

Target Hospitality
Third Quarter 2019 Earnings Conference Call
November 13, 2019

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Kevin D. McVeigh, *Credit Suisse*

Ashish Sabadra, *Deutsche Bank*

PRESENTATION

Operator:

Greetings, and welcome to Target Hospitality's Third Quarter 2019 Earnings Call.

At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, you may press star, then zero on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the call over to your host, Mr. Narinder Sahai, Senior Vice President, Treasurer and Investor Relations. Thank you, Mr. Sahai. You may begin.

Narinder Sahai:

Thank you. Good morning, and welcome to Target Hospitality's Third Quarter 2019 Earnings Conference Call. The news release we issued yesterday and the presentation for today's call are posted on the Investors section of our website. Joining me on the call today are Brad Archer, our President and Chief Executive Officer, and Eric Kalamaras, our EVP and Chief Financial Officer.

After prepared remarks by Brad and Eric, there will be a question-and-answer session. Troy Schrenk, our Chief Commercial Officer, will also join us for the Q&A session.

Before we begin, I'd like to remind you that some of these statements, including a discussion of our 2019 outlook, and responses to your questions in this conference call may include forward-looking statements. As such, they are subject to future events and uncertainties that could cause our actual results to differ materially from these forward-looking statements.

Known material factors that could cause our actual results to differ from those implied by the forward-looking statements are described in our news release issued yesterday, our most recent 10-K, most recent 10-Q, and other periodic filings with the U.S. Securities and Exchange Commission. We wish to caution you to not place undue reliance on any forward-looking statements, all of which speak only as of the date hereof. We undertake no obligation to publicly update or revise any of our forward-looking statements after the date they are made.

In addition, on today's call, we will reference certain non-GAAP measures. More information regarding these non-GAAP measures, including reconciliations to the most comparable GAAP measures are included in the news release issued yesterday.

With that, I'll now turn the call over to Brad.

Brad Archer:

Thanks, Narinder, and good morning everyone. Thank you for joining us today to discuss our third quarter 2019 results.

Before we get into the specifics, I want to thank the 800 women and men of Target Hospitality for their hard work and dedication in taking care of our customers each and every day. Their commitment to delighting our guests in every interaction, big or small, is exemplary and a true reflection of our customer-centered culture and service promise.

Now, let's turn to the quarter.

As you know, our energy end market customers are predominantly in the Permian Basin. This is our largest segment and a significant driver of revenue and earnings growth for the Company. Drilling and completions activity in the Permian Basin experienced a deceleration in the third quarter. Front loading of exploration and production, as well as energy service capital spending for the first half of this year has constrained activity for the second half as future capital needs are assessed. This, combined with keeping production spending within cash flows, is having cascading effects. The equipment utilization index is at its lowest levels since 2016 for oilfield services firms, and construction employment in the Permian Basin has experienced some contraction through the end of the third quarter.

Amid this backdrop, I am proud of the resilience of our business, as the third quarter was a solid operational quarter for us and we delivered strong financial results. As promised, we executed on our growth strategy, generated attractive margins, and at the same time, initiated Shareholder returns. Our cash generation was the highest it has ever been, allowing us the flexibility to simultaneously grow the Company and return capital to our Shareholders.

We had tremendous operational momentum in the quarter. Our system-wide total beds reached 13,000 for the first time. This helped us cross 10,000 utilized beds in this quarter, a key milestone for the Company. We have executed this growth in a very disciplined manner, and remain confident in producing consistent through-cycle returns.

On a combined pro-forma basis, which includes results of Signor for the third quarter of 2018, we saw growth in both our revenue and Adjusted EBITDA. Year-over-year, we grew our third quarter revenue by 6% to $82 million. Revenue growth was driven by increases in volume from having more utilized beds,

and average daily rate mainly due to benefits from our Signor enhancement program; both of which also translated into year-over-year growth in Adjusted EBITDA which was up 3% to $41 million. All of this is particularly impressive in a period of record growth and change for Target Hospitality, including becoming a public Company earlier this year.

Let me now take a few minutes to discuss our markets before turning the call over to Eric for our third quarter financial results and updated 2019 outlook.

