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National Energy Services Reunited Corp. (NESR)

Q1 2021 Earnings Call

CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the National Energy Services Reunited Q1 2020 (sic) [2021] (00:00:10) Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to turn the floor over to Mr. Chris Boone, Chief Financial Officer. Please go ahead, sir.

Christopher L. Boone

Chief Financial Officer, National Energy Services Reunited Corp.

Good day, and welcome to NESR's first quarter 2021 earnings call. With me today is Sherif Foda, Chairman and Chief Executive Officer of NESR. On today's call, we will comment on our first quarter results and overall performance. After our prepared remarks, we will open up the calls 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 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 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.

Also, as noted in our press release, the company is still reviewing the potential impact of the recent SEC guidance on accounting for warrants issued by SPACs. Certain GAAP financial information that could be subject to adjustment will not be discussed on the call today. This information will be provided upon the filing of our quarterly report with the SEC.

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 hand the call over to Sherif.

Sherif Foda

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

Thanks, Chris. Ladies and gentlemen, thank you for participating in this conference call. I'm very pleased with our sustained momentum and solid start of the year. We continue to solidify our position organically and inorganically, in line with our strategy.

We grew 7% year-on-year, while the market contracted by around 25% and maintained flat sequentially despite the usual slow start that was evident by our peer average drop Q-on-Q of 5% to 6%. We had a solid free cash flow of $37 million on the back of good collection this quarter, which gives me a very positive indication of the year as expected.

I would like to thank our team in the field for their dedication, perseverance, and efforts to achieve those outstanding results, despite the evolving COVID situation.

Middle East is now seeing the effect of the wave 2 and continue to be in a semi lockdown mood, watching carefully what is happening in neighboring countries like India. We have maintained our 100% capacity of operations, despite several countries in the region putting specific quarantine requirement, which have certainly made the logistics a very complex exercise.

Our crisis management team continue to be running the show on a day-to-day basis, and we don't foresee it changing until we have a solid vaccination and ease of movement. Some countries are progressing very well with clear mandated vaccine to people entering the premises and operations. Abu Dhabi is a very good example, where our client provided the vaccine for everyone.

On the macro side, on the long term, Middle East continues to cement its place as the pivotal figure in the oil and gas landscape. No one can compete with the lowest cost producers. In addition to global pressure and speed to move out of fossil fuel and the acceleration of the renewables for power infrastructure, the region has an unmatched reserve, and the biggest demand market next door in Asia.

The growth market in Asia largely insulated from the dynamics you see here in the western hemisphere and will depend on hydrocarbons for many years to come, especially as gas continue to replace coal as a cleaner fuel.

The drive for the region is to concentrate on diversifying and growing the renewable and massive increase in gas production to meet the local demand, while investing in oil production to meet the global demand.

Hence, from our point of view our existing core business has an inbuilt recession-proof baseline growth, which I don't believe the larger market appreciate its magnitude. This will continue for decades and our aim has always been to turbo charge the growth with accretive strategies as the partner of choice to all our customers.

On the short term, we have been saying now for over a year that the oil markets will tighten on the account of US shale effect, not enough discoveries, and lack of investment in exploration to offset the natural declines of existing field globally.

The pandemic delayed the onset of this demand tightening and, yes, it also may have structurally changed the demand longer term. But this has only delayed the inevitable, as yet we don't see alternatives covering for the declines we see in the oil and gas supply.

As an immediate effect, we already see our activity now starting to increase and I see double-digit activity growth in the second half of the year. I believe all our peers are also saying the same. Although demand from key markets like India may get affected by the second wave there, I believe we are now firmly in an early stage of an up-cycle which is here to stay for a while.

Also, with a lot of major advocating reduced investment in oil and gas project or actively talking about exiting markets or even the space altogether, it gives more responsibility on the NOCs to remain the reliable supplier to the world. And hence, all roads lead to the Middle East; again, if you want security of supplies and long-term stability. Therefore, the Middle East gaining back that position as the swing producer.

Our customers are very wise and are already making the right moves to ensure they are able to meet this demand. We at NESR have seen this coming and have planned accordingly by frontloading our capital needs, actually started planning since the second half of last year.

We also have worked with our strategic suppliers to get first in line on some of the long lead time hardware, including pre-ordering some items with manufacturers to hold them in inventory which go in the equipment to accelerate our deliveries to catch this growth in H2.

We have been evaluating our needs this quarter and deciding to order more equipment and products for the second half and early 2022. We need to maintain a buffer of resources and be first to act when our customers need us; again, as the most reliable partner.

To focus now specifically on some of our operations, I wanted to talk about Libya. Libya, as all of you know, has gone through a lot of turmoil over the last 10 years, and lately has achieved a breakthrough and amicable political situation that no one has ever dreamed of, which in turn gives the country a good stepping stone for growth.

