National Energy Services Reunited
National Services Reunited Fourth Quarter 2019 Earnings Call
February 26th, 2020

Presenters
Sherif Foda
Chris Boone, CFO

Q&A Participants
Sean Meakim – J.P. Morgan
Igor Levi – BTIG
Greg Colman – National Bank Financial
Black Gendron – Wolfe Research
Andres Menocal – Evercore ISI

Operator
Greetings. Welcome to National Energy Services Reunited Fourth 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 today should require operator assistance during the conference, please press star, zero, from your telephone keypad. Please note, this conference is being recorded.

At this time, I'll turn the conference over to Chris Boone, the CFO. Mr. Boone, you may begin.

Chris Boone
Thank you. Good day, and welcome to NESR's fourth quarter and full year 2019 earnings call. With me today, is Sherif Foda, Chairman and Chief Executive Officer of NESR.

On today's call, we will comment on our fourth quarter results and our overall performance. After our prepared remarks, we will open up the call to questions. Before we begin, I'd like to remind our participants that some of the statements that we'll be making today, are forward looking. These matters involve risks and uncertainties that could cause our results to differ materially from those projected in these statements.

I, therefore, refer you to our latest earnings release filed earlier today and other SCC filings. Our comments today may also include non-GAAP financial measures. Additional details on reconciliations to the most directly comparable GAAP financial measures can be found in our press release. Which is also on our website.

Finally, please feel free to contact us after the call, with any additional questions you may have. Our investor relations contact information is available on our website.

Now, I'll hand the call over to Sherif.

Sherif Foda
Thanks, Chris. Ladies and gentlemen, thank you for participating in this conference call.

We are very excited to report on this quarter's and our 2019 results as well as some of the key events since our last call which will have a significant effect on how 2020 shapes up for NESR. I am also going to spend a fair bit of time talking about our recently announced unconventional operations in Saudi, and our latest announcement to acquire SAPESCO which greatly enhances our position in the region and will open a new market to NESR.

This quarter was a record quarter as we grew our revenue 17% year-over-year and 15% sequentially despite geopolitical turbulence in North Africa and Iraq.

As you have seen recently, tensions continue in Libya whereby the situation has escalated in the last quarter and the production is down significantly. We continue to monitor and adjust accordingly, and we have not changed our view on what we want to do there and the overall potential for us. Similarly, in Algeria, the political situation is in flux and this affected the Rig activity and efficiency of operations. Again, we continue to be close to our customers and ensure we support them as best we can in those difficult situations.

Overall NESR grew at an average growth rate of 20% over the last two years and this is on the back of growth across all our portfolio. Chris will cover the details on the numbers, but I want to highlight some key points.

I believe we are one of the few, if not the only one, which grew at this pace and are slated to grow significantly in 2020, and in the near future. We secured most of this growth for this year and we have bigger plans for the future. Also, we are proud to deliver on all the promises we have provided last year.

So, this growth, gain in market share and financial performance needs to be seen in the light of a very competitive, oversupplied and sometimes irrational pricing behavior in the service industry today. This is a credit to the resilience of the Middle East market, innovative business models we have developed and how well we understand our customers and the environment in which we operate.

Most importantly, all this growth has also been achieved while maintaining stellar Health, Safety, Environment and Quality metrics as perceived by our customers. As a strongly people oriented and customer focused organization, we have achieved over 70% reduction in Lost Time Injury Frequency rate even though in the same period our headcount has increased by 25% and overall operating hours increased by approximately 50%.This is a remarkable safety performance as per the highest international standard.

In our business, your service quality and service delivery is as good as what the customer thinks of you and I am very proud that again this quarter our main customer ranked us the best service delivery provider when measured in terms of Non Production Time. This belief of our customers that we are capable of delivering the stretch goals and beating the best even though we may not have the history like the others in those business lines, is a strong testament to our ability to execute on what we say we are going to deliver.

Which brings me to first main topic: the commencement of our unconventional fracturing operations in Saudi Arabia.

I will touch base on the bigger macro picture before I delve more into the specifics of our Frac Operations. What we are seeing today are seismic shifts happening in the industry in the MENA region. You recently saw the announcement from UAE on the discovery of the 80 TCF Jebel Ali Reservoir which is the largest discovery of a Gas Reservoir since 2005 followed by a bigger one: the Jafurah Basin of Saudi Arabia, which is a record 200 TCF of Gas. The size of the Eagle Ford. Saudi Arabia's intention is to become a gas and a petrochemical exporter. The Kingdom has been investing in gas exploration for a while, with impressive results, to boost its industrial footprint and increase the gas usage for domestic power consumption.

So how does this affect the oilfield services business and NESR?

We think that most of the incremental gas production will come from how fast our customers can bring these unconventional and conventional reservoirs online. So, a complete reset needs to happen from how they approached this when Gas was not the prime focus…. Our Customers want a break from the old ways and really want to adopt a business model where they are able to leverage the best and brightest ideas and execution across the value chain to speed up the delivery of their key objectives.