The government side of our business is stable and highly predictable, so I'll focus my comments on our distinctive positioning within the U.S. energy end market. We have long-standing relationships with a blue-chip customer base that we have built over decades. The larger customers that partner with us tend to have longer investment horizons, and they view secured employee accommodations as part of their own competitive advantage. The mutually beneficial relationship with our customers is managed through long-term contracts with exclusivity and guaranteed payment provisions. For customers, this contract structure provides utilization flexibility and certainty of spending. In turn, it allows us to achieve stability and visibility into our future earnings and cash flows. This is a win-win for both our customers and us.

We believe that our playbook of aligning with the right customers and being disciplined with capital deployment is working. We spend a lot of time upfront in selecting the right location and the right size for our communities. Many of you also know that we do not commit capital to develop new communities until we have long-term agreements with our customers. This approach provides a high degree of certainty on returns.

Historically, the third quarter has been the strongest quarter of activity for our U.S. energy customers. Clearly, that is not the case this year. Further, an expected seasonally weaker fourth quarter implies that activity will likely not pick up at least until next year when E&P capital budgets are re-assessed. We don't expect the lower activity anticipated for the second half of this year to turn into a prolonged downturn in the energy market. This view is confirmed in our recent discussions with some of our key customers.

So, how does this dynamic in the U.S. energy market impact us and what we are doing about it? We expect a continuing bifurcation between those companies that are taking a long-term view of their resource assets and those that are likely to scale back in the short-run. Our core business, which comprises contracted revenue from our long-standing customers, remained resilient. Excluding TC Energy, revenue from our top 30 energy customers was higher sequentially in the third quarter versus the second quarter of this year. Many of our core customers continue to invest in the Permian Basin, and expect their workforce accommodation needs to remain relatively unchanged. We continue to align our services with the largest and best capitalized players in the market.

Our contract renewal rate remain above 90%, which demonstrates our strong partnerships with customers due to our network and exclusivity advantages, and importantly, as we make our way through the fourth quarter and head into 2020, we do not have any significant contract roll-offs.

Our un-contracted business is largely comprised of customers with less predictable workloads and select high probability commercial opportunities. We continue to work on converting promising commercial opportunities and more of the transient customers to multi-year contracts. While we experienced some impact on demand in the third quarter due to diminished visibility of our transient customers, and deferral of certain commercial opportunities into the next year, availability of our un-contracted beds allowed us to be opportunistic as a result. We are well-positioned to take market share from expensive hotels as they are the first to experience attrition in this environment, and we are typically the first call for such customers wanting better value. We recognize that one size does not fit all, so we are also leveling the playing field with regional accommodation providers through our flexible terms and contract structures. This approach allows us to better serve customers with differing needs. Target Hospitality's largest

network of communities, value-added services, and exemplary service are unmatched, and we will be assertive in demonstrating that.

Additionally, as we have done in the past, we continue to work to further strengthen the resilience of our total business by pivoting even more of our portfolio to large, integrated producers that are making investments over multi-year horizons. That's important to us because in the current environment we have retained all core customers. As activity levels recover and as customers reset budgets, our existing contracts with exclusivity provisions should allow us to grow utilized beds seamlessly with our customers' needs.

Let me also reiterate, Target Hospitality is a growth Company, and we have established a consistent track record of profitable growth. We have a mature pipeline of organic growth opportunities and healthy prospects for value-enhancing acquisitions, and we plan on executing both tracks simultaneously. We have evolved into a much more resilient business today than it was even a few years ago. We are confident the initiatives we have underway position us to continue our growth trajectory as we continue to strengthen our product offerings and service competencies. At the same time, we are diligently working to diversify into end markets where we can apply our core competencies, add value, and generate returns for our Shareholders. Our fundamentals are strong, and we expect to build on our progress going forward by balancing our resources to drive sales and margins while making investment in our future.

It is now my pleasure to turn it over to Eric for additional remarks on our third quarter financial results and our updated 2019 outlook.

Eric T. Kalamaras:

Thank you, Brad, and good morning everyone. This is my inaugural call with Target Hospitality, and I am pleased to be joining a high-quality organization with excellent leadership and great growth potential.

As Brad indicated, we delivered solid third quarter results. I will begin the discussion of our results, review our capital program, and follow up with details of our updated 2019 outlook.

