Target Hospitality
First Quarter 2019 Earnings Conference Call
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PRESENTATION

Operator:

Greetings, and welcome to Target Hospitality's First Quarter 2019 Earnings Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, you may press star, then zero on your telephone keypad. As a reminder, this conference is being recorded.

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

Narinder Sahai:

Good morning. Before we begin, I'd like to remind you, we will discuss forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those forward-looking statements, and as a result of various factors, including those discussed in our press release today, and the risk factors identified in our SEC filings.

While we may update forward-looking statements in the future, we disclaim any obligation to do so. You should not place undue reliance on these forward-looking statements, all of which speak only as of today.

We would like to remind you that some of the statements and responses to your questions in this conference call may include forward-looking statements. As such, they are subject to future events

and uncertainties that could cause our actual results to differ materially from these statements. Target Hospitality assumes no obligation and does not intend to update any such forward-looking statements. The press release we issued last night and the presentation for today's call are posted on the Investors section of our website. A copy of the release has also been included in an 8-K that we submitted to the SEC.

We will make a replay of this conference call available via webcast on the Company website.

For historical financial information that has been expressed on a non-GAAP basis, we have included reconciliations to the comparable GAAP information. Please refer to the tables in the slide presentation accompanying today's earnings release.

Now, with me today, I have Brad Archer, our President and Chief Executive Officer, Andrew Aberdale, our Chief Financial Officer, and Troy Schrenk, our Chief Commercial Officer. Brad will begin today's call with an overview of Target Hospitality's key operating highlights; Andrew will then provide additional details on financial results and discuss our outlook. Troy will join us to open up the call for questions.

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

Brad Archer:

Thanks, Narinder. Good morning, and thank you for joining us to review our first quarter results. Target Hospitality's culture is built on putting our customers first, empowering our employees, and driving continuous improvement throughout all facets of our business. Dedication to these foundational beliefs continues to evolve our winning strategy that places significant value on best serving our customers. We are a growth company.

Our approach continues to produce strong operating and financial results. This was evident in our first quarter performance, in which we nearly doubled our utilized beds while improving our average daily rate. We generated Adjusted EBITDA margin above 50% and delivered a solid increase in adjusted EPS to $0.21.

Additionally, we were excited to accomplish this while also completing our business combination with Signor, and listing in the public market as Target Hospitality. This was made possible by our people: the 800 hardworking women and men at our Company. They have proven their ability to deliver time and time again. I would like to thank them for their dedication to excellence, their commitment to our long history of success, and their assistance in getting us public.

Before we dive deeper into results, I'll provide a brief overview of the Company, given we have new investors and analysts joining us today. We are the largest, vertically-integrated, specialty rental and hospitality services company in the United States. We serve the U.S. energy and government sectors by uniquely combining the most attractive elements of specialty rental accommodations with hospitality and premium catering services.

We also provide housekeeping, security, maintenance and facilities management. We own and operate an extensive network of 20 communities, which provided an average of 11,160 beds for our guests during the first quarter 2019. Our facilities are situated in some of the most attractive markets in the U.S., which collectively form a large and growing multi-billion dollar addressable market.

In the Permian Basin, which represents 62% of our pro forma LTM total revenues, the market opportunity today is estimated to be over $1 billion annually. We are also the market leader in the Bakken Basin, which represents 8% of our pro forma LTM total revenues.

On the government side, which makes up about 21% of our pro forma LTM total revenues, we are also exceptionally positioned. That segment is largely comprised of our South Texas Family Residential Center. It's a best in class facility providing temporary accommodations to asylum-seeking women and children family units. We exclusively provide catering and facility maintenance services at this facility. This government segment is scalable and provides attractive gross margins. It also helps to further diversify the business.

Moving on to Slide 5, our differentiated value-added business model is truly a driver of our success. We have grown our business over the years to virtually blanket the entire Permian Basin from tip to tip. This provides us with a powerful network effect, allowing us to capture an estimated 20% share of the total addressable market, including hotels, modular units and other accommodation alternatives. Our customers generally don't pay for a specific employee to be in a specific room at a specific community. We have a flexible arrangement with most customers that allows them to consume room nights at any one of the communities across our network, on any given night.

