USA Compression Partners, LP
Form 10-Q
November 07, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED September 30, 2014

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO .

Commission File No. 001-35779

USA Compression Partners, LP

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware<br>(State or Other Jurisdiction of Incorporation or Organization) | 75-2771546<br>(I.R.S. Employer Identification No.) |
| 100 Congress Avenue, Suite 450<br>Austin, Texas<br>(Address of principal executive offices) | 78701<br>(Zip Code) |

(512) 473-2662

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

| | |
|---|---|
| Large accelerated filer | Accelerated filer |
| Non-accelerated filer | Smaller reporting company |
| (Do not check if a smaller reporting company) | |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of November 6, 2014, there were 30,716,424, common units and 14,048,588 subordinated units outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1.Financial Statements

USA COMPRESSION PARTNERS, LP AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(in thousands, except for unit amounts)

(unaudited)

| | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 7 | $ 7 |
| Accounts receivable: | | |
| Trade | 23,800 | 20,079 |
| Other | 2,779 | 350 |
| Inventory | 8,749 | 9,940 |
| Prepaid expenses | 1,387 | 2,400 |
| Total current assets | 36,722 | 32,776 |
| Property and equipment, net | 1,075,939 | 852,966 |
| Installment receivable | 20,948 | — |
| Identifiable intangible assets | 83,253 | 85,941 |
| Goodwill | 208,055 | 208,055 |
| Other assets | 5,395 | 6,146 |
| Total assets | $ 1,430,312 | $ 1,185,884 |
| Liabilities and Partners’ Capital | | |
| Current liabilities: | | |
| Accounts payable | $ 29,985 | $ 34,629 |
| Accrued liabilities | 35,560 | 10,412 |
| Deferred revenue | 14,306 | 11,912 |
| Total current liabilities | 79,851 | 56,953 |
| Long-term debt | 509,681 | 420,933 |
| Other liabilities | — | 271 |
| Partners’ capital: | | |
| Limited partner interest: | | |

| | | |
|---|---|---|
| Common units, 30,711,733 and 23,561,780 units issued and outstanding, respectively | 596,883 | 447,562 |
| Subordinated units, 14,048,588 issued and outstanding each period | 229,787 | 245,592 |
| General partner interest | 14,110 | 14,573 |
| Total partners’ capital | 840,780 | 707,727 |
| Total liabilities and partners’ capital | $ 1,430,312 | $ 1,185,884 |

See accompanying notes to unaudited condensed consolidated financial statements.

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USA COMPRESSION PARTNERS, LP AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

(in thousands, except unit amounts)

(unaudited)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Revenues: | | | | |
| Contract operations | $ 55,293 | $ 37,925 | $ 157,317 | $ 102,964 |
| Parts and service | 1,752 | 437 | 3,198 | 1,311 |
| Total revenues | 57,045 | 38,362 | 160,515 | 104,275 |
| Costs and expenses: | | | | |
| Cost of operations, exclusive of depreciation and amortization | 19,430 | 11,922 | 55,145 | 32,473 |
| Selling, general and administrative | 10,443 | 8,313 | 29,098 | 18,756 |
| Depreciation and amortization | 18,261 | 13,377 | 51,525 | 37,227 |
| Loss (gain) on sale of assets | 63 | (52) | (2,228) | 53 |
| Impairment of compression equipment | 1,163 | — | 1,163 | — |
| Total costs and expenses | 49,360 | 33,560 | 134,703 | 88,509 |
| Operating income | 7,685 | 4,802 | 25,812 | 15,766 |
| Other income (expense): | | | | |
| Interest expense | (2,677) | (3,029) | (9,269) | (8,963) |
| Other | 5 | 2 | 6 | 7 |
| Total other expense | (2,672) | (3,027) | (9,263) | (8,956) |
| Net income before income tax expense | 5,013 | 1,775 | 16,549 | 6,810 |
| Income tax expense | — | 63 | 103 | 176 |
| Net income | $ 5,013 | $ 1,712 | $ 16,446 | $ 6,634 |
| Less: | | | | |
| Earnings allocated to general partner prior to initial public offering on January 18, 2013 | $ — | $ — | $ — | $ 5 |
| Earnings available for limited partners prior to initial public offering on January 18, 2013 | $ — | $ — | $ — | $ 530 |
| Net income subsequent to initial public offering on January 18, 2013 | $ 5,013 | $ 1,712 | $ 16,446 | $ 6,099 |
| Net income subsequent to initial public offering allocated to: | | | | |
| General partner’s interest in net income | $ 194 | $ 34 | $ 467 | $ 122 |
| Limited partners’ interest in net income: | | | | |
| Common units | $ 3,338 | $ 941 | $ 11,133 | $ 3,196 |
| Subordinated units | $ 1,481 | $ 737 | $ 4,846 | $ 2,781 |

