National Energy Services Reunited
Third Quarter Earnings Call
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<u>**Presenters**</u>
Chris Boone – CFO
Sherif Foda – Chairman and CEO

<u>**Q&A Participants**</u>
James West, Evercore ISI
Sean Meakim, JPMorgan
David Anderson, Barclays
George O'Leary, Tudor, Pickering, Holt
Igor Levi, BTIG
Blake Gendron, Wolfe Research
Jeff Fetterly, Peters & Company

Operator
Greetings and welcome to the National Energy Services Reunited Q3 2020 Earnings Conference Call. At this time, all participants are in listen only mode. A question-and-answer session will follow the formal presentation. If anyone should require operator assistance or technical support, please press star zero on your telephone keypad. As a reminder, this conference is being recorded. It's now my pleasure to turn the call over to Mr. Chris Boone, Chief Financial Officer. Please go ahead, sir.

Chris Boone
Good day and welcome to NESR’s third quarter 2020 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, thank you for participating in this conference call.

We are very pleased with another outstanding record performance this quarter. We grew 35% year-over-year and 7% sequentially, which is a phenomenal achievement given this growth has been delivered against the backdrop of continued industry surplus supply, compounded by pandemic related effects on the global demand. I believe we are an outlier in the OFS space for delivering such results when the rest of the industry is contracting with these headwinds.

As I have previously stated we have achieved this due to the stellar effort of our teams on the ground. We not only have managed to hold the line but have learned to thrive in this very tough environment. I cannot speak highly enough of our management and operation team in each of the countries. I am blessed to have such talented individuals who run their operations with an unmatched passion and dedication. Most of our leadership in the country are nationals of the country, and not only do they have an acute understanding of all the nuances of what needs to be done for the business, but they also have stepped up to the roles as leaders in the community.

Just to give you an idea on how well we have managed the operations, we have increased our operating hours this quarter and we have added headcount to manage our growing operations while the rest of the industry is laying off people. All this, while being acknowledged as the best service quality provider this quarter by one of our main customers, measured by Non-Productive Time, or NPT, during operations.

One of our main differentiators is our execution ability during COVID-19 and maintaining 100% capacity at all times. We have been very clear that we will handle this crisis by fundamentally modifying and strengthening our processes, essentially a big emphasis on planning short and long cycles. We managed the recent curfews reinstated in some of the countries, the continuation of some border shutdowns, difficulties in crew changes and importing spares or chemicals on time. Our crisis management team is still in full action and so are the emergency response teams in each of the countries.

And, yes, in this new normal, there is an extra layer of costs you have to bear for COVID preparedness and handling. I just visited Middle East and was with our customers in different countries. By the time I finished my trip, I had taken four COVID tests and had quarantined in a couple of hotels for a few days. I was very pleased to see my dear clients and friends. I am very thankful to our customers to give us their trust and the opportunity to serve them. All this cost does add up, even though we have a large local content in our company. You also have to carry additional backup functionalities in the field in terms of personnel, larger inventories, some of which our suppliers carry, and some we have to. Meanwhile, you have to plan for any eventuality of a second wave, and the need to keep all these costs in place to ensure we are not taken by surprise and ensuring the safety of our employees and readiness to our customers.

Coming to the macro, which has evolved in some areas since our commentary last quarter, I won't spend a lot of time on the demand and supply debate, but, as we know, the global economy is seeing a contraction due to the pandemic and certain sectors, like air travel, have been affected severely with a longer recovery ahead of them while others, like shipping, have recovered much faster.

Our view is that the demand will rebound sharply, and the market underestimates how fast the demand will come back once we have a handle on the virus. The airports are not going to be always empty, and people are eager to get back to normal life, although this won't stabilize before we see a vaccine and more clarity on the potential second wave. However, the fact is our industry continued to drastically under invest for six years now. Therefore, most of the rebound and energy needs will come from the Middle East. As you saw in April and May, the main players in the region have the capacity to turn it on and meet the demand as the most reliable supplier, and we believe that would be the case when the time comes again. This could be sooner than many expect.

Meanwhile, as I mentioned last quarter, we continue to see the same pattern in the MENA region. The core GCC markets have been measured and deliberate in their approach. We see more rigs released lately, but overall, they run their business for the long term and the health of their countries and population. Others, the drop has been significant as expected, as it is characterized by smaller independent or larger IOC's with significant budget cuts, security concerns, pandemic fears with cash constrained in others. We are seeing anywhere from 40% to even 80% cut in some of the activities.

Given our size and scale and also our geographical exposure, we're able to manage these activity reductions by essentially gaining market share in either the same country or moving assets to other countries where we have gained recent work or replacing competition who can't deliver on their work scope. Best example, we managed to mobilize for our recently awarded coiled tubing and pumping contracts in Abu Dhabi by marshalling most of the resources internally. This also helps our overall utilization, which we have to balance with the need for adequate safety margins during this pandemic.

Last week, we announced that we extended our five main contracts in PDO for a period of up to nine years, and we landed an additional contract in drilling, which gives us an option to further expand in that space. These contracts, which are worth over $1 billion, form the backbone of our operation in Oman and our Drilling segments. It is a tremendous achievement for our Omani team, working very closely with our customers to achieve a mutually beneficial outcome. I would like to thank the ministry and PDO for their trust in our abilities and for their guidance throughout the process.