Scale matters, but our exclusive network, who we do business with and the structure of our contracts really matter. It is important to align with the right customers, and for us, those are mostly top tier, large, blue-chip companies who have the operational expertise and understand the value of providing exceptional care for their employees. We focus on securing long-term exclusive agreements with these high quality customers.

Exclusivity means that customers have agreed to use our communities only, for all of their needs within geographies that we serve. This means that they have decided to not use any other accommodation provider, including hotels. Our scale, combined with the exclusivity, creates a competitive moat around our network. This provides a strong platform for growth. Additionally, long-term agreements with our top tier customer base provide us with high visibility into our future performance.

One of the keys to our success is our proprietary Target 12 value proposition. Our value-added services help our customers attract and retain the best workforce. Customers understand they are more profitable because they get a safer, more loyal and more productive worker when they invest in the 12 hours that their employees are off the clock. We deliver a workforce that is well-rested, well-fed and optimized for performance each day. That is the promise we make to our customers when we have their employees for those 12 hours.

That helps the customer's bottom line, because they attract a higher quality workforce and have better retention rates. Furthermore, our services are mission critical and represent only a small portion of our customer's operating budget. These positive attributes of scale, premier customers, long-term exclusive agreements, and our Target 12 approach form the core of our differentiated, value-added proposition to customers. This is what enables us to achieve attractive ADRs.

Turning to Slide 6. We believe the structural advantages of our business model are unique to target hospitality. To put this in context, we typically have line of sight on approximately 85% to 90% of our forecasted revenue over a 12-month forward period. To break down the numbers for 2019, we estimate more than 86% of total estimated revenue at the midpoint of our outlook is contracted. Our weighted average contract term currently stands at over three years, and nearly 92% contracted revenue also benefits from guaranteed payment provisions.

When customers sign contracts, we know what we will be paid for: the duration of that contract. Nearly 94% of our contracted revenue benefiting from guaranteed payment is also protected by exclusivity provisions.

On an additional note, I mentioned earlier that Target has very attractive ADRs, which are amongst the highest of our peers. It is important to recognize that this is an average rate over time. It is also a function of our strategy to secure long-term commitments with customers. This insulates our business from fluctuation in commodity prices, or our customers' accommodation needs. We benefit from limited ADR volatility and high utilization secured across available beds on our network.

On Slide 7, we were pleased with our performance in the first quarter of 2019. We continue to execute our strategy and deliver exceptional results. We are firing on all cylinders against our key objectives, and winning in our markets. Simply stated, Target Hospitality is executing, delivering and winning. We command a dominant position within our market, with our first quarter average bed count increasing by 70% to 11,160 beds, up 7% on a pro forma basis.

In the Permian, we estimate that we continued to represent more than 20% of all available beds in the region, including hotel rooms. This progress was primarily attributable to the strength of our multiyear agreements with our customers, which, when combined with our expansive network, gives us a competitive advantage. This also allows us to run our business in a more predictable and highly profitable manner.

The increase in average beds contributed to Adjusted EBITDA more than doubling to $41.3 million, and up 37% on a pro forma basis. First quarter Adjusted EBITDA as a percent of total revenues grew by approximately 3.3% to 50.4% compared to the prior year.

We converted approximately 89% of Adjusted EBITDA into adjusted free cash flow, and ended the quarter with ample liquidity. With pro forma LTM net leverage at 2.2 times, we are well equipped to take advantage of the many identified organic and acquisition opportunities ahead.

To that point, today, we announced a new 200-bed community in the Delaware Basin for a major, integrated E&P customer. This is just the beginning. Like our other communities, we are building this community for future expansion. This new community can be expanded for up to 400 beds.

