EXECUTIVES

Sherif Foda
Chairman and Chief Executive Officer

Melissa Cougle
Chief Financial Officer

ATTENDEES

Barclays plc
BTIG, LLC
Citigroup Inc.
Credit Suisse Group AG
Evercore ISI Research
J.P. Morgan Chase & Co.
National Bank Financial, Inc.
Peters & Co., Limited
Raymond James Financial
Tudor, Pickering, Holt & Co.
Wolfe Research, LLC

TOTAL ATTENDEES: 95

National Energy Services Reunited Corp.
Fourth Quarter 2018 Earnings Call
February-22-2019
Confirmation #13686830

Operator: Ladies and gentlemen, thank you for standing by. Welcome to National Energy Services Reunited Corp's Fourth Quarter and Full Year, 2018, Earnings Conference Call. At this time, all participants are in listen-only mode. Later, we'll conduct a question-and-answer session and instructions will be given at that time. As a reminder, today's call is being recorded.

I now will turn the conference over to our host, Mr. Steve Calk. Please go ahead, sir.

Steve Calk: Good day and welcome to NESR Corp's fourth quarter and full year, 2018, earnings call. With me, today, are Sherif Foda, Chairman and Chief Executive Officer and Melissa Cougle, Chief Financial Officer. On today's call, Sherif and Melissa will comment on our fourth quarter results and overall performance. After our prepared remarks, we will open 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 matters. 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, as we expect some callers, today, to be relatively new to the NESR story, please feel free to contact us after the call with any additional questions you may have. Our Investor Relations contact information is available at www.nesr.com. Now, I'll hand the call over to Sherif Foda, Sherif.

Sherif Foda: Thank you, Steve. Ladies and gentlemen, thank you for participating in this conference call. We are excited to report on our tremendous results in this quarter. But before I talk about our fourth quarter results, I would like to take a moment and reflect on our journey in 2018.

As most of you know, we agreed to acquire both NPS and Gulf Energy in November of 2017, and spent most of the first half of 2018 securing SEC approvals and completing the remaining SPAC closing mechanics. I'm very proud of the fact that we did all this work in record time and at the minimum cost. NPS and Gulf Energy are two of the largest and well reputed local oil field service companies in the MENA region, with complimentary geographical footprints and service line offerings.

The result is that, today, NESR is the largest indigenous oil field service provider in the region with operations in 14 countries and over 3500 employees. Today, we have a portfolio of over 90 contracts across the region which we are continuously expanding. This is a result of continued excellence in service delivery, understanding what our customer needs and continuously providing them with fit-for-purpose technology. For example, in our testing services in Saudi, we have gone from the number seven service provider to the number one in a very short period of time.

Good service delivery, listening, adapting to client needs and fast turnarounds always yield results. It does not matter if it is in Midland or Dammam., the customers expect the same high level of efficiency, responsiveness and technology solutions to meet their specific requirements.

Now, let me spend some time talking about the macro environment. As I mentioned last quarter, rig counts continue to exhibit quarter over quarter improvement in the Middle East. More importantly, underlying drivers indicate continued growth. If you look across the region, rig counts are increasing while, at the same time, rigless work is on a faster growth pace. This is both for oil and gas. Gas activities continue to surpass expectations and budgets are expected to expand even further, year over year, to cope with the local demand and higher internal consumption.

On the E&P cap expense for the region, the region estimates for year over year growth are in the 6% to 9% range, which we believe is at the low end of the spectrum. As we have seen from the announcement by our customers on their five to ten years budget, these numbers are significantly higher than the current market estimate for the yearly spend. All of this indicates that we are seeing a paradigm shift in the plans of NOCs, going forward. What this means is that we will see, approximately 60 to 70 billion spend per year over the next five years, compared to 40-45 over the last five.

This is a significant jump and you are seeing that, already, in our key markets. The service intensity will continue to increase. Just as an example, Saudi Aramco, highlighting the importance of the company's gas program said it would attract investment of about $150 billion over the next decade. With production, we see 23 billion standard cubic feet a day from the current rate of 14. This is a massive undertaking, especially knowing Aramco and how world class their operations are. And in particular, with their recent unconventional program.

Now let me focus on our performance in 2018 and update you on the progress of the key objectives we discussed on our first two calls. First, integration. After we completed the combination, our focus turned to rolling that out our corporate vision and priorities, integrating our infrastructure, rationalizing our resource base and increasing the efficiency of assets and capital, all without compromising our service quality and footprint. We called these initiatives, Phase One.