This cements our foundations and ensures we can amplify our investment to achieve our goals to maintain and secure the highest level of Omanization and in-country value. We have big plans to bring job opportunities to talented Omanis to support our operations in the region. Today, we already have Omani nationals working in several countries. We will be hiring and training more to ensure we are ready for the future. As an example, today, all of our thru tubing business across NESR is headquartered in Oman, and they support all our operations across the GCC and the larger MENA. We proved the model works, and now we can do even more as we expand on our offerings and contract duration.

As you have seen, we are heavily invested in the social aspect of our business and engagements in the region, and this is ESG in action, with its direct consequence on the sustainability of our business. Another example of next NESR's ESG commitment is how we have taken our fracturing operation to the next level. As you know, we continue to break all operation records in terms of stage efficiency and wells delivered. Meanwhile, we looked with our customer how to continuously improve on the environmental impact. From smaller project, like solar lights for our camps and sites to our latest endeavor where we have worked with our customer to optimize the frac designs with cutting edge technologies to effectively reduce the slickwater fluid volumes by one-third. This means we are now transporting and pumping one-third less water, which is more than half a million barrels a month. This has a material effect in a water stressed area like the MENA region. In addition, such fluid systems supported the reduction of the frac fleet carbon footprint by 30% as the frac jobs are consequently shorter. We are working on more initiative with our clients and our partners to implement different technical solutions to the challenges we face. Just keeping to the water example, we are working very closely to come up with a solution to use high sulfate water for frac jobs, which will completely eliminate the usage of over half a million barrels of fresh water for these jobs.

In the same spirit of optimizing and make fractures better, we have recently invested in a technology company called Deep Imaging, which we are going to shortly introduce to the region. This technology allows us to monitor fracs as they happen downhole in real time and uses electromagnetic arrays on surface to measure the changes in the reservoir as the fracs are happening. This will allow us to control the fracs in real time, which is the holy grail of frac optimization. It is estimated from public studies that only 60% of the frac stages produce as expected, and this measurement technology will allow us to further improve the existing processes. Another tech company which we are partnering with is developing technology to deploy downhole pressure, temperature, and flow rate sensors during the frac jobs, allowing us to measure both the frac and flow back performance.

To marry all of this and to give the maximum value to our customers, we have also partnered with Bill Von Gonten & Co. and Bill Von Gonten Laboratories, who are the premier reservoir consultants and have a state of the art laboratory in the unconventional reservoir space. We are already working with them in the Middle East for one of the NOCs, who are in their planning stage, and we will continue to develop this across the region.

So, as you see, we're on the leading edge of taking the frac technology into the digital age, which will help reduce both the frac footprint and contribute positively towards the larger ESG goals.

In drilling, our KBOS investment is bearing fruit, and this shear-anything technology is now sold in the Gulf of Mexico. As you may recall, KBOS is making shear-anything rams, which will enable operators to shut in the wells if everything else fails in the case of blowouts. This innovation uses technology used in space programs and military application and applies to a problem in the oil field environment, which has the potential to take a terrible human economic and environmental toll whenever things don't work as planned. As is our norm, we invested in this company and now are in the advanced stages to take it to the region where the customer wants to apply this technology to use it as a barrier in each H2S environments, which, when it leaks, is known as the silent killer.

We have several other technology investments and partnerships in the works, which we should announce in the near future. They all have the same purpose: how to solve our customer problems using the most innovative technologies, which will help our clients to either produce more from the same reservoir or produce at a lower cost while reducing the overall carbon footprint of the operation.

Lastly, I wanted to give you a quick update on SAPESCO, where we have now fully closed the transaction. The integration is ongoing, and we are already seeing the benefit of this outside of the main operations in Egypt. Our customers in Egypt and outside have received the transaction quite well, and we have leveraged that position to either win some awards or bid for some tenders which previously NESR would not qualify for. So, a great start, and we have big plans to expand their industrial services portfolio outside Egypt.

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

Chris Boone
Thank you, Sherif.

As Sherif mentioned, we reported another record quarterly revenue record, with third quarter revenues of 218 million. This represents an increase of 35% over the prior year quarter and 7% over the second quarter. The sequential and year-over-year growth was driven primarily by the new frac product line in Saudi Arabia, a full quarter’s contribution from SAPESCO, and our new contracts in Kuwait and Abu Dhabi that offset market declines in Iraq and North Africa.

We also achieved another record quarterly level of adjusted EBITDA in the third quarter of $56 million, or 26% of revenue. This represents an increase of 17% over the prior year quarter and 8% over the prior quarter. EBITDA adjustments of $2.5 million for the quarter are mainly for transaction and integration costs associated with the acquisition of SAPESCO in Egypt.

Despite the market conditions, we are pleased that our adjusted EBITDA margins remained flat over first half 2020 levels. We have continued to experience increase recurring costs related to COVID-19, such as employee testing, rotation costs, field lodging, catering, and sanitization. We consider these costs as normal operations and have made no adjustments to EBITDA for them. To mitigate the impact of these incremental costs and reduced activity in some markets, we have been successful in finding opportunities to reduce costs in areas such as equipment rentals, transportation, and field facilities. These supply chain efforts continued in the third quarter, with improved pricing realized on certain production-related product costs.

