Solaris Oilfield Infrastructure, Inc.

Second Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

Kyle Ramachandran, *Chief Financial Officer*

Bill Zartler, *Chief Executive Officer*

Greg Lanham, *Chief Operating Officer*

Kelly Price, *Chief Operating Officer*

Jonathan Scheiner, *Vice President, Strategy and Commercial*

PRESENTATION

Operator
Good day and welcome to the Solaris Oilfield Infrastructure Second Quarter 2017 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 Second Quarter 2017 Conference Call. I'm joined today by our founder and Chairman, Bill Zartler; our Chief Executive Officer, Greg Lanham; our Chief Operating Officer, Kelly Price; and our Vice President of Strategy and Commercial, Jonathan Scheiner.

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 August 14, 2017, and the Form 10-Q filed yesterday, along with other recent public filings with the Securities and Exchange Commission that outline those risks.

I would like to 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 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 second quarter 2017 earnings conference call. I'd like to begin by providing an update on our business, our view on a few trends in the industry that we're seeing that impact our business, and Greg will follow up with details on the numbers.

We continue to gain market share with our mobile proppant systems. We remain fully utilized with our customers. We ended the second quarter with 44 systems in the fleet, all deployed. To give you some context, we ended the second quarter of '16 with only 23 systems in our fleet. This expansion is a testament not only to our manufacturing and operations team but also the commercial adoption of our technology.

We have accelerated our manufacturing output to meet market demand. Our historical customers are renting more of our systems, and we've added new customers to our base. The secular trends that have helped us grow our business in 11 of the last 12 quarters continue to drive our business today. These trends include the continued use of high concentrations of proppant during the completion of wells, the transition from evaluation drilling efforts to true manufacturing development and pad operations as well as the industry's continued laser focus on minimizing its operating costs.

Our systems provide the highest well site storage-to-footprint ratio, which creates a supply chain buffer at the most critical junction, the blender. With the industry's leading storage and throughput capacity, we help our customers maintain inventory at the well site, drive down last-mile logistics cost by creating faster truck turns, and reducing the number of trucks required to deliver proppant to the well site. In addition, we continue to see more operators exploring the self-sourcing of proppant. There's not necessarily a one size-fits-all model out there, but our operators continue to use more proppant and there's been an increasing focus on better understanding and reducing the total delivered cost of proppant to the well bore. Our recent announcement of the development of a high-speed transload facility in Kingfisher, Oklahoma, is a great example of this.

Our first customer currently rents several of our silo systems for well site management of proppant in the STACK. While working with our customer we discovered that relative to other basins, the STACK is unique in its need for additional infrastructure as the play transitions from evaluation to full scale development. We are building a first-class facility in the heart of the play, which will help our customers maintain proppant volumes across the supply chain to ensure operators complete their wells on or below budget, on time, and meet very important production targets.

Another recent trend in the industry I'd like to touch upon is the development of the local sand mines, primarily in West Texas. This is a testament to the industry's creative spirit to come up with new solutions to continue to drive down the cost of drilling and completing wells. Solaris is well positioned to benefit from this trend as the importance of having large storage at the well site is even more relevant in the case of local sourcing. As a mine operator, you need to ensure volumes flow or you risk of having to shut down your mine or throw good production into a pile that needs to be reprocessed. We believe the solution to keep volumes flowing to the well site is increased storage at the core demand point the well site.

While forward-staging areas can make a lot of sense in certain circumstances, we believe our system in the 6-pack configuration and even 12-pack configuration becomes the most economical way to maintain a steady flow of takeaway volumes from the mine. By placing storage at the demand center, we can reduce costly and inefficient double handling of sand.

I'll close with a comment on forecasted industry activity levels. There's been a lot of talk recently about the second half of 2017 and 2018 onshore drilling and completions activity. We believe we have a business that is secular-driven. Since starting in 2014, we have grown in a severely contracted operating environment. Today we estimate our market share to be approximately 15 percent. We believe that if the U.S. onshore completion levels slow down, we will continue to grow our business and increase market share.We save our customers money, reduce complexities around delivering ever increasing volumes of sand to the well bore, and improve safety at the well site. We continue to transition from a new technology to an incumbent solution for the industry's challenges.

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

Greg Lanham
Thanks, Bill. Good morning, everyone. During the second quarter, we delivered nine new systems to the fleet, ending the quarter with a total of 44 systems. The increase in our fleet size, growing customer demand, and industry activity levels led to a record 3,375 revenue days during

the second quarter, a 350 percent year-over-year increase and a 28 percent sequential increase versus first quarter 2017.