This announcement today follows another 400-bed community in Carlsbad, New Mexico that we announced earlier in the first quarter. These two communities will add an initial 600 beds to our network, which we expect to become operational in the third quarter of this year. Our returns average over 30%, and this applies to these two new communities. This is how we execute growth, deliver results, and win more business.

On Slide 8, I'd like to take a moment to discuss our outlook for the key end markets. Given the size and strength of our energy customers, most of them plan their business initiatives and investing strategies on a long-term basis. One of the key factors driving their growth is much lower production costs and breakeven points today, compared to just three years ago.

In fact, according to Rystad, a WTI price of $42 per barrel delivers a 10% return on each marginal well for the top 30 operators in the Permian. With improvements in technology, productivity gains and lower breakevens, our customers are investing billions in the U.S. onshore shale development. We believe they will continue to do so for some time, especially in the low-cost Permian Basin, our largest segment.

For the last 10 quarters, the Permian Basin has accounted for more than two-thirds of U.S. crude oil production growth since the fourth quarter of 2013. According to the Dallas Fed Energy Survey, first quarter activity in the energy sector grew modestly in first quarter year-over-year, primarily led by oilfield service firms. Oil and gas production increased for the 10th consecutive quarter, according to energy and production executives. Most importantly, the number of employees and wage hours continue to grow year-over-year. These are all positive factors which bode well for our energy customers.

On the government side of our business, the South Texas Family Residential Center has approximately 2,400 available beds to house and process asylum-seeking women and children family units. With 161,000 family units arriving in 2018 alone, the demand has far exceeded the U.S. government's ability to supply adequate housing accommodations. Because of our scale, innovative design, amenities and service track record, the U.S. government has identified the STFRC as the model for this type of facility. As a result, we remain well-positioned to support the U.S. government's needs in this category.

Onto Slide 9. We are making tremendous strides on our integration with Signor. As a reminder, we began operating the Signor property in September 2018, and immediately began upgrading the facility and implementing additional services. The synergy opportunities are twofold: cost and revenues. We are executing on both.

On the cost side, we are eliminating redundancies in areas such as SG&A, operations and purchasing. Specifically, we are integrating our hospitality and catering services into Signor's operations. Historically, Signor had no vertically-integrated communities. Seventy percent of their communities were served by third-party catering, and 30% had no meal plan at all. As of January 1, 2019, 100% of Signor's communities have been converted to full-turnkey hospitality services with in-house catering provided by our own employees.

These efforts are beginning to show results, and our customers have acknowledged this. In late 2018, we renewed four Signor contracts, which extended the average life by two years and added our full suite of services. The four renewals had an estimated contract value of over $200 million, representing incremental revenue of $45 million through the remaining life of these contracts. This ability to enhance our customer experience with upgrades and added services enables us to earn higher ADRs, as evident in our first quarter results.

As I said earlier, we're a growth story. Over the past decade, we have doubled the size of our Company, just about every three years. Our differentiated business model with our proprietary network, top tier customer base, long-term contracts and proven value proposition provides us with a powerful platform for both organic and inorganic growth.

Organically, we have a robust pipeline that can provide meaningful upside. Additionally, we continue to review attractive acquisition opportunities that could be strategically important and highly accretive to our business.

Overall, our relationships and contracts underpin the stability of our business, and form a solid bedrock to continue driving growth, high margins and attractive returns on our mature pipeline of new opportunities.

I will now turn the call to Andy to provide additional details on our results and outlook.

Andrew Aberdale:

Thanks, Brad. Beginning on Slide 10, our first quarter results were strong and in line with our expectations. Customer renewals, network expansions and operational enhancements drove broad-based financial and operational performance.

Total revenues more than doubled to $82 million. Adjusted EBITDA grew faster than revenues, to $41.3 million, producing an Adjusted EBITDA margin of 50.4%. I'll mention, the first quarter 2019 results included the impact of our business combination transaction, which produced higher than usual charges and credits in our reported figures.