Moving to our segments, our Production segment revenue for the third quarter was $148 million, another quarterly record, growing 53% over the same period last year and 7% over the prior quarter. The sequential and year-over-year growth is primarily related to frac activity in Saudi Arabia and the new contracts in Kuwait and Abu Dhabi. This was partially offset by lower activity in Iraq and North Africa. Adjusted EBITDA margins for the Production group were 29% in the third quarter. While margins were flat sequentially, lower margin pass-through revenue associated with frac activity grew as a percentage of total Production revenue in the third quarter. This impact was mitigated by less contract startup costs for the conventional fleet and other cost reduction efforts.

Separately, our Drilling and Evaluation segment revenue of $70 million in Q3 was also a quarterly record, up 9% compared to the same quarter last year and sequentially. The increase over Q2 is primarily related to a full quarter benefit from SAPESCO and higher well testing activity in Saudi Arabia. Adjusted EBITDA margins of 24% in the in the third quarter were down slightly from 25% in the prior quarter, mainly from a less favorable revenue mix.

Depreciation and amortization increased to $32.2 million in the third quarter compared to $30.4 million in the second quarter. Most of this increase was due to a full quarter impact of D&A from SAPESCO. We expect D&A to increase by approximately $1 million in the fourth quarter compared to the third quarter run rate, primarily from new capex editions.

Interest expense in the third quarter was $3.8 million, down slightly from $4.2 million in the prior quarter, primarily from the benefit of lower interest rates on LIBOR.

Our effective tax rate continues to track well below the rates seen in 2019 as we continue to optimize our tax structure. The reported effective tax rate for the first nine months of 2020 was 21.0% compared to 23.4% in the first nine months of last year and the full year 2019 rate of 24.9%. The increase over the first half rate was primarily due to an unfavorable mixed shift of income earned in higher tax jurisdictions. Based on current full year projections, we expect the full year 2020 effective tax rate to be similar to the year-to-date rate.

This resulted in reported net income of $11.7 million, or $0.13 per diluted share, and adjusted net income of $14.2 million, or $0.16 per diluted share.

Turning to cash, I will initially review the impact on Q3 of the closing of the SAPESCO transaction. First, we paid $11 million for the closing cash obligation. Second, we made $4 million of post-closing installment payments. Third, we paid off $11 million of the $21 million assumed bank debt. These were funded by available cash from operations. In the fourth quarter, we expect to make $4 million in additional post-closing installment payments plus possible other earnout payments. The remaining $10 million of assumed bank debt will be paid in the third quarter of 2021. The issuance of the closing shares will occur in the fourth quarter of this year but are already included in our share count for EPS.

Switching to operating and free cash flow, both were down sequentially, but we were pleased to generate positive free cash flow of $9 million while still investing in our sequential revenue growth and our capital spending program. Also, since the onset of the pandemic, our cash balances and net debt have remained relatively flat, even with our revenue growth and the funding of the SAPESCO transaction.

During the third quarter, we added approximately $12 million in net working capital, mainly through additional receivables to support the $15 million sequential increase in revenue and higher VAT receivables in Saudi Arabia as the VAT rate increased from 5% to 15%. This was partially offset by a corresponding increase in accounts payable. Included in this working capital addition was certain inventory purchases to both support our higher level of activity but also to ensure we have sufficient supply of production chemicals and spares in case of any disruptions from a second global COVID wave.

Capital expenditures in the third quarter were $24.8 million. The majority of this cash spend was for payments of capex received or ordered in 2019. In the first nine months of 2020, we have only authorized approximately $30 million in new commitments, which is about one-third of the original plan for 2020. We expect free cash flow to increase sequentially as the fourth quarter is typically the highest collection quarter of the year. Additionally, our customers' payment processes continue to improve as inefficiencies from COVID are mitigated or resolved.

Net debt increased slightly to $349 million at September 30th compared to $342 million at the end of the second quarter. Net debt increased sequentially primarily to fund these working capital investments. As of September 30th, our net debt to adjusted EBITDA ratio was 1.7, flat from last quarter, and should reduce to our target level of approximately 1.5 in future quarters. Also, we remained in full compliance with our credit facility financial covenants in the third quarter.

Moving to ESG, during the third quarter we added significant new ESG disclosures to the NESR website. These disclosures will help our investors and the rating agencies better understand how NESR does business and its commitment to ESG. As we look into next year, NESR will expand its executive compensation disclosures by voluntarily adding a CEO pay ratio, which we believe will show we have one of the lower sector ratios, and adding a Say On Pay vote to our proxy. As we have highlighted before, our executive compensation is highly focused on achieving performance targets, with participation in short and long term incentive plans carried down into the organization and not just with the executive team. At NESR, ESG is not just about achieving certain ratings but also how we manage the company every day for the sake of all our stakeholders.

In conclusion, NESR again strongly outperformed the market in revenue growth and margins through our regional focus and strong operational execution while still generating positive free cash flow.

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

Sherif Foda
Thanks, Chris. In conclusion, I would like to leave you with key takeaways.

1) We continue to manage the COVID situation better than anyone else and we did plan already for wave two just in case, ensuring we will serve our customers with no interruptions.
2) We aim to continue our growth trajectory and see no deviation in the coming quarters as we expand our offerings in the different segments and deliver on the recent contract awards.
3) We continue to invest, hire, and train national talent to fuel our growth, maintaining the highest standards and ESG commitment.