Libya has a lot of potential and production has dropped to almost 20% of its existing capabilities. As a start, the first million barrel is what they call the easier task. Then to get back to its full potential, you need a lot of rigs and massive rigless and workover activities.

We have been investing heavily since the beginning and now we have a solid base in both the East and the West, enabling us to service all the clients. We are adding product line and enhancing our facilities to ensure we can reliably answer all our customer needs.

In addition, we have an almost 100% national talented team with many years of experience under their belt. They know the customers and the NOC, and continue to be very close to them as we were since the beginning in the most difficult times. We need to provide technology and the product to swiftly increase the production.

Now let me move and talk about the technologies and segments. Here I have to specifically mention our progress in D&E this quarter. We have done very well by growing both Wireline and Slickline operations. And I'm very happy to say that we did the same amount of revenue for both this quarter as we did in the whole year prior to the merger.

We have deployed new tools to target markets, have managed to acquire several operating and Wireline slick units at the fraction of the price during the severe downturn last year in the US. It is a continuation of our drive to efficiently use our CapEx dollar and leverage opportunistic purchases as and when they come along.

On Drilling, we are making great progress operationally. In Kuwait, we have introduced new agitators as part of our downhole tools offering achieving record performance improvement, resulting in significant market share gain in our fishing services.

This quarter, we announced our partnership with Phoenix Technology for MWD and motors, and I'm glad to report that we have already run these motors in jobs designed and planned by us. And these jobs have significantly outperformed existing established players and broke ROP records for those sections. Actually, we broke existing records on 60% of the run, which is an impressive achievement.

To give you an example, we drilled this section in 30 hours instead of the field average of almost 60 hours, which means we saved the client more than a day in such a small section of the [ph] web (00:11:13). We continue to work on identifying key markets and get assigned rigs where we can demonstrate clear differentiation.

In addition, we recently announced our partnership with Beyond and we formed a new JV to operate and implement the market-leading managed pressure drilling technology, not only in our core MENA operation, but also in other countries in Asia and Africa.

With contracts awarded already in both Malaysia and Ivory Coast, we will be able to demonstrate better reliability, better drilling performance, better cost of ownership. Beyond has patented technologies that offer customers a more compact and practical full MPD package that takes less time to rig up, rig down, and it's easier to operate, saving time and money for customers.

As a result, it has become the leader in MPD market in the US and Canada. Unlike many players in the MPD specific spectrum, Beyond owns the technologies included in their MPD packages, from API monogrammed RCDs that outperform the competition by margins, up to 3 times to specialized state of the art MPD control and design software.

Another technology we are very proud of being an early investor and we believe is a game changer is Kinetic Pressure Control, who were recently featured on the cover of JPT. You may recall Kinetic, or K-BOS, has invented a device which merges next generation materials used in the space programs with military technology to address blowout prevention.

Essentially it acts as an airbag for the drilling operation. They have just completed the test on the drilling and coil BOPs, which have significant consequence on how our customer can safely conduct their operations.

As you know, blowout like Deepwater Horizon have significant negative environmental impact, and this device pretty much eliminates that possibility. And we are taking the lead in implementing it in the region. We have now a set on the ground which is shortly going to be qualified and tested so a great success in the making.

As you know, our performance has been achieved by continuing to focus on our execution capabilities, determination for the region, being the flagship MENA national champion, and our customer centricity. We are working relentlessly to provide a strong platform of technologies to enable our industry to produce efficiently and sustainably.

Part of our ESG IMPACT effort is our early investment in ICE Thermal Harvesting, which we believe is a very forward-looking idea on how to harness the thermal capabilities of the flared or produced gas to provide electricity.

We hope a pilot of this technology within a year and implement it in the region. We have also made considerable progress on firming up on our water-specific opportunities and are planning to run a pilot and technology demonstrator with one of our main customer.

We are also in the final stage towards an offering in the methane detection space and shall be announcing an investment and partnership to that effect shortly. This is something which will hit the ground running and we hope to run these technologies immediately.

Lastly, I want to convey that subsequent to our recent announcement on our acquisition in Kuwait, we have successfully closed the transaction and are effectively running the operation as we speak. I want to take this opportunity to thank Sheikh Mubarak and his team working round the clock with us to help grow this business.

These are accretive contracts from day one. And given our strength in cement and coal businesses, we can ramp up these operations significantly in a very short period of time.

Secondly, the Drilling Fluids product line, which was a very small offering for us, now graduates to a sizable part of the business in Kuwait and forms a baseline for our growth in the region. Kuwait is a big story for us as an anchor country that has significant reserves with a savvy NOC.

