03-Nov-2021

National Energy Services Reunited Corp. (NESR)

Q3 2021 Earnings Call

CORPORATE PARTICIPANTS

Christopher L. Boone
Chief Financial Officer, National Energy Services Reunited Corp.

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

OTHER PARTICIPANTS

James West
Analyst, Evercore Group LLC

J. David Anderson
Analyst, Barclays Capital, Inc.

Arun Jayaram
Analyst, JPMorgan Securities LLC

Taylor Zurcher
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Igor Levi
Analyst, BTIG LLC

MANAGEMENT DISCUSSION SECTION

Operator: Greetings. Welcome to the NESR Q3 Earnings Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] Please note this conference is being recorded.

I will now turn the conference over to your host, Chris Boone, Chief Financial Officer. Thank you. You may begin.

Christopher L. Boone

Chief Financial Officer, National Energy Services Reunited Corp.

Thanks, Alex. Good day, and welcome to NESR's third quarter 2021 earnings call. With me today are Sherif Foda, Chairman and Chief Executive Officer of NESR. On today's call, we will comment on our third quarter results and 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 we'll be making today are forward-looking. These matters involve risk 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 SEC 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 on our website.

Finally, 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

Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

Thanks, Chris. Ladies and gentlemen, good morning and thank you for participating in this conference call. The global commodity outlook is stronger than it has been in nearly two decades. On the oil side, as predicted more than a year ago, all the underinvestment and supply gap, along with North America capital discipline will lead to significant supply deficit which will consequently cause activity increases starting later in 2021. And this is what we are seeing now. As we have been very vocal about it, MENA region will carry most of the load, primarily because our customer always have taken the long view and have invested in spare capacity, as well as they understand that nobody but them will be able to fulfill this demand especially in the short term, and they can sustain it longer than anybody else.

This would put pressure on the talents and equipment from service providers to deliver on these needs, which, as you know, is a function of the health of the service industry. As I have been doing since the beginning of the pandemic, always wanted to be physically with our customers, listen carefully to their plans and needs, and feel the pulse of the evolving energy dynamics. This quarter is no different. I spent a lot of time in the field, in the different countries like Saudi, UAE, Oman, Egypt and Libya. Additionally, we started to have face-to-face industry forums, and I'm glad that I was able to attend and present in most of them.

I can tell you that everyone without exception is extremely bullish on the activities. They want to secure adequate resources to ensure deliverability of their objectives and also very focused on meeting their ESG goals and commitments. They are reviewing and discussing the service industry strength and weakness, and running proper sensitivity analysis on the different scenarios. This, again, reminds me of the 2005 super cycle.

I also led NESR's leadership visit to Libya to see all the customers in the entire country. We spend a solid week with the NOC and all the operators and visited the remote field locations. We wanted to ensure we are there for them at the highest level and we understand what is needed to restore the production to previous country-high. We are discussing together multiple approach and new business model given the nature of the activities and the fastest way to revive the production from shut-in wells.

Additionally, we are reviewing how to have a paradigm shift in using the existing resources, enhancing them, capitalizing on the fact we have 100% national trained workforce that understand the subsurface and the facility constraint. We have placed a multi-disciplined team to look at the entire value chain and proposed solution to our customer. Meanwhile, we are looking into the water scarcity using flared gas and how could we produce in the different fields in a sustainable manner.

Overall, we are completely aligned with our customer in the region for fast activity increases in the coming quarters. And this feedback from recent customer meetings gives me confidence that the outlook is very strong as we have predicted previously. Now, it is on us to demonstrate our industry-leading localization and execution as the national champion of MENA. Since we front-loaded our CapEx, as I have said before, NESR remains ready and nimble to meet the demand of our customers who will look to productivity and production capacity to new heights in the coming year.

We continue to invest in human capital and equipment as we are convinced that this cycle will last for several years and the talent gap will surely be felt very soon in the business.

Next, I want to turn to the ongoing COP26 climate summit and how the industry can be a total game changer in pushing the world and humanity forward in energy transition. Clearly, governments around the world are elevating the important issue of climate change, which will most likely result in laws and regulations that further incentivize green spending, particularly in Europe and North America. What the market may not appreciate is how our forward thinking customers in the MENA region are also taking leadership roles in the energy transition.

We have all seen the Saudi Green Initiative demonstrating its commitment to its people and to the world. I was impressed with the level of details they laid out their plans. Aramco, again, as a world leader, explained how committed they are to achieve net zero and how they walk the talk and put credible targets and how they will achieve it. Additionally, you also saw recent announcements from the Kingdom on the plans for using the gas from Jafura for generating blue hydrogen. And as you know, NEOM already has inked to build the largest green hydrogen facility in the world.