Customer demand for our systems has risen due to the increased well completion activity, increased proppant usage on average per well, in addition to increased awareness of the advantages of our proven technology. We continue to have a balanced customer mix. During the second quarter, approximately 65 percent of our revenues was sourced from operators, and approximately 35 percent was from pressure-pumping companies. We're very proud of our blue chip customer base, and we look forward to continuing to grow with our existing customers as well as add new customers.

I will now touch on where we are today. We currently have 49 systems in our fleet, all of which are deployed to customers. This coming Friday, we will deliver the 50th system to the fleet. Forty-six out of our 49 systems are deployed to customers running more than one system. Said differently, more than 93 percent of our systems are being rented by customers that are using Solaris technology on multiple well sites today. Customer adoption and retention is near and dear to us. Today our top four customers are renting a total of 30 systems. These top customers are a mix of operators and pressure pumpers, all of whom are responsible for the procurement and management of proppant. We believe our value proposition is evidenced by the adoption of our technology across our customers' operations.

We have not experienced a rollover or decrease in sand usage or per-well intensity bar customers. In fact, we are seeing increased demand and requests for our 12-pack configurations as several key customers are realizing the benefits of additional storage capacity at the well site.

We expect to deliver nine more systems in the third quarter, for a total of 14 systems, bringing the total to 58 by the end of the quarter. As we highlighted in our recent Kingfisher update call, we have increased our manufacturing capacity to address growing customer demand, and August will represent the first month where we deliver five new systems to the fleet.

Our most active operating areas continue to be the Midland and Delaware Basins, where we have 29 systems deployed. This is followed by the Eagle Ford, with 11 systems; the SCOOP/STACK; the Haynesville; and the Marcellus/Utica.

I'll now touch on our Kingfisher Facility development. Since announcing the development and seven-year customer contract on August 4th, we have received significant inbound interest from a mix of operators, pressure pumpers, and proppant suppliers to term up the capacity at the facility. We believe the facility's proximity to the basin and scalable footprint will lend to continued interest for additional capacity. The Kingfisher Facility is a great example of us increasing our stickiness factor with our customers. By providing additional proppant supply chain services, we can further integrate our data into the customer's supply chain management. We are actively working on linking our proprietary PropView well site inventory management system with the Kingfisher Facility assets to provide a comprehensive proppant supply chain dashboard for our customers to better manage their volumes from the transload to the blender.

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

Kyle Ramachandran
Thanks, Greg. In the second quarter, we achieved a number of record operational and financial results, including 3,375 revenue days, $13.4 million of revenue, and adjusted EBITDA of $7.5 million. This morning I will focus on providing a comparison of our second quarter 2017 results

to our first quarter 2017 results as we view that comparison as the most relevant. For those interested in comparing our year-over-year second quarter results in more detail, I would point you to our 10-Q that was filed with the SEC yesterday.

Revenue for the second quarter increased 30 percent to a record $13.4 million from $10.3 million in the first quarter. This increase was primarily due to a 28 percent increase in the number of revenue days, driven by an increase in our fleet size as well as growing customer adoption of our patented technology.

Gross profit, defined as total revenue less both the cost of proppant system rental and the cost of proppant system services, excluding depreciation and amortization expense, increased 29 percent to a record $10.2 million compared to $7.9 million in the first quarter, primarily due to higher revenue and operating activity.

Selling, general, and administrative costs and salaries, benefits, and payroll taxes increased to $3.3 million from $1.9 million in the first quarter. This increase was driven primarily by the transition to a public company status, including increased head count and bonus accruals; increased professional fee accruals for certain functions, including audit and tax; and approximately $600,000 in non-cash stock compensation expense related to recent grants under our long-term incentive plan.

Net income for the quarter was $1.1 million versus $4.8 million in the first quarter. I would like to highlight that our second quarter net income included several non-recurring expenses, including $3.7 million of costs in connection with our IPO and $0.4 million related to the loss on disposal of assets.

Adjusted EBITDA increased 22 percent versus the first quarter, to a record $7.5 million, reflecting the factors previously discussed. Total capital expenditures for the quarter were $13.9 million. As previously disclosed, we have increased our system outlook for 2017 to 68 to 72 systems in the fleet by the end of the year, and we have increased our 2017 forecasted capital expenditures to between $75 million and $95 million. Our revised capital expenditures include $20 million to $25 million of capital related to the Kingfisher facility. These strategic capital investments are designed to capture rising customer demand and to grow future earnings and cash flow.