We grew organically, securing several contracts in drilling, cementing, testing, and now with this [ph] force multiplier (00:16:05) acquisition, we will have a substantial role to play and be part of the vision to transform the oil and gas sector.

Overall, as you have noticed and as promised, we have announced and closed on two major transactions in approximately one year in the midst of the pandemic. We have largely handled these internal resources to keep the cost in check.

More important, we demonstrated our ability to agree on terms and execute the deals with our own cash generated from operations. That ability would even enhance going forward, as we will generate more cash and will have the capacity for more technology and M&A accretive deals.

On that note, I'd like to pass the call back to Chris to talk about the financials in detail.

Christopher L. Boone

Chief Financial Officer, National Energy Services Reunited Corp.

Thank you, Sherif. Turning to our preliminary results, we've reported quarterly revenue of $212 million. This represents an increase of 7% over the prior year quarter and flat over the fourth quarter. The year-over-year quarterly increase was primarily driven from the growth of the unconventional product line and new contracts in Kuwait and the UAE. These offset lower activity in other markets and other service lines related to the impact of COVID, which had little effect on our operations in the first quarter of last year.

Adjusted EBITDA in the first quarter was $50 million, or 24% of revenue. This represents a decrease from 26% in the prior year quarter and the prior quarter. EBITDA adjustments of $2 million for the quarter are mainly for integration costs associated with last year's acquisition, transaction costs associated with our recent acquisition, and other restructuring activities.

As we highlighted in our last call, we continue to incur significant COVID-related labor and supply chain inefficiencies and costs. We are carrying incremental labor costs in anticipation of the expected market recovery.

However, NESR will be positioned to react immediately to new customer requests while our competitors are delaying ramping up their operations. As is our practice, we do not reflect any of these COVID-related or other items in EBITDA or EPS addbacks.

Moving to our segments. Our Production segment revenue for the first quarter was $137 million, growing 3% over the same period last year and 1% over the prior quarter. Adjusted EBITDA margins for the Production group were 27% in the first quarter, down 2% sequentially due to the increased proportion of pass-through revenue from hydraulic fracturing operations.

Separately, our Drilling and Evaluation segment revenue of $76 million in the first quarter was up 15% compared to the same quarter last year, but down 2% sequentially. The increase over the prior year quarter is primarily related to higher drilling revenue in Saudi Arabia.

Adjusted EBITDA margins of 24% in the first quarter were up from 22% in the prior quarter, but down from 25% last quarter due to varying activity levels and product line mix.

Depreciation and amortization increased to $31.8 million in the first quarter compared to $31 million in the fourth quarter of last year. The prior quarter had a benefit from a fixed asset valuation adjustment for the final purchase accounting of last year's acquisition. We expect D&A to continue in the $32 million range next quarter before the impact of the recent acquisition.

Interest expense in the first quarter was $3.2 million down slightly from $3.4 million in the prior quarter

Our adjusted tax rate this quarter, which includes the impact of the noted EBITDA adjustments and any potential impact of a change in warrant accounting, was 12.1%. Excluding the benefit of the release of reserve on prior year taxes ,the adjusted tax rate would have been approximately 20%, which we expect to continue to improve upon going forward.

Adjusted net income and EPS, which includes the impact of the noted EBITDA adjustments and any potential impact of a change in warrant accounting, was $13.6 million and $0.15 per diluted share.

Switching to free cash flow, we're extremely pleased with the record cash flow generated this quarter of $36.7 million, up from $32.8 million last quarter, a negative $13.6 million in the prior year quarter. The sequential free cash flow improvement was accomplished mainly due to another quarter of strong collections and lower capital spending.

We continue to improve on our days to invoice while most customers have returned to normal payment practices. In addition, we're able to collect retention payments earlier than expected and that boosted overall collections.

Overall DSO improved by 16 days over the prior quarter level, a strong accomplishment by the whole NESR organization. Additional actions are in process to lower DSO even further during the year.

Capital expenditures in the first quarter were $11 million down from $14 million in the fourth quarter. This reduction was due to the lower new CapEx orders placed in 2020 and improved utilization. In 2021, we continue to expect capital expenditures to be flat with 2020 levels to support planned growth and pay for existing commitments.

Free cash flow in 2021 should significantly increase over 2020 due to flat planned CapEx, continuous improvement on fleet utilization, and improved DSO.

Also another positive, net debt decreased to $302 million at the end of the first quarter compared to $323 million at the end of the fourth quarter. The sequential decline is primarily from higher cash balances from improved free cash flow and net debt payments.

As of March 31, 2021 our net debt to adjusted EBITDA ratio was 1.6, flat from 1.6 last quarter and should reduce to our target level of approximately 1.5 or lower in future quarters. Also, we remained in full compliance with our primary credit facility financial covenants in the first quarter.