In the third quarter, we continued to benefit from our growing network, new builds and expansions, the successful integration of our recent Superior Lodging and ProPetro acquisitions, as well as a sharp focus on operational execution. While our overall results were modestly impacted by the slower than expected pace of the TCPL project and slower growth in our energy end market, we still achieved nice year-over-year growth in both revenue and Adjusted EBITDA. Total revenue increased 35% to $82 million, and Adjusted EBITDA increased 30% to $41 million and an Adjusted EBITDA margin of nearly 50%. The year-over-year growth in Adjusted EBITDA was a result of higher sales and improved operational cost leverage with improvements from an increase in utilized beds while total cost of services declined.

Recurring corporate expenses for the quarter were $9 million. The increase from last year is primarily associated with the transition to being a public Company, as well as infrastructure investments that allow us to scale the business and to support additional growth with minimal incremental costs. We expect our recurring corporate costs to remain around $8 million to $9 million per quarter.

Turning to our segment performance, the Permian Basin delivered third quarter revenue of $57 million, an increase of 65% versus the prior-year quarter. This increase was primarily driven by an increase in average utilized beds as a result of the Signor integration, as well as new community additions and expansions. We added 1,091 new available beds in the quarter. Average available beds more than doubled, and average utilized beds increased 72% despite declines in the overall basin activity levels. ADR decreased 4% primarily from lower average ADRs at acquired Signor communities. Recall, there is a 12 to 18 month timing lag to convert customers to our pricing model.

In the Bakken Basin, we deliberately right-sized our footprint late last year, which drove the expected decline in average utilized beds, while significantly improving utilization and creating cost efficiencies. This led to a nearly 300 basis point increase in adjusted gross profit margin. Revenue declined by 19% mainly due to a decrease in average utilized beds at lower ADR, reflecting lower activity levels compared to the same period last year.

In the Government segment, revenue of $17 million was flat compared to the prior-year quarter due to unchanged average available beds and ADR. The contractual nature of this asset provides relatively stable ADR, utilization, and revenue. Adjusted gross profit margin increased 500 basis points primarily due to lower occupancy costs.

Our All Other segment, which consisted primarily of construction fee revenue from the TCPL project, had revenue of $2 million and adjusted gross profit margin of 34% for the third quarter. This was driven by significantly lower than anticipated pre-FID activities. While we are hopeful of a contract start, we are expecting negligible contribution from this project for the remainder of 2019.

We had another significant period of cash generation. We generated $26 million in net cash flow from operations during the third quarter. This is particularly notable considering that we paid $17 million in cash interest in the quarter and still produced the same level of net cash flow from operations as in the second quarter of this year. Since much of our capital spending is discretionary given nominal maintenance capital needs, this quarter provides a clear glimpse of the exceptional cash flow generation ability of our business. We expect to continue to generate meaningful cash flow, allowing us the flexibility to fund our growth objectives.

Capital expenditures in the third quarter were $27 million. Almost all of this capital spending was for revenue-enhancing investments, including the construction of two new communities in Carlsbad, New Mexico and Orla, Texas expansions, and high-grading of legacy Signor communities. Capital expenditures also included $5 million for the purchase of ProPetro's Midland, Texas community earlier in the third quarter. Year-to-date growth capital expenditures, excluding acquisitions, was $74 million.

We ended the quarter with $410 million of total long-term debt, including $70 million drawn on our revolving credit facility, and consolidated net leverage of 2.4 times. We commenced stock repurchases in the third quarter pursuant to the $75 million stock repurchase authorization announced on August 16. To date, we have repurchased shares for approximately $13 million, or approximately 18% of the total share repurchase authorization.

We plan to continue spending our discretionary cash flow on attractive investment opportunities that generate superior returns for our Shareholders, whether those are organic growth opportunities or through attractive acquisitions. Our robust cash generation and solid balance sheet provide us with significant financial flexibility to accomplish both of these objectives. These are aligned with our broader capital allocation priorities to invest in growth, maintain a flexible balance sheet, and deploy capital into long-run value-enhancing initiatives.

Turning to our 2019 financial outlook, the contracted portion of our business remains largely intact. The slowing drilling and completions activity that we have experienced has primarily impacted the un-contracted and variable portion of our business. This has resulted in declines in demand, which has affected both pricing and utilization, as well as deferred some commercial development opportunities. In addition, run rate contribution from construction activities related to the TCPL project has not materialized as expected.

As a counter to these headwinds, we offset these impacts from incremental growth in utilized beds in the third quarter from our two new communities in Carlsbad and Orla, as well as cash flow from our acquisitions.