In Phase One, we relocated some of the Gulf Energy operation into NPS base and vice versa, in order to create synergies, across the different portfolios and regions. We made several organizational changes across the company. We aligned our bonus structure at all levels to reflect the financial results and quality delivery of our services.

The rationale behind this is that we want everyone to participate in the success of NESR, not just management, and remain motivated to deliver best in class service. Everyone has the ability to double his or her bonus and stock awards. And everyone contributes and sees the reward of his or her hard work. Additionally, I plan to waive my stock award bonus for the second year to ensure this amount goes to our top key performers in the company without any dilution to the shareholders.

We also consolidated our geographical management structure across each of our operating regions. Now, each region has its director who oversees the day-to-day operations and has the empowerment to run his or her business overseeing all the product lines. This allows them to be very close to the customer, find solutions quickly without having to navigate layers of bureaucracy.

Our Phase Two effort focus on harmonizing our back office function and support services, including finance, HR, and IT systems. These are process improvements which we are continually going to improve and be prepared to easily integrate any new acquisition to the company.

The second objective I talked about was our aggressive growth targets. Melissa is going to talk about the numbers in detail so I won't spend too much time, here. Having said that, I want to highlight that what you have seen in the sixth months since closing is just a preview of how we see NESR's story evolving over the next four to five years.

We grew revenue approximately 21% year over year. And in the second half of 2018, revenue was 22% higher than the first half. We have increased our bidding activity and our win rate. This is essential to achieving our long-term market share objective in these key markets and business lines. We plan to quadruple the company in four to five years and we produced a detailed roadmap, per country, to be there with the required investment and equipment and people.

We will continue focusing on enhancing in country value with local content at the top of our agenda, our plan to remain on target for manufacturing, recruiting, building the proper infrastructure in order to ensure we are in line with our customer directives and long-term plans.

Third, we wanted to improve and simplify our capital structure and we now have measures under way to rationalize our debt structure and right size our working capital facility. Similarly, we are working on our tax structure to bring down our effective tax rate. This is a key objective for our finance teams and we have world class tax expertise in the company, so I am confident about the results.

We are, also, ensuring that our teams on the ground constantly focus on the DSO, which has now come down from 132 days to 104, over the last six months.

Fourth, we give ourselves a very challenging objective of initiating operation in a new country. This is a very tough task in six months of life of a company. We did it in not only one but two countries. We were proud to enter Chad and NESR has been awarded a coil tubing contract, there. This is a $45 million award over five years. As we have been saying, sub-Sahara Africa, as a region, is of a great interest to us and we will select the opportunities when we believe we can provide differentiated services that match our strength.

We, as a management team, have very good experience in the region and understand it well. So, I look forward to building on this success. We are looking at more opportunities and remain in constant discussions with our customers in this area.

As you may have seen from our press release , last Friday, we have been awarded a major cementing contract in Kuwait. This award marks the entry of our production product line into Kuwait and will contribute up to $100 million to the top line over the next five years. This was a competitive bid with several incumbents and new bidders. This is a very critical win for us as this now further allows us to benefit from the growth and activity in Kuwait.

I would like to thank KOC for putting their faith in us and I am confident our team will deliver and exceed their expectations. Kuwait has very strong and ambitious production growth targets based on their history, consistent leadership. They are planning to grow in all types of production being heavy oil, conventional and now, off shore. We are very proud and honored to be part of that journey.

Lastly, we also wanted to introduce two new technologies by year end and we are proud to say we have accomplished these objectives. As a matter of fact, we signed multiple partnership agreements and either started operating commercial services or doing field trial to prove the technology in the client field. As an example, we have started to run Multiphase Meters in Algeria for surface measurements. These Multiphase Meters are source less. They don't have any radioactive sources which is crucial in some places for safety precautions.

The clients are receptive as it minimizes the safety risk and eliminates the need to escort those operations, which means more well tests can be performed daily and more cost effectively. We are, also, working successfully on down hole coil tubing stimulation technology which has now expanded into two different countries and we are looking for more application in three others.

In addition, we are working on our field trials and licenses for perforations, as well as directional services. We will be able to give you more color, once we complete those trials and get the customer endorsement.

We remain very close to our esteemed customers and only step in with fit-for-purpose technology when we know we can provide flawless delivery. We are not shy to decline some types of wells where we know we don't possess the expertise or the technology. And at times we even advise our clients on the readiness of the overall technology, what stage of the life cycle it is in and who has the best tool for the well. The key is to continue to build credibility and trust and provide the best possible advice to our clients and not focus on short term profits.