In conclusion, in Q1 we put the company on an even stronger financial footing with our strong free cash flow generation and are better prepared for the expected upcoming market growth and additional inorganic opportunities.

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

Sherif Foda

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

Thanks, Chris. In conclusion, I would like to leave you with key takeaways. We are focused to be the trusted and reliable partner to our customers and have the capacity and resources to tackle their needs, while managing the pandemic and restrictions.

Two, we are already seeing activity starting to pick up, and I'm confident that we'll have very strong second half. Three, ESG IMPACT segment is progressing well with our water, flaring, and methane detection efforts. Four, we will continue to produce free cash flow and will invest in new partnerships and accretive M&A.

And on that note, I'd like to pass back the call to the operator for your questions. Christy?

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions. [Operator Instructions] And our first question comes from David Anderson with Barclays. Please go ahead.

J. David Anderson
Analyst, Barclays Capital, Inc.

Q

Thanks. Good morning, Sherif. How are you?

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

A

Good morning, David. Thanks.

J. David Anderson
Analyst, Barclays Capital, Inc.

Q

So, maybe I just start from kind of a bigger picture question to start with. So, operations in the Middle East are heavily dependent upon a lot of labor from Southeast Asian countries, including India, and as you noted at the top, there is a lot of COVID issues still in those areas.

I'm just wondering, as we look out into the back part of the year and we're all kind of seeing this ramp up, is there any concern that that this situation could delay anything. Is that a concern for you at all in terms of the labor situation and how that could play out to the Middle East?

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

A

So, as an industry, you're absolutely right, some of the players will get affected, especially the ones that are dependent or they have a very small percentage of localization. They will get affected, especially with the restriction being put today on travel. I think for us, being again very national and have very high percentage of nationalization workforce, we will not see any of the issues that the others will.

I would say in some specific countries where you still have a high percentage, the industry overall will get affected and we might get affected accordingly because of some of the delays, for example, of rig readiness. So, in some countries, yes, you might not have a rig crew, for example, if the current crew are being – there now already for seven to eight months, and they will not be able to get a crew change. Definitely, there is a lot of things going on to replace some of those people. But yes, you're absolutely right, if the situation gets aggravated, you might get some delays of those rigs.

J. David Anderson
Analyst, Barclays Capital, Inc.

Q

Now, Sherif, you were talking about sort of the balance between natural gas and crude oil in the region. And I think over the last 10 years I guess you could say that Saudi and some of the neighbors have really shifted spending and activity towards natural gas. And if I'm not mistaken, I think around 60% of the onshore rig count in Saudi is actually directed towards natural gas.

Not sure what it is today. But just wondering kind of bigger picture, the oil markets tightening, OPEC clearly looking to recapture share, do you expect this mix to shift back to more the oil side. Do you expect the majority of tenders now to focus on the oil side or does that not actually change because of their capacity situation?

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

A

I think you're absolutely right in the second half of your question. It's not going to change. I think, definitely they have the capacity again to put oil to the market. Let's say if the market gets even tighter and they need to put more than 6 million barrel, yes, you will have some short-term shifts of some of the rigs going to the oil to get some of this production.

But overall, I mean, their vision is to really get the gas in the different countries to be the main fuel for their internal demand. And always remember that most of this in the countries are done for internal consumption. The only one that has huge capacity to export is Qatar. But the majority of the rest is really using it for internal consumption.

So, this is not going to change. And you saw, for example, the Saudi leadership very clear on moving to renewable and to gas for all internal consumption, and really sparing the production – the oil production for export.

J. David Anderson
Analyst, Barclays Capital, Inc.

Q

And then my last question, if I can just squeeze one more in. You talked about kind of preordering equipment in front of kind of what you're seeing as a ramp-up, and want to make sure that you've got the capacity while others don't. We've seen the last couple of years it seems like you've been growing, everybody else has been sort of treading water.

Just wondering if you could just kind of give us an overall sense of the capacity situation over there. I guess, if you're preordering equipment, you must be thinking that the capacity situation is pretty tight. I know everybody's kind of looking a little bit different in terms of capacity. But just from your standpoint, your product lines, could this market really tighten really quickly in the back part of the year? It just seems like you're the only one who's really been spending any money over there.

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

A

I would say there is still excess capacity overall, right? What will happen is the readiness of this capacity. So, if I want to be a bit more specific, today I know that the market is going to get tight on some of the product line. For example, readiness of coiled tubing fleets. When you have all this rigless activity that is going to sharply increase and people are not planning for it.

Some people as well have issues with spare parts or equipment they did not prepare – they did not, sorry, repair during the pandemic. And these equipment, despite the fact they are physically there, but they are not ready to answer some of the jobs. The jobs as well are getting a bit complicated, where the client needs higher specs, longer reach, bigger pipe. And some of this activity, these equipment are not ready in each country.

