NATIONAL ENERGY SERVICES REUNITED CORP.

First Quarter 2019 Earnings Call

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Operator: Ladies and gentlemen, thank you for standing by, and welcome to the National Energy Services Reunited Corp's First Quarter Earnings Conference Call. At this time, all participants are in a listen only mode. Later, we will conduct a question and answer session, and instructions will be given at that time. As a reminder, today's call is being recorded. I would now like turn the conference over to your host, Ms. Melissa Cougle, CFO of NESR Corp. Please go ahead, Melissa.

Melissa Cougle: Good day, and welcome to NESR Corp's First Quarter 2019 Earnings Call. With me today is Sherif Foda, Chairman and Chief Executive Officer. On today's call, we will comment on our first 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 materially differ 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 and reconciliations to the most directly comparable GAAP financial measures can be found in our press release, which is on our website. Finally, some of you may be calling for the first time, so please feel free to contact us after the call with any additional questions you may have. Additionally, 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, Melissa. Ladies and gentlemen, thank you for participating in this conference call. We are excited to report on our tremendous results and continuous progress in this quarter. We grew our revenue 29% year-on-year, which is more than double the industry average, while the overall rig count in the region increased by mid-to-high single digits in the same period.

Now I would like to take a moment to talk about the industry as a whole, and where I believe we are headed in the MENA region. As I mentioned last quarter, we continue to see strong activity trends in the core GCC countries as well as the larger MENA region. 2019 will be a solid growth year and the start of steady, long-term plans for the majority of the customers in the region. Across the GCC, we see our esteemed customers putting in place long-term field development and CapEx spending plans, and going forward, we will see approximately $60 billion to $70 billion average spend per year over the next five years, which is almost double of the last cycle.

Our customers continue to invest for the future of the region by building the infrastructure to ensure they are the most reliable and sustainable source of energy for the world economy. They are venturing into more complex reservoirs and harsher environments like unconventional, heavy oil, and high H2S fields. Another big driver in the region is gas production, which is seen as an enabler for internal growth. In our key markets, we see a great emphasis by our clients to develop and significantly increase gas production, mainly for internal consumption, conversion from diesel powered plants, and in the quest for cleaner energy.

Egypt spent almost $14 billion and a massive conversion to the newer gas plant and will be adding almost 300% over their existing capacity. Saudi Arabia plans to increase production from 14 to 23 BCF a day over the coming years. All the countries in the region have very aggressive plans, which, in turn, will require a lot of exploration and development spend for gas fields. The region is rich in both conventional and unconventional resources. This translates in a sharp increase in service intensity with deeper wells and requirements for service industry to ramp up their skill sets, investment in both human capital and equipment, which is good news for us.
How do we know that? One just has to look at the productivity of the wells in Saudi versus the US. Saudi Arabia has approximately the same production as the United States, and it does that by drilling just 7% of the wells the US drills every year. However, as we go to harsher environment, unconventionals, heavy oil, the region will need to drill more wells to keep the same production level, obviously not at the same magnitude of the US, however, much higher than today. That's in addition to the normal decline curve of the existing reservoirs in the different countries.

The larger region witnessed some geopolitical turbulence this quarter, mainly Libya and Algeria. Thus far, this has not affected the oil field areas nor our operations. We do not believe it will materially affect or change the long-term course of the oil industry in this region. We are taking all the contingency measures for our operations in Algeria and in Libya, where we mainly have local crews who understand the environment and deal properly with the situation in close coordination with our clients. We are not changing our forecast for the North Africa region, and we believe we can stay the course and grow at the rate we predicted when we made our 2019 plan.

Shifting gears to the capital market, I'm sure all of you are aware of the results of the Saudi Aramco bond offering, and you saw the scale of the numbers of our biggest customer. By some estimates, the bond offering was oversubscribed 10 times, and Aramco received an A+ rating from Fitch and an A1 rating from Moody's in its first ever credit ratings. This extremely successful bond issuance of the largest energy company is a very good indicator of the strength of the industry in the region and how capable they are. This is also a very strong vote of confidence for their future plans. This market validation further strengthens our view that our strategy of focusing on MENA is at the right time and at the right place.

We believe that as the national champion for oil field services in the MENA region, we are in the pole position to help our clients execute their vision and grow NESR at the aggressive target we set ourselves last year.

Now coming to a review of our operations, Q1 tends to be the slowest quarter for the region with our customers starting to implement their 2019 plans. We saw a muted effect on our revenue sequentially as our activity levels have remained solid through the first quarter. Coiled tubing, nitrogen services, and cementing have been strong through the quarter. This is on account of the market share gains which we have made, and also, very importantly, the excellent service delivery of our operation teams, which makes it easy for our customers to assign more work to us.

In Q1, we continue to see overall market pressure on pricing in some segments but mainly on larger LSTK type projects. We believe as activity continues to increase and with a more disciplined approach from the service industry, pricing should start to stabilize. Production segment has been our core strength, and we have shown year-on-year healthy incremental of approximately 50% on margins, which is largely driven by prudent management of our costs. As we have announced with the ongoing mobilization of our new contracts in Chad and in Kuwait, we have as you would expect already started incurring cost for these mobilizations, which will continue in Q2 for work to start sometimes in Q3. With this cost being considered, I believe the team has done an excellent job at managing the margins.