With this background, we are now expecting full-year 2019 combined pro-forma revenue to grow between 5% and 8% and be in the range of $318 million to $328 million, and combined pro-forma Adjusted EBITDA to grow between 5% and 8% and be in the range of $157 million to $162 million.

As our new-build and expansion capital programs near completion, we expect the pace of our capital spending to decelerate for the remainder of this year, and expect non-acquisition growth capital spending to be between $80 million and $90 million for 2019.

We are confident in the structural advantages of our business model and our strategic focus on large, long-term oriented customers. Our network and exclusivity-focused business model, coupled with our ability to generate significant cash flows, allows us to control not only the quantum, but also the pace of our capital spending, and gives us confidence not only in our updated full-year 2019 outlook, but also our ability to execute on our growth initiatives through time.

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

Brad Archer:

Thanks Eric.

In summary, our continued solid operational momentum and execution is delivering strong financial results. We have continued to deliver on our growth strategy and our relationships, and contracts with our core customers underpin the stability of our business, and this was clearly evident in this quarter. We grew our bed count in the quarter and generated exceptional cash flow from operations.

While we cannot control the market, our value proposition to Shareholders is the confidence that we have in the structural advantages in our business. We maintain a line of sight on a significant majority of our revenues, and as I reiterated today, we are actively working to further increase our mix of business from high-quality integrated producers and large oilfield service companies.

We are also focused on returns. Our solid balance sheet and significant cash generation ability allows us to execute our growth strategy without sacrificing returns for our Shareholders. Our team is committed to executing our strategy, winning in our markets, and delivering outstanding results.

Thank you again for your interest in Target Hospitality.

Operator, you may now open up the line for questions.

Operator:

Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment, please, while we poll for questions.

Thank you. Our first question comes from the line of Stephen Gengaro with Stifel. Please proceed with your question.

Stephen Gengaro:

Thank you. Good morning, gentlemen. Can I start with the fourth quarter guidance? When we sort of back-of-the-envelope tried to figure out what your fourth quarter contracted revenue looks like, we came up with a number around $77 million, and I think your revenue guide implied $73 million to $83 million. Can you talk about the moving pieces in the fourth quarter that kind of lead to the variance in your range of about $10 million, and kind of what portion of that is part of that—those 85% of revenue that's contracted?

Brad Archer:

Hey, Stephen. This is Brad. Thanks for joining here today.

Let me take high-level take on the business, and then if Eric wants to jump in and give some more color to more specifically on that number, he can, but look, as we've mentioned in the past, our core business is our strength, and this is part of the business that's still intact. We've got great visibility on the business due to our long-term contracts.

Now, conversely, the un-contracted portion of our business, which can be variable, we have less direct visibility on, and we experienced softness in this portion of our business, specifically, two areas: the spot transient market and in commercial opportunities, which pushed to the right. Look, we believe this softness is short term through the fourth quarter, and when budgets reset in the first of the year, we expect this portion of the business to improve, and here's why I say that.

I'm out there quite a bit. Troy is, and the business hasn't gone away, and the market's not shut down in the Permian. It's still very busy. The good thing is a lot of the work, we don't have to rebid for it, because it's under our exclusivity contracts, so when budgets reset, we're set up to get this work back, and I look at this—and some customers maybe have dropped some headcount in the fourth quarter, they haven't went away, and in talks with them we know some of this work is coming back in the new year, so again, not rebidding it. If they come back to the Basin, they go into our rooms, so that's a good point to look forward for past the fourth quarter, and then I'd tell you, remember, on a high level the goal is to always convert this variable portion of our business to long-term guaranteed contracts, and we'll continue to gain momentum in doing this.

Eric T. Kalamaras:

Stephen, good morning. This is Eric Kalamaras. I think the only thing that I would add is as we think about fourth quarter relative to the—what we've seen in 2019, our structural contracts have not changed, right, so there's no real change there in what we've seen historically and what we're seeing now in Q4, and frankly, into 2020, for that matter. A substantial portion of that revenue, as you mentioned, is fully contracted, and I wouldn't quarrel with your number. It's directionally correct, but look, I mean nothing structurally has really changed here. I think, as Brad mentioned, the variable portion of the business has been impacted, and that's really what's driving the spread in the outlook.

Stephen Gengaro:

Okay. Thank you, and then when you think about 2020, you mentioned it just now, and you think about the comments you've made over the last several quarters that 85% of revenue is contracted, I'm assuming that 85% was based off of 2019 guidance number, is that—because what I'm getting at is when I think about that, it's—it would seem to suggest that there's $280 million to $300 million of revenue contracted available for 2020, and I'm just trying to get a sense on is that a reasonable number? Is that too high? Is that too low?