And that's where I'm saying, we've frontloaded our CapEx. We looked at this last year. We have obviously – I explained it in the prepared remarks, we looked at the opportunity to buy some of the equipment. So, we bought actually several of those equipment at a fraction of its price, $0.20 to the dollar, and bought slickline equipment, wireline equipment, some of the high-pressure equipment, and we shipped all these to the Middle East, and we have that ready green tagged, as I call it, ready to be deployed.

So, it is very important. I think some of the smaller companies will not be ready at all for this increase. Already, I see them turning down jobs and we will be able to capture some of the work and some of the others as well – some of the other like, I would say, competitors, they have issue with cash, right? So either they have a restructuring or something like that. So, they are not capable of putting CapEx as we can, right?

And I think this is where the client looks at who has a buffer when they make a call and ask for this. So today, you don't see that visibility, but I am quite confident that this is going to happen in H2, and that's why we're preparing for specific market to have specific equipment for what I think they will need, and then I will be able to capture that before the others.

J. David Anderson
Analyst, Barclays Capital, Inc.

Q

That's a nice opportunity. Thank you, Sherif.

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

A

Thank you, sir.

Operator: And our next question comes from George O'Leary with TPH & Company. Please go ahead.

George O'Leary
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Good morning, Sherif. Good morning, Chris.

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

A

Good morning, George.

J. David Anderson
Analyst, Barclays Capital, Inc.

A

Good morning.

George O'Leary
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Just curious for little more color on the shape of revenues throughout the year. Q1 2021 panned out much more resilient than all your competitors and then our expectations, which was great to see. But I wondered if you could bifurcate a little bit between Production and the D&E segments and talk about the progression of revenue Q2, Q3, Q4, just if it's heavier in the back half or we see a nice ramp in the second quarter.

And just curious on the bifurcation between the segments, given some of the idiosyncratic factors that play in, like the M&A you guys have executed on the partnership with Phoenix that could provide a boost to the directional drilling side and already seems to be doing so. Any color there would be super helpful.

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

A

Okay, great. So, let me start with first the split. I would say that given, again, the size of the unconventional and the frac operation, with all the growth that we are seeing on the D&E, I would say the split will not change that much until year end. I would say, it's going to start to change maybe from next year. But until year end, I would say, you would see more or less the two-third/one-third in our business between Production and D&E.

In addition to that, as I said, the H2 is going to be very strong and, obviously, some of the countries will want to see some of their regulatory and production activity increasing. I would say, the demand of some of the production segments will increase. And even with the growth of the D&E, you're still going to get growth – or higher growth even in the Production segment because of that.

On your second part of the question, I would say, H2 over H1 is going to be significant. And as I mentioned, you're going to get a little increase in Q2, but really you will see the real increase in H2. And one of the reason of that, people have to remember that during Q2 you have the month of Ramadan, which we are in now and then you have the holidays.

So, this usually comes at a bit of a slower activity due to that. So, I would say, you're going to see real ramp up in H2, where obviously as well the clients wants to see clarity of the demand and clarity of the situation of the pandemic and the European opening. And then the boarder – I mean, you see most of the countries now are talking about 1st of July complete opening. Tourism is back.

You see there is a still lockdown. There is still restriction. Some countries did not open at all and you cannot even enter them, for example. So, what I would say, you're going to see a significant H2 over H1, and that's why I call it always a double-digit growth for ourselves, in my opinion, H2 over H1 revenue. I do not remember all your questions. You had something – yeah.

George O'Leary
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

No, that was great, Sherif. And then just drilling into the partnership with Phoenix a bit and pun fully intended there. It seems like now you're in a good position to compete with the largest players there and I think back to a conversation you and I had a few years ago when we first met in person in Houston, and that was kind of one of the areas you guys were really looking to press forward into and get more exposure to it in the Middle East. So, does this do all you guys need to do to compete against the big boys, so to speak, in that Middle East market on the high end of the directional drilling market?

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

A

No. The honest answer is, absolutely not. This is basically, as they call, a stepping stone on the drilling portfolio. So you have to differentiate the drilling portfolio today is you have the motors, high spec motors, MWD business, and then the real rotary steerable market that is the large part of the business, and today that part is with LWD, high spec or high end, right?

So, what we have been doing all along is we are very credible with our customer and we want to only bring partners that are reliable and they make a difference. So, what we looked at Phoenix and I was very impressed with what they achieved here in the Permian and replacing everyone on their higher high-spec Atlas Motors and the Velocity with the MWD.