This is where NESR has been instrumental in changing the paradigm in the region.

We started discussions with Saudi Aramco in the first half of 2019 on deploying a North America style High Efficiency Fleet as well as duplicating our existing solid performance in Coil, Testing and Site Management to the Unconventional arena. We signed a contract with Aramco…brought on NEXTIER (NYSE:NEX) as a partner, shipped the fleet as well as other technologies which we selectively procured and/or partnered with and finished the qualification, and executed trial jobs in the second half. And by the way, we broke all the records on stages per day within the first week and the stages in a month within the first full month of operations. Needless to say, our Customer is very pleased with our ground-breaking performance and has recently decided to award us a long-term contract for two solid years.

All this typically would take years in the previous way of working and landscape. We went from nothing to breaking records in 6 months. This not only reflects our capabilities but also our

Customer's nimbleness and willingness to think out of the box and innovate which is extremely commendable considering they are the largest company in the world.

Just to give you the scale of our operations of which Fracking is a subset. We take on the wellsite and everything from the Frac Trees to Wireline to Fracturing to Milling and flow back Testing until we give the producing well back to our client. All of this is part of our work scope. We also run the site which includes the Camps, Catering, the Sand Logistics as well as provide all the Chemicals. The scale of what we have achieved in terms of a cold start is an impressive feat. It is a credit to both our Teams on the ground and the support of our client's Unconventional Team.

Our innovative business model called for partnership. Rather than purchasing a new fleet, we opted to leverage the existing capacity and significant experience of NEXTIER (NYSE:NEX). This partnership also allowed us to leverage the supply chains of both the Companies resulting in a win-win to both the client and us.

Let me touch base on other countries in the region. We are now at full tilt for our Cementing Operations in Kuwait, increasing our market share on the back of solid startup which our Customer complimented us on. We also deployed assets in Libya which are now working in Q1 post qualifying the services. We gained competition market share in Oman and won couple of small contracts in India.

In Iraq, we won a large integrated contract with a Super Major that we never worked with before. This is a 3 (three) year contract which is a significant milestone for us as it gives us further diversification of our revenue stream in Iraq.

In the fourth quarter we opened a Casing Accessories manufacturing facility in Nizwa in Oman and was inaugurated in the presence of various dignitaries from the Ministry of Oil and Gas. PDO and other customers. The plant has the capacity to handle all the demand in Oman. This is ESG in action and one of the key sustainability drivers of the region: to ensure we bring as much of the value chain in the country to generate skills and employment for the nationals. We have previously demonstrated with our investments in the Drilling Tools and Fishing Businesses that we can create a large-scale manufacturing and maintenance setup and employed a large number of Omanis, essential for our In-Country Value mission. We are going to continue and grow our efforts in this regard, and we are completely aligned with the country vision.

In Saudi, we just completed the IKTVA 2020 forum during which we had the ground-breaking of our Research and Innovation Center: NORI

Now I would like to touch on the second major point on the call which we recently announced. That is our agreement to acquire SAPESCO, the oldest service company in the MENA region, with operations across Egypt, Libya, UAE, Kuwait and Saudi Arabia.

We have been working on this acquisition for a year now. As announced, the deal is financially accretive upfront and allows NESR to enter the last country in the MENA region. In addition, we gain a new product line, Industrial pipeline services, with a leadership position.

Egypt is one of the growth markets in MENA with their recent move to be a Gas hub for the Eastern Med. In addition, several new exploration contracts were signed with XOM and Chevron among others. Outside of Egypt, SAPESCO has contracts which we don't have like Slickline and TRS in Saudi, perforation and Cased hole logging in Libya. They have a strong leadership position in industrial services business in Egypt, and we plan to take it to our footprint of other countries and operations. We have immediately started partnering with them in countries like Saudi and UAE. NESR will obviously introduce its business lines which today SAPESCO does not offer in Egypt like Cementing, Drilling and downhole tools etc.

On an unaudited proforma basis they finished the year with approximately 65 million in revenue and 20 million in EBITDA so their margins are in line with ours. We expect to close the transaction by April.

We have spent the last two weeks in Cairo to finalize this deal and I can tell you that both sides are super excited with the opportunities it provides to grow. We also held our Board Meeting there and we are totally committed to our customers to invest in Egypt. We also had the honor of hosting the Minister of Petroleum and he was kind enough to share his vision for the Egypt Upstream sector and we are proud to be part of this great story.

Chris will talk about the deal numbers in detail but in summary we are funding this transaction wholly by ourselves on the back of our very strong free cash flow generation.

And on that note, I will pass the call over to Chris, to talk about the financial in detail. Chris?