Eric T. Kalamaras:

Sorry, no, thank you for the question, so I would say this, so we're not ready to give a certain, nor detailed, 2020 outlook at this time. Look, here's what I can say, right, so what—I guess what I would say is we see these short-term activity levels that have come down. We are seeing some impact on the variable portion of the business. I do expect some of these commercial opportunities to re-emerge through 2020. I don't want to specifically opine on what the contracted portion of the business looks like until we get through our business planning cycle through the back half of—the back part of this year, so allow us to come back with a more fulsome update on that, and I would just leave it at that for now.

Stephen Gengaro:

Okay, but is it—was I right in saying that when you talk about 85% being contracted, that that was relative to your 2019 revenue guidance?

Eric T. Kalamaras:

That is correct. The one thing I would add I think that would help, as you think about 2020 and in the meantime is, we have no significant roll-offs contractually coming through into 2020, so I think as you think about that, look, I mean the outlook that was previously provided certainly was predicated upon the prior 86% number, so you're directionally right on that.

Stephen Gengaro:

Okay, great. Thank you.

Operator:

Our next question comes from the line of Scott Schneeberger with Oppenheimer. Please proceed with your question.

Daniel:

Good morning, guys. It's Daniel on for Scott. Honing on utilization a little bit, you noted in the release that the year-over-year decrease was due to a higher number of new bed additions in the third quarter that are not being contracted by quarter end. How have you progressed in the fourth quarter '19 with contracting those beds, and how will your utilization be impacted by the 200 additional beds at the new communities?

Troy Schrenk:

Hey, Daniel. Good morning. It's Troy. I appreciate the question. Look, as we look forward and think about the fourth quarter, we do expect utilization to be soft as it was in the third quarter, and again, largely that's attributable to the variable portion of the business, which is the un-contracted portion. Look, I'm pleased with some of the progress that we've made, but candidly, as Eric and Brad have both mentioned, and we mentioned in our remarks, is that we have had several commercial opportunities that have been deferred in 2019. Now, that work hasn't gone away. We have direct line of sight on that work, and we have reasonable confidence in there in 2020 that we can capture that work by virtue of our exclusive contracts as Brad mentioned, right. We're set up very well to really capture that work on its return when budgets reset first half of the year. Is that helpful?

Daniel:

Got it. No, perfect. Thank you. Switching gears to ADR a little bit, you noted that, excluding the Signor communities, ADR has been pretty stable at remaining communities on a year-over-year basis. Could you provide us a perspective on ADR in the fourth quarter here, both excluding Signor and including Signor, how we should think about it both quarter-over-quarter and a year-over-year basis?

Eric T. Kalamaras:

Sure, I'll make a comment, and I'd like Troy to jump in as well. I think as you think about ADR moving, or if you do see—we do see modification in mix as we head into Q4, right, so I think you may actually see some positive trends there heading into heading into Q4, and perhaps into part of 2020, so I think it's going to be really a mix issue, more than—really more than anything else.

Troy Schrenk:

Yes, so Daniel, I think the only thing that I would add—I mean again, just to reiterate, as we've said, the core is intact and this portion of the business is not impacted by the spot or the transient, including ADR. Look, I think it's important to recognize that we're carefully balancing price, terms, utilization to maximize profitability, so when you think about the un-contacted portion, we're focused on balancing those prices—that pricing, that ADR, and the terms and utilization again for max profitability, but that core is intact from an ADR perspective.

Brad Archer:

Daniel, this is Brad. Just one addition there and just to call it back out, when you look at Q3 versus Q2, our top 30 customers spent more with us in Q3 than they did in Q2, so when we continue to say our core is intact, that's part of it, right, and then you take it down further to—we're still 90% plus on our renewals, so those things hold up consistently, and that renewal is even in the variable part of our business, so the business part of that we feel good about it fundamentally continuing on not just in the fourth quarter, but as we roll into 2020.

Daniel:

Got it. Thank you very much.

Operator:

Our next question comes from the line of Jeff Grampp with Northland Capital Markets. Please proceed with your question.