So, what we said, we looked at the market in the Middle East, we segregated, and we said, why nobody is doing that in that market? Why those sections are being drilled with normal motors? And we had a very good agreement with John Hooks with Phoenix. And we agreed let's put those, but let's make sure when we go there and replace some of the competitors on those sections, we have to outperform. Otherwise, what's the point, right?

So, we did that and they did an outstanding job. And almost every single one we outperformed the existing field average that they call ROP. So I was actually quite impressed yesterday when I looked at the numbers. And actually we had an 83- to 84-foot per hour versus the average of 42, right? So, basically they doubled the ROP of that section, which is basically you can drill that section in 50% of the time.

So, if that section takes you today two days or, for example, the example I put there is 60 hours, we do it in 30 hours. That's day, day-and-a-half. If the rig count and spread rate in the Middle East cost you around $45,000 to $55,000 a day, day-and-a-half is significant, right? So you're talking about $70,000, $80,000. And if the price is the same or equivalent, then you already save this client. And that's where we see how can we grow this pie.

We have a full-blown technology road map on the drilling to ensure that we have all those factors, so we will have high spec motors working on our – working on MWD, LWD, et cetera, and this is when I would say I have solid portfolio and now I can tell you, yes, I can compete with the big boys for the entire drilling portfolio. But today, no, we are only specifically targeting that part of the market.

George O'Leary
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Great. I appreciate the honesty and the color there. That was very helpful context. Just to sneak in one more if I can, the acquisition you guys announced during the quarter, was nice to see and good to see you guys press into Kuwait further.

Just wanted to get your thoughts on pull-through opportunities that might emerge from that. Or is this more a Kuwait-focused acquisition? Do you have opportunities to pull those revenues into other geo markets?

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

A

No. I would say, yeah, this Kuwait basically make us, as they call it, an anchor country, like the big countries that we have. And this will make sure that we have that presence and breadth where we can have fantastic infrastructure. They have an amazing facility, three facilities. They have the solid, obviously, relationship and contracts for five years.

The only bar that, I would say, will make a big difference for us to go outside of Kuwait on this is the Drilling Fluids. So, today the Drilling Fluids they have is a state of the art. They just started that contract. They have a very strong base. And we will be able to demonstrate that ability to show some technology partnership that we have added to that contract and take that business the way we perform and showcase this to the other countries.

It's exactly like, for example, what we did in the frac business in Saudi Arabia. Today, as we are the leader in that business, we can demonstrate this to all the neighboring countries. They see what we're doing in Saudi, and Saudi with their leadership in how they perform this as a client, how did they make this unconventional a huge success for them, and we were a part of it as one of their provider.

Now, if we do the same thing on the Drilling Fluids and then show it to the neighboring countries, then you start to gain share on that $1.5 billion market that today we don't even touch, right? So, this Drilling Fluids is very good business that we just started now.

George O'Leary
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Thanks, Sherif. I'll turn it back over.

Operator: [Operator Instructions] Our next question comes from Igor Levi with BTIG. Please go ahead.

Igor Levi
Analyst, BTIG LLC

Q

Good morning.

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

A

Good morning Igor.

Igor Levi
Analyst, BTIG LLC

Q

On the ESG front, last quarter you talked about plans to convert infield water into drinkable water, as well as remove sulfate from water, so you can use lower quality water for drilling, [ph] storing up (00:40:26) higher quality water for drinking.

I remember you mentioned I think you were in conversations with three customers and thought they may pull the trigger on a project before the end of the year. I wanted to see if you could provide some color on how many customers you're speaking with. Is that still the plan in terms of timeline and such?

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

A

Thanks, Igor. Yes, absolutely, very exciting about the water, especially the freshwater part. And we are in the final stage of designing the pilot, sending it, and we will have the pilot in four to six weeks, I would say, in the country. And we will be able to see the benefits and the results of that facility with one of our major customers. And then, definitely this will be a showcase, if it works exactly as we said it will work, being able to remove the solids, being able to – and I would say, tested that in extreme conditions.

So, what we are working on is actually taking that technology to a different level. So, there is H2S, there is some oil content, there is very high salt and very high solids content. And we want to see can we design that pilot to be able to remove all this and get fresh water on the other side, right? So, yes, I would say, as promised, we will have that definitely before year-end. And we are, at the same time, in parallel negotiation with two other customers to make the same thing and making sure that we have this type of facility or a pilot as well before year-end.

So we're very excited about the water. And I would say that we should see that – and then, obviously, as we explained, we should see then after that big projects making able to convert those pilot to a big facility, because that's our aim, right, and the client as well. Most of our clients in the Middle East have huge, huge targets for their

ESG and their circular economy. So, you can see that they announced a lot of – like 5 billion trees, and there is a lot of activity going on today for this. And this, definitely will be a huge differentiation.