As you see from our year on year numbers, D&E has come a long way for us. Drilling and evaluation segment almost doubled from a year ago, and we continue to deploy new product lines and technologies to the countries where we did not operate previously.

We invested heavily this quarter towards the ramp up of activity, adding people and rigless sites, but the dynamics here are a bit different. Let me explain. In our rigless business, as our customer continue to give us more work and entrust us with their operations, they asked us to manage the associated third-party service for the sites. This traditionally used to be contracted directly by the client. However, as we continue to demonstrate solid project management skills, they like to have the same standard of HSE, service quality, contractor management to all the sites subcontractor, for example, trucking, catering, minimal road construction. We do that at cost plus. However, it enables more efficient operations and more wells to be tested per day. This has a dilutionary effect on our overall margin percentage, given we have increased this activity significantly through the quarter, which is clear from the revenue increase year-on-year. We are continually working toward expanding our product offering as well as our footprint, and in this light in Q1, we continued to negotiate multiple contracts and extension of services in this area.

Meanwhile, we managed to qualify two new product lines to our portfolio in record timing, where it takes traditionally more than a year to do so. In Oman, we started execution on two large coiled tubing contracts, and I have to commend the operation team for flawless start-up and performance. This quarter we were recognized by our major customer in UAE and Algeria as the best cementing service provider in terms of quality. In Algeria, we also inaugurated our new cementing lab in Hassi Messaoud. In Indonesia, we got qualified for pumping services with Pertamina and conducted the first perforations job with our partner GEODynamics. This would be the first perforation job the company has ever done in the region.

On the integration front, we are starting to see the benefit of the new single management structure in every country. Our clients like to interface with the Country Director who is managing all the segments, and we leverage the back office and supply chain in terms of size and buying power. We are working relentlessly on back office and harmonization of the ERP system. Overall, we are very pleased with the progress. We set ourselves a goal to meet with all the management team every quarter after the board meeting to ensure we review periodically our aligned objectives and listen openly to the criticism of what is not going well in the company.

As we conduct our board in a different city every quarter, we try to time it with an industry event. It gives a great opportunity for team building with the management, enriching the company culture, meeting with the key clients, exposing the high value employees to board members and senior clients, thus ensuring proper succession planning. Our last meeting was in Bahrain during MEOS, and we had positive feedback from our customers, employees, and our leadership. Most importantly, our values, image and role as the National Champion are well recognized in the region.

On the corporate level, and Melissa will cover this in detail, I am pleased to also announce that we completed the first landmark refinancing of our debt. We now have access to more capacity as well as better debt terms, which gives us flexibility on consummating any accretive M&A

opportunity that may present itself. We are constantly looking at the different opportunities, which add value to our operations as attractive valuations. This quarter, we also completed some key market innovation technology contracts. This is in line with our philosophy of being an open platform for technology companies to work in the Middle East with adjustable models. One of them is a well control technology, a game changer for our customer and will allow them to access difficult reservoirs, which previously carried a certain risk profile. The model which we have is the technology provider will contribute the assets, and NESR will be the implementer on the ground and the contract holder with the customer, and both of us will share revenue. This capital light model will be accretive to our margins.

Another one is for an innovative wireline technology, which will be custom built for one of our clients, where we will be the party buying and running the tools while the clients and us will fund the technology provider to custom design and build the tool. This flexibility in developing the business model permits us to implement promptly and adjust the model accordingly. I hope this brief summary gives all of you a better understanding of where we are and how we are progressing throughout 2019. With this, I will pass the call over to Melissa to talk about the financials in detail.

Melissa Cougle: Thanks, Sherif. This morning we filed our earnings release reporting our first quarter results. As excitement continues to build around our story, we remained pleased with the results of our operations as we conclude our third full quarter post business combination. First quarter revenues were $152 million, an increase of 29% over the same period last year. It was highlighted by our continued cross-selling of new services from our drilling and evaluation segments as well as solid performance from our production segment. First quarter adjusted EBITDA was $41 million, which grew over 30% over the same period last year for the legacy companies, demonstrating that we continue to be able to translate our growth into cash flows.

The first quarter is traditionally the slowest of the year for oilfield service companies in the region as our customers begin to deploy operating budgets. Despite this, we know that our first quarter adjusted EBITDA on an annualized basis is already on pace to exceed full year 2018 adjusted EBITDA. And as we go into the latter half of the year, we believe our strong growth pattern will continue. Drilling down, our drilling and evaluation segment revenue for the first quarter was $60 million, growing more than 60% over the same period last year. We continue to expect D&E to grow at a fast pace, mainly enabled by the continued cross-selling of the drilling portfolio, where we have a leading position in Oman into our other operating locations.

One good example of this effort has been in our fishing and remedial solutions, which was particularly successful in the first quarter with revenue gains of nearly 50% in comparison to revenues of the 2018 fourth quarter. On the evaluation front, we are continuously looking to expand our leading position in our evaluation business line in Saudi Arabia and also to replicate that success in neighboring countries. D&E segment EBITDA was $10.7 million, an increase of over 90% over the same period last year for the legacy companies. This improved performance is including the additional services, which we are providing at cost plus in some of our D&E contracts, which Sherif mentioned earlier.