Chris Boone

Thank you, Sherif. Fourth quarter revenues were $185 million, an increase of 17% over the prior year quarter and 15% over the third quarter. Adjusted EBITDA is $52 million for the fourth quarter of 2019, increasing 8% over the prior quarter. Year-to-date, our adjusted EBITDA is $186 million, which is 15% higher than 2018 for the combined companies.

EBITDA adjustments of $11.6 million for the quarter are primarily for costs associated with the unconventional qualification process, plus integration and restructuring costs. As well, we incurred certain discrete costs, consisting primarily of a non-cash actuarial expense due to the impact of lower discount rates on projected employee end of service benefits, and a non-cash increase in Algerian tax reserves. We do not expect additional costs for the unconventional qualification process to be incurred in 2020. Also, integration and restructuring costs in 2020 should reduce to primarily include SOX implementation costs and SAPESCO transaction and integration costs.

Adjusted net income is $18.9 million or $0.21 per diluted share, as compared to $16.2 million or $0.19 per diluted share reported in the third quarter. Reported net income was impacted in the fourth quarter from increased depreciation of $7 million. Higher sequential depreciation is primarily related to incremental, unconventional equipment's. The contracted unconventional equipment with Nexteer followed capital lease accounting and is depreciated.

This higher depreciation rate will continue in 2020, with quarterly depreciation also increasing sequentially each quarter by approximately $1 million to $2 million as our 2020 capex program is capitalized. In addition, once the transaction is closed, SAPESCO will add $3 million to $5 million in annualized depreciation and amortization, depending on final purchase accounting.

Moving to our segments, our Drilling and Evaluation segment revenue for the fourth quarter is $64 million dollars, growing 8% over the same quarter last year. Year-over-year results for D&E were led from our continued expansion of our D&E service lines from our market leading position in Oman to other geographies.

Adjusted EBITDA margins fell sequentially due to an unfavorable segment mix. Separately, our production segment revenue for the fourth quarter is $121 million dollars, growing 23% over the same period last year from multiple product lines. Adjusted EBITDA margin for the production group were approximately 33%, with a sequential decline primarily related to the impacted activity in North Africa.

The effective tax rate for the fourth quarter of 2019 is 37%. The fourth quarter rate was impacted by a non-cash Algerian tax reserve. As adjusted for charges and credits, including qualifying and other start-up costs, the fourth quarter tax rate was approximately 17%.

As we enter 2020, the effective tax rate should show improvement from the reported 25% effective tax rate for the full year of 2019 due to the reduced impact of start-up costs on pre-tax income and lower non-cash tax reserves.

In addition, we are actively exploring several tax planning strategies that we believe will positively impact our effective tax rate in future periods. Looking at the balance sheet and cash flows, free cash flow for the fourth quarter was $26 million. Operating cash flow improved significantly for the third quarter, due to improved accounts receivable collections, offset partially by new receivables from revenue growth during the quarter.

Gross collections were $207 million, that's a 34% increase over the third quarter of 2019. The company-wide focus on improving our billing processes to limit payment delays and increased customer outreach on past due invoices, produced positive results. Company-wide, day sales outstanding improved from 128 days in Q3 2019, to 110 days in Q4 2019.

During the first quarter of 2020, we expect to see further improvement in collections, including the release of delayed retention payments and other older receivables of approximately $20 million. Capital expenditures for 2019 were $111 million, as part of our efforts to invest in our growth opportunities.

In 2020, we expect the capex spend of approximately $100 million, but could trend upwards depending on the timing of cash payments. Cash and cash equivalents increased to $73 million dollars as of December 31st, 2019, while net debt decreased to $310 million, or a decline of $20 million since September 30th, 2019.

The decrease in net debt was primarily driven by improved working capital. Interest expense decreased slightly from $5 million to $4.3 million. As of December 31st, 2019, our net debt to adjusted EBITDA ratio was approximately 1.7 but should reduce to our target level of approximately 1.5 in future quarters, as collections continue to improve, and we see returns from our capital spending investments.

We will see a short-term increase in net debt from the SAPESCO transaction as we fund the $27 million cash portion of the purchase, repay certain debt of $22 million, and assume some additional short-term liabilities of $8 million. We will fund the $49 million of cash needed at closing from our existing cash balances in credit facilities.

We are excited to continue our journey as the national champion for the Middle East as we enter 2020. We closed 2019 on a high note, generating record revenue, while at the same time, significantly strengthening our balance sheet by improving collections and reducing net debt.

With this, I'd like to pass back to Sherif for his final comments.

Sherif Foda
Thanks, Chris. In closing, 2019 has been a very eventful year. We grew significantly our core countries and started in various geographies, added several technologies to our portfolio and invested in some unique start-ups. We broke all efficiency records for the Unconventional in Saudi and finalized an accretive M&A transaction which has opened a new market and a new product line for us. All this while maintaining stellar service quality, capital discipline and thinking out of the box for business models and partnership. I am very proud of the team and fully realize the pace at which we operate and make decisions is extremely dynamic and is a key to our success.