On that note, I would like to pass it on to the operator for your question. Thank you.

Operator
Thank you. We will now be conducting a question-and-answer session. If you'd like to be placed in the question queue, please press star one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing star one. One moment, please, while we poll for questions.

Our first question today is coming from James West from Evercore ISI. Your line is now live.

James West
Hey. Good morning, Sherif. Morning, Chris.

Sherif Foda
Morning, James.

James West
So, Sherif, I wanted to get a quick update on the stimulation work you are doing in Saudi. Number one, the number of kind of spreads you guys are running now, what the expectation is as we go into next year, and then, I apologize if it didn't catch it, but the relationship with Deep Imaging, which, as you know, we know those guys well. Is that already in place—is that taking place in Saudi, or is that broader to the region? And kind of how does that wrap in with what you and NexTier are doing with the stimulation work in in the region?

Sherif Foda
Thanks, James. So, for our frac, we have two frac fleets running in Saudi Arabia today. We have one dedicated to the Jafurah Basin and one dedicated to the Conventional, or what we call single wells, frac operation. Both are running extremely well with our dear customer. And, as we said, we worked closely with our customers to break all the records that have been ever in the Middle East region. So, I really, really thank them for their trust and how they guide us through the whole process to enable us to deliver such stellar performance.

The future is, as far as I know, is as planned and announced previously. So, we should be continuing with this operation as planned. The country has big plans for the gas. Obviously, they might tailor this activity, and this is definitely up to them.

As for the Deep Imaging, yes, we have a relationship with them. We did an investment in the company close to a year now, and we looked very, very carefully on what they can do. And the plan is to take them to the region and show the customer what this technology can do. Definitely, they had they had to slow down because of what happened in the US here, but our plan is to get the crew and to go there and show the clients what could be done.

James West
Okay. Fair enough. Then maybe one for Chris on—free cash flow was, I guess, a bit less than we was looking for, but there were a lot of puts and takes during the quarter such as with the transaction. Could you maybe talk about what your expectations are for—or where they maybe came in like this in the third quarter and where we could see some upside going forward?

Chris Boone
Sure. When we provided some guidance last quarter, we weren't assuming we'd hit a $218 million revenue. So, obviously, there was some increase in working capital to support this. And, I don't want to go in to super technical discussion, but, for example, the VAT rate change, that was about a $4 million impact on the quarter. It's one-time thing. There's just some timing impact between receiving and paying VAT. And as I said, we built a little more inventory as saw more and more risk of a second wave potentially disrupting. So, those were the primary factors. Collections were about where we expected. We would like to maybe have beaten a little more on our collections' targets, but they came in about as we expected. Fourth quarter, as we've said, is usually a very strong quarter in collections, and that we expect a stronger free cash flow in the fourth quarter.

James West
Okay. Perfect. Looking forward to it. Thanks, guys.

Chris Boone
Thanks, James.

Operator
Thank you. Our next question today is coming from Sean Meakim from JP Morgan. Your line is out live.

Sean Meakim
Thanks. Hey, guys.

So, on the broader MENA trajectory and how it will influence you in the coming quarters, as you said in the prepared comments, you're expecting a faster return to activity as many are expecting, but it could be worth maybe just elaborating on how you've been able to perform relative to the larger diversified service companies in this environment. How much of that is product and service mix? How much of it has been your ability to have your crews ready to work in the field despite all the restrictions? And your expectations with—in terms of being able to retain that market share in activity recovery.

Sherif Foda
Okay, Sean. Today, our Q3 results are plus 35% year-on-year with a minus, you can say, 20 to 25% activity drop, right? So, on that deviation, which I would say completely opposite to the market. Why is it opposite to the market? Two main reasons: First of all is, as I always say, is our scale. Being smaller than the big guys, you can target a lot of the contracts that we were recently awarded, so you can grow and you deliver on them. Then you're going to gain market share, based on your size. And the other part, we had zero disruption. So, I don't want to talk about others, but I can tell you not a single competitor we have in the entire Middle East had zero disruptions. Everyone had anywhere from 5%, 10% to some had almost 50%. They almost shut down, or they almost had half of their crews they cannot operate.

we had zero. So, basically, we had 100% capacity, so we managed to take a lot of the work when these competitors could not manage. And then, we just won a lot of contracts over 2019, and we started to deliver on them. The biggest one, obviously, is the frac. So, if I look today on our frac activity, we did not have frac business in 2019, and we have frac business in 2020. So, obviously, the difference in that gives you the magnitude and that you can clearly see it from the production.

So, it's three way differentiation from folks that did not have the capacity. They didnt have the equipment. They didnt have the inventory. And a lot of people are short in cash. Some of the small service companies, they didn't buy any inventory, any chemicals. We were ready. As Chris mentioned now, for example. On the free cash flow, today, I am prepared already. So, if somebody comes and let's say what happens in Europe happens in the Middle East, which God forbid it does not happen and most likely will not happen, because they're actually very deliberate and strict in in their approach in closing borders, and nobody is traveling, and still the airports are closed and if you look at the rates they have today is very, very low. I mean, you're talking hundreds a day. That's it.