Our production segment revenue for the fourth quarter was $92 million, which grew 14% over the same period last year. EBITDA for this segment totaled $32 million, growing 21% over the same period last year. The increased activity is primarily related to year-over-year market share gains, which we have achieved in Saudi Arabia, Oman, Algeria, and Iraq. Adjusted net income for the quarter totaled $14.5 million, which excludes the impact of integration costs of $1.4 million. We would note that our net income both now and in future quarters will include amortization charges resulting from the purchase accounting for last year’s business combination. These charges are $4.1 million quarterly.

For the first quarter, operating cash flow was $21 million or $22.4 million adjusted for integration costs. As we think about 2019 and our anticipated cash flows, we remain steadfast in pursuit of an aggressive growth strategy, and we will look for opportunities to deploy capital where we feel like we can create value. Looking at the balance sheet, cash and cash equivalents were $19.9 million as of March 31st. As you will see from our filings, in the quarter we repaid almost $22 million in debt, including the final installment on the Hana convertible loan. We paid nine million in capital expenditures, some of which is reflected in payments and borrowings as they are financed in short term facilities.

As of March 31st, our net debt to EBITDA ratio was 1.7. We've mentioned during prior calls our desire to improve the capital structure and recently completed a refinancing as part of this effort. The refinancing was conducted through a formalized and highly competitive proposal process led internally and inclusive of both global and regional banks. We have termed out our existing debt of $300 million, which includes a one year grace on principal repayment and a five year graduated repayment maturity. Our other working capital facilities have also been refinanced into new facilities that will have capacity of up to $150 million.

Total borrowing capacity under the term loan as well as the facilities is $450 million. This refinancing has achieved multiple objectives for NESR. Firstly, our overall economics are improved with lower borrowing rates that are anticipated to save us meaningful interest costs going forward annually. Secondly, we have been able to add a revolving credit facility to the structure of $65 million, which gives us the ability to seize smaller and organic opportunities quickly as they are identified, as well as manage our working capital efficiently. Thirdly, our borrowing structure has been optimized to allow for maximum deductibility of our interest expense, improving our tax rates going forward.

Finally, an aligned parent company covenant package was put into place that will allow us financial flexibility going forward with additional borrowing capacity, should it be needed. We are exceedingly pleased with the outcome of this transaction and are appreciative of all of our banking partners who worked with us to make it happen. Our first quarter net income tax expense totaled $2.9 million, giving us a first quarter ETR of 18%. As compared to the prior period, the ETR benefited from fewer non-deductible transaction and integration costs. Additionally, we have begun to realize the benefit of our restructuring activities and believe they will continue to positively impact the tax rate in the future.

In 2019, we have placed orders for much of our anticipated capital items needed 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, although we would again draw your attention to the fact that this will translate more slowly in terms of cash flow effects given the short-term financing we previously mentioned. We look forward to 2019 with good momentum gained from our first three 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. Q1 has been a great start, and I'm pleased that we are on the path to deliver on our objectives this year and in the future. The national market is heading for strong recovery. MENA in particular will have a solid 2019, and I'm confident in our ability to double the growth rate of the region. With this, I would like to take this opportunity to thank everyone for joining this earning call, and if there are any question, we would be happy to address them now. Operator [unintelligible]?

Operator: Thank you. If you would like to ask a question, 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 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 star keys. One moment, please, while we pull for questions. Our first question comes from the line of Greg Coleman with National Bank Financial. Please proceed with your question.

Greg Coleman: Hey, guys. Congrats on the strong year-over-year growth.

Sherif Foda: Thank you, Greg.

Greg Coleman: I wanted to start by taking a look at some of the contracts available in the region. Last year, especially in the latter part of the year, you had pretty big bookings. I think you put something like $450 million in contracts on stretching over the next four or five years. Was that an unusually big year for contract bookings? Should we expect 2019 to be a little less eventful, or is there still big stuff in the region that you're chasing?

Sherif Foda: Thanks, Greg. So, I would say obviously last year was significant, because it was the first year the Company was put together. So, we had a lot of opportunities that we were targeting, and we managed to capture a lot of them. Some of them were tenders which come about every four or five years. So, it was significant. However, saying that, I think 2019 will be similar or larger, because we managed to put a lot of product line in every country that is much more than what the two companies alone used to do. Another way to think about it, today we are bidding on much bigger pool of contracts than what we used to do before, and, therefore, I would believe that we should be able to announce similar or larger size this year than last year. The difference is the timing.

As you would imagine, maybe you will ask me now why you didn't announce anything this quarter, I'd tell you because we are negotiating. So, the type of the tenders, again, in the region, some of it comes with what we call a binary, so basically it's a very clear who won--you have three or four players that won, and they get announced immediately. And some of it we keep negotiating with the customer, either an extension to the current contract we have, or we negotiate after we submit the pricing based on who would be the L1, L2, L3, L4, et cetera, and, therefore, after all this is settled and the announcement is made, then we announce obviously to the market after the client’s acceptance where we are. So, in a summary, you will be seeing more of the same of last year toward the coming quarters.