Looking forward to 2020, All I would like to say, the best is yet to come and 2019 was just a trailer to what you will see this year. We expect to grow at a more accelerated pace than the previous years.

On that positive note, I would like to pass it on to the operator for your questions. Thank you. Operator?

Operator
Thank you. We'll now be conducting a question-and-answer session. If you would like to ask a question today, please press star, one, from your telephone keypad and the confirmation tone will indicate your line is in the question que. You may press star, two, if you would like to remove your question from the que. For participants that are using speaker equipment, it may

be necessary to pick up your handset before pressing the star keys. One moment please, while we pull for questions.

Thank you. Our first question is from the line of Sean Meakim with J.P. Morgan. Please proceed with your questions.

Sean Meakim
Thanks. Hey, guys.

So Sherif, I'd like to start by talking about how you see the margin trajectory in 2020. Chris highlighted some of the start-up cost that impacted 2019 results. So, some lapping of lower numbers there should help. But specifically, can you talk about the mix in D&E that drove that lower margin in the quarter and how we should think about that trajectory through 2020?

Sherif Foda
Yeah, sure. So, Sean, the D&E, as we mentioned previous quarters, always had a mix of drilling and evaluation. And the drilling business that we have, the majority, has to do with fishing and remedial work; it actually fluctuates by month to month.

So, , sometimes you have a fishing work and jobs in that arena that is very profitable. And sometimes you have more of the rental business that is less profitable than the others. When you have a month with more evaluation work, then you get the more profitable month than the others.

That's why I always say, if you look at it over a year, the D&E segment more or less will stabilize on that rate. I don't expect it to go to 30%-plus like the production.

So, but quarter-on-quarter, the flux between them is always the mix between the drilling and evaluation. And inside the drilling, you have the mix of the segments.

Sean Meakim
Right. So, we got some mix, or shift, quarter-over-quarter for D&E in particular. And, I guess, bringing that back to the overall company margin trajectory, we've had also some mix, as you've taken in some of the cost plus work, that's impacted by some of the larger projects that you won, how do we roll that altogether? How should the margin trajectory look year-on-year or exit to exit? How should we think about how that trend to keep growing, volumes will keep growing?

There's not much dispute there, but then I think people were trying to get better handle on how the margins progressed given all these moving pieces of the business.

Sherif Foda

Yeah. So, our plan is to keep the growth on profitable grounds. And we always believe that, as we said before, we are in the upper 20s. So, when you think about the mix of the company and you think about what's going to happen with all the new contracts that we've been awarded, I would say, you will get, maybe, better growth rate, and you will lose one or two point on the margins.

So, if we are always within the window, as I always say between the 25% and 35%, some of the contract would still run above the 30% and some of the contract we are at the 25%. So, the mix should always be within that, between 25% and 30%. And definitely, when you have more of the cost plus, that gets you some of the quarters where you basically do a lot of this camps and catering etc., at the cost plus. Which is basically a bit of dilutive to our overall margin, but on dollar value is accretive.

So, I would say, to give you a number, we always want to maintain in the high 20s numbers, which is, anytime between the 28%, 27%, 26%, and this is where we always believe our quarters in 2020 will be at.

Sean Meakim
Right. Okay, thank you for that. And then just, the capex spend ran a little hot in the year-end, perhaps we're front-loading a bit for some of the growth initiatives for 2020. Working capital saw some improvements, still an ongoing effort. Chris made some helpful comments there about early in 2020, maybe there is some catch-up coming. Just, how do we think about balancing growth with preserving those margins like we just talked about? And then, generating more cash than we consume in 2020?

Sherif Foda
So, if I look at overall, and maybe I'll let Chris comment more. But if I look overall, our commitment is to keep growing at this, plus 20% year-on-year. And we are expecting to do even better in 2020.

As per our plan, a lot of the capex has been spent, and, kind of, taken to use, as a lot of these contracts we already contracted.

So, we know, we upfronted the capex, we knew that we would have to be ready. All the projects we talked about, being able to do all this kind of projects in six months, obviously, you have to have a lot of equipment in testing, coiled tubing, logging etc. And we see already that revenue stream coming.

And that's why we are going to have, including the acquisition of the SAPESCO, we maintained $100 million cap on our 2020 spend.

Chris, you want to comment more?

Chris Boone
And as I said, sometimes you may see a movement from one category to another between our net debt and capex. As I said, sometimes it's a decision of when we choose to pay things. If we have the cash, we may pay for them. If I don't, then we can just short-term borrow it and that delays the capex cash.

So, as we said, the numbers can fluctuate a bit. We have a general target that over an amount of time it will be the same, but it can be plus or minus that $5 million or plus. And I'm assuming we had a little bit of extra capex to support the unconventional, which we didn't necessarily guide to you last quarter.

Sean Meakim
Right. Okay, thank you for that feedback.