The key now is to remain pragmatic on how best we use our resources to achieve what is best for the humanity. We do not want just to pass the emission from one area to another. What we want is to lower the overall carbon footprint and how to achieve that while looking at all other angles from eliminating waste and elevating the lives of people under the poverty lines. As I expressed in my Hydrogen Panel during the Future Investment Initiative in Riyadh last week, all of us can play a major role in actualizing this vision by taking the produced water and using the electricity generated from heat from the producing gases, and facilities along the gas feedstock to provide the essential ingredients for this endeavor.

Our thesis is that the industry can leverage existing infrastructure and production streams to support the production of new energies like hydrogen. We have invested in technologies to deliver part of this workflow. And I personally see a great opportunity by leveraging all this new tech and mesh it with our existing footprint, technical knowhow, and more importantly, project execution capabilities.

This is where NESR ESG impact comes in. After we launched this new segment in January of this year, NESR has partnerships and investment in several technologies in particular in the water space, where I strongly believe our industry can play a vital role especially in a water-starved region like the Middle East. I believe once we prove the economics in separate project, this segment will be as big or even bigger than our other two segments.

Our esteemed customers play an enormous role in their existing economies, and they are all and will be at the forefront of development and adoption of green technologies, which will enable the transition with the aim of not only the largest oil and gas companies, but also the largest full-spectrum energy companies in the world.

On the water side, following the previously announced and ongoing water pilots in Iraq and Saudi, we have been in continuous dialogue with customers' inquiries and proposal for additional project in the region.

A key feature of this water market is that we are bringing new technologies in front of oil and gas producers. So it's a market that we are essentially creating alongside our tech partner that today do not exist. In emission detection, we recently finalized an MOU with another IP partner which we should announce shortly at [indiscernible] (00:10:28). To bring GHG and H2S detection capability to the region that is moving quickly to both quantify and reduce Scope 1 and 2 emission in normal upstream operation.

Similarly, we are also moving quickly in the realms of flare management and elimination. And I believe that there are fantastic bundling opportunities with both emission detection and flaring. Progress across all ESG impact sub-segment is being driven both bottoms up by NESR and continuously canvasing and evaluating the new energy technology landscape and also top down from forward thinking customer partners.

NESR flexibility and nimbleness is key in having these discussions and in bringing new ideas to the table. Our open technology platform, much like it has enhanced our oilfield service portfolio is also the key element in bringing new innovations to the ESG impact discussion.

Now, I want to turn to another key theme that is driving both our strategy and our positivity for the future, which is the progress we have made in our D&E segment with a number of key technology investment, breakthroughs, and partnership that will completely transform our capability in this segment.

So far in 2021, we have announced marquee technology alliances in the direction drilling tools with Phoenix Energy Service, a company that continues to break records in NAM and now doing the same in [ph] MENA (00:12:05) and Ulterra, the US leader in drill bit technology. Over the last couple of years, we decided to invest ourselves with some of the most innovative minds in the industry to come up with new state-of-the-art downhole technologies.

One of these investments is around rotary steerable technologies. And what could we – what new could we bring to the industry? Historically, typical development cycle has been in the range of several years, five to seven normally. Our aim was to do that in less than three years. And I'm glad that we have recently tested our innovative RSS tool with one of our customers, and we managed to deliver the well ahead of time with superior performance. We continue to test the tool with other customers, and we believe we will have a commercially viable, leading-edge RSS in the very near future.

The tool is designed to have minimum maintenance cycle and greater dogleg than existing tools in the market. This will complete our portfolio of drilling technologies and enable the company to enter that space. So with the market-leading motor, market-leading bit, the latest generation RSS, we feel fairly confident that we can offer our customers alternatives with the same quality and service delivery they have witnessed from us in the production space.

The recent D&E contract awards highlight the strategic focus of ours. During the third quarter, we announced more than $150 million in D&E awards across slickline, tubular running services and testing with several key NOC partners.

In terms of innovative breakthroughs, we've decided to increase our investment in Kinetic Pressure Control; they had successfully commercialized a deployment in deepwater and is receiving multiple orders from several clients. We have implemented successfully multiple clients in Saudi for the Fit for Purpose device for continuing operation. This technology today is relevant in all the base and globally, as this is essentially a true environmental ESG technology to take the probability of blowouts to zero. We see ample opportunity to put this technology through in areas with highest worth and those proximate to local communities given the clear safety and reliability future of this technology. For some of our customers, this is transformational as it now allows them to access reservoirs which were off limits before.

Another key investment we have done is ICE Thermal Harvesting where we are a significant shareholder and will form an anchor tech for our offerings around the hydrogen opportunities. This has now progressed with patents being granted and is generating significant interest from not only oil and gas, but industrial and power generation space. In one study, by utilizing the heat generated by power plant, this technology was able to deliver an additional 10% to 15% power versus what was previously being generated.