Jeff Grampp:

Good morning, guys. I was curious, Brad, you talked about in your prepared remarks evaluating maybe some new end markets for the Company. I was hoping maybe dig into that a bit more. Can you kind of touch on maybe from a high-level characteristics of the market that you guys might be looking at and how you kind of see Target fitting into kind of the ecosystem, if you will, of whatever markets and, understanding, maybe you don't want to get too specific here, but just trying to get a little bit more, I guess, details on how you guys are seeing that opportunity?

Brad Archer:

Sure, and I'll hit this on a kind of a larger scale too, yes starting with, look, we're going to continue to invest in the Permian. We continue to look at organic and inorganic, where there's good returns and visibility. We invested there because we believe it's a long-term play, and that hasn't changed, so that part of our—the way we look at the business has not changed at all. We'll continue to be disciplined in how we deploy the capital, as we have for many, many years.

On the diversification piece, we're in the early stages of this. I would tell you, the great thing is, with our cash flows, which I don't think can be overstated, gives us the ability to be opportunistic as we look at adjacent markets and industries to add diversification, so we've started that process. I'm not going to tell you the playbook, because, to be honest, we're not too far down that road, but it is something that we look at internally and we'll keep pushing forward.

The last part of that is—we'll always put our capital to work in the areas that deliver the best returns for Shareholders, so when I tell you we'll continue to invest in the Permian, there're other things out there that we are looking at, such as diversification.

Jeff Grampp:

Got it, got it. I appreciate that, and my follow-up, trying to frame, I guess 2020, understanding you guys are still in the early process and don't want to get too specific, but on the capital side, excluding any potential acquisitions or new build communities, is there any other cap ex we should be thinking about outside of maintenance cap ex, whether that's maybe upgrades at acquired facilities or things like that?

Eric T. Kalamaras:

Good morning. This is Eric. It's a great question. We really have—we're very fortunate to have really flexible capital plan at this point, and so, I would say heading—as we head into 2020, we're still trying to shore up what that looks like, but really, we have pretty, pretty minimal capital needs. The caveat there would be again, we have some deferred commercial opportunities, right, so that would be the one hole that we would look to fill, but right now it's pretty flexible.

Brad Archer:

Then I would just add for Eric there, remember, our playbook's still the same. If we don't have a contract that supports that returns, we're not going to go out and invest in a new facility or a new build or an add-on, so as they come, we'll take a look at them. That's the organic piece of the business, and even the same thing with the inorganic. It's a buy versus build scenario, as we look at that. We're not going to get the returns, even though we have the cash to go and prosecute this, then we're not going to do it, so we're going to be very disciplined in that approach.

Eric T. Kalamaras:

Yes, I think the other thing that I would add is partially off of Brad's comment is we generate a lot of cash in this business, and so to the extent that we have minimal capital spending heading into 2020, there's a lot of discretionary cash flow that's available to us, and so that's a pretty—look, that's a pretty enviable position to be in for us as we look to move the business forward and to grow it.

Jeff Grampp:

Understood, I appreciate the time, guys.

Brad Archer:

Thank you.

Operator:

Our next question comes from the line of Kevin McVeigh with Credit Suisse. Please proceed with your question.

Kevin D. McVeigh:

Thank you. Hey, can you just give a sense of how much ProPetro and Superior Lodging contributed to Q3, and what the impact is on the full-year 2019 guidance?

Brad Archer:

Sure, hi Kevin. Good morning, I don't want to give specific numbers on that. Suffice to say that there wasn't—there was a contribution there, mid—kind of mid-single digits or so in terms of EBITDA, but I don't want to give specific numbers if that's okay.

Kevin D. McVeigh:

Yes, no, that's fine, and then, I guess the other thing, it looks like the midpoint of the range kind of implies, Brad, to your point, kind of a 17% decline in revenue, but Q3 seasonally stronger. It didn't happen this time. Just as you think about—again, I know you're not giving 2020 guidance, but is that base $280 million to $300 million, is that a reasonable—like is that the worst downside scenario as we think about, at least a bottom-up from a modeling perspective?

Brad Archer:

Again, I'm not sure we're ready to give that number. Here's what I'd say high-level, right, and that is what I wouldn't do is take the fourth quarter '19 as a barometer for predicting our future business. We feel good about the business. We have a lot of long-term contracts. We believe this fourth quarter is a short-term scenario. We have talked to—we've doubled down talking to our customers and making sure we understand where they're at next year, what they believe their customer’s doing, no significant roll-offs in 2020, but I think—we think we have a lot of protection on that side of our business, and when you look back at history, it’s supportive, so I'm not going to give you a number, but I would tell you that, again, fourth quarter '19 is not the barometer to be looking at for '20.

