

Solaris Oilfield Infrastructure
Q1 2017 Earnings Conference Call
June 13, 2017 at 8:00 a.m. Eastern

CORPORATE PARTICIPANTS

Kyle Ramachandran – Chief Financial Officer

Bill Zartler – Founder and Chairman

Greg Lanham – Chief Executive Officer

Kelly Price – Chief Operating Officer

PRESENTATION

Operator

Good morning, ladies and gentlemen and welcome to the Q1 2017 Solaris Oilfield Infrastructure Earnings Conference call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question you may press star then 1 on your telephone keypad. To withdraw your question, please press star then 2. Please note this event is being recorded.

I would now like to turn the conference over to Kyle Ramachandran, Chief Financial Officer. Please go ahead.

Kyle Ramachandran

Thank you, operator. And thank you for joining Solaris Oilfield Infrastructure's First Quarter 2017 Conference call. I'm joined today by our Founder and Chairman, Bill Zartler; our Chief Executive Officer, Greg Lanham; and our Chief Operating Officer, Kelly Price.

Before we begin our call today, we would like to caution listeners that some of the statements today will be forward-looking statements. Such forward-looking statements may include comments regarding future financial results and reflect a number of known and unknown risks. Please refer to our press release issued on June 12, 2017 and the Form 10-Q filed last night, along with other recent public filings with the Securities and Exchange Commission that outlined those risks.

Similar to our earnings release that is available on our website, our comments this morning refer to the historical results for Solaris Oilfield Infrastructure LLC, the accounting predecessor of Solaris Oilfield Infrastructure, Inc., which is a newly incorporated entity formed in connection with our recent initial public offering. For more details, please refer to our prior disclosures.

I will also point out that in our earnings release and in today's conference call we have discussed and will refer to Adjusted EBITDA, which is a non-GAAP measure of operating performance. We use Adjusted EBITDA to measure operating performance over various periods exclusive of certain items such as costs associated with our current capital structure that reflect our underlying operating performance. Our earnings release provides a reconciliation of Adjusted EBITDA to net income, the nearest GAAP financial measure.

With that said, I'll turn the call over to our Founder and Chairman Bill Zartler.

Bill Zartler

Thank you, Kyle, and welcome to our First Quarter 2017 Earnings Conference call. I'll begin with a brief reminder and description of our business and speak to our recent IPO. Greg Lanham will then review the operational highlights from the first quarter. And finally, Kyle will come back and review the quarterly results in significantly more detail.

Solaris' business model and growth is anchored in offering a value added service to our customers, combined with positive secular trends in our area of the business. Since we started the business in early 2014, we have grown in 10 of the last 11 quarters despite commodity price volatility and a significant decrease in overall industry activity. We serve the US onshore completion space. We have seen a sharp rise in the amount of proppant being used by operators per lateral foot in the development of manufacturing style development of the acreage.

Our absolute growth and rising market share has been driven by the simple fact that we save our customers money, we reduce complexities around delivering ever increasing volumes of proppant down a well bore, and improve safety at the well site. We are vertically integrated in manufacturing our patent proppant management systems that we rent to our customers. Our systems are becoming increasingly popular with customers, which include oil and gas operators, pressure pumping service providers and proppant suppliers because we drive last mile logistics efficiencies, enhance well site proppant inventory management, deliver critical supply chain information and improve our customer's overall economics.

Let me provide some context for the growth we've experienced over the last three years. When we started the business in 2014, the typical horizontal well design included somewhere between 5 and 8 million pounds of proppant or the equivalent of 100 to 160 truckloads. Today, leading-edge well designs include up to 50 million pounds of proppant or the equivalent of 1,000 truckloads. That's up tenfold over the throughput in the last three years.

With two and half million pounds of inventory in our standard six pack system, our customers have significant inventory buffer at the most critical point in the supply chain, the demand center. This buffer and the ability to unload multiple trucks simultaneously allows our customers to maintain proppant volumes on site while keeping the trucks rolling.

I'll now touch on our recent IPO. On May 17, 2017, we closed our initial public offering of 10.1 million shares raising gross proceeds of \$121.2 million. We've utilized a portion of the proceeds to repay borrowings under our credit facility leaving Solaris substantially debt free and we added approximately \$75 million of cash to our balance sheet. We believe our balance sheet positions us well to continue to fund the organic growth of the business and are well positioned to execute on strategic opportunities to continue to provide value to our customers.