Summary. Our industry fuels the growth of the world and is the most reliable energy source. Alongside the oil production, we do generate associated gas sometimes wasted. And with each barrel of oil, we produce reservoir water that is again not used all the time, and we generate a lot of heat from the well all the way along the Pacific chain to bring this product to market. We are everywhere in this chain. And we can take these raw materials to help our customer deliver the plans and properly reduce the carbon footprint.

Carbon capture and storage is absolutely essential. Furthermore, the industry has the infrastructure. It just needs economical technologies and the regulatory framework to put all these together and deliver on the ground.

On that note, I will pass the call back to Chris to talk about the financials.

Christopher L. Boone

Chief Financial Officer, National Energy Services Reunited Corp.

Thank you, Sherif. Turning to our results, we reported quarterly revenue of $218 million. This is flat over the prior-year quarter and 7% [indiscernible] (00:16:44) the second quarter. The sequential decline was primarily driven by lower unconventional frac activity, partially offset by higher activity in Kuwait. Adjusted EBITDA in the third quarter was $49 million or 22% of revenue. This represents a decrease from 26% in the prior-year quarter and 23% in the prior quarter. The sequential decline was primarily driven by the leverage impact of lower production revenue.

EBITDA adjustments of $5 million for the quarter were mainly for head count restructuring costs, non-capitalizable project startup cost in certain markets, transaction and integration costs associated with our recent Kuwait acquisition, non-capitalizable SAP and SOCs implementation costs and certain non-cash FX charges due to currency weakness in Libya and Algeria.

Moving to our segments, our Production segment revenue for the third quarter was $138 million declining 7% over the same period last year and 10% over the prior quarter. The sequential decrease was primarily driven by lower frac activity.

Adjusted EBITDA margins for the Production group were 26% in the third quarter, down from 27% in the prior quarter, as we maintain our current manpower structure in anticipation of improved markets in upcoming quarters as clearly highlighted by Sherif.

Separately, our Drilling and Evaluation segment revenue of $80 million in the third quarter was up 13% compared to the same quarter last year, but down 3% sequentially. Adjusted EBITDA margins of 21% in the third quarter were flat sequentially.

Depreciation and amortization increased to $36.7 million in the third quarter compared to $35.1 million in the second quarter of this year. The sequential increase was primarily related to additional D&A from the recent Kuwait acquisition, as well as the impact of additional employee equity grants. We expect D&A to be in the $38 million range next quarter. Interest expense in the third quarter was $3.7 million, up from $3.2 million in the prior quarter due to higher debt levels.

The reported tax rate for the first nine months of 2021 was 19.7%. Excluding the net benefit of adjustments of reserves on prior year taxes, our reported tax rate would have been 22.9%. The sequential increase in our tax rate is due to an unfavorable shift in income across tax jurisdictions. We expect to improve upon this rate going forward as the income mix shifts more favorably and to the benefit of certain tax planning initiatives. Adjusted net income and EPS, which includes the impact of the noted EBITDA adjustments, were $7 million and $0.08 per diluted share.

Switching to free cash flow, we are pleased with another quarter of positive free cash flow generation of $17 million. This brings the year-to-date cash generation to $64 million, compared to $11 million in the first nine months of last year. While we continue to improve in our invoicing and collections, DSO increased by nine days over the prior quarter level still bringing a year-to-date DSO down 18 days, a strong accomplishment by the whole NESR organization. This sequential increase was primarily driven by the impact of summer holiday processing delays. We expect to see the DSO levels improve in the fourth quarter.

Capital expenditures in the third quarter were $18 million, down slightly from $21 million in the second quarter. In the fourth quarter, capital expenditure should increase to approximately $45 million, in line with our full year estimate of capital expenditures near $100 million. We continue to expect free cash flow in 2021 to significantly increase over 2020 levels due to flats planned CapEx, continuous improvement on fleet utilization, and improved DSO.

Net debt decreased to $326 million at the end of the third quarter, compared to $335 million at the end of the second quarter. The sequential decrease is primarily from higher net cash balances from the free cash flow generated in the quarter. As of September 30, 2021, our net debt to adjusted EBITDA ratio was 1.6, flat from 1.6 last quarter. Also, we remained in full compliance with our primary credit facility financial covenants in the third quarter.

As was noted in the press release, we're extremely pleased with the refinancing that was recently completed this quarter. We are proud to have entered into a green loan facility as part of the broader refinancing which is based on certain sustainability key performance indicators encompassing environmental, social and governance metrics. With the addition of two additional banks to the syndicate and increased commitments from our existing lenders, we have expanded the term loan capacity by $175 million, the revolving credit facility or RCF by $15 million and the working capital facility by $140 million.

We will utilize the additional term loan funds to repay the current $65 million RCF balance, $10 million of term debt acquired through the SAPESCO transaction and $36 million of short-term debt, leaving approximately $64 million of additional cash plus the full $80 million RCF to fund additional growth opportunities in 2022 or pay down additional short-term debt.