We incurred certain transaction expenses of $8 million. We also had approximately $28.5 million in one-time costs related to transaction bonuses in connection with our business combination. It is important to

recognize that these transaction bonuses were cash neutral to Target Hospitality. We received a contribution from our former parent to pay these bonuses. On the cash flow statement, the contribution is reflected as an inflow in the cash from financing activities section. The matching payment is reflected as an outflow in the cash from operating activities section.

Now for accounting purposes, the transaction bonus payments are reflected as an increase in SG&A expense of $28.5 million. The transaction expenses and bonus payments have been excluded from our adjusted results to better reflect core performance. Excluding pre-tax charges and credits of $38.4 million, SG&A totaled $6.4 million for Q1 2019. This demonstrates our ability to achieve cost leverage while still investing in our people, processes and technologies to support our transition to being a public Company.

On a net basis after taxes, first quarter adjustments totaled approximately $31 million, or $0.39 per diluted share. Our adjusted earnings per share of $0.21 excludes the impact of these items, which we believe provide a cleaner EPS metric to assess our core net profitability.

We continued to deliver outstanding operational performance. This is clearly evident in our total ADR of $82.40 and utilization of 87%, both at the highest levels for the Company since Q1 2017.

Finally, we are pleased to end the quarter with a net debt of $356.9 million, putting us squarely within our target net leverage ratio of around two times.

Moving to Slide 11, Adjusted EBITDA for the first quarter of $41.3 million represented an increase of 127% compared to the prior year quarter. More than half that increase was due to Signor's contributions, so I'll give some additional context on a pro forma basis to show our year-over-year progress in a more meaningful light.

First quarter 2019 Adjusted EBITDA of $41.3 million increased 37% when compared to pro forma first quarter 2018 Adjusted EBITDA of approximately $29.7 million. We are pleased with this performance. The improvement in Adjusted EBITDA on a pro forma basis was primarily the result of higher sales, with $5.4 million from an increase in ADR, plus $5 million coming from higher utilized beds.

We further benefited from efficient management of our operations, as indicated by the $1.8 million improvement in cost, which more than offset the incremental SG&A of $1.2 million recorded in the quarter associated with becoming a public Company. Overall, we grew our business year-over-year while preserving an attractive EBITDA margin of above 50% in Q1 2019.

Moving to Slide 12, we are pleased with our operational performance during the first quarter. We performed well on an as-reported and pro forma basis. As a reminder, our pro forma basis includes the prior year impact of Signor.

Looking first at our operational results on an as-reported basis, the notable jump in available beds from 6,552 in Q1 2018 to 11,160 in Q1 2019 is primarily due to the addition of Signor into our business, along with a new community and expansions in our legacy portfolio. The as-reported improvement in ADR and utilization reflect favorable customer contract renewals across many communities. On a pro forma basis, average available beds increased by 7% year-over-year. This increase was led by a new community addition and expansions at our lodges.

The success of our story is more evident on a pro forma basis, as indicated by an 8% increase in ADR. Approximately half that increase is attributed to the combination of upgrades and improvement at the Signor communities, the addition of vertically-integrated services such as catering at all the Signor communities, as well as overall larger networks offered to our customers. Also, a portion of our year-over-year improvement was helped by our data analytics and revenue optimization efforts. These efforts

enable us to identify incremental opportunities to accommodate customers based on their workforce needs, logistics and geographic activities across our network.

On Slide 13, we delivered attractive results across each of our key segments. In the Permian Basin, which is our largest segment, we have more than tripled total revenue and adjusted gross profits. This reflects the addition and integration of Signor communities into our business. Adjusted gross profit grew faster than sales, resulting in a 145 basis point increase in the Permian adjusted gross profit margin to 61.8%. This is a direct reflection of our growth in utilized beds and tight cost controls.

In the Bakken Basin, which is a relatively smaller operation for us, adjusted gross profit margin increased by 139 basis points despite the expected decline in sales. We tightened our footprint in the Bakken Basin, which significantly augmented the segment's utilization rate and allowed us to drive efficiencies on the cost side.