Greg Coleman: Got it. Okay. And kind of keeping on that growth theme here, if we see those contract wins coming forward, can you give us a reminder of how much capital you're looking to deploy, I guess both from our maintenance, but also more importantly from a growth perspective in 2019? And is that capital deployment dependent on securing additional contracts, or is it is pretty much locked at this point?

Sherif Foda: So, if you look at what we're planning in 2019 is, as we said before is around, $100 million CapEx, because we are quite comfortable of the awards we are going to have, and as well the growth that we already had last year with the contract awards. So, most of this is already almost committed, and we will be deploying it through the year. If you look at what we did already this year in contracts and what we need to have for maintenance, I always say rule of thumb is almost 4%. So, if you look at the $100 million CapEx, $20 million of this would be maintenance, and $80 million would be growth.

Greg Coleman: Got it. Alrighty. Good to hear. Just focusing in a little bit more on the detail of 2019, just because you and your company were still getting used to the seasonality, I mean, we've seen in the region for the majors for a long time now, but is there any reason to expect that we shouldn't--is there any reason that 2019 shouldn't exhibit the same seasonality pattern that we saw in '18, meaning we sort of saw a ramp up of each quarter sequentially? Is there any nuance in last year or in this year that would prevent that from happening, or would that be in line with what you're expecting internally?

Sherif Foda: It will be in line. It will be exactly in line. You will always see Q2 stronger, Q3 stronger and then Q4 the strongest. So, this will--I mean, the way I see it, this year will not be any different. The only difference that you might have is security in the region in Algeria and Libya, which is, in our case, will only be I would say muted, because obviously our size is very small and if something happened and the operation is to halt in one of those countries. For us it will not make any difference, but for others it might make for the seasonality that you are asking for. But taking that in a different step today, Libya was never a big contributor to any of the service company, right? So, it's not going to be a huge effect either way. So, I would say, for NESR in particular, I would say the second half will even be stronger, this year than last year, because of the fact of the contract awards, and they are all ramping in the second half of the year.

Greg Coleman: Got it, so that $450 million in wins last year kind of starts this in 2019 but really ramps in the back part?

Sherif Foda: It's a mix. Some of it has already started, which you know already. I mean, the stuff that we had that--for example in the GCC with our large customer, and we started this already since last year. So, this was already awarded, and we started immediately, but some of the contract award the smaller ones like in Chad and Kuwait et cetera only start in the second half of the year.

Greg Coleman: Got it. Okay, and the last one for me, and sorry to hog the questions, but, Melissa, on the debt side it's great to see the consolidated line there on all sort and easy to understand package. But when we look at our Q2 numbers, is there any one-time costs associated with that that we should just be watching for sort of with that start-up?

Melissa Cougle: No, I don't think you're going to see anything significant. We paid one upfront fee, but I don't think it's worth it to call out, but it was shy of 100 bps.

Greg Coleman: Got it. Okay. That's it from me.

Melissa Cougle: It would be something I would not tag as material, but you'll see it in terms of financing cost compared to the cash flow in this quarter, but it's not very large.

Greg Coleman: Roger. Okay, we'll pass it back. Thanks a lot for that color.

Sherif Foda: Thanks, Greg.

Operator: Thank you. Our next question comes from the line of Sean Meakim with J.P. Morgan. Please proceed with your question.

Sean Meakim: Thank you. Hey, good morning.

Sherif Foda: Good morning, Sean.

Melissa Cougle: Good morning.

Sean Meakim: So, Sherif, maybe we could start with D&E? Can we talk a little bit more about the mix impact quarter-over-quarter in profitability? I guess I'm trying to get a sense for how much of the revenue mix was coming from cost plus? And as you look out, what would you say is the normalized mix for cost plus as this shift in a customer demand changes?

Sherif Foda: Sean, thank you. So, if you look at the D&E, obviously it's drilling and evaluation, right? So, it's a lot of product lines, and the mix makes a big difference if you have more of the evaluation type work than the drilling type work. So, obviously evaluation comes with the better margins than the fishing rental type work, right? So, in Q4, we had, I would say, better evaluation than drilling and Q1 was--the mix was a bit different. This is part of the margin, I guess that's what you're saying, Q1 versus Q4, but the big one is what you call cost plus as we now will be coming to, the customer is really depending on us on some of these huge contracts. At the beginning of this, they ask us to go and manage a lot of those sites, right?

So, obviously we take it because this is definitely a sign of strength for us to be able to perform this work. And definitely, the client wants to have, as I keep saying, more efficient way of testing those wells, so they don't want to manage between trucking, contracting, catering, camps, and et cetera, which we do it as cost plus. We don't want to do this in any other way. So, if you think about it, Sean, in a very simple math, if you do our margins for our business is intact, it's the same. So, if you--let's say, for the sake of argument, if you do $10 million at 30% margin, it's the same. So, you make $3 million, and then you have this additional work that you take, which is, let's say, 30% of that, which is $3 million, you do it at cost plus, so it gives you 10% or so.

