of what we anticipated. So that was sort of a function of us switching over to the new contract, some population fluctuations at the community and we just realized our operational efficiencies ahead of schedule.

And so we don't necessarily expect that to continue into 2024. But again, in 2024, we have a minimal variable revenue contribution considered there. And it's more heavily weighted towards the fixed minimum revenue contracted component of the contract.

Mark Schuck: Yes. Greg, this is Mark. Just to add on to what Jason said. We did capture some of the very minimal variable revenue that is embedded in the 2024 outlook so far in 2024. So certainly gets back to what Jason was describing as a very small amount to consider there to the full year outlook. But specifically to your question around where to be with that range, yes, the midpoint is fine there. But I think importantly, just staying within that range is where we feel comfortable and certainly was the basis for us reiterating that today and then this morning in the release.

Greg Gibas: Great. Yes. I appreciate the color there. And really nice to hear that that pipeline is improving on the organic growth initiative side. And it seems like there's a range of opportunities. I wanted to get a sense of that timing there. I mean, it seems like the third ICF would be a huge opportunity that's closer to the back half of 2024. But I'm guessing there are

some smaller opportunities that you maybe have been evaluating for a while. Any sense on when those types of contracts could be announced?

Brad Archer: Yes. It's just too hard to put a time frame on it at this point. There's definitely some. If everything goes right, it could happen in 2024. But I don't want to put a time frame on it at this point.

Operator: There are no further questions at this time. I'd now like to turn the call back over to Mr. Archer for final closing comments.

Brad Archer: Sure. I just want to thank you all for joining the call today. Have a great day. And we look forward to speaking again in May when we deliver our numbers for the first quarter. Thank you.

Operator: Thank you, sir. Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines. Have a lovely day.