| | | | | |
|---|---|---|---|---|
| Weighted average common units outstanding: | | | | |
| Basic | 30,460,239 | 17,947,198 | 27,197,912 | 16,142,989 |
| Diluted | 30,517,689 | 17,988,650 | 27,263,124 | 16,173,877 |
| Weighted average subordinated units outstanding: | | | | |
| Basic and diluted | 14,048,588 | 14,048,588 | 14,048,588 | 14,048,588 |
| Net income per common unit: | | | | |
| Basic | $ 0.11 | $ 0.05 | $ 0.41 | $ 0.20 |
| Diluted | $ 0.11 | $ 0.05 | $ 0.41 | $ 0.20 |
| Net income per subordinated unit: | | | | |
| Basic and diluted | $ 0.11 | $ 0.05 | $ 0.34 | $ 0.20 |
| Distributions paid per limited partner unit in respective periods | $ 0.50 | $ 0.44 | $ 1.47 | $ 0.79 |

See accompanying notes to unaudited condensed consolidated financial statements.

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USA COMPRESSION PARTNERS, LP AND SUBSIDIARIES

Condensed Consolidated Statement of Changes in Partners' Capital

Nine Months Ended September 30, 2014

(in thousands)

(unaudited)

| | Partners' Capital Common Units | | Subordinated Units | | General Partner | Total Partners' Capital |
|---|---|---|---|---|---|---|
| | Units | Amount | Units | Amount | Amount | |
| Partners' capital, December 31, 2013 | 23,562 | $ 447,562 | 14,049 | $ 245,592 | $ 14,573 | $ 707,727 |
| Vesting of phantom units | 68 | 1,591 | — | — | — | 1,591 |
| General partner contribution | — | — | — | — | 294 | 294 |
| Cash distributions and DERs | — | (38,337) | — | (20,651) | (1,224) | (60,212) |
| Proceeds from issuance of common units | 7,082 | 175,827 | — | — | — | 175,827 |
| Unit-based compensation | — | 277 | — | — | — | 277 |
| Modification of unit-based compensation | — | (1,170) | — | — | — | (1,170) |
| Net income | — | 11,133 | — | 4,846 | 467 | 16,446 |
| Partners' capital, September 30, 2014 | 30,712 | $ 596,883 | 14,049 | $ 229,787 | $ 14,110 | $ 840,780 |

See accompanying notes to unaudited condensed consolidated financial statements.

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USA COMPRESSION PARTNERS, LP AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

| | Nine months ended September 30, 2014 | 2013 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 16,446 | $ 6,634 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 51,525 | 37,227 |
| Amortization of debt issue costs, discount | 917 | 1,396 |
| Unit-based compensation expense | 2,956 | 905 |
| Net (gain) loss on sale of assets | (2,228) | 53 |
| Impairment of compression equipment | 1,163 | — |
| Changes in assets and liabilities: | | |
| Accounts receivable and advances to employees | (1,861) | (5,468) |
| Inventory | 1,191 | (3,133) |
| Prepaids | 1,013 | 216 |
| Other noncurrent assets | (76) | 3,838 |
| Accounts payable | (6,986) | (11,564) |
| Accrued liabilities and deferred revenue | 6,541 | 11,574 |
| Net cash provided by operating activities | 70,601 | 41,678 |
| Cash flows from investing activities: | | |
| Capital expenditures | (275,229) | (108,906) |
| Proceeds from sale of property and equipment | 621 | 123 |
| Acquisitions, net of cash | — | 3,667 |
| Net cash used in investing activities | (274,608) | (105,116) |
| Cash flows from financing activities: | | |
| Proceeds from long-term debt | 390,088 | 177,888 |
| Payments on long-term debt | (301,340) | (289,848) |
| Net proceeds from issuance of common units | 137,285 | 180,555 |
| Cash distributions | (22,228) | (9,129) |
| General partner contribution | 294 | 4,009 |
| Financing costs | (92) | (37) |
| Net cash provided by financing activities | 204,007 | 63,438 |
| Increase in cash and cash equivalents | — | — |
| Cash and cash equivalents, beginning of period | 7 | 7 |
| Cash and cash equivalents, end of period | $ 7 | $ 7 |

| | | |
|---|---|---|
| Supplemental cash flow information: | | |
| Cash paid for interest | $ 9,324 | $ 7,982 |
| Cash paid for taxes | $ 115 | $ 196 |

See accompanying notes to unaudited condensed consolidated financial statements.

