National Energy Services Reunited Corp.
Q3 2021 Earnings Conference Call
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Presenters
Chris Boone, Chief Financial Officer
Sherif Foda, Chairman and Chief Executive Officer

Q&A Participants
James West - Evercore
David Anderson - Barclays
Arun Jayaram - J.P. Morgan
Taylor Zurcher - Tudor, Pickering, Holt
Igor Levi - BTIG

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. If anyone should require operator assistance, please press "*" "0" on your telephone keypad. 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.

Chris Boone
Thanks, Alex. Good day. And welcome to NESR's Third 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 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 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. 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

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 under investment and supply gap, along with North America capital discipline, will lead to a 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, the MENA region will carry most of the load, primarily because our customers 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 will put pressure on the talent 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, I've 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 the adequate resources to ensure deliverability of their objectives and are 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 massive leadership visit to Libya to see all the customers in the entire country. We spent 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 highs.

We are discussing together multiple approach and new business models, 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 a 100% national trained workforce that understands the subsurface and the facility constraints.

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 water scarcity, using flare gas and how we can 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 push activity on 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 industry.

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 detail that they laid out in their plans.

Aramco, again, as a world leader explained how committed they are to achieve net zero and how they walk the talk to put credible targets and how they will achieve it. Additionally, you also saw the recent announcement from the kingdom on their plans for using the gas from Jafurah for generating Blue hydrogen. And as you know, NEOM already has aimed 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 emissions 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 expounded upon in my hydrogen panel during the future investment initiative in Riyadh last week, OFS 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 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 investments 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 improve the economics in several projects, 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 should enable the transition with the aim of not only the largest oil and gas companies, but also the largest fullstream 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 customer inquiries and proposals 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 partners that today do not exist.

In emission detection, we recently finalized an MOU with another IP partner, which we should announce shortly at ADIPEC. To bring GHG and H2S detection capability to the region that is moving quickly to both quantify and reduced component two emission in normal upstream operations. Similarly, we are also moving quickly in the area 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 subsegments is being driven both bottoms up by NESR in 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 investments, breakthroughs, and partnerships that will completely transform our capability in this segment. So far in 2021, we have announced marquee key 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 MENA, and Ulterra, the U.S. 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 new could we bring to the industry? Historically, the 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. 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 a minimal maintenance cycle and greater dog leg build than existing tools in the market. This will complete our portfolio of drilling technologies and enable the company to enter that space. So, with a market leading motor, market leading bit, and 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.

Recent D&E contract awards highlight this strategic focus of ours. During the third quarter, we announced more than $150 million dollars in D&E Awards across Slickline, Tubular Running Services, and Testing with several key NOC Partners. In terms of innovative breakthroughs, we decided to increase our investment in kinetic pressure control. They had successfully commercialized a deployment in deepwater and is receiving multiple order from several clients.

We have implemented successfully multiple trials in Saudi for the fit for purpose device for Coiled Tubing operation. This technology today is relevant in all the basin globally, as this is essentially a true environmental ESG technology to take the probability of blow out to zero. We see ample opportunity to pull this technology through in areas with high H2S and those proximal to local communities, given the clear safety and the reliability features 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 VC 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 inputs from not only oil and gas, but also the industrial and power generation space. In one study, by utilizing the heat generated by the power plant, this technology was able to deliver an additional 10% to 15% power versus what was previously being generated.

To summarize, 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 value chain to bring this product to market.

We are everywhere in this chain. And we can take these raw materials to help our customers deliver their 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.

Chris Boone
Thank you, Sherif. Turning to our results, we reported quarterly revenue of $218 million. This is flat over the prior year quarter and 7% down over 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 headcount restructuring costs, non-capitalizable project startup up costs and circuit markets, transaction and integration costs associated with our recent Kuwait acquisition, non-capitalizable SAP and stocks 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% percent in the third quarter, down from 27% percent in the prior quarter as we maintain our current manpower structure in anticipation of improved markets and upcoming quarters as clearly highlighted by Sherif.

Separately, our drilling and evaluation segment revenue of $80 million dollars 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 9 months of 2021 was 19.7%. Excluding the net benefit of adjustments of reserves of 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 through 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 dollars. This brings the year-to-date cash generation to $64 million, compared to $11 million in the first 9 months of last year.

While we continue to improve in our invoicing and collections, DSO increased by 9 days over the prior quarter level, still bringing the 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 expenditures 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 flat 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 30th, 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 facilities 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 forty 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 in 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 SOX compliance in 2022 and provide opportunities to enhance financial reporting and analysis. In addition, it 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 time 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 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
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 in 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 customer 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 emissions 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 result of our investment in the drilling and evaluation portfolio especially our RSS, given this was delivered in a record time. Meanwhile, our investment 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 questions. Alex?