We will not be required to make any term loan amortization payments until the first quarter of 2023, and the term loan repayment period has been extended by two years. The increased working capital facility will provide us more capacity to issue LCs for contract bids and awards.

Also, we are pleased with the progress we have made on our SAP projects. We have implemented the system in countries representing approximately 80% of our revenue. We expect all of our operations to be using the new system for 2022 transactions. This will provide us a common and enhanced platform that will facilitate SOCS compliance in 2022 and provide opportunities to enhance financial reporting and analysis. In addition, we will be able to improve our back office efficiency by centralizing certain functions that were impractical when on multiple ERP systems.

Lastly, as you've already heard from most reporting companies, the activity bottlenecks from supply chain impacting our short-term growth are transitory, and we believe that burgeoning capacity tightness will give away the service pricing improvements in 2022 and beyond if the OFS industry as a whole stays disciplined.

In the interim, as we have shown with our margin performance, we will state vigilant on cost control and equipment deployment will be prioritized to margin accretive opportunities. Also, we will continue to strategically invest in our D&E segment as part of our long-term growth and portfolio strategy. We believe strongly that the next six months will be an inflection period and conversations after this period will be dramatically different than what we have had in the last two years for the industry.

NESR has strongly grown through the tough times for the industry, and we firmly believe that the next leg will come from how well we deliver on our core as well as new endeavors. We are squarely focused on this.

In conclusion, we are very pleased with even stronger finance and health of our balance sheet and the financial markets' appreciation for our strategy and outlook. I will now turn the call back to Sherif for his closing remarks.

Sherif Foda

Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

Thanks, Chris. To conclude, the MENA region will be an even more prominent engine for oil and gas, particularly given detailed and favorable feedback from my most recent visit to the GCC and North Africa.

Secondly, as we have heard and seen from COP26, FII, and the Saudi Green Initiative, transition is here. And although oil and gas will be an integral part of the global energy picture, the industry as a whole has to view this as an opportunity to evolve. And our customers are wholeheartedly embracing this leading the change within our industry.

For NESR, with steady progress in our ESG impact segment, we can clearly see how we can leverage existing energy infrastructure and expertise to not just pass emission from one spot to another, but to totally reduce the carbon footprint of the industry for the benefit of the world and humanity.

Third and finally, I'm extremely excited about the progress and results of our investment in the Drilling and Evaluation portfolio, especially our RSS given this was delivered in a record time. Meanwhile, our investments with our partners have been well-timed for the coming super cycle.

And now, I would like to pass the call to the operator for your question. Alex?

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we'll be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of James West with Evercore. Please proceed with your question.

James West
Analyst, Evercore Group LLC

Q

Hey. Good morning, guys.

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

A

Good morning.

James West
Analyst, Evercore Group LLC

Q

Sherif, we've heard from some of the larger service companies about their outlooks for 2022. You are clearly in the folk – your business clearly in the focal point of where the growth will be. I'd love to hear your thoughts on both spending growth in the MENA region in 2022 and what that means for equipment tightness and then, of course, like you said, leverage in the pricing.

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

A

Thanks, James. Absolutely. The region is going to go, as I said, as they spend on their spare capacity. And as they are looking forward in 2022, 2023, you're going to see a very sharp increase. In my view and my visit and my talks, I'm talking about the significant double digit. I mean, it might go in some countries above 30%, 35%. So it depends where do you start. Some of those, for example, like obviously the bigger ones will have a less percentage, and the smaller ones will have a much higher percentage. And the ones that had problems will have a very significant.

So if I look, for example, a country like Libya, I wouldn't be surprised of a more than 100% growth year-on-year because you're talking about revising the shut-in wells, adding rigs, trying to get the budget approved. And then obviously with this oil price, these guys make some serious money, right? So it's going to be seen.

As for the service industry, you wouldn't see the same growth pattern, unfortunately, because of pricing. So pricing discipline is not there yet. And what you're just going to see is you are going to see the pricing happening after the equipment tightness. So – and that's why I predicted last quarter it usually takes six months for the equipment and talents to dry up and caught up with the activity increase. Then you will see pricing capturing. All the large tenders today have seen a price deterioration in sometimes in the 25%, 30%.

James West
Analyst, Evercore Group LLC

Q

Okay. Okay. Understood. And then perhaps a somewhat unrelated follow up, but you touched on Saudi and the Blue Hydrogen Initiative, and I know that you're all over this and how you guys can leverage your skill set to help some of these companies and countries move forward with their hydrogen plans. Could you maybe elaborate a bit more because this is a – I think this is a huge theme, and something that's underappreciated by the market that the oil service companies roll in the burgeoning hydrogen economy.