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USA COMPRESSION PARTNERS, LP AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Organization and Summary of Significant Accounting Policies

(a) Organization

USA Compression Partners, LP (the "Partnership") is a publicly traded Delaware limited partnership formed to own and operate the business conducted by its subsidiaries. The common units representing limited partner interests in the Partnership ("common units") are listed on the New York Stock Exchange ("NYSE") under the symbol "USAC." USA Compression GP, LLC, the general partner of the Partnership (the "General Partner"), is owned by USA Compression Holdings, LLC ("USA Compression Holdings"). Unless the context requires otherwise, references to "we," "us," "our," or "the Partnership" are intended to mean the business and operations of the Partnership and its consolidated subsidiaries and references to the "General Partner" refer to the General Partner. References to "Riverstone" refer to Riverstone/Carlyle Global Energy and Power Fund IV, L.P., and affiliated entities, including Riverstone Holdings LLC.

The Partnership, through its wholly- owned subsidiaries (the "Operating Subsidiaries"), primarily provides natural gas compression services under term contracts with customers in the oil and gas industry, using natural gas compressor packages that it designs, engineers, owns, operates and maintains. The condensed consolidated financial statements include the accounts of the Partnership and the Operating Subsidiaries and all intercompany balances and transactions have been eliminated in consolidation.

Our ownership is as follows:

| | September 30, 2014 | | | |
|---|---|---|---|---|
| | USA Compression Holdings | Argonaut and Related Parties | Public | Total |
| General partner interest | 1.7 % | — | — | 1.7 % |
| Limited partner interest: | | | | |
| Common unitholders | 10.1 % | 16.2 % | 41.2 % | 67.5 % |
| Subordinated unitholders | 30.8 % | — | — | 30.8 % |
| Total | 42.6 % | 16.2 % | 41.2 % | 100.0 % |

Partnership net income (loss) is allocated to the partners in proportion to their respective interest in the Partnership.

(b) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of the Partnership have been prepared on the same basis as the audited consolidated financial statements included in the Partnership's annual report on Form 10-K for the year ended December 31, 2013 ("2013 Annual Report"). In the opinion of the Partnership's management, such financial information reflects all adjustments necessary for a fair presentation of the financial position as of September 30, 2014 and December 31, 2013, and the results of operations for the three months and nine months ended September 30, 2014 and 2013 and changes in partners' capital and changes in cash flows for nine months ended September 30, 2014 , respectively, in accordance with accounting principles generally accepted in the United States ("GAAP"). Operating results for the three months and nine months ended September 30, 2014 and 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. All intercompany balances and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Therefore, these consolidated financial statements should be read in conjunction with the Partnership's audited consolidated financial statements for the year ended December 31, 2013 contained in our 2013 Annual Report filed on February 20, 2014. As the closing of the Partnership's initial public offering ("IPO") occurred on January 18, 2013, the earnings and earnings per unit for the nine months ended September 30, 2013 have been pro-rated to reflect earnings on a pre-IPO and post-IPO basis.

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(c) Use of Estimates

The unaudited condensed consolidated financial statements have been prepared in conformity with GAAP, which includes the use of estimates and assumptions by management that affect the reported amounts of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities that exist at the date of the unaudited condensed consolidated financial statements. Although these estimates are based on management’s available knowledge of current and expected future events, actual results could be different from those estimates.

(d) Intangible Assets

As of September 30, 2014, identifiable intangible assets, net consisted of the following (in thousands):

| | Customer Relationships | Trade Names | Non-compete | Total |
|---|---|---|---|---|
| Outstanding at December 31, 2013 | $ 71,388 | $ 13,728 | $ 825 | $ 85,941 |
| Amortization | (2,051) | (468) | (169) | (2,688) |
| Outstanding and exercisable at September 30, 2014 | $ 69,337 | $ 13,260 | $ 656 | $ 83,253 |

Intangible assets are amortized on a straight line basis over their estimated useful lives, which is the period over which the assets are expected to contribute directly or indirectly to the Partnership’s future cash flows. As of September 30, 2014, the amortization periods of identifiable customer relationships and identifiable trade names vary between 20 and 30 years and the amortization period of identifiable non-compete is 4 years.

The Partnership assesses intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Partnership did not record any impairment of intangible assets for the three and nine months ended September 30, 2014 or for the three and nine months ended September 30, 2013.

(e) Property and Equipment

Property and equipment are carried at cost. Overhauls and major improvements that increase the value or extend the life of compressor equipment are capitalized and depreciated over 3 to 5 years. Ordinary maintenance and repairs are charged to income. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets as follows:

| | |
|---|---|
| Compression equipment | 25 years |
| Furniture and fixtures | 7 years |
| Vehicles and computer equipment | 3 - 7 years |
| Leasehold improvements | 5 years |

See more information on property and equipment in Note 4 to our unaudited condensed consolidated financial statements.

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(f) Impairments of Long-Lived Assets

Long-lived assets with recorded values that are not expected to be recovered through future cash flows are written-down to estimated fair value. An asset shall be tested for impairment when events or circumstances indicate that its carrying value may not be recoverable. The carrying value of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. If the carrying value exceeds the sum of the undiscounted cash flows, an impairment loss equal to the amount of the carrying value exceeding the fair value of the asset is recognized. The fair value of the asset is measured using quoted market prices or, in the absence of quoted market prices, is based on an estimate of discounted cash flows.  See Note 4 for discussion of the impairment of compression equipment recorded in the three and nine months ended September 30, 2014.