I'll close with a brief discussion on our liquidity. During the second quarter, we strengthened our cash position through the IPO and expanded the size of our credit facility. At the end of the second quarter, we had a cash balance of $70.1 million and $20 million available under our undrawn credit facility, for total liquidity of approximately $90 million.

With that, we would be happy to take your questions.

QUESTIONS AND ANSWERS

Operator
Thank you. 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 are using a speaker phone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then 2.

Our first question comes from Scott Schneeberger of Oppenheimer. Please go ahead.

Daniel
Good morning, guys. This is Daniel filling in for Scott. Congratulations on a good quarter. I'm curious on the last-mile logistics initiative, if you can give us an update there and how conversations are going with customers?

Greg Lanham
Good morning. Well, we're continuing to have those discussions right now, and I'll say that it looks like 2018, we certainly have quite a few options that we're putting together. I can't get into specifics with customers or areas, but I will say that we've actually picked up our interest level quite a bit there and anticipate putting something together in place in early '18.

Kyle Ramachandran
Hey, Dan, this is Kyle, you know, obviously the Kingfisher announcement and the development of that project is certainly constructive to our view of continuing to integrate along the supply chain, and so we think that this is certainly a strategic move that will help position us to continue to develop this integrated last-mile offering.

Daniel Hultberg
Okay. Thank you very much, guys.

Operator
Our next question comes from John Watson at Simmons & Co. Please go ahead.

John Watson
Good morning, guys.

Kyle Ramachandran
Good morning, John.

John Watson
It looks like rental revenue per system might have increased in Q2. Is that due solely to legacy pricing agreements resetting, or is there another factor for us to think about?

Jonathan Scheiner
Yeah, this is Jonathan here. I think it's a combination of new customers coming in and legacy pricing rolling off, so we have various customers that are on first-half pricing or customers that were on pricing through the first quarter that might have rolled off in the second quarter, and then, obviously, as we bring in new customers, we're looking to push rates there.

Kyle Ramachandran
And this is Kyle just following up on that. I think what you'll see going forward is a real transition to monthly rental across the board, and so what that's going to translate into is more revenue days, not necessarily incremental revenue, but it will indicate all the sets are with customers on a term basis rather than on a spot or day rate. And so we've been successful in repositioning — and I think Jonathan can correct me here — all but one of our systems today with customers on a monthly basis.

Jonathan Scheiner
That's correct.

Kyle Ramachandran

But your math is right. In my math, I think our implied rental revenue was up about 3 percent.

[audio break]

John Watson
Okay, great. And then if I think about the additional systems that you all will have by year end, can you help us think about how many of those you expect to go to new customers versus legacy ones?

Jonathan Scheiner
This is Jonathan here**.** We lost audio there, and the question was around where do we see the rest of the year allocation versus current customers and new customers? I think right now a good estimate is 50 percent current customers and 50 percent new customers. That allocation is fluid, and, you know, we'll be flexible there.

Kyle Ramachandran
I think just — Kyle jumping in — what we've seen is customers — obviously, this is a relatively new technology, but once they get their hands on it and start to roll it out, the adoption rate is really — it kind of gets increased in a way where somebody's going to roll it out across their operations, and I think — I don't know if it was in the press release or in the prepared comments, but I think 30 of the 49 current systems are with our top four customers. And so what we've seen there is just a group of operators and pumpers really roll this out across their activity.

Greg Lanhan
Yeah, over 90 percent of the customers are using multiple systems.

Jonathan Scheiner
So for us, it's — we've got customers saying, "We would like to roll this out across everything," but we're also balancing that with — look, we want to continue to grow market share across a broad set of customers.

John Watson
Got it. That's helpful. And maybe one more, if I could. In the Permian specifically, can you provide any color regarding trucking rates for pneumatics and how those might be affecting your customers?

Jonathan Scheiner
This is Jonathan here. I think we have seen trucking rates increase. I think that's across the board. Trucking is getting tight. I think, as we think about last-mile work, we've got a preferred set of trucking companies that we would like to work with, and we're trying to stay ahead of their demand.

Kyle Ramachandran
Yeah, and I think just the thing we always try to harp on is the significant amount of truck turns that we're seeing when customers are using our system, and we're seeing, again, 20, 30, maybe even 40 percent fewer trucks required to deliver a fixed or given amount of proppant, and I think that's really the unique thing of what we're doing, is we're making the existing infrastructure much more efficient.