We're very proud of the company we have built. We're excited about the next stage in the business. Our employees have done an exceptional job delivering a top quality product and service to our customers, and our team is well prepared to execute on continued growth of the business. Today our employees and members of the board own more than 22% of our outstanding shares and we'll continue to remain focused on driving value to all shareholders.

With that I'll turn it over to Greg to discuss the operational highlights from the first quarter.

Greg Lanham

Thanks, Bill and good morning, everyone. I'll start by touching on some operational highlights from our first quarter.

During the quarter we delivered five new systems to the fleet ending the quarter with a total of 35 systems. The increase in our fleet size, growing customer demand and industry activity levels led to a record 2,627 revenue days during the first quarter, a 138% year-over-year increase, and a 23% sequential increase versus fourth quarter 2016. Customer demand for our systems has risen due to the increased well completion activity and more proppant being used on average per well, and the increased awareness of the advantages of our proven technology.

As Kyle will describe in his financial review, our results showed our ability to leverage our scalable operational footprint to efficiently convert revenue to operating cash flow. We continue to have a balanced customer mix. During the first quarter, 65% of our revenue was sourced from operators and 35% was from service companies, including sand providers. We're very proud of our blue chip customer base and look forward to continuing to grow our business with existing customers as well as add new customers.

As a reminder, our equipment is highly reliable and remains in the field. Preventive maintenance is typically performed when our equipment moves from one pad to the next. Our personnel generally do not operate the equipment, but rather train our customers to operate the systems. Our scalable operational footprint provides us with the flexibility to ramp quickly and maintain high up times on our equipment.

For example, as Bill mentioned, a key differentiator of Solaris is that we're vertically integrated. We manufacture our systems at our facility in Early, Texas, which is well positioned to quickly deploy new systems to customers as demand grows. We currently have 41 systems in our fleet, all of which are deployed to customers. We expect to deliver 3 more for a total of 9 new systems manufactured during the second quarter bringing the total to 44 by June 30th. We've increased our manufacturing capacity to address growing customer demand and June will represent the first month where we deliver four new systems to the fleet, more than two times the total number of systems that were manufactured in the entire fourth quarter of 2016.

Like much of the industry, our most active operating areas are the Midland and Delaware basins where we have 24 systems deployed. This is followed by Eagle Ford, SCOOP/STACK, Haynesville, the Marcellus/Utica. Our manufacturing operations and commercial teams are doing an excellent job, and it's great to see the positive feedback we continue to receive from customers. We're focused on continuing to deliver value added service and being a critical partner in helping our customers improve the well completion economics.

With that, I'll now turn the call over to Kyle for a more detailed financial review.

Kyle Ramachandran

Thanks, Greg. Let me start out by saying that our first quarter results were at the high end of the projected ranges we outlined in our prior disclosures related to the IPO, and we remain on track with our projected fleet expansion and related capital expenditures.

For the first quarter, revenues increased 228% to a record \$10.3 million from \$3.1 million in the prior year. This increase was primarily due to 138% increase in the number of revenue days driven by increases in overall industry activity, completion intensity and growing customer demand for our patented technology. On a sequential basis, first quarter revenue grew 42% from the fourth quarter of 2016.

Gross profit, defined as total revenue less both the cost of proppant system rental and the costs of proppant system services, excluding depreciation and amortization expense, increased 287% to a record \$7.9 million compared to \$2.0 million in the prior year due to higher revenues and better utilization of our operating cost base. Gross profit increased sequentially by \$2.5 million or 46% from fourth quarter 2016.

Selling, general and administrative costs, and salaries, benefits and payroll taxes increased 41% to \$1.9 million from \$1.3 million in the prior year. This was driven by increased headcount and bonus accruals, and both recurring and onetime expenses related to our IPO preparations. SG&A as a percentage of our total revenue improved to 18% for the quarter compared to 41% in the first quarter of 2016.

Net income was a record \$4.8 million for the quarter, up \$4.9 million from the year ago period. Sequentially, net income increased \$1.8 million from \$3 million in the fourth quarter of 2016.