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp. A

You're absolutely right. And I was very fortunate to have been in the panel during the FII, the Saudi Great Future Investment Forum and Initiative, and I was with the CEO of Aramco. And during that panel, we discussed actually how the whole, as you rightly said, the market totally underappreciate, that the whole infrastructure of having the gas infrastructure that today exists, for example, in Saudi, and how you're going to dig this, either if you go to the blue hydrogen with the feedstock and then separate it and how you do the carbon capture.

All this comes to what, to how to understand the subsurface, how to inject the CO2, how to put this into – a lot of activities. If you will look at the green and this is what I'm advocating that region starved of water, there is no way I'm going to use the RO plant and use electricity to get water to be able to make green hydrogen. I mean, that's basically again, we are passing from the emission from one spot to the other. What you need to do, can he energy sector itself use that water, and can we use the heat from all the facility, etcetera, to harness it, and make something out of it besides obviously the renewable. It's not this to replace this, but we can use the infrastructure. I think the service company will play a big role in that. That's why we are advocating and we are discussing and definitely, as I said, Saudi really had a very big leadership in that.

James West
Analyst, Evercore Group LLC Q

Great. Thanks, Sherif.

Operator: Thank you. Our next question comes from the line of David Anderson with Barclays.

Please proceed with your question.

J. David Anderson
Analyst, Barclays Capital, Inc. Q

Thanks. Good morning, Sherif. So expanding unconventional gas development has been kind of one of the more prolific elements of your growth strategy – growth story in the Middle East. You've been talking about kind of adding fleets in Saudi and now Oman. I recall a couple of weeks ago, Schlumberger talked about how they had won a large unconventional tender in Saudi and another one in Oman. The question on a lot of people's minds is kind of what this means for your growth strategy. Can you just kind of talk about that and kind of just address that issue head on, please? Thank you.

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp. A

Sure. So as I explained earlier in calls, what we have and what the market is having in the Middle East and – is a growth, exponential growth in the unconventional and the fracturing business and have been – I mean, even in your conference, I think I explained that this is going to go 5X to 10X, right, what it is. So if today what did we do for ourselves as NESR, we – I said we're going to have three to four fleets before the end of the year, and that's what we have.

Today, I have four fleets running. We have two fleets in Saudi. The third fleet actually going to start – just started or going to start in the next week. And we have a fleet in Oman working for a client as we are awarded a contract in Oman and we are actually fracking as we speak. So today we have four fleets in the region, three in Saudi and one in Oman, as we predicted.

The difference here, what people misunderstand or underappreciate, is the size and the scale. So the big fleet is definitely the Jafura, and this where it is very equivalent to the North America type of fleet, which is obviously what we have accomplished with our client, with Aramco over the last couple of years is a breakthrough. Together, we managed to get this 10 to 12 stage a day that will – that is unheard of in the previous life of all the company. So Aramco obviously leads that in a big way. What is – what's happening, and obviously I'm not commenting on others' comments or awards, but I can tell you what happened is the Saudis obviously decided that this is going to be a huge contract and multiple awards as they did in the last bit had to be awarded. So multiple companies were awarded that scope. So the same Jafura that is coming now for a huge scale up, as announced publicly, multiple companies were awarded. And definitely, I mean, the client are very smart, so they managed to get a very solid price concession to be able to because of the scale.

J. David Anderson
Analyst, Barclays Capital, Inc. Q

Okay. So the pie is getting bigger and unconventional. It's not that you're not getting shut out by any stretch. You're just – the scope is getting bigger. And in other words, I would imagine your slice of that pie is going to get bigger as well.

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp. A

Yeah. Basically the whole contract is much bigger. And as you know, I mean, this contract people have to understand as well. What we have been doing over the last couple of years was a multiple award as well. It was not only us. It's just because of the performance, we managed to be the sole provider. And the scope was available for – if you like, for one provider. Now, the scope is much, much bigger, and they managed to slice it to several, right? The issue becomes the scale, becomes the difference of the who gets bigger pie. It's who would usually sometimes is the cheapest one, right? So – and then that scale, the prices, as I said, Aramco is very smart. So they managed to get a very good price concession.

J. David Anderson
Analyst, Barclays Capital, Inc. Q

That's not surprising. Thank you very much for clarifying that. A little bit more specific though on Saudi rig count, I was wondering if you could just kind of provide a little bit insight. We don't have a ton of – the numbers I don't really trust on the Saudi rig count numbers that we see. Can you just kind of tell us what's going on the ground? I think we're expecting, kind of, some rigs to come in September and maybe, kind of, a slug of more coming on by year-end. Can you just kind of bring us up to speed on kind of what you're seeing on the ground in Saudi in terms of the pace of that ramp up and is it kind of what you were expecting? Is it a little slower? Just any, kind of, insight on onto that that you're comfortable sharing would be really appreciated. Thank you.