Greg Lanham

I'll just add, as Kyle mentioned, that's what makes the system so powerful, is just giving that buffer and able to reduce the number of turns, but also just keep in mind we've also mentioned our non-pneumatic option that we're developing, and that's going to be rolled out by the end of September. So that will give us optionality from both non-pneumatics and belly-dump systems — or belly dumps and pneumatics, excuse me.

John Watson
Got it. Well, thank you for the update, and congrats on a good quarter, guys. I'll turn it back.

Kyle Ramachandran
Thanks, John.

Operator
Our next question comes from Jim Wicklund of Credit Suisse. Please go ahead.

Jake
Hey, guys, this is Jake on for Jim.

Kyle Ramachandran
Hey, Jake.

Jake
Just a quick question on the deployment of new systems in 2018. So you're going to do 14 in 3Q versus what we consider to be capacity of 12. Should we assume that you're going to build 14 systems a quarter through '18?

Kyle Ramachandran
We certainly have that capacity, and we would argue greater capacity than that. At this point, we haven't really leaned too forward into looking at '18, but as we've indicated, we've got a really robust order book, and we feel like the adoption and penetration of the product is increasing by the day, so I think certainly we could do 14 a quarter next year, but certainly we could do more than that, and if the market's not there, we can pull that back.

Greg Lanham
We've managed our — this is Greg — we've managed our supply chain looking forward in '18 so that we'll be able to flex that up as needed within limits, but certainly that's achievable. We're just going to watch the market and see what the demand does, and if we continue on the same trajectory, I think that's certainly a number that we'll get to.

Jake
And what's the — so you've managed your supply chain to flex up or down, what's the range that you've managed it to be able to flex up or down to?

Greg Lanham
Six.

Yeah, we started off with four systems per month, and we're up — and we've taken that up to about six considering some outsourcing components, so we're working within that — those operating boundaries. We can go up. Obviously, we can go down if we needed to from that, but we have managed that pretty well, going out and looked at long lead items and ordered them long enough in advance to manage through that. So we're thinking in terms of that four to six per month right now.

Jake
Okay, great. And then are you guys going to look to do further projects like the Kingfisher transload? So should we expect to see you guys at least looking at opportunities like that in other basins or in the SCOOP/STACK as well?

Greg Lanham
Yeah. I think we're going to be, you know, highly focused on projects that link into our last model in our well site solutions, so very selective opportunities where we've got a solid customer base, I think we will continue to look at opportunities around that.

Kyle Ramachandran
We'll make sure that the businesses that we go into will certainly be accretive and additive to what we're doing on the well side silo side of things, but then there's certain opportunities that make sense, and we're watching those closely, but, again, we'll manage our capital prudently.

Jake
Okay. And then the last one for me, just a clarifying question. You said you think market share is about 15 percent. Was that on average in the second quarter or at the end of the quarter?

Bill Zartler
I'd run that about the end of the quarter. I'll let you get the market, but let's say we've got, you know, 44 systems in in a quarter, 50 this week, roughly 15 percent of the market.

Jake
Okay. Perfect. Thanks for the color, guys, I appreciate it.

Greg Lanham
Thanks.

Operator
Our next question comes from James West of Evercore ISI. Please go ahead.

Blake
Hey, good morning, this is Blake on for James. I just wanted to piggyback on the other LML questions that have already been asked. Emerge on their conference call, mentioned you guys by name as a potential partner down in San Antonio with their regional mine in the Eagle Ford. Could you just give us any more incremental color on what that partnership will look like? And then, more broadly, when you have these conversations with industry participants, is it the E&Ps that are driving these partnerships, trying to get sand, or is it the sand guys trying to target blue chip E&P customers through you guys?

Greg Lanham
Well, to answer the second question first, it's a bit of both. We certainly work a lot with E&P companies who are self-sourcing, and, again, that's a good avenue to look into where we can be a last-mile provider, but, then again, sometimes the sand companies with a local presence, they might reach out to us as well.

To talk more specifically about that opportunity, again, we're fortunate enough that a lot of folks reach out to us, because they see us as a great solution at the well site, and they reach out, and we have a lot of conversations just like the one with Emerge that came up. Certainly, it's something we think that we can benefit from as a company, and there's also some synergies between us and some of the local sand providers as well, so those conversations are going on all the time. And I think that we'll have a little more color on that as the year rolls out and we crystalize some of those plans.