Adjusted EBITDA was a record \$6.1 million compared to \$0.8 million in the first quarter of 2016 reflecting the factors previously discussed. Relative to the fourth quarter of 2016, adjusted EBITDA increased by \$2.0 million or 48%.

Total capital expenditures for the quarter were \$7.6 million. As previously disclosed, we forecast total capital expenditures for 2017 to be between \$40 (million) and \$55 million based on our outlook of 60 to 64 systems by year-end. This strategic fleet expansion is designed to capture rising customer demand and to grow future earnings and cash flow.

Turning to our balance sheet. As Bill stated, during the second quarter we strengthened our cash position through the IPO. We also recently expanded the size of our credit facility. Our consolidated cash balance today is approximately \$75 million and we have \$20 million available under our undrawn credit facility.

Looking back to the first quarter, as of March 31st, we had \$1.8 million in cash and total debt of \$2.9 million, including \$2.5 million of borrowings under our credit facility. In April, we drew an additional \$3.0 million under our credit facility. We used a portion of the IPO proceeds received in May to repay the balance on our credit facility as well as certain vehicle financings.

With that I'll hand it over to Greg for closing remarks.

Greg Lanham

Thanks, Kyle. I'll close with just a couple of quick comments. First, a reminder that Solaris is uniquely positioned as a vertically integrated specialty rental company with positive secular trends in our area of oil and gas industry that will continue to drive our growth for the foreseeable future. Despite volatility in the oil and gas sector over the past three years, we have grown our business with a conservative approach to balance sheet and a laser focus on delivering a value-added service and product to our customers. Solaris has a track record of creating long-term value for our partners and shareholders. We will continue to be responsible stewards of capital and we look forward to continuing to build our relationships with our new investor base and the analyst community.

With that we'll be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

We will now begin the question and answer session. To ask a question you may press star then 1 on your touchtone phone. If you're using a speaker phone, please pickup your handset before pressing the keys. To withdraw your question, please press star then 2. At this time, we will pause momentarily to assemble our roster.

The first question comes from Mr. Jim Wicklund of Credit Suisse. Please go ahead.

Jim Wicklund

Good morning, guys. I looked at the number of systems and I look at the reported number of frac crews, and of course everybody knows that the frac spreads are going out as fast as humanly possible. Are you concerned about your ability to keep up? And I ask that because I calculate you're about 16% market share and that's an awful lot unserved and I'm just wondering, I know the OSHA requirements come in next year and you doubled, Greg, your manufacturing capacity. Is it enough?

Greg Lanham

Hi Jim, good morning. We're also looking at outsourcing so we can add additional capacity, but in market share you're right on the absolute frac fleets, but in the areas we're currently operating, we're sitting at 20-25%, which also means there is a lot of upside in the areas where we're going to move into the future. But it's something that we're focusing on and we've increased our capacity to meet demand and we're

going to continue to look at that.

Jim Wicklund

Okay, and my follow-up, if I could. You have a war chest, you're looking for synergistic acquisitions, and of course the challenge is going to be finding anything that's nearly as attractive as what you already have. Are there basins, are there product lines, are there synergistic products? Can you give us some idea what you probably might be looking at?

Greg Lanham

We see our system as adding value to the supply chain, so we'll look at adjacencies within that supply chain as we discussed before. And so broadly, that's the way we're going to go and we see that as a market that needs an independent provider and someone that can address that. . Nothing we want to announce at this moment, but certainly we're making good progress. We have inbound calls nearly every day about opportunities and we're investigating them as quickly as possible.

Jim Wicklund

So, [overlapping voices], you already worked for and the people at the companies you already deal with?

Greg Langham

I think that's right, Jim. It's focusing on locking down a term and locking down the supply chain efficiency, using the supply chain piece of the silos combined with the delivery systems and/or transloads where we have customers looking for a long-term sand solution in a particular area, and we can put the pieces together to both protect the silo margins and enhance it with new assets that fit in that chain.

Jim Wicklund

Excellent. Okay, thank you, guys. Good job.

Operator

The next question comes from George O'Leary of TPH & Co. Please go ahead.

George O'Leary

Good morning, guys.

Greg Lanham

Good morning.

Kyle Ramachandran

Good morning.