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp. A

Obviously, I mean, I would comment on this, David, that Saudi is a public company and they would definitely announce whatever they would like to announce. What they will tell you is on the activity is very evident. The plans, as they always do, is very long-term and they know exactly which increment and where to put the rigs, the facility etcetera, they do this in in a very coordinated manner. And I would say they are world-class in that.

So, what we are preparing ourselves is we're preparing again for that increase of activity to ensure that we have the equipment in the ground, so on the ground. So I ordered a lot of those equipment at the beginning of this year. And as you have seen from our CapEx number, despite the fact that you don't see it because there are all the delay of the supply chain that happened and the way the accounting works, we're going to take the CapEx only when it arrives. So we don't see that – you don't see it in our capital, but everything I ordered already was ordered in January, February, March. So we're going to have – we're going to take delivery of all this equipment in the fourth quarter and the first quarter of next year, which is basically I'm ready for their sharp increase of activity. So, whether this gets delayed a bit because of COVID to whether there is some shifting here and there, but at least I know I'm ready because I know activity is going to increase.

J. David Anderson Q
Analyst, Barclays Capital, Inc.

So it sounds like you think we're sort of on the precedence of this is to sort of a little bit of a timing issue, but it's pretty clear to you that this is coming?.

Sherif Foda A
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

Absolutely.

J. David Anderson Q
Analyst, Barclays Capital, Inc.

Thank you.

Sherif Foda A
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

Thank you.

Operator: Our next question comes from the line of Arun Jayaram with JPMorgan. Please proceed with your question.

Arun Jayaram Q
Analyst, JPMorgan Securities LLC

Yes, Sherif. Good morning. I want to maybe start. Clearly, NESR is engaged on the new energy opportunity set in MENA. And so, I was wondering if you can maybe help us frame the near-term versus the longer-term top line opportunity set for you over the next couple two, three years?

Sherif Foda A
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

Thanks, Arun. I think the immediate on the new segment what you will see because obviously this project, as you know, takes time. If you look, for example, at the hydrogen and etcetera, and people are talking about 2026, 2027, until you really materialize and see those projects into motion, what I think from a service company from us, I would see that you would see the top line very evident on the water project because that's I think, in my opinion, no brainer. The industry has to do this immediately.

It's really – we have to do that. You will see this in the flaring. You will see this in the emission measuring, and with the geothermal. So, I'm very excited with the geothermal as well. The latest patent that we got with ICE is impressive. So I see that happening in – I would say, in 2022. And more into 2023, 2024, you will see more of the carbon storage and all the other activity that comes to the whole value chain of the new energy. And again, I'm repeating, I'm here talking about a lot of it has to come that the existing oil and gas needs to be greener, and there is so much to be done for that.

I mean, you just saw the COP26 with the minus 30% methane. How are you going to do that? You need to stop all this pop-up valves and flaring and some of the operation time where it's 80% of that comes during that period. And if we have the tools to stop that and monitor it, immediately you have a quick win, right? And that is, I think, where we are very focused and that's why we have so many partnership and we did invest a lot of money for the last now two years. And I see this going to happen from next year. So the two pilot projects will be paid in Iraq and Saudi, so that will be already revenue from 2022.

Arun Jayaram
Analyst, JPMorgan Securities LLC

Q

Great. And just my follow up is I know, Sherif, you and your team had some boots on the ground in MENA. And so I'm just trying to – as we think about our modeling over the next six to eight quarters, trying to think about some of the near-term pressures you face on COVID and just general inflation and then your point about, the business hitting an inflection point at some point in 2022, any sense of how the margin progression could trend? And maybe about the – in terms of timing, when would you expect to hit that inflection point?

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

A

Okay. So definitely COVID is an issue, right, in the sense of moving, in the sense of extra cost and, as we said in a couple of quarters, we still carry that. It didn't go away and we still carrying the testing. A lot of it as well used to be paid by the government. Now it's paid – everything is paid by the company. There is no more subsidy on that. We still have the hotels. We still have the – for some of the times, you have to test the people every week when they are on the rig side, et cetera, et cetera, right? So all this costs, I think...

Operator: Ladies and gentlemen, we are experiencing some technical difficulties, please stand by.

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

A

Oh.

[Technical Difficulty] (00:42:18-00:43:10).

Operator: Ladies and gentlemen, we apologize for the technical difficulties. Please stand by. Our conference will resume momentarily. Again, please standby. The conference will resume momentarily.

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

A

Hello?

Operator: Hello, Sherif and Chris. You may proceed.

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.
A

Should I go ahead, Arun?

Operator: Yes. Our line is live. Arun, you may continue. I apologize for the inconvenience.

Arun Jayaram
Analyst, JPMorgan Securities LLC
Q

Yes, Sherif, this is Arun again. Hopefully you can hear me. I just wanted to get your thoughts on...

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.
A

Yeah. I heard your question.