Bill Zartler
Yeah, and, as I mentioned in the talk, there is no one size-fits-all. There are various cases where operators are exploring and buying proppant. There's proppant companies trying to deliver to the well site. There's, you know, pressure pumpers letting operators buy it and then buying it themselves, so there's a combination as this industry goes through this evolution of how and who buys the proppant and who supplies it to the well. As we've stated frequently, we're there to facilitate the movement of proppant. We're there to make it easier and more efficient for the industry to work, and partnering up with various customers to do all of that makes a lot of sense.

We talked a little bit about the local mines, and I think the Emerge discussion is around a local mine and the fact that this solution will help those mines operate, and it's a matter of where you build the storage. Do you build it at the market area, at the well site, or do you build more storage at the mine operation to make it more efficient? And so we're exploring that in many ways with various customers as well.

Greg Lanham
Yeah, and I think I would mention that what we're aspiring to be and what we're continuing on down the path, is just being a midstream company that delivers and manages the proppant from either the local mine or the transload to the well site and then link that back via our data management system to help supply chain constraints. So that's our model, and that's what we're driving towards.

Blake
Okay, great. And in addition to the growth plans that you guys just outlined, do you guys know where incremental fleets this year are going to go? Any chance you're going to expand to the Bakken DJ or possibly western Canada, or are you going to try to gain a little more scale in the basins that you currently operate?

Greg Lanha
Yeah, so we've actually had a number of recent requests about the Bakken. For us, before we make that move, we want to have some scale, so we view that — you know, to make the move up there, we'd need a commitment on terms, 6 to 12 months, and the minimum fleet of three to five systems.

Blake
Okay, great. And then last one for me, just for market share modeling purposes, how many of your customers are currently using the 12-pack configuration?

Jonathan Scheiner
Today it's zero, but we'd had requests. We have a rollout plan for about five to ten to customers by the end of the year or early '18.

Greg Lanham

Yeah, the choice is use none or use a six-pack for now. We've done some trials with a customer on 12. We've had follow-up customers looking, so we've got that embedded in our rollout schedule, managing that mix, as Jonathan mentioned earlier between new customers and existing customers, and those existing customers, a large number of them are requesting to work on a 12-pack situation. So we're managing that as we manage the construction at more sites — more assets.

Blake
So if you guys — say you guys exit the year with 60 to 64 systems, you're saying that five to ten of those will be doubled up on 12-packs?

Greg Lanham
Yeah, I think that's a realistic expectation.

Jonathan Scheiner
Well, probably closer to five than ten. Probably closer to five then ten.

Blake
Got it. Got it. Okay. Thank you.

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

Our next question comes from John Woodiel with Raymond James. Please go ahead.

John Woodiel
Hey, good morning, guys. I was curious, within the incremental fleets and systems that you're adding, are you seeing more interest from pressure pumpers and E&Ps, and how do you see the customer mix evolving, especially with the self-sourcing of sand by E&Ps in the Permian region?

Greg Lanahm
Hey, John. We're pretty much in the same mix that we were before, about two-thirds E&P, one-third pressure pumpers, so we really haven't seen a shift away from that, and I think that was in our comments. And in terms of self-sourcers, you know, it's a mix of those E&Ps who are self-sourcers as well.

John Woodiel
All right. That's helpful. And then when thinking about your contract structure going forward, you mentioned that if you're looking to move into a new basin such as the Bakken, you'd be looking to pick up term contracts on those. Is that something that we would be looking for, that you'd be willing to do contracts in your legacy basins as well, or is it just primarily focused on new basin deployments?

Kyle Ramachandran
Well, I think we're in discussions with a couple of folks around terming up capacity on the existing fleet. It's obviously customer dependent from the perspective of what their current rates are. We've got some customers in there that are leading-edge rates, and I think we'd look to contract there, but we've also got customers in some legacy rates where we'd like to see some improvement there before we would move forward with terming anything up.

Greg Lanham

Yeah, frankly, John, we've had a high degree of customer demand, and so in order for some customers to want to get into the queue, they've reached out and said, "Can we term up some contracts?" We suggest that's a good way to get into the queue, and so that's part of the narrative that's going on as well.

John Woodiel
All right. Perfect. All right. Thank you, guys. Appreciate it.

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

CONCLUSION

Greg Lanham
All right. I'd like to thank everyone for joining today, and I'd also like to send out thanks to the hardworking employees at Solaris. So I want everybody to have a great day, and, again, thanks for joining the call.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.