Operator
Thank you. At this time, we will begin conducting a question-and-answer session. If you would like to ask a question, please press “*” “1” on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press “*” “2” if you would like to remove

your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the "*" keys. Our first question comes from the line of James West with Evercore. Please proceed with your question.

James West
Hey. Good morning, guys.

Sherif Foda
Good morning.

James West
Sherif, we've heard from some of the larger service companies about their outlooks for 2022. You are clearly in the – your business is 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 '22 and what that means for equipment tightness and then, of course, like I said, leverage on the pricing?

Sherif Foda
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 '22, '23, 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 35%.

So, it depends where you start. Some of those — for example, obviously, the bigger ones will have a less percentage, and the smaller ones will have a much higher percentage, and the one that had problems will be 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 revisiting the shut-in wells, adding equipment, 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 are just going to see is you are going to see the pricing happening after the equipment tightness. 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 would see pricing capturing. All the large tenders today have seen a price deterioration sometimes in the 25%, 30%.

James West
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, the oil service companies' role in the burgeoning hydrogen economy.

Sherif Foda
You're absolutely right. And I was very fortunate to have been in a panel during the FII, the Saudi great future investment form and initiative. And I was with the CTO of Aramco. And during that panel, we discussed, actually, how the whole, as you rightly said, the market totally under appreciates that the whole infrastructure of having the gas infrastructure that today exists, for example, in Saudi and how you're going to take 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 – how to understand the subsurface, how to inject the CO2, how to put this into a lot of activities. If you look at the green hydrogen, and this is what I'm advocating, that a region starved of water, there is no way I'm going to use a RO plant and use electricity to get water to be able to make Green hydrogen. I mean, that's basically, again, we are passing the emission from one spot to the other. What you need to do is scan the energy sector itself, use that water, and can use the heat from all the facility, et cetera, to harness it and make something out of it, besides obviously the renewal.

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. And that's why we are advocating, and we are discussing and definitely, as I said, Saudi really has a very big leadership in that.

James West
Great. Thanks, Sherif.

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

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

Sherif Foda
Sure. So, as I explained earlier in calls, what we have and what the market is having in the Middle East 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 five to ten "x", right, what it is. So, if today, what did we do for ourselves as NESR, I said we are 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 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 under appreciate, is the size and the scale.

So, the big fleet is definitely the Jafurah. And this is 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 to this ten to twelve stage a day that is unheard off in the previous life of all the company. So Aramco obviously leads that in a big way.

What's happening, and obviously, I'm not commenting on others' comments or awards, but I can tell you what happen is the Saudi's obviously decided that this is going to be a huge contract and multiple awards as they did in the last bid has to be awarded. So multiple companies were awarded that scope.

So, the same Jafurah that is coming now for a huge scale up, as announced publicly, multiple companies were awarded. And definitely, I mean, the clients are very smart. So, they managed to get a very solid price concession to be able to because of the scale.

David Anderson
Okay. So, the pie is getting bigger and unconventional. It's not that you're not getting shut out by any stretch. 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
Yes. 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 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 usually sometimes 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.

David Anderson
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 can 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 some rigs to come into September and maybe a slug or more come on by year end. Can you just bring up to

speed on what you're seeing on ground in Saudi in terms of the pace of that ramp up? And is it what you expecting? Is it a little slower? Just any kind of insight onto that that you're comfortable sharing would be really appreciated. Thank you.

Sherif Foda
Obviously, I mean — I would comment, obviously, David, that Saudi is a public company, and they would definitely announce whatever they would like to announce. What I 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, et cetera. They do this in a very coordinated manner. And I would say they are world-class in that.

So, what we are preparing ourselves for is we're preparing, again, for that increase of activity to ensure that we have the equipment 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 all the delays 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 take delivery of all this equipment in the fourth quarter and the first quarter of next year, which is basically — I am 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.

David Anderson
So it sounds like you think we're sort of on the precipice of this. It's just a little bit of a timing issue. But it's pretty clear to you that this is coming?

Sherif Foda
Absolutely.

David Anderson
Okay. Thank you.

Operator
Our next question comes from the line of Arun Jayaram with J.P. Morgan. Please proceed with your question.

Arun Jayaram
Yes, Sherif. Good morning. I want to maybe start — clearly NESR is engaged on the new energy opportunities said 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
Thanks, Arun. I think the immediate view 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 et cetera, people are talking about 26, 27 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, a no brainer. The industry has to do this immediately. 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. And I would say in '22. And more in the '23, '24 you would 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 that 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 off valves and flaring and some of the operation time. 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 partnerships, and we did invest a lot of money for of the last now two years. And I see this going to happen from next year. So, the two-pilot project will be paid in Iraq and Saudi. So that will be already revenue from 2022.