I hope with this summary, all of you have a better understanding of where we are and where we are going in 2019. With this, I will pass the call over to Melissa to talk about the finance.

Melissa Cougle: Thanks, Sherif. This morning, we filed our earnings release reporting results for the 4th quarter. We are pleased with the results of our first two quarters of operations since combination. Fourth quarter revenues continued to demonstrate meaningful growth, quarter over quarter, at almost 9% top line growth. In total, the second half of the year grew 22%, sequentially, from the first half of the year.

Our adjusted EBITDA also shows that we continue to be able to translate our growth into the bottom line. In 2018, we achieved combined full year adjusted EBITDA of $162 million. This compares to $148 million in 2017, which is roughly 10% growth, year over year. This growth was achieved with only seven months of combined operations, including in our fourth quarter, which saw a significant drop in oil prices to levels not seen since 2015.

Our fourth quarter growth was driven primarily by the better utilization of our assets with increased activity across both segments, as well as the expansion of new and existing contracts. We continued to realize cost synergies from our integration work and began to see some traction in our ability to cross sell new services in our existing footprints. In addition to our segment top line growth, we were also able to advance our geographical footprint goals, growing quarter over quarter in all five of our largest operating locations.

We posted a combined adjusted EBITDA of $50 million for the fourth quarter. This represents a sequential growth rate of 7% and year over growth of more than 14%. Drilling down, our Production segment revenue for the fourth quarter was $99 million with EBITDA of $36 million. The improvement over last quarter was influenced by higher coil tubing activity across our operating locations, larger scale projects for customers in Saudi and Iraq and overall margin improvements with a continuous focus on cross management.

Our Drilling & Evaluation segment for the fourth quarter was $61 million with EBITDA of $14 million. We saw continued strength of our well testing and logging activity across several regions. We continue to grow our D&E product lines at a much faster pace than the market, mainly by enabling cross selling of the drilling portfolio of the former Gulf Energy into our current larger global footprint.

We continue to invest in the D&E infrastructure and are positioned to capture the growth of these newly awarded contracts. You may notice lower margins between Q4 and Q3 and this was heavily influenced by the gain on a sale of overlapping business that occurred in Q3 and did not re-occur in Q4.

Net income for the quarter totaled $23 million which included the impact of transaction and integration costs of $1.2 million, as well as amortization from our contract intangibles of $3.8 million. Net income was also impacted by an adjustment made to update the contingent earnout consideration finalized at year end.

In turning to cash generation, through the post combination period of June through December, 2018, cash flow that came from business operations was, approximately, $75 million. And for the combined full year totaled, approximately, $115 million.

The combined companies' free cash flow for the full year, once adjusted for transaction cost totaled, approximately, $60 million. As we think about 2019 and our anticipated cash flows, we remain steadfast in pursuance of an aggressive growth strategy and will look for opportunities to deploy capital where we feel like we can create incremental value.

Some of the highlights of our balance sheet include a cash and cash equivalent balance of $25 million, as of December 31. This is compared to $68 million, as of September 30. As you saw from our filing, in the quarter, we repaid $44 million of the Hana convertible loan that matured on December 14. The remaining balance was extended and repaid fully during the month of January. As of December 31, our net debt to adjusted EBITDA ratio was 1.7.

Post combination income taxes totaled $9.4 million, giving us a successor period ETR of 21% for 2018. This rate was affected by the 2018 transaction costs that were largely not deductible for tax purposes. We continue to work on our restructuring activities and believe it will positively impact the tax rate in the future.

In 2019, we are already ramping up our capital spending to meet our growth plans for the year. It's our intention to get capital deployed and working as quickly in the year as possible. We look forward to 2019 with good momentum gained from our first two quarters of combined operations. We've set aggressive targets for ourselves and look forward to what the future holds.

With this, I would like to pass back to Sherif for his closing comments.

Sherif Foda: Thanks, Melissa. We are incredibly proud of the work our team is doing and are excited about our future. I would emphasize that 2019 would be a great year for MENA. And we are very well positioned to exceed the growth target of the region.

As mentioned, several times, we plan at the minimum, to double the growth rate of the MENA region and we have the people, focus, technology, and financial capabilities to achieve that. With this, I would like to take this opportunity to thank everybody for joining the earnings call and if there are any questions, we will be happy to address them now. Thank you. Operator.

Operator: Thank you. We'll now be conducting the question and answer session. If you would like to ask a question, please press star, one, on your telephone key pad and a confirmation tone will indicate your line is in the question queue. You may press star, two, if you would like to remove your question from the queue. For participants that are using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment, please, while we pull for questions.