(g) Fair Value of Financial Instruments

Accounting standards on fair value measurement establish a framework for measuring fair value and stipulate disclosures about fair value measurements. The standards apply to recurring and nonrecurring financial and non-financial assets and liabilities that require or permit fair value measurements. Among the required disclosures is the fair value hierarchy of inputs the Partnership uses to value an asset or a liability. The three levels of the fair value hierarchy are described as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Partnership has the ability to access at the measurement date.

Level 2 inputs are those other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for the asset or liability.

The Partnership’s financial instruments consist primarily of cash and cash equivalents, trade accounts receivable, trade accounts payable and senior debt. The book values of cash and cash equivalents, trade accounts receivable and trade accounts payable are representative of fair value due to their short -term maturity. The carrying amounts of senior debt approximate fair value due to the variable interest rates charged on the outstanding senior debt.

Awards granted to employees under the 2013 Long Term Incentive Plan (the "LTIP") are accounted for as liabilities and the liability is re-measured on a quarterly basis. The liability is based on the publicly quoted price of the Partnership's common units, which is considered a Level 1 input.

(2) Acquisitions

On August 30, 2013, the Partnership completed the acquisition of assets and certain liabilities related to the business of providing compression services to third parties engaged in the exploration, production, gathering, processing, transportation or distribution of oil and gas (the "S&R Acquisition") in exchange for 7,425,261 common units, which were valued at $181.9 million at the time of issuance. The S&R Acquisition was consummated pursuant to the Contribution Agreement dated August 12, 2013 (the "Contribution Agreement") with S&R Compression, LLC, ("S&R") and Argonaut Private Equity, L.L.C. ("Argonaut"). The S&R Acquisition had an effective date (from a standpoint of revenues and selected costs) of June 30, 2013. In connection with the S&R Acquisition, Argonaut and certain related parties agreed to participate in the Partnership's Distribution Reinvestment Plan (the "DRIP") through the distribution relating to the quarter ended June 30, 2014 (subsequently extended through the first quarter of 2015), provided that USA Compression Holdings continues to participate in the DRIP through that same period. The effective purchase price of $178.5 million reflects customary effective-date adjustments such as a $3.4 million purchase price adjustment due to working capital changes from the effective date to the closing date.

There were no adjustments during the nine months ended September 30, 2014 to the S&R Acquisition purchase accounting disclosed in the Partnership's 2013 Annual Report. Expenses associated with acquisition activities and transaction activities related to the S&R Acquisition for the nine months ended September 30, 2014 and the year ended December 31, 2013 were $0.05 million and $2.1 million, respectively, and are included in selling, general and administrative expenses ("SG&A").

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Revenue, Net Income and Pro Forma Financial Information — Unaudited

The assets acquired in the S&R Acquisition were not included in the Partnership's consolidated results until the closing date of August 30, 2013. The unaudited pro forma financial information was prepared assuming the S&R Acquisition occurred on January 1, 2013. The financial information was derived from the Partnership's unaudited historical condensed consolidated financial statements for the three and nine months ended September 30, 2013 and S&R's unaudited interim financial statements for the three and nine months ended September 30, 2013.

The pro forma adjustments were based on currently available information and certain estimates and assumptions by management. If the S&R Acquisition had been in effect on the dates or for the periods indicated, the results may have been substantially different. For example, we may have operated the assets differently than S&R, realized revenue may have been different and costs of operation of the acquired assets may have been different. This pro forma financial information is provided for illustrative purposes only and may not provide an indication of results in the future. The following table presents a summary of our pro forma financial information (in thousands, except unit amounts):

| | Three months ended September 30, 2013 | Nine months ended September 30, 2013(1) |
|---|---|---|
| Total revenues | $ 44,934 | $ 127,547 |
| Net income | $ 3,822 | $ 13,269 |
| Basic and diluted net income per common unit: | $ 0.10 | $ 0.34 |
| Basic and diluted net income per subordinated unit: | $ 0.10 | $ 0.34 |

(1) The Partnership did not complete its initial public offering until January 18, 2013.

In preparing the pro forma financial information, certain information was derived from financial records and certain information was estimated. The sources of information and significant assumptions are described below:

(a) Revenues and direct operating expenses for S&R were derived from the historical financial records of S&R. Incremental revenue related to the S&R Acquisition was $6.6 million and $23.3 million for the three and nine months ended September 30, 2013, respectively. Incremental operating costs related to the S&R Acquisition were $2.9 million and $10.3 million for the three and nine months ended September 30, 2013, respectively.