Operator
Thank you. Our next question is from the line of Igor Levi with BTIG. Please proceed with your question.

Igor Levi
Thank you. Hey, guys. So, you first talked about the unconventional opportunity in the Middle East, extensively about a year ago. And since then, you now have one of the two unconventional fleets operating in Saudi. So, that's a pretty big achievement.

The question is how much bigger could the unconventionals service requirement be in Saudi? And do you see any near-term opportunities for unconventional work in other Middle East markets?

Sherif Foda
Yeah, sure. if you look at the announcement of our clients, between both in UAE and Saudi and you can see the scale, it's quite massive. Much bigger than what we've talked about before, right. So, if you talk about today of Saudi Arabia and Jafurah basin, which HRH the Crown Prince mentioned last week, it's enormous, right?. It's the size of Eagle Ford. And as we said, based on the performance we manage to achieve in Saudi Arabia, now we know that actually less fleets can accomplish a larger number of stages because we managed to break the barriers of efficiency and are running at the same rate at what you see today as the Permian. Which was never achieved over the last six or seven years in the Middle East.

And today you have that scale. So, you know that you can do this number of stages per day and per month. So, if I look, are they going to add? For sure they're going to add, depending on the drilling performance. So, they are adding today, they are adding ways to develop Jafurah basin. And meanwhile, you saw that Abu Dhabi is having the same, I would say, big, big discovery. And hence definitely, you will see more activity in that space.

Today, as we said before in our last quarter, we are engaged with the three countries and we are qualifying our equipment and our services. And what we are saying, is once we see the opportunity at the right time to deploy the fleet, we will deploy the fleet and we have a very strong agreement with NEXTIER, with ready equipment, and we'll push the button when we know that we're going to get the contract. And we believe we can have the same success, that today, we have in Saudi Arabia.

I mean, you're talking about the scale that is much bigger than anyone would've ever thought.

Igor Levi
Great, that's very helpful. And where do you see the biggest risks in your 2020 expectation, is it North Africa, you had a few announcement there, but there has been some unrest there, or is it Saudi where you're having some of the biggest, fastest ramp up we've seen for your company?

Sherif Foda
You have to always remember, this has nothing to do with North America. This is the region dynamics on a long-term basis. So, even you have today the coronavirus and you tell me, is there any activity drop, zero. There is zero activity drop.

So, all these countries they develop and plan their business for long term. So, the difference that you have for the activity is usually a risk on the security or geopolitical risk. So today, for example, as I mentioned, you have Libya production now down to 200,000 barrels and almost shut down.

So, obviously much slower than what's expected. Some of the efficiency of North Africa and the rigs as well is affected. So, I would say, to answer for your question, North Africa and Iraq will always be the number one higher risk than other GCC countries because of security concerns. So, some of the clients, maybe, will not resume work until they feel it's been secure. And that, mainly, is the case.

If you look at a macro view and you say, oh, global demand will drop by another million barrels or something. Right, yeah, definitely our customers will adjust, but that will be across the entire group. But today, if you look at the plan, on our plan, and again, that is small. So, we know that we will not get affected, like, if someone has like a 40% market share. We today, we do not see risk on our 2020 numbers, except some small pockets in North Africa and in Iraq.

Igor Levi
Great. Thank you very much, I'll turn it back.

Operator
Thank you. The next question is from the line of Greg Colman with National Bank Financial. Please go ahead with your questions.

Greg Colman
Hey, thanks. Hi guys, congrats on a good-looking quarter. I hate to harp on margins, but I'm gonna. So, I'd like, just to come back and focus on that for a little bit and talk about the mix.

Sorry, phone problems there, I'm back at you, though.

If we look at the margins, which we saw EBITDA margins in Q4 were down 300 BPS year-over-year and sequentially down as well. But the production services revenue was actually up 25% sequentially. So, I'm just trying to reconcile that, because per your earlier comments Sherif, we always view production services has being the highest core margin part of the business. So, that's kind of point one, I'm just trying to understand the rising production services contribution with declining margins.

And then number two, is just more factually, your NEXTIER partnership, is that in production services as well? Is that where you keep that and is that additive or dilutive to that segment's margin contribution?

Sherif Foda
Okay. So, if I take the question, I think is the mix of margins. So, if you look back at the last four quarters or so, you will see all of this. There is always fluctuation of the D&E margin, that's actually quite big. I mean, 500 basis point or so.

So again, same answer I gave to Sean and because of the mix we do and because of the contracts we have, right. So, it's more of the fishing, remedial, downhole tools etc. some months it is going to fantastic month, with very high margins. If most of the activity is rental type of business, if most of your evaluation work is slickline basic business, you will get to the lowest end of the margin. So, this is always going to be the case. And it's not going to really be any different in the near future.