Thank you. Our first question is from Greg Coleman with National Bank. Please proceed with your question.

Greg Coleman: Hey, thanks lots. First of all, congratulations, everyone, on the inaugural year, a pretty big accomplishment, so, excellent work.

Sherif Foda: Thanks, Greg.

Greg Coleman: Wanted to start with a couple just, sort of, detail questions on the quarter and then one or two bigger ones. Just on the gain of sale there, that's a bit of new information for us. But can you help us understand the impact that had on Q4 or Q3, I suppose, so we can try to normalize for the growth from the third to the fourth quarter?

Melissa Cougle: Yeah, Greg, this is Mellissa. We had a small overlapping business in Oman that we sold shortly after the close of the business combination and it was, ultimately, all the accounting took place in Q3. It was, if I'm recalling correctly, $1.8 million of gain.

Greg Coleman: Okay, got it. Then, staying on that theme from the margin perspective, you know, we saw phenomenal growth from, sort of, the first half of the year into the second half of the year but now, we're seeing EBITDA margins kicking around that 31, 32 percent level. Just wondering if that's the level we should be thinking about as we look out into 2019, or if we should be anticipating, sort of, margin growth reigniting. And where I'm coming from is, we don't have a ton of detail on the close to half a billion dollars in contracts you signed so I'm not too sure if the margin profile of the contract work coming on is going to be additive or dilutive to the margins we've seen in 2018.

Sherif Foda: So, Greg, I mean, as I mentioned before, we look at all our opportunities and contracts across the region within a range of profitability. --some contracts you're going to win at a higher margin, some contracts you're going to win at a lower margin. We had a window of, we always said, between 25% to 35% and we look to stay at always in this window and operate.

So, sometimes you will have contracts at much higher rates. Some contracts, , you'll have contract of much lower rate. You have startup cost, as well, in some of these. But you always have to assume within that range we are pleased to operate in most other countries. So, we don't really run the business by quarter but within that range, you'll have most of our contract wins will be.

Greg Coleman: Your call. So, all the numbers you were talking about are consistent with, sort of, the margin profile we've seen so far, kind of splitting down the middle. Is that a reasonable expectation, going forward, or are the contract wins bulking either end of that 25 to 35 you mentioned or is it, sort of, evenly distributed throughout and so, using sort of the midpoint as a reasonable assumption?

Sherif Foda: Yeah, I would say so.

Greg Coleman: Okay, great. Moving on to the contracts themselves, you know, great to see the Kuwait win just before the quarter here. Wondering if you can offer us a little bit more details on that. It is cementing, you said, competitive bid with several incumbents. When should we expect that to kick off? Is that, sort of, first half of '19, or is it something that will take a little bit of time to deploy assets? You guys aren't ones to move slowly, so, just trying to get a feel for when that starts.

Sherif Foda: Yeah, I mean, basically, this is very typical of contracts in this region. This was, definitely, a long process. It took a long time to--the competitive bidding especially we are a newcomer. So, they kept some incumbent and they took two newcomers. And it takes, usually, four to five months to start up the contract between auditing, awarding, so the award will start after that, usually, they come in your site, you move the equipment, they start assigning you rigs. You estimate second half of the year, is a good assumption to start.

Greg Coleman: Good, great to hear. And then, the $45 million contract that you mentioned in your prepared remarks there, Sherif, the coil tubing. Is that something that I missed in prior announcements or is that a new announcement? Maybe it was part of the major multi-year contract you announced in December. Just trying to understand if that's additive to what you've announced or if it was already included in some of your prior announcements.

Sherif Foda: No, it was not announced before that. We just got awarded over the weekend and that's why we just announced it, now.

Greg Coleman: Phenomenal. Okay, great, so that's additive. And then, just lastly, on the contracts. I mean, I don't want to hog up all the time, here. If we look at 2019, you're going to be incorporating a lot of stuff. So, you've got the $45 million log coil tubing, $70 million in Kuwait, the combined contracts you announced earlier in 2018, 380 million and then, the major multiyear at the end of December. Should we be worried, at all, about implementation cost or deployment costs. I mean, should we be kind of a little bit more cautious on our margin profile in 2019, as you put a whole bunch kit to work or is that just sort part of a normal issue for you and we wouldn't be too worried about that, certain deployment cost or start up cost on all these new contracts.