Arun Jayaram
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 in terms of timing, when would you expect to hit that inflection point?

Sherif Foda
Okay. So definitely COVID is an issue, right? In the sense of moving, in the sense of extra costs, and as we said in couple of quarters, we still carry that. It didn't go away. And we are still carrying the PCR testing. A lot of it as well used to be paid by the government now everything is paid by the companies. There is no more subsidy on that.

We still have the hotels. We still have, for some of the times, you have to test the people every week when they are on rig side et cetera, et cetera right? Should I go ahead, Arun?

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

Arun Jayaram
Yeah, Sherif. This is Arun, again. Hopefully you can hear me. I was just – wanted to get your thoughts on how you see the —

Sherif Foda
— Yeah. I heard your question.

Arun Jayaram
Okay. Great. Just wanted to make sure.

Sherif Foda
And I was answering, I don't know if you heard my answer.

Arun Jayaram
You got cut off just maybe midway between in the second question so —

Sherif Foda
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 NOVs and the rest of the world. The pipe is ridiculous, the cost inflation.

So between transportation and raw material, it is a very significant cost increase. Obviously, we manage it. We talk to the long-term partners to manage this properly. But the key, again, I mean, let's not be — 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 LSTK type contract, and you know that your cost is increasing, but then the leader of the industry goes and drops the price by 30%, don't expect there will be any margin improvement, right?

So the key 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 anymore, 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 industries that are 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 the degradation of our margins.

Arun Jayaram
Great. Thanks a lot.

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

Taylor Zurcher
Hey, good morning, Sherif and Chris. And thanks for taking my question. First one is on the technology partnership strategy that you continue to make a lot of progress on, and in the recent months you've announced a couple with Cactus in Ulterra. And I guess I'm curious where we sit in this 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
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. 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 localized people trained, et cetera, et cetera. Look at our – so Phoenix has been doing a great job in North America. I think they are almost — has a leadership now in the U.S. land. And Ulterra the same with drilling bits. We are there now offering this to our customer. We took Cactus, where again, with the leadership position they have, and they have their trees rigged up in the frac in Saudi. And we are getting them 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 and some of the companies with new energy and other stuff. And obviously, we don't announce until we sign everything. And so an agreement has to be with credible people 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 frac together in Saudi. And we decided to that in other places. And then, very, very smartly, for example, they are getting extremely, extremely busy in the U.S. And we decided together. Sherif, let's have a new arrangement where basically you take over the fleet financially, so I don't have to keep — basically, I buy the fleet from you, and we keep all the workflows, all the training.

We trained 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 software, all the 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, I want to deploy another, or for the time being, I'm very busy. Pricing is getting traction in North America. I'm extremely happy now. But we will keep the partnership and see when we do it next.

You see, this is the type of partners and the type of technology we want to do. Just to conclude, what is so important for us, what we wanted to do in-house as well. And that's why I am super, super excited when I went and visited our RSS. I mean, our RSS is going to be something new, 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 new RSS tool here, but that can go to this dog leg, can have a low maintenance hour, and can drill the wells faster and very professionally. And this is where we want to be.
So, partnership with solid people and innovation when 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
Good to hear. And that's a good segue into my follow-up, which is on 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 how you're thinking about potential incremental R&D investment for RSS moving forward?

Sherif Foda
So obviously, without giving all the secret sauce — so what we did is, we put that investment two years ago with partners, And the way it works is we have a set-up where 100% we have continuously invested and improved the tool on the ongoing basis. And that's why the way we

do it is our innovative R&D setup is, basically, we have the set-up 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 Middle East. And 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 will have, obviously, it's no secret. What is a steerable, today, the difference is what type of mechanism we do to steer? How can you stay within zone — is it a couple of feet? How you get a very solid and homogenous hole to be able to have a good LWD and good casing running after that. And then the production right? So our tool will have a superior feature in any and 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 couple of billion dollars.

Taylor Zurcher
Got it. Good hear. Thanks for the answers.

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

Igor Levi
Good morning. So, to start, could you provide a little bit additional color on how the two-water contract, both the pod contract in Saudi the and the brine contract in Iraq, are progressing and as far as the revenue ramp up from that into next year?

Sherif Foda
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 obviously, it started as a very small number. And then, until you get the scalable plant.

On the brine contract in Iraq, with 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 liked, 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 you will see significant increase of activity in Iraq going forward.

Igor Levi
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% less of your sales are driven by the ESG segment?

Sherif Foda
Yes. 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, again, and 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 this in addition, my personal opinion, this is going to be bigger than the other two segments by 2030.

Igor Levi
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
Thank you. Thank you. Thanks, Alex. Thanks, everyone. And we are, again, extremely excited. And remember this is a super cycle, whoever was 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.