If you look at the production now, definitely all the gains that we have significantly on the contracts wins, majority of which came actually from the production business. So, we won a lot of North Africa, well intervention, which is coiled-tubing contract, we won couple all of this type of work in new geographies like Kuwait, like Chad, , and definitely now, you have announced our unconventional business that is quite huge.

So today, this entire unconventional is production, except the part that has flowback testing on it. And then, you have the effect of dilution of the margins due to the cost plus. So, you have the cost plus because you do the catering, you do the trucking, you do the sand, and all the stuff that is used to improve efficiency. The expectation should be that the practice is when it goes to a full-fledged site, you will have, maybe, a couple of points less than you are left of the production division because of all the cost plus that you do with it.

So, with that, if you grow that business for another 20% to 30% and you lose couple of points, it’s from a pure financial accretiveness perspective very acceptable.

Greg Colman
Okay, that's very helpful. Just to make sure I understand here correctly. The production services is higher margin contribution versus the drilling and evaluation? But the drilling and evaluation margins itself can vary greatly from quarter to quarter. So, even though we saw production services revenue up 25% sequentially, the margin pressures were because of D&E, that's where that variability sits?

Sherif Foda Correct.

Greg Colman
Got it. And then, and just finally, and I might have missed that at the end there. As we see the ramping of the unconventional work, as we see-- I've seen budget expansions tripling of Saudi commitment toward some of the larger reservoirs. I think you mentioned in your opening comments, but I can't remember if you did or not, we would expect to see a larger percentage of your business in that segment as well. Where were the margin profile of that style of work sort out on this spectrum that we're looking at, from sort of the low 20s into the 25 for the D&E, and then up to as high as 35 for the production services, where would that specific bucket of what seems to be more meaningful work for the coming couple of few years sit that margin grade scale?

Sherif Foda
Yeah. So, if you look at the production and you look at the unconventional, the fracturing business, it's entirely depending on the efficiency of what you do. So, if your very efficient and you perform the number of stages, like USA, as what we're doing with the pricing, it can go above 30% margins.

So, if you go in a month, where the efficiency is a bit below, for a number of reasons like readiness of well or pads, yes, you are going to go to the 20% margin levels more or less, right. So, it’s a mix, weighed on month-to-month, but our expectation of our philosophy of that contract, is to be within that range, which is below the production today of 30%, but to be always in the 20s. And depending on the month of efficiency, you can fluctuate that month and that quarter respectively.

Greg Colman
Got it. Thank you.

Sherif Foda
I hope that answered your question.

Greg Colman

It does. And I appreciate it. And then just one last one from me. Switching gears entirely on the M&A side. Every time I look at my screen things just keep getting cheaper over here in North America. With the oversupply of frac equipment here, some of the companies are trading, not necessarily just on frac, maybe expanding in technology. I know you just executed, on probably your largest purchase to date, but are you seeing an increased opportunity to pick up assets, either asset purchases or whole company purchases, in some of the North American stuff? Basically, playing between the weakness in the market here and the strength in the market in where you're operating, or is it kind of unchanged on the M&A front?

I'm basically trying to figure out, are we going to see a tick-up in your M&A activity in the coming, sort of, six months to nine months because of where asset prices are here?

Sherif Foda
Yeah. Again, this for me, I don't count it as acquisition or M&A. I count it as capex. So, if we find, which we discussed with several Canadian and US companies, if we find they have good assets and we can buy it at $0.20 to the dollar, or below, why not? We are open, we will look into it. After that we'll get very good terms and conditions and it has to be fit for purpose for Middle East. Because a lot of those equipment do not fit the Middle East operation and that's number one.

And number two, I'm not really focused on getting some of our, I would say, the old-type equipment, in a high-end operation we have in the Middle East. So, you have to balance this as well. Having to acquire a company as a whole, or do an M&A in North America, and bring it over to the Middle East, today we don’t think too much about these. Maybe, if strong opportunity arises in a technology arena then we could either do a partnership, or we could put investment in that company. But it needs to be what they call innovative technology, some like very unique IP, very unique state of the art technology that we can take it make it fit for purpose. It's like a start-up VC type of thing. Like we did with Kinetic, for the Wellheads.

So, this is something we like, and we are interested in. Otherwise, we don't see any value to bring some old equipment or capacity and buy the company. And as we always said, we are not planning to operate in North America. So, there is no market for us, or for that matter anybody, in North America.

Greg Colman
Got it. And then just one more thing, that your comments spurred one more question, which is you just viewed as capex, which is whether you're spending capex on organic or capex on acquisitive. Just more from a clarification perspective, is the money you're deploying for SAPESCO part of your $100 million capex budget or outside of that?

Sherif Foda
It’s part of it. So, we have the capex reduction from last year, because as I said earlier, we upfronted a lot of our capex. We already planned it, we already deployed it. And more capex is

coming for more growth. But at the end of the day, this effect of capex, that we planned for it, is included in our $100 million.