So, I don't think they will have a second wave, but let's say they do have a second wave in that case we are ready. So, we already bought our chemicals. We bought the inventory. We have products for more than six months in each of our countries, and we will be able to deliver on any products. Somebody cannot deliver, we will be able to jump in. And, in addition, as I said, we won a lot of contracts that we are going to be able to capitalize on. And that's why as I said, what do I see for the future quarters? We see a similar approach, similar growth profile, year-on-year growth, sequential growth, and you will see this in the coming quarters.

Sean Meakim
Thanks for that, Sherif. That's really helpful. And then I'm interested in hearing a little bit more about the industrial portfolio expansion with SAPESCO outside of Egypt. I'd love just to hear about how that can unfold. What does the addressable market look like? Are you able to leverage your existing relationships? Do you need to work with new contacts? Just trying get a sense for this growth lever and how it unfolds while upstream opportunities are more limited near term. I think that would be interesting to hear more about.

Sherif Foda
Yeah, sure. So, as you know, SAPESCO guys have very amazing track record in Egypt and the industrial arena. We took the portfolio. Obviously, now we just closed the transaction, and we've been working on it since June with the clients in the different GCC market how to take that qualification, and that's what I tried to mention in my in my remarks and tell the client now I have 20, 30 years' experience in that business. So, you get qualified, and you get to the bidder list that they never even called you before. And now today, we launch this to all the GCC and to North Africa, Algeria, Iraq, now Libya. Even now in Libya, it's open. So, now we are qualified. So, that footprint that we have today that is the best, I would say, definitely. Outside the Big 3, we have the best footprint now in the MENA, and every country we have already presented it. Every country, we have a country director. Every country, we know the clients. So, we put that qualification, that process, that experience to the client, so know we are invited to bid.

We are already bidding in seven of those projects. So, we're bidding in Algeria. We're bidding in Saudi. We're bidding in Kuwait. We're bidding in UAE. So, we are bidding on those projects. If you want to ask me a number, I would say I cannot give you a number today. Why? Because most of those pipeline downstream projects were the first to be cut. So, if you look at the budget of our main clients, they cancelled a lot of the projects mainly on the new downstream projects. And that's the biggest part that you gain from the industrial cleaning when if you look at, for example, at Egypt. The biggest revenue they ever made, SAPESCO, was on Zohr. When they had the discovery in ENI for the East Mediterranean gas, they had to do the purging of the pipeline. They had to do it in 16 months, because the president of the country wanted to inaugurate, and they wanted to break all the records for having that platform on time. And they did that, and actually, everybody worked on it, SAPESCO and other companies, and it was the biggest revenue ever.

So, I would say, the time it will take us in the next three to five months is to make sure that we are in the bidder list on all these countries, and we will be able to land couple two, three projects in 2021 outside Egypt. And that's our target for the guys is obviously much harder than that. We ask them for 20 projects. So, let's see how they can deliver. The market, Sean, is $300 million, right. So, it's quite significant.

Sean Meakim
Got it. Thank you very much.

Operator
Thank you. Our next question is coming from David Anderson from Barclays. Your line is now live.

David Anderson
Hey. Good morning, Sherif.

Sherif Foda
Morning, sir. How are you?

David Anderson
I'm doing good. So, the Middle East rig count is down 20% during the quarter, your revenue continues growing. You explained before how you had a bunch of contracts coming on. And I guess that explains part of it, but I was wondering about the rig count and spending in the Middle East if you could maybe sort of categorize what's going on over there. I'm wondering what's happened with that rig count. And is that mostly oil rigs that are falling off? And maybe just kind of talk about kind of the gas versus oil mix in terms of drilling and kind of your exposure to that. But secondly, I'm really wondering about maintenance spending. Is that something that's been pulled back? And is that something that will come back first? Because we hear a lot of skepticism from investors about spending in the Middle East. That seems to be the general view that there's so much capacity, they don't need to do anything for a long time. So, maybe you can just kind of talk about kind of those different parts, sort of generally in Middle East, but I'm kind of talking Saudi.

Sherif Fode
Okay. So, I'll talk Middle East. So, the easiest one is oil versus gas. I will tell you, for ourselves as NESR, there is absolutely no difference. We work on both. The exposure is exactly the same, so there is no difference for us. It's the mix. The only difference for us is really activity wise is if they are exploration wells, offshore deep water versus normal land operations. So, I would say these exploration, deep water are the projects that would cut significantly, and if you look back just to go to your other part of the question, what happened at the Middle East. And I said this before. They always cut the big, nice to have projects, and they cut the downstream that they don't need, right? So, that's exactly what happened for most of them, that's what they did. So,

if you look at the offshore projects, they were all postponed. They are not cancelled. They are postponed. They are pushed back.

So, you look at Kuwait. You look at Oman and others. All of these guys, they just push those projects to ‘21 or ’22. They don't need them now. It's exploration for new places and new frontiers. So, all this stuff is pushed back. Then you look at what most of the clients would do in GCC. And they look at their core business, what exactly they need to do, and they look at the long term. They don't look at maintenance etc. and I know that the investor skepticism about the maintenance, et cetera, as they would for an American public company. These are national oil companies. They are also balancing other aspects of the activity for e.g. from a social aspect. It's not just pure economics.