Igor Levi
Analyst, BTIG LLC

Q

Great. Thank you. And then, as a follow-up, could you comment on how your partnership with ICE on the geothermal side will contribute to your ESG goals? Is that something we're going to actually as well before the end of the year on that front?

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

A

No. This is now early investment, right? So, this is basically – if I give more – even color on that. So, the partnership we do is very important to differentiate. So, we do – some of established companies have a proven technology and we have that partnership, like for example we have with NexTier, like now we have with Phoenix.

We just announced Beyond, which is actually we took Beyond to a joint venture as well to operate with that joint venture into the international market, which is something that we announced and now we have two contracts awarded, so this JV will operate those contracts. And then, you have the early stage, what I call the innovative people that have something that is not proven, right? So, it is today ICE is an amazing ideas. They are working on some patents, they are working on some new technology, and here we become an investor.

So, we put money – this is like venture capital. So we put money and with other investors and they are going to work on the idea. They are going to work on the technology. They are going to test the technology, and then they have an [ph] EXP (00:44:34), then they have an [ph] E&P (00:44:34), and then we commercialize it.

So, as a small company usually this cycle can take up to two to three years, as a small company and a small – and very talented people like we have with ICE, we are targeting one year. So, 12 months for that [ph] EXP (00:44:43). So basically we put the investment, there will be call for an additional investment, and then the product will come in a year time for us to be able to take it and pilot test it.

Whether we're going to pilot test it directly in Middle East or we're going to pilot test it first in the US, then transfer it to the Middle East, that's yet to be seen. But today, Igor, we have around four or five of those that we are working on, and then it's – again, that's our R&D, and that's what I always explain, that's our philosophy of open platform.

So, we target with very innovative people, and we give them money to start a new project or a new tool or a new idea. And that's how we see how it will work, and then take that outside. We have one of them that we've been investing not more than a year, and it's – because it's heavy in electronics. I don't see this, for example, until next year. That's why we don't announce about it, right? But we are working on – that's our R&D arm, and that's how we do it.

Igor Levi
Analyst, BTIG LLC

Q

Okay. Appreciate the color. I'll turn it back.

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

A

Thank you.

Operator: And our next question comes from Blake Gendron with Wolfe Research. Please go ahead.

Blake Gendron
Analyst, Wolfe Research LLC

Q

Thanks. Good morning. Wanted to follow-up on the unconventional opportunity and really just frac broadly. I think before where there was more focus when this was ramping up, there was one unconventional fleet in Saudi, maybe another quasi-unconventional, [ph] cross-conventional (00:46:27) fleet in Qatar and maybe rotating between a few countries. What do operations look like now? And now that we're getting through the pandemic somewhat here slowly, but surely, what's the ambition to grow that part of the business for NESR?

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

A

Thanks, Blake. So, let me just emphasize. We have today two fleets in Saudi Arabia. So, we have – and they are working actively between Jafurah Basin and South Ghawar. And again, Saudi has been really pioneer in developing those fields and state of the art what they have done. So, we are working with them.

We are in discussion, as I explained earlier, with three other customers in other countries to start the frac business in those countries. The discussion is very active. Our ambition is to land two of those before yearend. So, as I explained before, our aim is to have four fleet in the country in those countries before yearend. And my expectation is we're going to have one in H1 and one in H2, right?

So, that's exactly – and then, obviously, you're going to see real revenue, I would say, in the second half of the year. The clients, majority – we have lot of clients that are working around the clock around those activities. You have to, again, differentiate in the Middle East between unconventional and the conventional. They do frac in the Middle East, but they do not frac what you know in the US, whatever you have.

The only – that style of multi-pads, 50, 60 stage per well is only done today in Jafurah Basin. The rest is really much smaller footprint. But you have a lot of fracs. You have fracs in Oman since very long time. They have tight formation. You saw the announcement of UAE with His Excellency and with ADNOC and Total and they exported – they said they exported the first unconventional gas from Diyab. It was announced definitely they have a huge program in UAE for the unconventional.

You have unconventional everywhere. But I think the main activity – or the matured activity is always going to be – obviously, is in Saudi because of the size. And then, you would see more and more coming. So, we are in very, very, I would say, good shape to announce hopefully the awards of those fracs before year-end.

Blake Gendron
Analyst, Wolfe Research LLC

Q

That's very helpful. Moving to the back half and the double-digit activity increase that you anticipate. It was helpful to hear about the equipment readiness. It was helpful to hear about the split between PS and DE. Just wondering in terms of your market share assumptions, it sounds like you're still going to be able to outmaneuver some of the smaller competitors that are maybe cash strapped.

It was our understanding, though, that through the pandemic you were able to also maybe outmaneuver some of the larger competitors, just because of travel restrictions. Do you anticipate those larger competitors perhaps reestablishing some share in the back half of this year or is it still very much NESR's for the taking, just given your [ph] nimblity (00:50:01) and equipment readiness?