Sherif Foda: You always have the start up cost and, again, if you run the company per quarter, you'll have a yes, for sure, you would have a start up cost. So, the earlier quarter when you start to deploy this, your margins will be reflected to that. And then, once you have the contract fully run, then you go back to your normal margins. So, definitely, the earlier quarter of the implementation, you always have some cost, start up cost.

Greg Coleman: Great, that makes sense. Just want to get that feeling. And then, finally, capital structure, you mentioned just kind of working on that and keeping an eye to it. Should we be looking at your debt profile and kind of expecting any, sort of, more structure to permanent longer term terming there to just kind of lock in your interest rates or is the current structure, I guess, Melissa, this is something that you're comfortable with and your current maturity dates.

Melissa Cougle: So, from the profile of the capital structure, I'm comfortable with it but for the reasons I think you and I, previously, talked about. I think we're--it makes sense for us to look at consolidating and, maybe, terming out some of that and a more efficient structure. So, we continue to explore that and that is what Sherif was mentioning in those measures. But from an overall debt level, we're comfortable with it. But we think that there's improvements we can make to create more efficiency within the structure, for sure.

Greg Coleman: Awesome. Okay, that's it for me. I'll hand it back.

Sherif Foda: Thank you.

Operator: The next question is from the line of Igor Levi with BTIG. Please proceed with your question.

Igor Levi: Good morning, guys.

Sherif Foda: Good morning.

Igor Levi: So, while most of your work is on shore, you guys do have a foothold in the offshore market in Qatar. So, do you see an opportunity to increase your offshore presence in markets like Saudi, UAE, Kuwait, given the large number of offshore FIDs and indicating that we'll see a large uptick in offshore activity in the coming years?

Sherif Foda: Thank you Igor. Yes, absolutely. Let me just remind everyone. So, we do work onshore and offshore. We work both in the countries you just mentioned, so, we work offshore in Saudi Arabia, we work offshore in Abu Dhabi . So, the difference is we have a leading position in the offshore market in Qatar, especially on the coil tubing business. So, the difference between offshore jackups and offshore deep water is, basically, the jackup today, when you operate them, cementing, coil tubing, slickline, wireline, it's almost like they are operating onshore, as well, right? Because you go on a jackup and you perform the work from there.

We do not have any deep water activity but we do have offshore. So, to go back to your question, yes indeed, there are a lot of offshore projects being sanctioned in the Middle East, especially, new entry, like Kuwait starting, you know, Algeria, Egypt, etc. So, we are working on all this in preparation of the equipment and the people, , etc. And again, we have the capability on working both offshore and onshore. So, we have a very good position in Saudi, as well.

Igor Levi: Great, thank you. And could you provide us an update on pricing trends in the region and the competitive environment, as you bid on new work.

Sherif Foda: Yes, so pricing remains competitive. I mean, all the bidding goes through the same competitive long-term contracts, a lot of clarification, I mean, if you look at the last award, we had four or five clarifications, even reverse pricing. So, it is very similar. The difference, again, is it's long term. People have long view of the sustainability of the contract. When you get the contract, it's not only about the price. It's about your service delivery, your nationalization, local content, etc., So, there is advantage that we have on certain contracts versus the other.

If you look at the competitive of the large huge project which is like the LSTK, yeah, this is very, very challenging and the pricing is quite low, actually, on this project.

Igor Levi: Great. And then, lastly, how should we think about the first quarter in terms of revenue and margins. Do you expect any negative seasonality or is your order book strong enough to offset that?

Sherif Foda: As we always say, we don't give guidance, but I can tell you that, from an activity point of view in the Middle East, it's always a sequential quarter. So, you will always have the Q1 as the lowest and then, ascending Q2, Q3, Q4. This is not because of weather. It's mainly because, usually, at the start of the year, all the NOCs have their budget approved. But deeper of the year, you know, with the higher spend to understand where activities, etc., etc., and then, you'll have the slower start, especially on the rigless side, right. Because the rig is already contracted, you have a rig growth, you have a percent year on year. So, we would see always, for example for ourselves, some for others. I would say year on year are very strong growth, as always.

We would have a continuation possibly, obviously, all of the contract wins we have. So, we will weather it a bit that seasonality from the others. But, definitely, you'll have a stronger second half than the first half, always, in the Middle East.

Igor Levi: Great, thank you. I'll just turn it back.

Operator: Thank you. At this time, I'll the floor back to Sherif Foda for closing remarks.

Sherif Foda: Thank you very much. We really appreciate the time. Again, we are very excited about the MENA region for 2019. We think it's going to be a phenomenal year and looking forward to future calls. Thank you.

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