So, all of a sudden, now you take 10% of 3, is 300, so 3.3 over 13 gives you 25% margin, right? So, your margin dropped due to dilution, the dollar value has increased because you have 300K more, you don't lose any money on taking care of that business. However, the overall dilution gets you 300, 400 points less. So, in Q1, you saw that our revenue was--as I said, D&E doubled from a year ago, but part of it was small, but part of that contract where we operate we are now are taking that responsibility of managing the third parties. And I think as the company gets bigger, you will have always this demand. Can you take care of this? Obviously, the customer has to trust you that you can manage better than them or as good as them.

Sean Meakim: Got it. That was a very helpful explanation. Thank you for that. On production, is there a similar dynamic, or is it limited more to D&E? And I guess it would be great to hear a little bit more color on geographic and product mix in the quarter for production, maybe a little bit more about upfront contract, perhaps start-up costs et cetera that you're experiencing and as we think about the impact on second quarter in the back half of '19?

Sherif Foda: Yeah, so, the production is obviously where the company is very strong, and we continue to have a fantastic year this year on--and especially on our core countries, Saudi, Iraq, Algeria, Qatar, a very, very strong--we are taking more work, the customer are giving us more rigs. We are just discussing with them very, very big kind of additional work scope on our current contract in Oman, and the clients are discussing, coiled tubing business, for example, I mentioned in my remarks, they added to us like big scope of it where we take care of the high pressure, some high stimulation work, et cetera, and we are taking care of that.

So, I think that the production will continue to be our stronghold, and we definitely want to make it much bigger than what we have today. And we are venturing into a couple of new business lines in it and a larger contract with the customer. The start-up cost is definitely there, because as we announced, we won two contracts in two countries where we never existed before. So, we are setting up the base, we are setting up the facility, the bulk plant, the lab, hiring people. So, we started this already in this quarter, and we will continue in the second quarter to make sure that we are ready by the second half. The whole model we have here, we don't want to manage our business only on quarterly nos.. We need to make sure that we are ready with the service quality and the delivery, and we want to always pleasantly surprise our customer.

Our customer is the most important thing for us, and we need to make sure that they are entrusting us and that all of a sudden they're going to give us this work instead of somebody else, or, as a newcomer, we need to make sure that they are extremely happy with how we perform from day one. We do not want to have a learning curve of six to eight months like the rest of the industry. We want to start and hit the floor running from day one, and that's why we put some preparation on the ground, hire the best people, and setting up the right base. So, I wouldn't say that you will see a huge drop of--or a difference between the quarter, because obviously we have to always be smart how to manage the cost and balance it through the quarter and until you get the revenue, but definitely you have a start-up cost.

Sean Meakim: Understood. Thank you for that feedback.

Operator: Thank you. Our next question comes from the line of Byron Pope with Tudor, Pickering, Holt & Company. Please proceed with your question.

Byron Pope: Good morning.

Sherif Foda: Good morning, Byron.

Byron Pope: I just have one qualitative question for you based on kind of comment you made during your prepared remarks about the increasing service intensity per well in the GCC region countries. And so as you think about it, you've got tons of organic growth opportunities for both business segments, but as we think about that trend toward rising service intensity per well, how do you think about which of the two business segments probably benefits this proportionately from that service intensity trend?

Sherif Foda: So, I would say--Byron, thank you. I would say in the short term definitely production services will benefit more. So, as you start this very heavy intensity work--and especially you go to the unconventionals, it's like the US, right? The same story. So, you will get a lot of you know coiled tubing, stimulation, artificial lift, fracturing, et cetera, which is all in the bucket of the production. Definitely, on the longer term, our customers are very smart, you will see the clients--today , planning very prudently, how they are going to have large field development plans for, I would say, lower productivity wells than previously like the beautiful Ghawar, Burgan, right?

You also have the heavy oil; definitely, once the projects are sanctioned and starting in some of the countries, where they have huge plans for it, you'll have the drilling portfolio by far getting much bigger, because then they start drilling all these wells. Some of these feed development calls for 1,600 wells, right? So, there is a lot of construction--well construction type of activity that will take place. But I think for the shorter term, you will see a lot of production increase, which is--again, we are in good shape for it. And then longer term projects focused on well construction, the big project we will see a lot of, as well, drilling will catch up. And definitely between the two to three countries where they have a huge unconventional scope, there will be a lot of rigs going in and well construction magnitude much higher than what you always are used to be in the Middle East.

Byron Pope: That's helpful. Thanks, Sherif. Appreciate it.

Sherif Foda: Thank you.

Operator: Thank you. Our next question comes from the line of Igor Levi with BTIG. Please proceed with your question.

Jacob: Good morning. This is actually Jacob on for Igor. You touched a little bit about current contracts in your prepared remarks, as previously you've turned to North America to acquire technologies required to meet these contracts in the Middle East. Can you discuss some more of the gaps and technology that you may need to fill this year going forward to execute on your contracts? And how you're thinking about acquisitions versus partnerships for these technologies?

Sherif Foda: Thanks. Very good question. Yeah, absolutely, I mean--and that's how we mentioned our open platform strategy on the technology. Today we have half a dozen agreements signed and sealed with, I would say, state of the art technology and we are working on another almost dozen more now between Canada, US, and Europe. Most of those contracts are partnership and that's how we look at it at asset light, as I keep saying, and plus we need to--the whole idea of our philosophy is--that's the usual old style that you like someone just go and acquire them, right? And we don't want to do that. We want to keep this innovation with the people.