Arun Jayaram
Analyst, JPMorgan Securities LLC
Q

Okay. Great.

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.
A

I heard your...

Arun Jayaram
Analyst, JPMorgan Securities LLC
Q

Just want to make sure. Great.

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.
A

And I'm answering. I don't know if you heard my answer.

Arun Jayaram
Analyst, JPMorgan Securities LLC
Q

You got cut off just maybe midway between in the second question. So...

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.
A

Okay. Okay. So what I was saying just to try to – I was saying that yes, the COVID cost is there and yes, the supply chain bottlenecks are severe. You see a 300% cost increase for the containers from China, for example, on a lot of our suppliers, the NOCs and the rest of the world. The pipe is ridiculous, the cost inflation. So between transportation and raw material is very significant cost increase.

Obviously, we managed it. We talked to the long-term partners to manage this properly. But the key again, I mean, let's not be – there's no secrets here. The key for all this inflation and all this increase of cost and all this is to align the pricing. You have to understand that the industry has been dropping prices since 2014. There is seven years of dropping prices. So now, when there is a big tender that is the sort of this LSDK-type contract and you know that your cost is increasing but then the leader of the industry go and drop the price by 30%, don't expect there will be any margin improvement, right? So the key difference – the difference would be that the industry itself has to be able to recoup some of this cost inflation because you cannot push your supplier and your provider or – any more, right?

And honestly speaking, some of the shipping companies today tell you very clearly take it or leave it. I mean, this is the new price. And if you don't like it, we have so many other industry that is requiring shipping. So just wait at the bottom of the line. So that's, I think, what is the key. For us, we are going to be, as we said, very selective in maintaining the discipline to ensure that we can keep growing but without deterioration our margins.

Arun Jayaram
Analyst, JPMorgan Securities LLC

Q

Great. Thanks a lot.

Operator: Our next question comes from the line of Taylor Zurcher with Tudor, Pickering, Holt. Please proceed with your question.

Taylor Zurcher
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Hey, good morning, Sherif and Chris, and thanks for taking my question. First one's on the technology partnership strategy that you continue to make a lot of progress on. In the recent months, you've announced a couple of tactics in Ulterra. And I guess I'm curious where we sit in this sort of strategy moving forward. You've got a number of them under the fold now. And moving forward, should we expect you to continue to explore additional avenues with respect to incremental technology partnerships to kind of round out the portfolio, or are we kind of in the latter innings when it comes to these sorts of arrangements?

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

A

Thanks. No, definitely, you're spot on. We are very, very, very focused in our strategy since the beginning of the company. The established, well-run companies in North America that have solid credible execution and solid credible technology, we will partner with them to go to the MENA region and propose those fit-for-purpose technology to our customer. And I always repeat that we are not an agent, we are not a promoter, right? So this is – we are a technical company. We look at this technology and check them, check this person has what, this company has what, does it fit for the basin of the Middle East, where from that basin this would fit? And we look at this technology and propose and then put something locally so well done to be able to execute it. And it is well made in the sense of I want to make sure that it has a localized people trained, et cetera, et cetera.

Look at our – so Phoenix, it had – it's been doing a great job in North America. I think they are almost had the leadership now in the US land. And [indiscernible] (00:48:36) the same with the drilling bit. We are there now offering this to our customer. We took Cactus, where again, with the leadership position they have, and we are – they have the trees rigged up in the frac in Saudi, and we are getting them through to other countries, et cetera, et cetera. So that is the type of partnership. And we keep exploring this all the time.

Now, we are discussing in some of the companies with the new energy and other stuff, and obviously we don't announce until we sign everything. So the agreement has to be credible [indiscernible] (00:49:12) and it works for both of us transparently, very equally. For example, let's look at – I will look at my friend Robert next year. So we decided to do that together in Saudi and we decided to do that in other places.

And then very, very smartly, for example, they're getting extremely, extremely busy in the US and we've decided together, Sherif, let's have a new arrangement where basically you take over the fleet financially so I don't have to – basically, I buy the fleet from you and we keep all the workflows, all the training, we train all the national people. They've been doing a great job. People go back and forth between North America and Saudi. And we have all the set of software, all their knowhow. We don't want to reinvent the wheel, right?

So everything that is – whatever the latest technology comes, we work together. And again, very, very solid partnership and then we decide. Maybe after that, for example, like next year, oh, I want to deploy another – for the time being, I'm very busy. Pricing is getting traction in North America. I'm extremely happy now. But we can keep the partnership and see when do we do it next. You see, this is the type of partners and the type of technology we want to do.

What we just do to conclude, what is so important for us with what we wanted to do in-house as well, and that's why I am like super, super excited when I went and visited our RSS. I mean, our RSS is going to be something new, like really something new. And I don't want – once we have a track record of commercial run, and then we are going to make now a very viable alternative, solid RSS tool to the industry, and that is what is the key.