In the government segment, revenues were consistent with the prior year. We're in the middle of a seven-year agreement which provides relatively stable ADR utilization and revenue. Adjusted gross profit margin in the government segment increased 189 basis points year-over-year, mainly due to the reduced occupancy when compared to utilization.

Moving to Slide 14. As planned, we've generated strong adjusted free cash flow in the first quarter of 2019. Capital expenditures were approximately $21.8 million compared to $25.8 million in the prior year quarter. Except for nominal maintenance cap ex, the remaining capital spending was for revenue-enhancing investments such as the high-grading of Signor communities which have already started to generate returns.

Adjusted free cash flow improved to $36.9 million compared to $15.7 million in the prior year quarter. This was primarily driven by more than doubling of our Adjusted EBITDA. To provide additional context on our adjusted free cash flow in the first quarter of 2019, we start with Adjusted EBITDA of $41.3 million. Adjusting for maintenance cap ex of $500,000 and deferred revenue of $3.9 million gets you to our adjusted free cash flow of $36.9 million.

Our ability to generate adjusted free cash flow has been and is a very important part of our story. We have typically converted around 90% of Adjusted EBITDA to adjusted free cash flow. The conversion of 89% in the first quarter was in line with that. We expect to continue generating meaningful adjusted free cash flow for the balance of this year.

On Slide 15, our strong free cash flow and prudent debt leverage provides us with significant financial flexibility to accomplish our objectives. At quarter-end, we had a net debt of approximately $356.9 million. Total available liquidity was $108.1 million. This includes $23.1 million of cash and cash equivalents, plus $85 million in available borrowing capacity from our ABL revolver.

Our net debt to pro forma LTM Adjusted EBITDA, including a full year of Signor, was approximately 2.2 times. This puts us, essentially, in line with our long-term net leverage goal of approximately two times. I highlight this further on Slide 16 as we discuss our disciplined approach to capital allocation.

Moving to Slide 16, we have a history of prudently allocating capital, and we've generated exceptional returns. We plan to further invest in growth, optimize debt costs and deploy capital into shareholder returns enhancing initiatives. We expect the significant majority of our cap ex to be dedicated to growing our network through new communities and expansions at our existing communities.

On the debt side, we are well-capitalized, and as I mentioned earlier, within a comfortable range of our long-term net leverage goal of approximately two times. We are focused on maintaining a strong balance sheet and reducing our interest expense, while at the same time reinvesting in the business and driving our free cash flow.

In terms of other opportunities, we have successfully completed several M&A deals in the past and remain opportunistic to capitalize on strategic growth avenues in our existing segments, or new markets that make sense for our business. With our well-capitalized balance sheet and stronger liquidity today, we are poised to continue growing by focusing on who we do business with and where we do business.

On Slide 17, our 2019 outlook remains unchanged. It is aligned with our objective to generate another year of solid results. Based on our results to-date, a favorable market outlook and approximately 86% visibility on our 2019 estimated revenue, we affirm our full-year expectation for revenue to be in the range of $340 million to $350 million. We expect Adjusted EBITDA to be in the range of $175 million to $180 million.

All the structural advantages in our business that we've discussed today afford us a high degree of confidence in achieving our 2019 goals. Our formula for growth has been, and is, dependable. We plan to further increase utilization and ADR at our communities, expand available beds at existing communities and build new communities. To that point, keep in mind our two planned communities in the construction phase are not included in our outlook and represent incremental contribution to our financial outlook once operationalized.

I will now turn the call back to Brad for closing remarks, on Slide 18.

Brad Archer:

Thanks, Andy. We are very pleased by the solid start to the year. We delivered exceptional results and initiated the build-out of two new communities during a quarter in which we also completed our merger transaction, became a public Company and completed a debt capital raise. I'll emphasize that we place a high premium on execution and operational excellence. This allows us to produce superior margins and attractive returns.

We believe demand for our differentiated value proposition remains robust and supports our identified project pipeline of new communities, to add to what is already the largest network of workforce accommodations in the region. Community expansions, along with incremental synergies from the Signor integration, give us confidence in our future success. With our strong capital base, we believe accretive acquisitions and selective diversification into new end markets provide additional upside to our solid growth trajectory.