George O'Leary

So, you guys have a good line of sight on growth with your existing customer base, which is a very attractive position to be in. I'm just curious how discussions with potential new customers are proceeding given the perceived tightness out there in the market is a little bit easier of a pitch today and if you broke it out between the operator service providers and sand producers that you're targeting going forward, where would you say you're spending most of your time from marketing or commercial development perspective?

Kyle Ramachandran

I think you just touched on the first quarter, 65% of our revenue continued from operators and 35% from pressure pumpers. We think that continues.

From a marketing standpoint, the product is known. The inherent benefits of the product are understood by the market, as you alluded to. We have adoption by some of the leading operators and pressure pumpers in the space. So from a marketing standpoint it's really about managing from our side who we think are the best long-term partners, from both a capitalization standpoint but also from a long-term activity standpoint. So, we're continuing to high-grade our customer base in a way that regardless of near term volatilities in commodity prices, we're with operators that will continue to complete their programs.

George O'Leary

Great, thanks Kyle. And then it seems like you guys got a little bit of pricing in the first quarter. From here, without getting too specific, is there still room for prices to move higher as we progress into the back half of the year?

Kyle Ramachandran

I think we saw obviously as you alluded to there, a pretty significant increase in the first quarter. We continue to see slight rolling increases. As I think we talked about in the past, typically we'll go out with 6-12 months term with some of our customers in terms of pricing, so we'll see some of that start to roll over and increase in the second half of the year. I wouldn't expect the same increase that we saw in the first quarter, but we will see a gradual increase going forward.

George O'Leary

Okay, that's very helpful and then maybe sneak in one more if I could. You have some customers who opted to go the 12-pack route as they're doing some very high intensity completion from a frac sand loading perspective. Any other customers outside of the ones who have already got those 12-packs potentially looking to go that route? Are you guys pushing that from a marketing standpoint or is that more demand pull from the customer base?

Kyle Ramachandran

I would say we're not pushing it only because we're trying to get as many systems into as many customers' hands as possible. If we had unlimited supply of systems, we would certainly be pushing for more 12 packs because we think it can make a lot of sense.

When we started the business, and Bill mentioned in his notes, the average well size maybe 5-8 million pounds and today we're just seeing that go up and to the right. So, from our analysis and our work around logistics the key to continuing those efficiencies we provided over the last couple of years is additional buffer, additional storage at the demand center. So, we think it can make a lot of sense. We've gotten very good feedback from our customers who've used it and it fits right into our existing 6-packs. So, it's something that we can scale up and certainly increases our addressable market when you look at the potential of this business.

George O'Leary

Great, thanks very much for the color, Kyle.

Operator

Again, if you have a question, please press star then 1.

The next questions comes from Jason Wangler of Wunderlich. Please go ahead.

Jason Wangler

Hi, good morning, guys. Just maybe dovetailing on Jim's questions, the facility in Early, is four pretty much as big as we can go in terms of turn out units on a monthly basis?

Greg Lanham

In that existing footprint, yes it is. Again, but that's over doubling capacity from last year. But we're also looking at outsourcing certain components, key components and that will get us up to six. We're also going in and looking at potential bottlenecks and working on those as well to help our efficiency out. So we have our eye on the ball on that and making sure that we have no supply chain issues and we have no bottlenecks in terms of manufacturing and assembly and paint process.

Jason Wangler

Okay, thanks. And obviously, with where your sweet spot is you've talked about looking at last mile logistics. Is there is anything else you've seen in that arena that may be of interest or that you guys can leverage what you're already doing into some other business?

Greg Lanham

I'll just add on what Bill said earlier, as we look at our business I think it's important to think about terming up some of our systems and how we do that via the adjacent supply chains, and I think there is a lot of value in that. We recognize that feedback and certainly see that as beneficial to our shareholders. So, we'll continue to look at select opportunities there where they make sense.

I will emphasize, we're going to be selective in doing that and making sure that we're cautious and we're prudent with our capital allocation. But there is certainly some opportunities that do look very accretive to us and we're going to continue to pursue those in a real strong way.

Jason Wangler

Great, thank you. I'll turn it back.

CONCLUSION**Operator**

This concludes our question-and-answer session. I would like to turn the conference back over to Greg Lanham for any closing remarks.

Greg Lanham

I would just like to say thank you, everyone for dialing in this morning. We appreciate the feedback and the questions and certainly look forward to talking in the future. I want to wish everyone a great week.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect your lines. Have a great day.