As I said earlier in my remarks, we've been discussing with them for about a year plus now. So, we've been in negotiation for a year. So, we know exactly what equipment we need to add to the portfolio to be able to take it overall for the Middle East, and that is included in the $100 million.

Greg Colman
Got it. I'm glad I asked. Thank you very much. That's it for me.

Operator
Thank you. The next question is from the line of Blake Gendron with Wolfe Research. Please proceed with your questions.

Blake Gendron
Hey, good morning. Thanks for taking my questions. My first, just one on Greg's line of questioning, is just on the overall market and maybe some of the behavior of your peers at this point. You mentioned pricing being irrational at times. I'm just wondering, just given the sheer deterioration in the oil price that we've seen, and coronavirus may or may not be impacting operations in the MENA region broadly, I don't suspect they are at this point. But what is the risk, if we see further fallout in US land, that your larger peers start to rotate capacity into the region, is it your sense that is some downside, I guess, to the way that they're behaving or they're already behaving somewhat irrationally at this point and there is not much to go further down?

Sherif Foda
I would say, Blake, it's again, it’s a mix. Most of, without obviously mentioning names, but you have some of the big guys, are disciplined and they look at the returns and they look at deploying the assets only when it makes sense and when it is accretive. Which is very good behavior and they are doing that. And some others are not, but overall you can see that lot of the contracts when is still LSTK and big, you find some irrational behavior in some geographies. However, service quality suffers, and the clients are very aware of that.

Blake Gendron
Okay, that's helpful. And then certainly back on D&E for a second here, I'm just wondering the progress that you've made in pulling through the GES portfolio elsewhere in the region, have you found that it's been easier to pull through more of the drilling product lines, or are you getting some traction on the evaluation side as well? I would imagine that some of the friction on margin, maybe is due to pulling labor throughout the region and kind of spreading the portfolio out that way?

Sherif Foda

It's really the Gulf Energy portfolio. To put it into perspective, Gulf Energy strength has been the drilling portfolio and it does have a decent Production portfolio in Oman but the main driver is the Drilling Portfolio. The idea has been to take this drilling portfolio which was very strong in Oman and win contracts in several countries, but these contracts in the overall portfolio represent lower margin type of drilling work. And once again, as you become a trusted partner to the customer and you grow scale, then your margin will improve. So, the margins are better for e.g. in Oman because this is their bread and butter, very strong set up that they have over the last several years but not the same everywhere else. When you grow this into Algeria, Saudi, Kuwait, Iraq etc. with the start-up costs taken into consideration, definitely, this is not as profitable because you are adding a lot of capex e.g. in the business of fishing you have to carry a lot of inventory of different types of fishing equipment and use it when basically when the customer has a problem. So, need to look at utilization, optimization and scale to make higher usage. So, that's why, as well as all this fishing work, is not for everybody, right. It's a tough business.

But overall, if you look at the margin compared to the industry, it is actually normal. Because that margin, as you know, in many other places is negative today. So, when you grow our business at 16% to 20% it is still good, right. So, and you have to start like this because it's small, until it becomes big enough to operate and have a scale to improve your margins. But as I always been saying, do not expect it to be above 30%.

Blake Gendron
Got it. That's helpful. And then one more if I can slip it in here, on the M&A side. It was a pretty slick deal that you structure with SAPESCO. I'm wondering, just given that equity prices across the border and be challenged here in the foreseeable future. Same opportunity, as was mentioned earlier on the call, but if you have to now go forward with mostly cash and debt transaction, I'm just wondering if there is a maximum leverage that you guys would be comfortable with not going above, essentially? And if that, potentially limits, I guess in your term, M&A opportunity for you in the region now?

Sherif Foda
No. I mean, obviously, as we said we don't want to ever go above debt to EBITDA of two. Also barring two countries one of them being Egypt we did not really need to do an M&A to get scale there as we are in all the Countries and we managed to also enter the other country without an M&A where we were looking for an M&A to enter earlier. We are still looking for deals which make sense, but the urgency is not going to be there.

On this one, as you saw, the numbers are accretive, very solid, so you get two birds with one stone, I would say. You get to enter, what is the last country, which is Egypt, and you get this industrial pipeline service that we don't have.

And today, just to give you a scale when they did in the Zohr project, which was the largest gas project, I think worldwide, that went from exploration to production in 22 months, to now produce 2.7 BCF a day, and they have now similar projects upcoming between the four countries around the Meditteranean. All of them would need that service. And SAPESCO managed to do that because they have that leadership position.

And with our footprint now, we are bringing that experience and that number of years into all the countries. Just to give you a flavor. Most of these, when we try to do this ourselves, or even the previous companies tried to do this alone, NPS and Gulf Energy, they could not because the clients, require 10 year to 15 year experience for you to be in this business in that country. Because obviously they are very worried that you work on the EPC business and have an issue. So, they require you, how long have you been doing this, what is your experience?