Our focus on the customer is the major reason why we are so successful. That unwavering commitment has put us on sound footing to deliver on our 2019 objectives and generate shareholder value for years to come.

Operator, we are now ready to open the line to questions.

Operator:

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

Our first question comes from Stephen Gengaro with Stifel. Please go ahead.

Stephen Gengaro:

Thank you and good morning, gentlemen. I guess what I'd start with, if you don't mind, is—coming at this from sort of an oil service perspective and looking at the fluctuations we've seen in commodity prices at year-end and what we're hearing from the service customers as being a somewhat mixed outlook with a lot of companies referring to a lack of visibility in the second half of the year, I'm just trying to sort of understand, from your perspective, how that impacted your business and how that compares to your more positive view?

Brad Archer:

Yes, Stephen, this is Brad. Good morning and thanks for joining. Look, we've seen some of these reports as well, but let me tell you how we look at the business. Target Hospitality speaks in terms of multiyear, locked-in contracts, so our horizon is much longer. Quite simply, our time horizon is much longer; our business is much more predictable as well.

I would tell you, and this goes back many years, but our business is secular, not cyclical. What helps us with that is our advantageous customer mix. It truly comes down to lots of things, but one of them is who you do business with and where you do the business. I would also tell you, remember, and we've mentioned this before, we're a small fraction of their operating budgets, but we are mission critical to their success. They need us, we need them. It's a mutual relationship.

But, we look at the business much longer-term than you will when you talk to strictly an OFS company. We're looking out—as well as the customers we do business with, and looking out many years down the road. They're planning their cap ex cycles for years, as we do, and that's the reason they're signing long-term contracts with us. It gives us that stability and not the fluctuations you see in the oil and gas markets.

Stephen Gengaro:

Great, that's helpful color. Just as a follow-up, I know the exclusive contracts you have with customers are important and obviously give you an advantage in a lot of instances, but can you speak to how those contracts are structured and kind of what it ultimately means for your business?

Troy Schrenk:

Hi, Stephen, this is Troy, good morning. Exclusivity is a significant part of our business, clearly, and what it means simply is that our customers have agreed to only use Target Hospitality for accommodations and hospitality services across the U.S., across multiple shale basins, or within a specific basin like the Permian. Think of it as a trade. Our customers want and they need access to our expansive network, and we deliver that to them. They want that and they need that network because it saves them money and time. With that, they have much more operational flexibility to move their personnel across a broad region, similar to that of the Permian Basin, much more quickly and efficiently, again, reducing costs for them and time.

For us, it's significant for our growth platform. It provides us a platform to grow organically with our existing communities, and through M&A as well, by virtue of those exclusive agreements.

Stephen Gengaro:

Thank you. Just one real short follow-up; does it extend beyond basins? Do agreements to the Permian extend to the Bakken, or is it just on a contract-by-contract basis?

Troy Schrenk:

Yes, Stephen, this is Troy again. Yes, the exclusivity agreements and provisions can extend beyond basins, so it can cover the entire U.S., certain regions of the U.S., and also within a specific basin. But, it is also multi-basin.

Stephen Gengaro:

Oh, thank you, I appreciate it.

Brad Archer:

What that allows you to do is, you're getting the first call when you have that contract in another basin, for that facility. As Troy said, very powerful when you're looking at expansion or M&A activities.

Stephen Gengaro:

Thank you.

Operator:

Our next question comes from Scott Schneeberger with Oppenheimer. Please go ahead.

Daniel Hultberg:

Good morning, this is Daniel Hultberg on for Scott. With respect to the government segment, I mean, even (inaudible) news headline. Can you help us think about the impact to Target's business?

Brad Archer:

Sure, this is Brad. Look, when we signed this contract years ago, we specifically looked at this. The way we look at the business is, it's very similar to what we provide to our oil and gas clients. We're providing the assets, the catering and the facility management pieces of this business. When you look at it as a whole on what we're providing, very similar to what we provide.