(b) Depreciation and amortization was estimated using the straight-line method and reflects the incremental depreciation and amortization expense incurred due to adding the compression assets and intangible assets at fair value. Incremental depreciation and amortization was estimated at $1.6 million and $6.4 million for the three and nine months ended September 30, 2013, respectively.

(c) The S&R Acquisition was financed solely with common units issued as consideration for the acquired assets and liabilities.

(d) The capital contribution made by the General Partner to maintain its 2% general partner interest in the Partnership in connection with the issuance of common units in the S&R Acquisition was used to pay down the Partnership's revolving credit facility resulting in a reduction of interest expense. Incremental interest expense reduction was estimated at $0.05 million and $0.1 million for the three and nine months ended September 30, 2013.

(3) Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts of $0.6 million and $0.2 million at September 30, 2014 and December 31, 2013, respectively, is the Partnership's best estimate of the amount of probable credit losses in the Partnership's existing accounts receivable. The Partnership determines the allowance based upon historical write-off experience and the specific circumstances. The Partnership does not have any off-balance-sheet credit exposure related to its customers.

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(4) Property and Equipment

Property and equipment consisted of the following at September 30, 2014 and December 31, 2013 (in thousands):

| | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Compression equipment | $ 1,209,011 | $ 950,823 |
| Furniture and fixtures | 543 | 706 |
| Automobiles and vehicles | 16,945 | 12,476 |
| Computer equipment | 11,010 | 5,636 |
| Leasehold improvements | 530 | 116 |
| Total | 1,238,039 | 969,757 |
| Less accumulated depreciation and amortization | (162,100) | (116,791) |
| Total | $ 1,075,939 | $ 852,966 |

We recognized $17.4 million and $12.6 million of depreciation expense on property and equipment for three months ended September 30, 2014 and 2013, respectively. We recognized $48.8 million and $34.9 million of depreciation expense on property and equipment for the nine months ended September 30, 2014 and 2013, respectively.

At September 30, 2014 and December 31, 2013, there were $37.0 million and $15.8 million, respectively, of property and equipment purchases in accounts payable and accrued liabilities.

During the quarter ended September 30, 2014, the Partnership determined that certain compression equipment was no longer going to be utilized in its operating fleet. This compression equipment was written down to its respective fair value, measured using quoted market prices or, in the absence of quoted market prices, based on an estimate of discounted cash flows. The Partnership recorded a $1.2 million impairment of compression equipment for the three and nine months ended September 30, 2014, and no such impairment for the three and nine months ended September 30, 2013.

(5) Installment Receivable

On June 30, 2014, the Partnership entered into a FMV Bargain Purchase Option Grant Agreement (the “Capital Lease Transaction”) with a customer, pursuant to which the Partnership granted a bargain purchase option to the customer with respect to certain compressor packages leased to the customer (each a "Subject Compressor Package"). The bargain purchase option provides the customer with an option to acquire the equipment at a value significantly less than the fair market value at the end of the lease term.

The Capital Lease Transaction was accounted for as a sales type lease and resulted in a current installment receivable of $2.7 million included in other accounts receivable and a long-term installment receivable of $20.9 million at September 30, 2014. Additionally, the Partnership recorded a $2.8 million gain on sale of assets related to the Capital Lease Transaction for the nine months ended September 30, 2014.

(6) Accrued Liabilities

Other current liabilities included accrued salaries and benefits expenses and accrued property taxes.  The Partnership recognized $6.1 million and $2.2 million of accrued salaries and benefits expenses as of September 30, 2014 and December 31, 2013, respectively.  The Partnership recognized $4.5 million and $3.2 million of accrued property taxes as of September 30, 2014 and December 31, 2013, respectively.

(7)  Long-Term Debt

The long-term debt of the Partnership, of which there is no current portion, consisted of the following at September 30, 2014 and December 31, 2013 (in thousands):

| | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Senior debt | $ 509,681 | $ 420,933 |

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Description of Revolving Credit Facility

On June 1, 2012, the Partnership entered into a third amendment to our credit agreement whereby the aggregate commitment under the revolving credit facility increased from $500 million to $600 million. In addition, on June 1, 2012, the Partnership entered into a Fourth Amended and Restated Credit Agreement in order to provide a covenant structure that was more appropriate for a public company than was the prior credit agreement, including a reduction of the applicable margin for LIBOR loans to a range of 175 to 250 basis points above LIBOR, depending on the Partnership's leverage ratio. This amended and restated credit agreement went effective on January 18, 2013, the closing date of the Partnership's initial public offering, was secured by a first priority lien against our assets and had a scheduled maturity of October 5, 2015. On December 10, 2012, the Partnership amended the Fourth Amended and Restated Credit Agreement to extend the periods during which the maximum funded debt to EBITDA ratio thresholds would apply.