If I talk only from a view of economics, they can cut the rig count by 70% and they produce. They don't need anything, actually. They can run with 20 rigs, and they will produce the 8 million barrels. But they do not do that. They look at the sustainability of the business. They look at the employment. They look at so many other aspects. If I look at Oman, it’s the same. So, the rig count is minus 20%, minus 25%, which is quite significant, actually, for that region, because usually they cut only 5% to 10%. So, when you count minus 20% minus 25%--that's what they did. If they cut more, they might lay off another 5% or so rigs, because they will definitely be able to produce. Now, if I look at the gas, again is an internal resource for internal consumption. The only outlier to that is Qatar. Everywhere else, the gas is needed for internal consumption, so they will not change any of the projects of the gas.

If I look at—overall, how do I see it? I see it that they are definitely preparing for readiness of the other side, if the comeback is much faster. If I look at how the spend is slashed everywhere else in the world. If I look at the supply destruction and who is going to be able to come back, I would say, in my personal opinion, the only region that would be able to deliver it is the Middle East. Nobody else will be able to deliver. Is anybody going to go and invest in a deepwater project in West Africa today? You didn't do this last year or last two years and you will not do it today. But if I look at the activity and the ability to push back the production, it’s definitely there, and their ability, as well, to put back those rigs is very, very fast. Most of the rigs that were not deployed in the Middle East are warm stacked and not cold stacked. So, they are very simply able to put them back once they need them.

I don't know if I answered your question, David, but, I mean, I would say the activity is going to come back much faster than what people estimate. And there is a lot of social aspect to it, and I think, if you look at North Africa and Iraq, it cannot get any lower. I mean Kurdistan is zero. Iraq, Basra, is minus 80% recounts. Algeria, Egypt, Libya is almost minus 50%, minus 60%. And, obviously, as you saw, Libya is coming back, and already, they are producing a half million barrels, and they have the plan to get back to a million barrels, which means they need to add 20 rigs or so plus the work over and the ESP change out.

David Anderson

Just curious about your plans on the pressure pumping fleet. You've talked about four or five by the end of next year. How do you feel about that? Is that number up, down, sideways? And then maybe just kind of a little update on how, I know the operations are going quite well, or just any update and kind of what that's looking like over the next couple of quarters would be great. Thanks.

Sherif Foda
Thanks, David. I would say we see same trajectory towards the end of next year. I would say we should be adding a fleet quite soon. And then, depending on the pandemic and who is going to start first, I would say in the second half we'll be adding another one or two. So, today, I still see we're going to be four to five fleets by end of '21.

David Anderson
Fantastic. Thank you.

Sherif Foda
Thank you, sir.

Operator
Thank you. Our next question today is coming from George O'Leary from Tudor, Pickering, and Holt. Your line is now live.

George O'Leary
Morning, Sherif. Morning, Chris.

Sherif Foda
Morning.

George O'Leary
Piggybacking on David's last frac question—I was going to ask the same one, but just—the expectation that you expand that frac presence outside of the kingdom, or are there opportunities in other geographies, or do you expect most of those fleets to go to work in Saudi Arabia?

Sherif Foda
No, most of the fleet will go outside Saudi Arabia.

George O'Leary
Okay. Great.

Sherif Foda
So, our plan, hopefully—and obviously, that depends on the clients. But our plan hopefully that the additional fleet will work outside Saudi Arabia.

George O'Leary
Great. That was a quick and easy answer. I appreciate that. And then, for just underlying activity in that MENA region in the fourth quarter, clearly, we started the third quarter higher than we ended it, given the 22% average decline. For Q4, what's the kind of underlying activity expectation, fully realizing that's not necessarily what NESR will see in their business.

Sherif Foda
I would say if you recall my first quarter comment, I always said that the activity first quarter would be the best out of the year, opposite to previous years. However, for us, our plan is to maintain growing over the year like we did before. And so far, that's what we are delivering. So, we're delivering exactly what we said. I would say the fourth quarter is similar in the sense. Activity is not going to get better. I would say, on the contrary, some of the customers might actually shut down some of the work, because the opposite effect will happen this year, which means they are running out of budget, or they do not want to spend any more, and the government says shut down, that's it. Let's not spend more than what we did.

In our case, I don't see any difference, as I said, from our trajectory. We will have growth sequentially, and we don't see any issue, even if the activity gets dropped further. If the activity does not drop, we'll have even higher growth. But overall, I don't see the activity increasing, because nobody needs it except for Libya. Libya would be the only outlier where they're going to increase. I don't see Iraq, any of the IOCs putting any money in the next two months. There's only two months left. And the rest—the GCC is very, very stable, but I wouldn't say increase. I would say it's just that it's stable activity. For us, we will have an increase.

George O'Leary
Great. That's very helpful. And I'm going sneak in one more if I could. Just M&A and then kind of pull through of the service lines that you acquired via mergers and acquisitions continues to be a big part of the story. Could you just frame kind of what the M&A landscape looks like, given the challenging market that we face? Has that created incremental opportunities for you guys, or how would you describe it?