Then you look at what this facility does. It's one of a kind, it's the only one of its—in the U.S. It provides the amenities that are provided there. Remember: this is an asylum-seeking women and children facility, only family units. There's not children by themselves being housed there.

Then I would tell you, the STFRC has been noted as best in class facility, and it's part of the U.S. government's permanent portfolio. That really goes back to how it was built and how it's operated. On our end, when we look at reputational risk, we just don't see that. It's very close to what we do in the other business segments, and we perform very well there.

Daniel Hultberg:

Got it. As a follow-up to that, if you could talk about the growth opportunities overall in the government segment? Thanks.

Brad Archer:

Yes, and this is a piece that is a little different from the oil and gas, when you talk about selling rooms and how you go about that. I will tell you, the demand in this side of the business far exceeds the supply. But

we can't go out and truly sell these beds. We're not going to the government every day and saying, hey, give us more beds. But what you can do in this business is you can put yourself in the right position or the prime position to expand once any new contracts are awarded. We've done that. We have the available land, we have the community relationships, we have all the entitlement.

The other thing we have is the track record with the U.S. government. We have the operational knowhow, so we've put ourselves in the best position to be that first call to expand when their budget allows it. That's kind of how we look at the government business on an expansion side.

Then I would tell you, the way we look at this government business as we lump it into the whole Target Hospitality structure, it's very stable, attractive cash flows, free cash that we can invest back into the business where we choose so for growth. It's great in that way.

Daniel Hultberg:

Got it, thank you. A final one for me, just housekeeping; could you clarify the bonus transaction in the quarter?

Andrew Aberdale:

Yes, sure. Hey, Daniel, this is Andy, thanks for joining. The bonus that you're talking about, probably the $28.5 million bonus, just as a refresher, I just mentioned it on the call; this was a cash neutral transaction to Target Hospitality, really a one-time, non-recurring event. The cash came into Target Hospitality, and the cash went out of Target Hospitality.

Target brought in cash from the previous parent, and you can see this on the cash flow statement and financing activities, and then the same amount was paid out by Target Hospitality per previous agreements, and you'll see that outflow in operating activities.

As for the P&L, you probably saw it show up in the SG&A, so that's really a one-time, non-recurring event for SG&A. As I said, keep in mind, this is cash neutral to Target Hospitality, so what we've done is we've excluded it from Adjusted EBITDA, adjusted net income and adjusted earnings per share.

Daniel Hultberg:

Got it, thank you.

Operator:

Our next question comes from Ashish Sabadra from Deutsche Bank. Please go ahead.

Ashish Sabadra:

Can you help us find the (inaudible) EBITDA from the 600 beds which are not included in your guidance? Can you also talk about the pipeline for new business going forward?

Brad Archer:

Yes, Ashish, this is Brad. On the pipeline, first let me say, very happy with Troy and team's performance on what they continue to do on the sales pipeline and continuing to grow those opportunities. As far as the Company, we're executing very well against the identified pipeline of new communities.

As we mentioned earlier, two new communities in the first quarter in the Delaware Basin, so we're very happy with that. We all know that's a very large piece of the Permian Basin, lots of large integrated suppliers there putting a lot of cap ex in that area. We look for that to continue to grow.

The other part of the pipeline, it represents a lower risk growth opportunity to expand the Target network through our guaranteed exclusive contracts.

Overall, as we said, it's very strong. The pipeline continues to grow, and we're happy with what we see, and continue to look forward to the rest of the year and performing on that.

Ashish Sabadra:

That's helpful, thanks, Brad. Then maybe a question on Bakken; the question there is, you've done some right-sizing there. Do you think there is any more opportunity for right-sizing Bakken, and then, is there an opportunity to also grow—improve the utilization in that region?

Brad Archer:

I think the Bakken is right-sized at this point. I think the utilization definitely has some ability to get stronger. That's an area we're starting to see some folks move back into. I'm not going to give guidance on the utilization there, but I would tell you, it is still an important part of our business that we think will produce good results.