Usually they are small, nimble, they come up with a lot of good ideas. We give them access. We want to tailor with them some of these technologies. What do we do, usually, if--and I tried to mention that in my remarks, if the technology that we think, because obviously we are technical people, as well, so, we think that they should modify the tool and to do something for the reservoir in the MENA that we know very well, and we invite the customer from the beginning, then we fund the technology. So, instead of acquisition, we just give them money to fund the technology and the tool, and then we have, obviously, exclusivity, royalty, et cetera to make sure that the tool is targeted for that market.

When the tool works for somebody else outside that region like the US, we are fine that they can do it, and even actually it's encouraging, because we need to run more jobs to ensure and to validate the tool, and the tool can be commercial, right? So, we will continue to do with that philosophy. We have a lot of opportunities. We keep looking at chemistry, downhole tools, a lot of other metrics, and we will continue to enlarge our portfolio of D&E and production to ensure that we have the best in line to the customer. And, again, we always maintain a credibility when we do not have a certain technology, or we do not master that in declined field, we decline doing the job, and we actually advise the customer who has the best tool, and that's good, long way to be a real trusted partner with your customer. Acquisition wise, I would say, we--it will be--maybe a very--if there is anything ,it has to be something extremely, extremely small in the region here for an R&D company that we think better than giving them money is to acquire them, but so far this is not our target.

Jacob: Great. Thank you so much. I'll turn it over.

Operator: Thank you. Our next question comes from the line of Blake Gendron with Wolfe Research. Please proceed with your question.

Blake Gendron: Yeah, thanks for taking my questions. Following on Byron's question in your prepared remarks about unconventional gas, just wondering if you can give us some more color on the opportunity for NESR in that regime over the coming years, specific product or service lines that NESR would like to add? I guess restating that maybe you know how much of the $80 million growth CapEx is earmarked for unconventional gas specifically? And then, finally, would you have to requalify in these segments for unconventional gas, assuming the NOC's customers release a portion of them, run the qualified pool of service company's kind of separately for both unconventional oil versus unconventional gas?

Sherif Foda: Certainly. So, yeah, I mean, I would--it would be hard for me to really qualify to you exactly line by line. Obviously, there is a competitive edge here, and there is some, I would say, trademarks of the customer. But, overall, I will tell you, the region is definitely going on a big way on their unconventional resources. Definitely Saudi leads the way, because they already started years ago before, and--I mean, Saudi and Algeria actually almost started at the same time, but Saudi obviously put a lot of emphasis on the gas, because they want gas from the unconventional--they know that they have a very rich resource into the different areas. They announced this publicly, so I can speak about it. And they're extremely successful.

So, they had an amazing seismic business in the beginning, and then they went for exploration. They did not want to do this in six months. They wanted to spend years to develop it properly, because they wanted to put science in it. They didn't want--they knew that they cannot do that statistical model like you do here, so they wanted to go through a very strong exploration and they do a very good job in reservoir simulation and trying to understand where is the best productivity of each of the reservoir. And they did that, and now they are enlarging in a huge scope between drilling, fracking, everything.

Definitely, what we are doing, as we always do, we qualify ourselves, and I tried to mention that we qualified two new product line during the quarter and basically to be able to qualify ourselves. And I think that's what you try to do. The question is you can be qualified to do services for oil, and you can qualify to do service for gas. Then you have to, what you call high pressure gas, and then you have to have that unconventionals. So, you go through a process of qualifying the service company to all these services, and the key is, can you be qualified in all this. And I would say we are working towards ensuring that we are successful in qualifying the company to be able to participate in all aspects of the oil and gas industry, from oil, gas, high pressure, high temperature, unconventional. So, we are working on that, and I would say I'm quite positive of the results. If you look at the other parts of the region for unconventional, obviously Algeria has huge reserves. It will move much slower, obviously, because--I think they would most probably get a partner to do that with them, but they are already on track as alone, has already a program, it's working, but it's still on its early phase. And then you have UAE that announced officially, they started already with couple of campaigns to look at unconventionals.

So, everybody is looking at unconventionals. Egypt even is looking at it. So, I would say there would be a lot of growth. What is for us? For us if we qualify. Today we qualify ourselves with the product lines. We make sure that we are invited, and we can participate. To your question specifically about the CapEx, no. The CapEx is meant for our growth in all the contracts that you want. And obviously some of it you already deploy in the normal. I mean, if you do drilling, fishing, remedial, cementing whether it is conventionals or unconventionals, it's part of the CapEx, but the large other items like fracking for unconventionals no, it's not part of our CapEx.

Blake Gendron: That's helpful color. And then really quickly, if you could just comment on the status of the labor market. Will this be a gating factor for you as you ramp up some of the more specialized segments across both businesses? We've heard in D&E specifically across your peers that really labor is the gating factor in addition to the tools themselves. And then with the recent developments in one of your larger peers Friday after market closed, does this drastically change the labor landscape in the Middle East?

