NATIONAL ENERGY SERVICES REUNITED CORPORATION
Second Quarter 2019 Earnings Call
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Operator: Greetings and welcome to National Energy Services Reunited Corporation Second Quarter 2019 Financial Results Conference Call.

At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star zero on your telephone keypad. Please note this conference is being recorded.

I would now like to turn the conference over to your host, Mr. Chris Boone, CFO. Thank you. You may begin.

Chris Boone

Good day and welcome to the NESR Corp.'s Second Quarter 2019 Earnings Call.

With me today is Sherif Foda, Chairman and Chief Executive Officer and we are hosting this call from London where we just concluded our second quarter board meeting.

On today's call, we will comment on our second 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 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, 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. 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, Chris and welcome to your inaugural call.

Ladies and gentlemen, thank you for participating in this conference call. We are excited to report on another quarter of tremendous results and continuous progress. We grew our revenues 22% YOY which is more than double the industry average operating in the MENA region. This remarkable growth is due to continued and sustained spending of our customers while NESR continues to properly execute and take more share on our existing contracts. We are expanding our footprint as well as introducing new business lines in our operating countries.

I would also like to highlight our stellar financial performance this quarter which Chris is going to discuss in detail later. Adjusted EBITDA of 46 million dollars is 12% higher sequentially and 33% higher Year-over-Year. Adjusted Net Income of 16 million dollars grew approximately 13% sequentially. We saw strong performance in both our Production as well as Drilling and Evaluation segments with Production growing revenue by 10% year over year and D&E growing by 45% for the same period. And we shall see activity strengthen as we go further into the second half, same as the previous years.

Now, I would like to talk about the details of the MENA activities and our plans going forward.

As most of you have heard many times, and this is something I have been very vocal about. The market overall is underestimating the magnitude of activity growth in the MENA region. All the estimates out there were in the mid-single digit range, for 19 versus 18. We have been consistently saying that the actual growth rate is at the high end of that range to lower double digits. As you may have noticed this narrative is now being validated by the recent commentaries you are hearing by the other players in these markets. We are very close to our customers; we understand their long-term goals and how they want to achieve them and what is happening on the ground. Continued activity growth in the MENA region is here to stay.

As I mentioned in the previous quarter, we grew 20 percent in 18 versus 17. In the first half of this year we grew more than 25% over the same period last year and we aim to have a higher rate through the year end. We obviously have done an excellent job at capturing share over and above the activity growth to produce these results, and we have continued to execute and win more contracts in this quarter. We continue to bid for new work and our customers want to add new players and ensure the business is given to the most reliable and responsible supplier. They obviously look at the prices, however more focus is on in-country value, service quality and proper set-up.

Most of you saw our recent announcement for the awards in Saudi Arabia. These awards are key for us as they are the foundational contracts in the Kingdom. Notably, the expanded scope and total term of up to 7 years for these contracts, gives us the runway to invest locally and further build our capabilities. With the increased scope and revenue, the clients want to entrust you with managing a larger pool of services taking a bigger role in the value chain executing on those contracts

We also announced multiple awards for well intervention services in Bahrain which will allow us to enter another growing market in the region. Today we do not operate in Bahrain and with these awards across multiple product lines we will have a foothold to start expanding. With the discovery of the Khalij Al-Bahrain Basin, the E&P industry is poised to take a big leap forward. This high-quality tight oil and gas reservoir will require a newer approach and will need higher intensity and more complex services and we believe we are in a good position to leverage these awards to become a key partner for the Ministry in Bahrain during the execution phase.

In addition to these announced awards, we have had quite a bit of success in bidding for tenders across our different countries of operations. In North Iraq, we got awarded multiple contracts by various independents including an integrated services contract, water treatment and a Nitrogen service contract. In South Iraq we further consolidated our position by deploying a flareless testing package for one of our clients. In addition, we re-negotiated an extension to some of our well intervention work. In India, we won another Coiled Tubing contract. In Oman, we won a casing accessories contract and did the first Well testing job for one of our clients. Here is a case of us taking the expertise of what the company is very good at outside of Oman (testing services) to Oman. Also, we ran heavy weight Coil strings in HPHT Wells for our main client. This is a first for Oman and for the client and shows our technical capabilities to plan and then execute complex operations.

Also, in Oman as part of a JV initiative, we have started manufacturing casing accessories. This project has been in work for quite a while and I am glad to see it getting off the ground. This is a unique initiative and we are one of the first services company to invest in manufacturing in Oman. The objective of this is to become the major supplier of these casing accessories to all our customers in Oman and in the broader region.