Eric T. Kalamaras:

Yes, and I think Kevin, the other thing that you're seeing in the outlook as well, is recall that this year alone, right, we've had a decent amount of TransCanada, kind of what I call base revenue coming through from some of the pre-work activities while we're waiting for the larger contract, which was, certainly additive to growth beyond the outlook. During the second half, we won't see much in a way of that at all right, so that also impacts Q4. That's also embedded in the outlook as well.

Kevin D. McVeigh:

Got it, and then Eric, if it's too specific, I get it, but from the TCPL, any sense of where you thought that was going to be versus where it came in?

Eric T. Kalamaras:

I would say—look, I don't want to give specific numbers on that. I would just say—just look, generally, I would say for Q3, it was probably about half what we thought it might be. I would say for Q4, just to put an order of magnitude on it, it's probably looking to be about a third light, if not more.

Kevin D. McVeigh:

Great. Thank you.

Operator:

Our next question comes from the line of Ashish Sabadra with Deutsche Bank. Please proceed with your question.

Ashish Sabadra:

Thanks for taking my question, so the outlook was reiterated in—on the last call which was in mid-August, so I just wondering how quickly did the environment change? Can you just talk about the trends in the quarter and how you exited the quarter? Thanks.

Brad Archer:

I'm sorry. Can you repeat your question? We were breaking up here.

Ashish Sabadra:

Sorry about that. Yes, I was just—my question was just the guidance was reiterated on the last quarter, and that it excluded expansion and the acquisition, and so my question was how quickly did the environment change? Can you just talk about the trends in the quarter, and how did you—like when you entered the quarter versus exiting the quarter?

Brad Archer:

Yes, high level. Again, I point you back to definitely the core business remained intact. We were good at kind of putting our finger in that. The variability part of our business, that variable portion, definitely that was the change that we seen starting sometime in Q3 going what we believe is a deeper down which we've changed the range for Q4. That was the biggest portion of that, as well as the deferred commercial opportunities that have moved to the right. Look, these were fairly sizable on that, and we think those don't go away. They're moved to the right, and then TCPL was a portion of that as well, so those three things really made up the—what we're telling you today for the fourth quarter.

Troy Schrenk:

Yes, and the biggest pace—the only thing I'd add is the biggest portion of that was really the deferral of opportunities that really started kind of picking up in back half of Q3, and so we really haven't started seeing that until really just a month or so ago.

Ashish Sabadra:

That's helpful, and just given where the stock price is, how do you think about the use of capital for growth versus just buyback? You have a lot of authorization still remaining—buyback authorization still remaining, so just as we think about use of capital going forward?

Eric T. Kalamaras:

Sure. This is Eric, so I made a couple of comments on cash flow and capital combined. They do go hand in hand, so we generated about $43 million in cash flow from ops ex interest expense, so gives us a lot of flexibility, and when we think about that and then we look at that relative to our return of capital opportunities, we like the idea of being opportunistic. We're going to continue to invest in this business for growth, and so I can't comment on certainly specific plans for any capital market activity, buyback included, but look, we're going to execute all options that are in concert with our bigger strategic plans, and so to the extent buybacks are part of that, great, but I think at the end of the day, we're a growth Company, and we're going to facilitate growth for the best long run use of capital and shareholder returns.

Ashish Sabadra:

That's helpful. Thanks, and maybe one final question on the gross margins or gross profits in the Permian. Those moderated a bit from second to third quarter. How should we think about that trajectory going forward? Thanks.

Eric T. Kalamaras:

Sure, no problem. So, look, I think as we move forward, we clearly expressed that there's a—there is a little more challenge in the variable part of the market. However, some of that is offset by some higher ADR mix, as we've talked about, so, look, I think you see a little bit of degradation on the margin on the Permian. I wouldn't—I don't think it's—I wouldn't call it substantial though.

Ashish Sabadra:

Okay. Thanks.

Operator:

Our next question is a follow-up question from Stephen Gengaro with Stifel. Please proceed with your question.