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

So we're, obviously, very careful about everybody and we, I would say, have a lot of respect to every competitor we have. I would say that we have a path of our growth and our market share. I don't see this hampering or slowing down in the near future. Part of it is what we explained that we understand the customer extremely well. We have kind of, I would say, visible activity what's coming in the second half. We prepare those equipment. We prepare the people. Honestly speaking, I don't think anybody else is.

So, there is a lot of constraint on the smaller guys for cash strapped or profitability, et cetera. And some of it you have to really, I would call it, bite the bullet. And again, be socially responsible, especially with the pandemic not to release the people to make sure that you have your crew ready. You have to make sure as well you take care of them and their family, et cetera, and this will pay out, right? So, we have readiness in a lot of the countries, where I see our small competitors not ready.

I see, again, the cash strapped people or some of the competitors or even the international ones, some of them have some issues with the CapEx deployment. I don't see – I'm not saying that the big guys are not ready. They are, obviously. But I don't see them being able to take part of the growth that we are forecasting. I see that we are going to have the market share gain that we are planning, and I see that we are very confident that we're going to have the second half with double-digit on the first half. The path is clear and I would say that we will make our numbers.

Blake Gendron Q
Analyst, Wolfe Research LLC

That's totally fair. One more housekeeping one if I could squeeze it in here for Chris. It looks like very few charges and credits this quarter, obviously, versus last quarter and it was largely due to the transaction costs it looks like in this quarter.

I know we'd previously talked about logistics costs associated with pandemic and how you included those in numbers and not wanting to adjust those out. But, Chris, are those charges and costs still very much there? And do you anticipate those to moderate through the year? And do you have any visibility into sort of the pace at which those heightened costs moderate for you?

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

The costs are there. Like Sherif said, the real key is having the revenue growth that will absorb them and improve the employee utilization. That's really the key. So, it's just getting the leverage back on those employee costs. The costs will stay, they're not going away. They just need to be utilized.

Blake Gendron Q
Analyst, Wolfe Research LLC

Okay. Thanks. Appreciate your time.

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

Yeah. I mean, if I just may – maybe to complement what Chris has just said. I mean, if you look at our – the way we structured the whole thing of the CMT and Crisis Management Team, et cetera, is we just said that this is part of the business and you just have to live with it. You see what I mean. So, your PCR test, your extra people, your restriction on travel, your airport issues.

Today, for example – I just give you an example that if you want to go to one of the countries, they are requiring you – if you come from a certain – you have to stay in another country for 14 days. All this people go to that other countries, stay there for 14 days, and then after that, what they call they are from the green country, then they will be able to travel to the other one. And all this is part of our business.

If I look at our transaction and costs, which we take out – or we call out, that's all due to the nature of acquisition, M&A, lawyer fees, some of the exit of some people, for example, if we do some restructuring, and then all the stuff that we call out, like the preparation for SOX and et cetera, et cetera. That's the only cost we call out, because that's basically it should stop. And going forward you should not have that, right?

So, I mean, I would say you might see for a while; because we are very active in M&A, so you will see that. But definitely, as Chris explained, the pandemic and all the stuff, I cannot call this out, because this might stay for – I don't know how long. But definitely, as we said, the CMT and the way we operate, we keep it the same way because we don't know how this will last, when it's going to stop, how it's going to work out.

We are, obviously, working very hard with vaccinating our people. But we do this with the government and with the clients and with the customers in the different jurisdiction, right? So trying to elaborate more on it.

Blake Gendron
Analyst, Wolfe Research LLC
Q

[indiscernible] (00:55:17) source of upside potentially for you as we move through – I know you don't call it out and appreciate that you don't call it out. But understand that there is a pandemic related costs that's in there. And I just didn't know if it was going to be a source of upside potentially for margins moving forward.

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

Yeah. I mean, honestly,- there is – I wouldn't call it an – I mean, yeah, it might be. But I have to be as well be quite frank that you have as well – we save some costs because nobody is travelling except a couple of people, right? So, there is as well some cost avoidance working on a lot of people, especially on the management side on Zooms, et cetera, right, but yeah, might be.

Blake Gendron
Analyst, Wolfe Research LLC
Q

Thank you.

Operator: And I'm showing no further questions from the phone lines at this time, so I'll turn it back to management for any closing remarks.

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

Thanks, Christy. Thanks, everybody. Very excited again on solid quarter and, I would say, very bright future. Quite optimistic actually about the next second half and next year. Thank you very much. Thanks for your time.

Operator: And that does conclude today's conference call. Thank you for attending. You may disconnect your lines at this time and have a great day.