On December 13, 2013, the Partnership entered into a Fifth Amended and Restated Credit Agreement whereby the aggregate commitment under the revolving credit facility increased from $600 million to $850 million (subject to availability under our borrowing base and a further potential increase of $100 million) and reduced the applicable margin for LIBOR loans to a range of 150 to 225 basis points above LIBOR, depending on the Partnership's leverage ratio. The revolving credit facility is secured by a first priority lien against the Partnership's assets and matures on December 13, 2018, at which point all amounts outstanding will become due.

The Fifth Amended and Restated Credit Agreement permits us to make distributions of Available Cash to unitholders so long as (a) no default under the facility has occurred, is continuing or would result from the distribution, (b) immediately prior to and after giving effect to such distribution, the Partnership is in compliance with the facility's financial covenants and (c) immediately after giving effect to such distribution, the Partnership has availability under the revolving credit facility of at least $20 million. In addition, the Fifth Amended and Restated Credit Agreement contains various covenants that may limit, among other things, the Partnership's ability to (subject to certain exceptions):

- grant liens;
- make certain loans or investments;
- incur additional indebtedness or guarantee other indebtedness;
- enter into transactions with affiliates;
- merge or consolidate;

· sell the Partnership's assets; or

· make certain acquisitions.

The Fifth Amended and Restated Credit Agreement also contains various financial covenants, including covenants requiring the Partnership to maintain:

· a minimum EBITDA to interest coverage ratio of 2.5 to 1.0; and

· a maximum funded debt to EBITDA ratio, determined as of the last day of each fiscal quarter, for the annualized trailing three months of (a) 5.50 to 1.0, with respect to any fiscal quarter ending on or after December 13, 2013, the closing date of the amended credit facility, through June 30, 2015 or (b) 5.00 to 1.0, with respect to the fiscal quarter ending September 30, 2015 and each fiscal quarter thereafter, in each case subject to a provision for increases to such thresholds by 0.5 in connection with certain future acquisitions for the six consecutive month period following the period in which any such acquisition occurs.

If a default exists under the revolving credit facility, the lenders will be able to accelerate the maturity on the amount then outstanding and exercise other rights and remedies.

On June 30, 2014, the Partnership entered into the Capital Lease Transaction pursuant to which the Partnership granted an irrevocable purchase option to a customer with respect to the Subject Compressor Packages.

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In connection with the execution of the Capital Lease Transaction, on June 30, 2014, the Partnership entered into a letter agreement regarding a limited consent, amendment and subordination with respect to the Fifth Amended and Restated Credit Agreement to (a) permit the Capital Lease Transaction, (b) permit the lien of the customer with respect to the Subject Compressor Packages, (c) subordinate the lien of JPMorgan Chase Bank, N.A., as the administrative agent, for the benefit of itself and the other lenders, to the lien and purchase option of the customer with respect to the Subject Compressor Packages, (d) authorize the release of the lien of the administrative agent, for the benefit of itself and the other lenders, upon the exercise by the customer of its purchase option with respect to a specific Subject Compressor Package and (e) amend certain other provisions as more specifically set forth therein.

At September 30, 2014 and December 31, 2013, the Partnership was in compliance with all of its covenants under the Fifth Amended and Restated Credit Agreement.

At September 30, 2014, subject to financial covenants, borrowing availability under the revolving credit facility was $288.4 million. The borrowing base consists of eligible accounts receivable, inventory and compression units. The largest component, representing 96% of the borrowing base at each of September 30, 2014 and December 31, 2013, was eligible compression units. Eligible compression units consist of compressor packages that are leased, rented or under service contracts to customers and carried in the financial statements as fixed assets.

In the event that any of the Operating Subsidiaries guarantees any series of the debt securities as described in the Partnership’s registration statement filed on Form S-3 (Reg. No. 333-193724), such guarantees will be full and unconditional and made on a joint and several basis for the benefit of each holder and the Trustee. However, such guarantees are subject to release, subject to certain limitations, as follows (i) upon the sale, exchange or transfer, whether by way of a merger or otherwise, to any Person that is not an Affiliate of the Partnership, of all the Partnership’s direct or indirect limited partnership or other equity interest in such Subsidiary Guarantor; or (ii) upon the Partnership’s or USA Compression Finance Corp.’s (together, the “Issuers”) delivery of a written notice to the Trustee of the release or discharge of all guarantees by such Subsidiary Guarantor of any Debt of the Issuers other than obligations arising under this Indenture and any Debt Securities issued hereunder, except a discharge or release by or as a result of payment under such guarantees (as such capitalized terms are defined in the Form of Indenture filed as exhibit 4.1 to such registration statement).

## (8) Partners’ Capital

At November 6, 2014, USA Compression Holdings held 4,600,086 common units and 14,048,588 subordinated units and controlled USA Compression GP, LLC, which held an approximate 1.7% general partner interest and the incentive distribution rights (“IDRs”). See the Unaudited Condensed Consolidated Statement of Changes in Partners’ Capital.