Stephen Gengaro:

Thanks. A couple of things actually, but just following up on the prior question on cash flow flexibility, in the oil service world, companies with debt or a lot of debt—and you don't have a lot of debt from a leverage perspective, but like from a debt cap perspective, people see it as having a lot of debt, there's a desire to see a reduction in leverage over buying back stock, and I understand how you feel about your valuation and your free cash flow visibility, but have you thought about those—that as another option as far as de-levering and kind of getting this debt to equity conversion if the multiple remains the same. I mean just how do you think about that relative to just buying back stock?

Eric T. Kalamaras:

Yes, sure. Look, it's a great question. There's always a balance there, right? It really comes down, Stephen, to strategic intentions as to how you want to execute and prosecute growth of your business going forward, right, so what's more advantageous to you? I think what you're hearing us say is, look, we're—we are investing in our assets for the long run here. We do have $70 million in pre-payable debt, and if you just think about the cash we generated this quarter, look, you could theoretically pay down all your revolver in a couple quarters, so we look at our leverage at roughly 2.5 times or less and think about where that portends in the future, and frankly, we feel pretty good about it, so look, I think we want to maintain flexibility

there, but we'll just play it by ear, but I would just tell you that we're pretty pleased with where we are from balance sheet perspective, albeit I'd love to have more flexible, you know, more flexible capital structure through time, and we'll always look at ways to maximize that.

Stephen Gengaro:

Okay, thank you, and you mentioned Brad, I think you mentioned twice your top 30 customers. Are you willing to tell us what percentage of the revenue they account for?

Brad Archer:

No. so we're not—I won't do that, but I appreciate the question.

Stephen Gengaro:

I didn't think you would, but I figured I'd ask.

Brad Archer:

You had to ask it, right?

Stephen Gengaro:

Okay, and then just as a final one from me, when you think about your mix—and I'm not sure if you can add a little color here, but when you look at the mix of revenue from the oil service companies versus revenue from the E&P providers, I think some of the oil service companies are larger customers and clearly in oil service world, and we see all of U.S. pressure pumping companies, etc., seeing a pretty sharp drop-off in the fourth quarter with an expected recovery in 1Q, but can you give us a sense for the relative importance from a revenue perspective of the service companies versus the E&Ps?

Troy Schrenk:

Yes, Stephen, this is Troy. Good morning, by the way. Look, good question, and look, the way to think about this, and I think it is the two new facilities, greenfield that we announced and built this year in the Permian Basin, both of which were integrated producers in the Permian Basin. Clearly, I think that's a good example of us really migrating the business and leaning into the E&P that are there for the long term, look at the Permian as a long-term investment. And so, look, our business has matched that, right, so make no mistake, oilfield service sector is an important part of the business on the upstream side, and will continue to be, but as we think about the Permian on a long-term basis, we have made a concerted effort strategically to lean into the integrated producers and other E&P companies that have strong balance sheets, strong free cash flow, and a great operating base with great acreage in the Permian. I think we've had — I think we've demonstrated great success thus far, and we've got a pipeline that remains intact for further organic growth with those producers.

Brad Archer:

Look, I'll add just one statement to that. It's doing business with the right people in the right places. We continue to say that, and I think it's proven true today and will prove true in 2020. When you look just at the Permian Basin, it's a fairly bifurcated market today. We have lodges that we are totally sold out of; you can't put another person in, and then there's a few areas that are softer, which is where we're seeing some of this variability, but when you look at some of the large integrated producers, as Troy said, where we're leaning into, those guys are continuing to spend, continuing to add rigs, and then some of the others are becoming more disciplined in their approach until they get some of their financial orders in place, but overall,

that business is very healthy for us out there, so again, right—doing business with the right people in the right places continues to pay-off for us.

Stephen Gengaro:

Thank you, and just one final, quick one. I think you alluded to this earlier that the sort of other segment without the—without visibility on the pipeline work, I mean is that going to kind of be a million dollar per quarter revenue run rate type business until we hear more about pipeline work? Is that reasonable?

Eric T. Kalamaras:

Yes. Look, I would say, probably for Q4, it's maybe a little more than that. Going out it's probably—your number is probably about right.

Stephen Gengaro:

Okay, great. Thank you, gentlemen.

Brad Archer:

Thank you.

Operator:

Thank you. We have reached the end of the question-and-answer session. Mr. Archer, I would now like to turn the floor back over to you for closing comments.

Brad Archer:

Sure, thanks. I would like to thank you for joining the call today. We appreciate your continued interest in Target Hospitality, and look forward to speaking to you next quarter. Thank you.

Operator:

Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.