Sherif Foda
So, M&A is I would say, in the US, definitely, we get kind of invaded by opportunity, but we have no interest, as we always say, except to buy supplies or resources in US. But we are not planning to do anything here in US unless the company is so innovative that we take it over there. And that's different approach to our M&A. So, as I said this before, but I just wanted to be very clear. So, the M&A for us is in the geography, and that's when we buy a company. Are there opportunities? There are plenty. Not like the US, but there are several, and those, we are negotiating with two or three. Negotiation in the Middle East takes time. And you need to have very detailed due diligence. And today, we are not able to do that, because there's no travel. So, I don't think we can land anything in the next quarter or so.

If I look at what we do in the U.S. you have two points. You have the technology partnerships that we talked about, and we do several. Today, we have an investment in four companies. So, we put money in four companies. We don't buy them. We put money in them to get the technology—like a PE or VC. So, basically, I want the technology to happen. Some of the innovation we wanted to be tailor made for our Middle East operation, and we put money for this company to make it happen. And the third part is basically a lot of the Chapter 11 guys, and we are happy to look at their equipment if it makes sense to buy ten cents to the dollar. But we take this as CapEx. We don't take this as M&A.

George O'Leary
Very helpful. Thank you, Sherif.

Operator
Thank you. Our next question today is coming from Igor Levi from BTIG. You line is now live.

Igor Levi
Oh, yes. Good morning, guys. So, you talked about the significant contract awards in 2019 being a big tailwind, but you also mentioned you expect similar growth in the coming quarters. So, could you talk a bit about the drivers of those growth? Of course, we do have—I mean. we know about SAPESCO and the incremental drilling contract in Oman. But is that sufficient? Of course, there's the additional frac fleets, but, again, those, I think, still need to be awarded. So, how much of that growth still needs to come in the form of contracts to coming quarter or two?

Sherif Foda
I would say, Igor, we have a lot of contracts that were awarded. We don't announce everything. And a lot of the contracts that we have today, what you do on them is you expand on their portfolio. So, the best example is Oman. So, today, we have this fantastic Oman operation, and we managed to extend those contracts for a decade which is unheard of. I mean, the client never did this. So, today, we have all these contracts now for 10 years. So, what you do in these contracts, some of them you expand the portfolio and some of them you add technology. We actually added a full scope of drilling contract into our other contract.

So, our expectation is to deliver on those, introduce all this technology and partnership we did in the US over the last 15, 18 months, and put those technologies to action. Today, most of those technologies take 12 to 18 months for us to have a tool. And then you have that tool. You send it there. It has to work, and it has to be competitive, and it has to work as good as the others or even better. Once you have that, you get part of that spend. So, the landscape of work, of market is huge, and I keep repeating this. This is a $20 billion market. We are not even 5% of it. So, having the infrastructure, having the image, having—being like, I would say, the darling of a lot of the NOCs, for us to be able to be 10% of their market share is not that hard. And we have the platform to be able to do that. You don't have to win a contract in each place and each tool to make that happen. So, as I said, until our $2 billion revenue mark is achieved, I don't see any problem with the growth trajectory.

Igor Levi
Great. That's very helpful. And then, as far as the fleet that you mentioned, the additional fleet that that would be doing frac outside of Saudi Arabia, would they be as profitable as the one that you're adding this year, given that they're not—from what I expect, not likely to be working on unconventional fields like Jafurah, so they wouldn't have as many stages per well. Could you talk a bit about that?

Sherif Foda
Okay. So, in the whole Middle East, Igor, only Jafurah is a multi-pad well like the US. Everything else in the Middle East are single wells. So, any contract you have, any frac business you have will always be single wells. Is it multi-stage? It is multi-stage, but it's a multi-stage Middle East style, right, which basically, some of these wells are six stages, some are four stages, and, yes, some of them are one stage, which is single frac. So, the price per stage is completely different, and the structure of the fleet is totally different. So, I would say you can make the same—you have the same profit as a percentage, but you will not have definitely the revenue or the top line like you have with the multi-stage doing 80, 90 stage a month, right? So, if I look back at my olden days, some of these wells, we used to do stage every two weeks. So, you do two stages per fleet per month. But definitely the stage is not like what you have here in US, right? The stage is like of the order $1.5 million. So, it's a totally different structure, totally different setup, and each country is different.

Igor Levi
That is very helpful. Thank you. I'll turn it back.

Operator
Thank you. As a reminder, that's star one to be placed in the question queue. Our next question is coming from Blake Gendron from Wolfe Research. Your line is now live.

Blake Gendron
Yeah, hey. Thanks. Good morning. So, my first question is on margins. They seem to have stabilized even though your top line growth trajectory is just on a different level relative to the rest of the sector. If I were to isolate the segments, production services will continue to see stabilized margins, you'll add some frac capacity, maybe there's some cost plus sort of dynamics in there. On the other hand, you're going to see some scale absorption in operating leverage. In D&E, it's a little bit tougher to pinpoint margins. It tends to be a little bit lumpier and seasonal. But perhaps instances like the PDO contract will allow you to get higher technology exposure in the D&E realm. As we look out 2021, 2022, I know your bogey is just flat margins, and you're more focused on the top line growth, but what kind of levers can you pull, or what kind of dynamics are in play that could either push the EBITDA margin higher or lower moving forward?