So, then you can complete the portfolio, go to the customer with the things that are well-established, but then something new to the table, new innovation, then we tell them, by the way, we have a [indiscernible] (00:51:29), can have a low maintenance hour, and can drill the wells faster and very professional, and this is where we want to be.

So, partnership with solid people and innovation when it's something that I know that I can get something new to the customer, it's not just a me too, then I go and tell them we have a full portfolio.

Taylor Zurcher
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Good to hear. And that's a good segue into my follow-up which is on a rotary steerables – the rotary steerable market I imagine is largely dominated by the OFS big boys in the Middle East. And it's not like you're new to competing with those guys, but for RSS, certainly at the higher end of the technology spectrum. So, just curious if you could frame for us what sort of features with your tool might be a little bit different than what's currently out on the market? And I tend to think of RSS as requiring some element of R&D investment on an ongoing basis just to stay competitive with sort of the leading edge technology curve. And I'm just curious if you would agree there and who – how you're thinking about potential incremental R&D investment for RSS moving forward?

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

A

So, obviously, without giving all the secret sauce, so what we did is we put that investment two years ago and with partners. And the way it works is we have a setup where 100%, we have continuously invest and improve the tool on an ongoing basis. And that's why the way we do it is not – our innovative R&D setup is basically, we have the setup here in North America, we have the partners. We are small, I would say, part of equity holder of the company itself, and we have the tools to use it in our in our Middle East, and they are – they can sell and they can run the tool in North America and others. And that's how the whole setup works.

What features this tool would have obviously is a no secret. What's rotary steerable today the difference is, is what type of mechanism you do to steer? How can you stay within – is it a couple of feet? What – how you get the very solid and homogeneous hole to be able to have a good LWD and good getting running after that? And then the [indiscernible] (00:54:10), right? So our tool will have a superior feature in any – in every single piece of that once we commercialize. And my expectation is in six months. So we should have the tool commercialized, launched in six months as a commercial tool, and this will allow us to go after that market in the Middle East, which is a couple of billion dollars.

Taylor Zurcher
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Got it. Good to hear. Thanks for the answers.

Operator: Our next question comes from Igor Levi with BTIG. Please proceed with your question.

Igor Levi
Analyst, BTIG LLC

Q

Good morning. So to start, could you provide a little bit additional color on how the two water contracts, both the [indiscernible] (00:55:00) contract in Saudi and the brine contract in Iraq are progressing and as far as the revenue ramp up from that into next year?

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

A

So the pilot in Saudi is rigged up as we speak. And we are going to run the pilot. And as soon as then it proves the scalability, then definitely then we see which part that we should start with on the scalable setup, right? So I would say the revenue would come from January, but it's obviously to start at a very small number and then until you get the scalable plant.

On the brine contract in Iraq with our – with the one of the super majors, this is, today, is being constructed. So the revenue will come maybe in Q1. It starts when it's fully functional. And as I said, this is very innovative in the sense that it's real ESG in action, that's what we really like, which is basically you are going to replace what used to be done for years and years with something so innovative, removing all – you don't need to truck the salt, you don't need to truck all this wasted energy and take the produced water and take the aquifer, unused water, if you like, and make brine and send it to the different fields.

This is, I think, is going to get so much bigger because of the increase of activity in the different fields in Iraq. I mean, now with the oil price, it's a no brainer that they will – you will see significant increase of activity in Iraq going forward.

Igor Levi
Analyst, BTIG LLC

Q

Great. And you also mentioned that ESG could be bigger than the two other segments. What is your roadmap to get there? What has to happen? And do you think you'll be there by 2030 where 50-plus percent of your sales are driven by the ESG segment?

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

A

Yeah. I mean, if you're talking with all what you heard in the last couple of days in COP26 with all the infrastructure that the energy sector has to do to leverage and capitalize on what they have existing and if I look at the amount of carbon capture and storage, the amount of emission control in – again, nobody talks about that, but

I'm still very – my personal opinion, this is the low-hanging fruit is the water projects. If I look at all of this in addition, my personal opinion, this is going to be bigger than the other two segments by 2030.

Igor Levi
Analyst, BTIG LLC

Q

Great. Thank you. I'll turn it back.

Operator: Thank you. Ladies and gentlemen, we have reached the end of the question-and-answer session. I will now turn the call over to Sherif Foda for closing remarks.

Sherif Foda
Chairman & Chief Executive Officer, National Energy Services Reunited Corp.

Thank you. Thank you. Thanks, Alex. Thanks, everyone. And we are again extremely excited. And remember this, this is a super cycle. Whoever were around in 2005, this is going to repeat itself. So good time to be in this industry. Thank you very much.

Operator: This concludes today's conference and you may disconnect your lines at this time. Thank you for your participation and have a wonderful day.