Subordinated Units

All of the subordinated units are held by USA Compression Holdings. The First Amended and Restated Agreement of Limited Partnership of the Partnership (the “Partnership Agreement”) provides that, during the subordination period, the common units have the right to receive distributions of Available Cash from Operating Surplus (each as defined in the Partnership Agreement) each quarter in an amount equal to $0.425 per common unit (the “Minimum Quarterly Distribution”), plus any arrearages in the payment of the Minimum Quarterly Distribution from Operating Surplus on the common units from prior quarters, before any distributions of Available Cash from Operating Surplus may be made on the subordinated units. These units are deemed “subordinated” because for a period of time, referred to as the subordination period, the subordinated units will not be entitled to receive any distributions from Operating Surplus until the common units have received the Minimum Quarterly Distribution plus any arrearages from prior quarters. The practical effect of the subordinated units is to increase the likelihood that during the subordination period there will be Available Cash from Operating Surplus to be distributed on the common units. The subordination period will end on the first business day after the Partnership has earned and paid at least (i) $1.70 (the Minimum Quarterly Distribution on an annualized basis) on each outstanding unit and the corresponding distribution on the General Partner’s percentage interest, which is currently approximately 1.7% (the “General Partner’s Interest”), for each of three consecutive, non-overlapping four-quarter periods ending on or after December 31, 2015 or (ii) $2.55 (150.0% of the annualized Minimum Quarterly Distribution) on each outstanding unit and the corresponding distributions on the General Partner’s Interest and the related distribution on the incentive distribution rights for the four-quarter period immediately preceding

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that date. When the subordination period ends, all subordinated units will convert into common units on a one-for-one basis, and all common units thereafter will no longer be entitled to arrearages.

Cash Distributions

The Partnership has declared quarterly distributions per unit to unitholders of record, including holders of common and subordinated units and the General Partner's Interest and IDRs held by the General Partner as follows (in millions, except distribution per unit):

| Payment Date | Distribution per Limited Partner Unit | | Amount Paid to Common Unitholders | Amount Paid to Subordinated Unitholder | Amount Paid to General Partner | Total Distribution |
|---|---|---|---|---|---|---|
| May 15, 2013 | $ 0.348 | (1) | $ 5.2 | $ 4.9 | $ 0.2 | $ 10.3 |
| August 14, 2013 | 0.44 | | 6.7 | 6.2 | 0.3 | 13.2 |
| November 14, 2013 | 0.46 | | 10.6 | 6.5 | 0.3 | 17.4 |
| February 14, 2014 | 0.48 | | 11.3 | 6.7 | 0.4 | 18.4 |
| May 15, 2014 | 0.49 | | 11.8 | 6.9 | 0.4 | 19.1 |
| August 14, 2014 | 0.50 | | 15.1 | 7.0 | 0.5 | 22.6 |

(1) Prorated to reflect 72 days of quarterly cash distribution rate of $0.435 per unit.

The Partnership Agreement requires that, within 45 days after the end of each quarter, the Partnership distribute all of its Available Cash to the partners of record on the applicable record date. Certain limited partners, including USA Compression Holdings and Argonaut and certain of its related parties, have elected to receive distributions in the form of additional common units in accordance with the DRIP. Distributions to these holders relating to the fourth quarter of 2013, first quarter of 2014 and second quarter of 2014, which were paid during the nine months ended September 30, 2014, were reinvested pursuant to the DRIP. Such distributions totaled $38.5 million and are treated as non-cash transactions in the accompanying Statements of Cash Flows for the nine months ended September 30, 2014.

On October 23, 2014, the Partnership announced a cash distribution of $0.505 per unit on its common and subordinated units. The distribution will be paid on November 14, 2014 to unitholders of record as of the close of business on November 4, 2014. USA Compression Holdings, the owner of 41.7% of the Partnership's outstanding limited partner interests, and Argonaut and certain of its related parties, the owners of 16.2% of the Partnership's outstanding limited partner interests, have elected to reinvest all of this distribution with respect to their units pursuant to the DRIP.

Equity Offering

On May 19, 2014, the Partnership closed a public offering of 6,600,000 common units, of which 5,600,000 common units were sold by the Partnership and 1,000,000 common units were sold by certain selling unitholders, including USA Compression Holdings and Argonaut (the "Selling Unitholders"), at a price to the public of $25.59. The Partnership used the net proceeds of $138.0 million (net of underwriting discounts and commission and offering expenses) to reduce the indebtedness outstanding under its revolving credit facility. USA Compression Holdings and Argonaut granted the underwriters an option to purchase up to an additional 990,000 units to cover over-allotments, which was exercised by the underwriters and closed on May 27, 2014. These sales resulted in USA Compression Holdings' ownership percentage being reduced from 50.1% to 40.6% and Argonaut's ownership percentage being reduced from 17.9% to 14.7%. The Partnership did not receive any proceeds from the common units sold by the Selling Unitholders.