Sherif Foda: So we are--we are lucky to be small, so--and we are lucky, as well, to be attractive. So, we have absolutely no issue attracting the best talent in the region. We actually get invaded almost by excellent people. And we do not see any issue of our ramping up to the level of growth or higher this year and beyond due to people or personnel. We will have absolutely no issue due to human capital. If I understand you correctly, I would say yes, for sure, there will be some turbulence, and definitely we are looking at all opportunities.

Blake Gendron: Okay great. And one more if I can sneak it in.

Sherif Foda: Sure.

Blake Gendron: The single management structure that you alluded to, I imagine you're running a little bit more lean from a middle management perspective in some of your peers, and I would imagine that management structure is aimed at capturing or at least heightening the visibility or the intimacy with your larger NOC customers, but for an investor that maybe is worried about you running a bit too lean as you grow as rapidly as you are, could you just provide a little bit of color as to how this management structure is designed to take in some of the growth that you perceive through 2022?

Sherif Foda: Yeah, no, it's obviously--we understand the business and understand when should we add--so, the key is at the country level the most important thing that you have the infrastructure, the support of the technical people to make sure that the country runs properly. And that's the most important aspect of the job. So, for example, the gentleman in Saudi Arabia he reports directly to me, right? There's no layers between him and me --I will call him the CEO of Saudi Arabia. So, he runs the show, and he has the full authority and autonomy to run the business and all the segments, all the product line reports to him, but when he goes and see the senior people of the customer, they know he can call the shots, and he has the authority to do that.

What you need to do is you need to make sure that he has the right support when he wants to--when he needs to. And we have a VP of Drilling and Evaluation. We have a VP of Production, and we have obviously a Subject Matter Experts that exists between the countries and an headquarter. So, the whole idea that we were trying to do, is we want to always remain light on headquarter, like the top man--at the senior executive level, we are very light, but when we put resources we put it in the region close to the customers, close to the people that do work. But--the people where I call the floaters in between that you will just--we just do not have those in a big way, but we have a very strong structure in those countries, and we have the technology team that is already existing in the company.

So, today we added a lot of what we call subject matter experts, so we have a subject matter expert for chemistry, for perforation, for drilling, for cementing, for stimulation, for coiled tubing. So, people can go to that subject matter expert and ask for advice and et cetera, et cetera, and, obviously--I try to mention again the back office--we strengthen the back office to make sure that the supply chain, the economy of scale, people don't waste time as they used to do before bidding on every little thing, because now they can go to the system and the supply chain and get what they want. So, I think yes, we are light. We are, what you call, lean and mean. But, yeah, as we grow, we will make sure that the structure is well taken care of.

Blake Gendron: That's excellent color. Thanks, I'll turn it back.

Operator: Thank you. Our next question comes from the line of James West with Evercore ISI. Please proceed with your question.

Jason Bandel: Hi. Good morning, and this is actually a Jason Bandel on for James this morning. My first question, have you seen any change in the competitive dynamics from what you're seeing in the Middle East? As you know, we continue to push companies to focus more on returns, and in your prepared remarks you stated you believe that pricing will start to stabilize as the industry shows more discipline, so just curious to see you have you seen any evidence of that discipline emerging yet?

Sherif Foda: No. On the big projects, no, there is no discipline so far. And I would say that's what I'm saying, as activity continues to grow on a bigger scale, people will not be able to bid, I would say, almost foolishly on some of these contracts and then the industry would stabilize itself. You will not be able to obviously bid the same margins in every contract based on the scale. You will have to sacrifice, sometimes, the margins for a bigger project, but should not bid to lose money, right? So, I would say, yet to be seen, to put it lightly, and I would say only the electrical project that is the extreme undisciplined projects.

Jason Bandel: Got it. Second question, looking at the international recount, the Iraq recount crossed 70 for the first time since 2014. Can you talk about what you're seeing right now on Iraq and what your expectations are for the country this year?

Sherif Foda: Yeah, Iraq--I mean, as expected since last year as the security stabilizes, as a lot of the contracts with the super major had been signed and sanctioned by the customer, they are adding rigs. They are adding back to go to that production target that they have, which is very aggressive. And the super majors are adding a lot of, as well, what we call rigless and services and workover sites, where we work, right? Because we do not today participate in the well construction, because it's all LSTK. And the majority of the other services is increasing, because the customer wants to get the production up. I cannot talk about it from our super major, but most of them now have a very clear plans of how many rigs they're going to add and how many sites et cetera, and we have a very strong growth ourselves. Last year, we grew almost 50% to 70%, and we are expecting a very strong growth, as well, this year over '18, but definitely I think the well construction people will see a huge growth, because of the drilling well constructed wells.

Jason Bandel: Got it. That make sense. And then my last one, your ability to qualify product lines in your portfolio, you talked about the two recent ones being able to do that in an under accelerated timeline. Does that depend on the product line itself, or just your ability to bring new services to the market as you gain experience doing that?

Sherif Foda: Yeah, actually, depends on the country, but a lot of times you have a time frame to be able to get qualified, and the client approves that you are capable of performing one additional business either in that segment, which I tried to explain before, like for example, they tell you high pressure gas. Can you operate a high pressure gas operations? No, you're not qualified. So, you go out and you go through a qualification process to be able to qualify. Sometimes--and generally, this could take almost up to three years. Two years to get qualified with a lot of tests et cetera.