Sherif Foda
Okay. So, Blake, thanks. I would say similar answer. If I look at the D&E, if you get to be more on the E and more on the higher end of the D, your margins will improve. So, you have to be in a technology intensive higher end on some of the services to be able to improve the margin to that level. But, however—by the way, now, if I look at the industry and I look at the pricing, I would see destruction almost in some of those services. Actually, our profitability in the D&E is higher than the best guys. So, it's kind of shocking that you are running, basically, what you used to call in the olden days, dumb iron, but you have a higher profitability than reservoir sampling. So, those margins today are quite strong, but, definitely, they can get a bit higher based on the mix.

So, if I would answer you, do I see this going to 30%? No, I don't. Would I see a couple of percentage point like we have between 20, 24, 22, maybe sometimes jump to 26? Yeah, maybe. But, definitely, we need some traction to the market to be able to do that. If I look at the production, there is a lot of pass through revenue, as we always said, I mean, if I look back, we used to run a higher margin in production when we didn't have the frac and all the pass through. Basically, as you know very well, all the hauling, water, land, camps, all the stuff, today you have to do that to be able to do the frac, because that's part of the business. Do I see the client changing the behavior on that? I don't. I think, on the contrary, now, they see more efficiency. They see more of the stage count being delivered better than anyone else. I think they might actually seek, and they do even more.

The one thing I would say, Blake, that we have significant costs for the COVID-19. And I know we are, again, maybe the only ones that don't call it off. But we make it part of my business, and we look at it. And I can just give you an example, when I was in the Middle East myself, I tested four times. How much did I spend? I mean, I spent just on testing $1,000, just for myself. Every test is $300, $250. If I look at how many tests, we did last month in the company, we did 2,600 tests. So, if I look at how many people do I test today just to keep working, anytime you have suspected case on the rig, what we do is we go and test every single person. They have to quarantine until their test result is negative. When they are quarantining, we have to put another crew to operate until they are clear. All this costs and we decided to absorb as part of the operations. We don't pass this to the customer. We take that cost, and we took that cost in our operation as part of our operation. So, I would say, we might have an improvement here on margins when you take this cost out. But I don't want to—I would say—I'd just like to say, if we manage to keep that growth profile and maintain that profitability margin that is in my books, I think it's the highest in the industry today, I think we are very happy.

Blake Gendron
That's totally fair. We do appreciate the cleanliness of the numbers. And just confidence in the stability of the margins, I think, is the most important just given the growth trajectory. And just a quick follow up here, if there is time on free cash. I want to approach it from a different angle. Say we get a second wave, say some of the organic growth opportunities fall by the wayside next year, where do you think capital intensity goes? I don't want to put you on the spot and

guide CapEx, but in terms of maybe giving investors a little bit more confidence in the free cash flow elasticity relative to growth, would be great to nail that maintenance CapEx level down.

Chris Boone
Sure. So, I think we've said our plans for next year will probably still be in the 70 million, 75 million range with similar growth rates to this year. That's what we've said. Could it be higher? Sure. But that would require we win more contracts and have other things to support. So, that's about where we see next year.

Sherif Foda
So, if I may add, Blake, the best way to look at it is always—the rule of thumb of maintenance CapEx is 2% to 4%, depending on your segments, depending are you on the high end, low end, a lot of inventory items, et cetra. And then the rest is growth. We have a different profile, because we front loaded our CapEx. And plus, we added this buffer to make sure that the clients trust our ability to deliver there if something happens. A lot of people came to tell me, you are adding a lot of equipment. And I said, no, I'm not adding a lot of equipment. I know what we're doing, because we know the customers very well. So, our deep knowledge of the customers, unmatched I would say, second to none. And that works very well for us, and that's how you see this revenue growth like this. At a certain level with a certain stability, we will be able to leverage it in an amazing way that you're adding now only for technology and for something to change and maintaining that growth profile. So, I would say, next year, as this growth profile of this year, we will only spend $70 million, $75 million. If something happens and we don't grow as much, that capex would be much lower.

Blake Gendron
Got it. That's helpful and encouraging. I'll turn it back.

Operator
Thank you. Our next question today is coming from Jeff Fetterly from Peters & Company. Your line is now live.

Jeff Fetterly
Good morning, guys. Just a couple of quick follow-ups. On the CapEx side, what are your commitments at this point for the rest of this year or going into 2021?

Chris Boone
That's part of our quarterly filing disclosures. But they are approximately $20 or so million that is committed, not received. Now, there are some additional LC payments that flow through capex. So, I'd say there is about $30 million as of right now that would still be for Q4 or next year.

Jeff Fetterly

And do you think most of that will come in in Q4, or is that similar to what you saw this year longer--.

Chris Boone
Let’s call it, approximately maybe $10 million of that will hit in Q4, and the rest will be next year.

Jeff Fetterly
And are there any other projects or commitments that you're contemplating before the end of this year?

Chris Boone
Yes. Well, obviously, we've discussed the addition of a third fleet. So, that will be one that’s not in our numbers yet.

Operator
Thank you. We have reached the end of our question-and-answer session. I'd like to turn the floor back over to management for any further or closing comments.

Sherif Foda
Thank you very much. We know we're out of time. So, we're very, very excited about the future. We look forward for continuation of our growth profile in the coming quarter and next year. Thank you very much.

Operator
Thank you. That does conclude today’s teleconference. You may disconnect your line at this time and have a wonderful day. We thank you for your participation today.