Ashish Sabadra:

Okay. Thanks.

Operator:

Our next question comes from Jeff Grampp with Northland Capital Markets. Please go ahead.

Jeff Grampp:

Morning, guys, and congrats on the inaugural call here.

Brad Archer:

Thank you.

Jeff Grampp:

Hoping to get you all's take, obviously consolidation in the Permian a major topic here. How do you guys kind of envision Target fitting into that dynamic, and obviously, Anadarko's a big customer of yours and likely maybe have some new tenants at some of your facilities, or maybe not. But just curious as to kind of how you guys strategically view Target fitting in, should we continue to see that dynamic playing out?

Brad Archer:

This is Brad, I'll take that. Look, we like the consolidation. First of all, we're the best performer; we're the largest in the Permian Basin. We're the only one that can offer this network across the basin, so it sets us up very well. The biggest part I like about it, in these consolidations, it's usually the bigger—if you will, some of these integrated producers that will have the capital structure to continue to invest. That's the

way we've built our business, signing with these bigger companies that aren't looking at the short-term, and they're looking more on a longer-term spend.

We're positioned in these areas where there would be consolidation. If that is what happens, we like it. Anadarko is a customer of ours, as you said, but there's a lot of other big customers out there we won't get into that also have contracts with us. We like this because of the way we're set up as a business. We think it plays very good for us if there's consolidation in the market.

Jeff Grampp:

Great, great, appreciate those comments. On the M&A side, can you just talk in general what you've been seeing on that side, both within your existing markets there, and then any high level commentary you can make on—I think one of the slides talked about maybe some new markets you guys can get into via the M&A route. Obviously, I understand you don't want to share your cards too much, but maybe any kind of broad level commentary you can provide on what other areas you guys might find yourselves looking at?

Brad Archer:

Yes, on strictly M&A I'll address is this: we definitely have a pipeline of M&A opportunities that we're looking at, we'll continue to look at it. But, I think everybody on this call knows the way—we're very disciplined in our capital spend. Whatever we do, we're going to look at a build versus buy scenario and many other things. It's going to have to fit our models. We want to manage our debt to that two times leverage. All of this we'll take into account, but we are definitely looking at some M&A activities within what we do today. We'll see if they come to fruition.

Outside of that, we mentioned that we would look at some things outside of, if you will, the oil and gas piece of it. We will, but it wouldn't take us too far. It is definitely more of a bolt-on than anything, a little bit of a diversification, but it's not too far outside of what we do today.

Jeff Grampp:

Okay, great. Last one for me, a smaller one, any chance you guys could disclose any more specifically where that new 200-bed community is within the Delaware Basin, either by county or maybe proximal to some of your existing facilities?

Brad Archer:

I don't think we'd give that guidance today on that, Jeff. I would just say it's in the Delaware Basin, and I know you know that area very well. I know it's expansive. Again, as we said, it's with a very large player.

Jeff Grampp:

All right, fair enough. We'll stay tuned. Thanks for the time, guys.

Operator:

I would like to turn the floor over to Brad for closing comments.

Brad Archer:

Thank you. I want to thank all of you for joining the call today. I would also like to reiterate how excited we are to bring Target Hospitality into the public markets, as we have known for years what a great Company it is, and we are happy we can now share that with a much larger audience.

I would also like to say, again, thank you to the entire Target Hospitality team. I can get on these calls every quarter and tell you about all the good things we have to offer, but without our great people and their consistent execution, none of that will matter. I have always said that the hardest part of our job, and is really unique to our business, but we literally live with our customers 24 hours a day, seven days a week, 365 days a year. To do this, you must be able to execute. There is no one that consistently executes better than Target Hospitality. We are simply the best when it comes to execution, which allows us the opportunity to do so many more things across our Company.

Again, thanks for joining the call, and we look forward to delivering our second quarter results on our next call. Thank you.

Operator:

This concludes today's conference. Thank you for your participation.