Also, we got to leverage their experience in services which we also are present but can't bid in countries where they ask for in-country experience. So, these guys are approved and qualified in Saudi, and Kuwait, and UAE, and all these countries. They didn't go ahead and capitalize on this, because they didn't want to spend the capex in all these countries to enter.

Today, we have most of the equipment, but we need the expertise and the know-how and the number of years in the country to qualify. So, all of the sudden we have all these countries open and are allowed to bid for all of them. So, it was very obvious why it made sense. Because again, once you have an M&A that has almost no overlap, it's the most accretive.

Would I look at other M&A opportunities, we would definitely look at others. I do not foresee anything that would require us to change our leverage in the future.

Blake Gendron
That's really helpful perspective. Appreciate the time. I'll turn it back.

Operator
Thank you. To ask a question today, you may press star, one. The next question comes from the line of Andres Menocal with Evercore ISI. Please proceed with your questions.

Andres Menocal
Hey, Sherif. Hey, Chris. So, this question pertains to the SAPESCO acquisition. And if I think about the past one year to two years, your team heavily been working on optimizing the back office, ERP systems, internal controls of your company. How will SAPESCO's operations fit into that and how you think about the operational risk profile of the company?

I guess, my question related on top of that is, do you plan to leverage your new footprint in Egypt to rethink back office and corporate footprint of your company?

Sherif Foda
So, actually, one of the very strong strength of SAPESCO, which we didn't mention before, is they have a deep talent pool of people. They also adopted a full SAP based management

system which is very interesting for us. And they have a very strong 10 years' experience on this system with a full back office implementation team inhouse. So that's another part of what we love about the acquisition. Obviously, we need to study it and Chris, has the full team to look at that. How can we take that? Should we take it across the country, is the team ready to deploy it?. We are evaluating and will shortly make a decision.

The other advantage, obviously, of having back office for the functions in Egypt, is definitely the low cost, right. Egypt is a very cost competitive country, and we will be able to deploy many of our remote monitoring initiatives like journey management etc. So, over all we will look at what we can take from their 40 years of experience and apply across the Company.

Andre
Okay, great. Thank you for that. And then my second and last question is, I need to touch again on the point on margins but let me just try to approach it a different way. So, if I read through the proxy that you guys filed in early November, and I appreciate that you disclosed your compensation goals and pay for performance framework when you are not really required to do that at this point. So, thank you for doing it. For your short-term compensation goal, Sherif, I see that you have different targets for revenue, EBITDA, and you kind of have a target, you have a superior target and then you have an exceptional target, right, with different implied EBITDA margins reached. But I think, in the exceptional targets that you set for yourself last year, which is implied, like, 33% EBITDA, versus the target, which is like 20%, 29%, what would have to happen in your business in order to get to those target margins? I mean what kind of things that we have to see, right, and is really needing that 28% to 29% level, your target implied EBITDA margin for your short-term goals. Is that, maybe, the more appropriate way to think about things going forward?

Sherif Foda
So, okay. I mean, obviously, I don't want to give guidance. But if I look at the growth profile. If I want to go into only businesses which will do 32% margin, etcetera, we can for sure right but obviously it will limit some of the growth that you see.

So, if I take my core business, for example, I go in production business and I remove all the add-on, and I remove all the add-ons on the D&E, all the catering, camp, and IPM type integrated approach, I'll be at that margin. So, at the end of the day, we are now going through a set-up, like for example, when I do to unconventional, I'm doing this to grow and build on the setup costs to then incrementally improve the margins. As an example, in the unconventionals, there is only one other company, a major service company, that is in that project and me. And basically, we are beating them for the last two months and building credibility with the client which we need to get into that business and then improve our position.

So, the idea now, are you capable of doing that business? You have to take on the full-on business of the size, of the camp, of the catering, of the sand. To do all this, it takes you to 27% or 26%, depending on how many stages you do in that month.

Is this the business you want to do? Yes, I will keep doing that because as long as it is dollar accretive. Also, if you’re going to grow at plus 30% year-over-year, for sure, you are going to take couple of points down on your margin. Right, it's accretive on the dollar, but it will affect your margin based on the profile of the projects you are taking.

We are talking now, as I said before and people obviously appreciate that, that you're taking a full-on large-scale development project in Jafurah that is the size like Eagle Ford. There are only two companies operating there and we are very proud that we are one of them. So, that is the scale and the magnitude and the potential for the future of this activity once it goes to the levels that Saudi Aramco announced.

Andre
Great, thanks for elaborating on that. That was all the questions I had now. I will turn it back to the queue.

Operator
Thank you. At this time, we have reached the end of our allotted time for question and answers and I will turn the floor back to management for closing remarks.

Sherif Foda
Thank you very much. And we're very, very proud of the year and we are looking forward to a very successful 2020 with much more growth than the previous year. Thank you.

Operator
Thank you. This concludes today’s conference. You may disconnect your lines at this time. Thank you for your participation.