Once you are trusted, and the customers understand that you are really doing an amazing job, and you are obviously national, you perform extremely well. They trust what you do, so they will speed up the process of qualification, and they get you qualified faster. And that's what we managed to do on two product line this quarter, which traditionally--if we went through the normal course, it could have taken almost a year. So, the beauty of that is once you are qualified, you are allowed to be invited to tender. Once you tender, you obviously have a chance to win, and then you can add those service to your country. So, the presence in the country, the image, the being national champion, obviously understanding what the customer exactly wants, and knowing how to access that makes a huge difference.

Jason Bandel: Great, thanks for taking my question.

Operator: Thank you. Our next question comes from the line of Jeff Fetterly with Peters & Company. Please proceed with your question.

Jeff Fetterly: Good morning, everyone. Just two follow-ups. On the pricing side, Sherif, is the pricing pressure resigned or exclusively in the LSTK side or are you seeing it in specific countries and/or product lines or projects?

Sherif Foda: I would say LSTK as a whole, yes, everywhere. There's no country difference. Any LSTK project pricing is pretty bad. And if you look at specific--yeah, I cannot mention countries, but I can tell you when the project is large, you tend to have a less disciplined approach, because obviously nobody wants to lose such a big contract, especially if it's for three to five years, right? So--and on top of it, if it's binary. So, when it is multiple awards, it's good to navigate when it is like take it or leave it, then obviously people tend to be worried to lose that counterpart, which is understood. Again, I'm not blaming anyone, I'm just saying as an industry as a whole, and, again, if you are small, you have the better advantage of being able to choose. If you are extremely big, it's harder to choose.

Jeff Fetterly: Are you seeing any signs of pricing discipline emerging across any product lines?

Sherif Foda: I think--as I said, I think once the activity continues to grow, which is in--I am quite confident that that's what will happen, and I think the activity will grow at a much higher rate than what the industry or the analysts expect. You will see automatically, because of capacity, the price will be disciplined.

Jeff Fetterly: Second question for Melissa, the revised or the new credit facility--the $300 million term loan, have you repaid or will you repay all of the other existing loans to fund that?

Melissa Cougle: Yes, all existing outstanding facilities and term loans are getting refinanced into essentially new--the new term loan of $300 million as well as into the underlying facilities, right? So, everything that we have outstanding right now gets reissued underneath the new facilities and term loan.

Jeff Fetterly: And you said, just to clarify, for the term loan, you have a one year grace period for principal repayments and then a five year amortization period?

Melissa Cougle: Yes, but not straight line. So, the early years of amortization are much lighter with a build up anywhere from 10% to 15%. and then final payment at maturity six years would be closer to 35%.

Jeff Fetterly: And are those facilities secured?

Melissa Cougle: They are not formally collateralized with security documentation, but in one way or another they are secured, yes.

Jeff Fetterly: Okay, great. Thanks for the clarity.

Melissa Cougle: Okay.

Operator: Thank you. Our next question comes from the line of David Herman with Crispin Capital. Please proceed with your question.

David Herman: Good morning, Sherif and Melissa. Congratulations on a great quarter. I just want to understand the margin profile, not specifically as it relates to D&E and the project management side on the cost plus, which you alluded to, but as you have invested in this success based capital and some of the new projects you've won--new contracts you've won. How should we think about the margin profile of those over time, i.e., the allude to the fact that you're making heavy investment in Q1 and Q2 for some of the stuff that's going to start materializing in Q3? Is there a negative margin impact in the first half of the year from that investment, or is that purely capital, and then how should we think about the margin profile as those projects progress?

Sherif Foda: Thanks, David. Yeah, the majority of it is capital. The ramp up costs that you have is basically people that you hire ahead of time, and some of the infrastructure spend, if it is not CapEx related, that you start to really get ready for that project to materialize. So, I would say the ramp up--the contract that we--that you will see the award--and you should expect the same type of profitability. When we perform the work, definitely. You'll have always--even like last year, your margins increase or improve while you're--you start to execute these large projects.

The only difference--I alluded to, and you mentioned again, is all this third party business. It's basically an add on from a dollar value, but from a percentage, people see it as lower, because you did this, as I explained to Sean, you do like a $3 million at 10%, because you just the cost plus, right? You take all the catering and camping and whatever into the equation. But the majority of the preparation of the ramp up is definitely your human capital gets to be the main costs that you--get ready, because, obviously, again, we want to start that well or that contract without learning curve. And the learning curve, the customers expect six to eight months, and we want to always pleasantly surprise them that we are ready from day one.

David Herman: Okay. And you alluded to in the presentation--Melissa alluded to the facility that are available for $65 million, I think it was, available for potential M&A. Is that what she was referring to that you would be able to access that for an acquisition?

Sherif Foda: Yes correct.

Melissa Cougle: Yes.

David Herman: Okay, great. Thank you.

Operator: Thank you. There are no further questions at this time. I would like to turn the call back over to Mr. Foda for any closing remarks.

Sherif Foda: Thank you all for joining us. We look forward updating you on all our progress the next quarter. We are extremely excited about our performance, and we believe we're going to have an absolutely outstanding year. Thank you.

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