Earnings Per Common and Subordinated Unit

The computations of earnings per common unit and subordinated unit are based on the weighted average number of common units and subordinated units, respectively, outstanding during the applicable period. The Partnership's subordinated units and general partner interest (including its IDRs) meet the definition of participating securities as defined by the Financial Accounting Standards Board's ("FASB") Accounting Standards Codification ("ASC") Topic 260 Earnings Per Share; therefore, the Partnership is required to use the two-class method in the computation of earnings per unit. Basic earnings per common unit and subordinated unit are determined by dividing net income

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allocated to the common units and subordinated units, respectively, after deducting the amount allocated to the General Partner (including distributions to the General Partner on its IDRs), by the weighted average number of outstanding common units and subordinated units, respectively, during the period. Net income is allocated to the common units, subordinated units and the general partner based on their respective shares of the distributed and undistributed earnings for the period. To the extent cash distributions exceed net income for the period, the excess distributions are allocated to all participating units outstanding based on their respective ownership percentages. Diluted earnings per unit are computed using the treasury stock method, which considers the potential issuance of limited partner units associated with the Partnership's 2013 LTIP.

Incentive Distribution Rights

The General Partner holds all of the IDRs. The following table illustrates the percentage allocations of Available Cash from Operating Surplus between the unitholders and the General Partner based on the specified target distribution levels. The amounts set forth under "Marginal percentage interest in distributions" are the percentage interests of the General Partner and the unitholders in any Available Cash from Operating Surplus the Partnership distributes up to and including the corresponding amount in the column "Total quarterly distribution per unit." The percentage interests shown for our unitholders and the General Partner for the minimum quarterly distribution are also applicable to quarterly distribution amounts that are less than the minimum quarterly distribution. The percentage interests set forth below for the General Partner include its General Partner's Interest, and assume (i) the General Partner has contributed any additional capital necessary to maintain its General Partner's Interest and has not transferred its IDRs and (ii) there are no arrearages.

| | Total quarterly distribution per unit | Marginal percentage interest in distributions | |
|---|---|---|---|
| | | Unit holders | General Partner |
| Minimum Quarterly Distribution | $0.425 | 98.3 % | 1.7 % |
| First Target Distribution | up to $0.4888 | 98.3 % | 1.7 % |
| Second Target Distribution | above $0.4888 up to $0.5313 | 85.3 % | 14.7 % |
| Third Target Distribution | above $0.5313 up to $0.6375 | 75.3 % | 24.7 % |
| Thereafter | above $0.6375 | 50.3 % | 49.7 % |

(9) Transactions with Related Parties

For the nine months ended September 30, 2013, the Partnership incurred $0.05 million of expenses related to a management fee under an agreement between USA Compression Holdings, LLC and certain of its affiliates. No management fees were incurred during the nine months ended September 30, 2014.

William Shea, who has served as a director of USA Compression GP, LLC since June 2011, also served as a director and the chief executive officer of the general partner of PVR Partners, L.P. (“PVR”) starting in March 2010. On March 21, 2014, PVR merged with and into Regency Energy Partners LP, a Delaware limited partnership (“Regency”), with Regency as the surviving limited partnership (the “Merger”). As a result of the Merger, the separate limited partnership existence of PVR ceased, and Regency continued its existence as the surviving limited partnership. For the three months ended September 30, 2013, subsidiaries of PVR made compression service payments to us of approximately $0.8 million. For the nine months ended September 30, 2014 and 2013, subsidiaries of PVR made compression service payments to us of approximately $0.6 million and $2.2 million, respectively.

The Partnership provides compression services to entities controlled by Riverstone, who owned a majority of the membership interest in USA Compression Holdings, which owns and controls the General Partner and owned 41.7% of our limited partner interests at November 6, 2014. For each of the three months ended September 30, 2014 and 2013, such controlled entities made compression service payments to the Partnership of approximately $0.1 million. For each of the nine months ended September 30, 2014 and 2013, such controlled entities made compression service payments to the Partnership of approximately $0.3 million and $0.4 million, respectively. The Partnership may provide compression services to additional entities controlled by Riverstone in the future; any significant transactions will be disclosed.

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(10) Recent Accounting Pronouncement

In May 2014, the FASB issued an update to the authoritative guidance related to clarifying the principles for recognizing revenue and to develop a common revenue standard for GAAP and International Financial Reporting Standards. The standard is updated in order to:

- remove inconsistencies and weaknesses in revenue requirements;
- provide a more robust framework for addressing revenue issues;
- improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets;
- provide more useful information to users of financial statements through improved disclosure requirements; and
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