In most countries, we are actively engaged with our customers to qualify new services and products. This process can take up to 2 years, however, we are demonstrating our capabilities and moving on a much faster pace to get several of those business lines approved. This will allow us to bid on different product lines and the faster growing unconventional Gas projects across the region.

On the operating side, in this quarter, we have been in full mobilization mode for several of our contract wins. These include cementing in Kuwait as well as Coiled Tubing in Chad. Both are start from scratch operations and the client is pleasantly surprised with the level of our preparation for both projects. We should start seeing revenue from both during Q3. We were also recognized as the best service quality provider for cementing services by one of our major customers. I am very proud with the effort the whole team has put in ensuring we continue to deliver stellar service quality to our customers as that is our backbone to remain their reliable partner.

Last quarter, I commented on the on geopolitical turbulence in the region. Specifically, for Libya, we are holding to our initial assessment and continue to work towards building our business. The ongoing issues have not affected the oilfield areas where we work nor our operations. We are taking all the contingency measures where we mainly have local crews who understand the environment and deal properly with the situation in close coordination with our clients. We met with NOC and ensured them of our commitment to build a solid base to support their ongoing operations.

As previously mentioned, we are constantly looking for innovative technologies which we believe will provide our customers solutions as well as a step change in how they operate. And we may employ a flexible approach in how we partner with these companies and this may span from just being an exclusive service provider to forming JVs or taking an equity stake and providing development capital to these innovative inventors or companies. In this light we made our first investment in probably the most innovative company in Well Control space, Kinetic Pressure

Control. Kinetic is working on developing a path breaking BOP which will go in the middle of a normal BOP stack and its innovative shear blade design activated by an propellant charge will pretty much shear anything, It is like a guillotine built inside a BOP and you will have 100% guarantee that in the event of a well control you will be able to shut and isolate the well. The company has already several marquee investors and NESR would be taking a nominal minority position as part of a Series A Investment round. We are very excited to partner with them and we already introduced them to our clients in the MENA region. As I previously discussed, this would classify into an opportunistic category as today we don't do much in the wellhead or BOP space, we do have a very small offering in Oman, but this technology provides us an opening to do something special for our clients and we can build on this to expand into this Business line.

We are always keenly looking out for such technology companies which will augment our product offerings and allow us to solve key customer challenges. Once we have identified we want the customers to buy into that vision as it adds significant value to them. In parallel, …we continue to work towards qualifying more services to work with our clients which will enable us to deploy these innovative technologies as we are doing with Kinetic.

I hope with this brief summary, all of you have a better understanding of where we are… and how we are progressing throughout 2019.

With this I will pass the call over to Chris to talk about the financials in detail. As most of you know Chris joined us recently and I am glad to say that he has hit the ground running and I am very happy he is part of the team. Chris?

CHRIS BOONE
Thanks, Sherif. I am excited to be part of NESR and all its growth opportunities, as well as all our highly motivated and professional employees.
Earlier today we filed our earnings release reporting our results for the second quarter. Second quarter revenues were 160 million, an increase of 22% over the prior year quarter, primarily from continued growth from our Drilling and Evaluation segment.
Adjusted EBITDA was 46 million for the second quarter of 2019, an increase of 33% over the same period last year for the legacy companies, driving incrementals of 40%. Our EBITDA growth demonstrates that we continue to be able to profitably grow revenue that will yield future additional cash flows for both organic and inorganic growth opportunities. Year-to-date, our

adjusted EBITDA was 86 million, which is 32% higher than the first six months of 2018. We anticipate continued growth in the second half of 2019, which is traditionally a more active time period for oilfield service companies as oil companies spend their remaining capital budgets for the year. EBITDA adjustments of $2.9M for the quarter are primarily for integration, restructuring and new country and product line start-up costs.

Adjusted net income was $16.4M, or 19 cents per diluted share. Prior year comparisons are not relevant due to predecessor accounting. In addition to previously mentioned EBITDA adjustments, we incurred adjustments to net income that primarily include exceptional interest and tax charges, which will be discussed later in my remarks.

Moving to our segments, our Drilling and Evaluation segment revenue for the second quarter was 65 million dollars, growing more than 45% over the same period last year. We continue to expect D&E to grow during the second half of 2019, mainly enabled by the continued cross selling of the drilling portfolio into our other operating locations from our leading position in Oman. Additionally, we are very pleased with the expansion of our evaluation business in Saudi Arabia, which has contributed significantly to our D&E segment growth in the second quarter of 2019 as compared to the prior year quarter. D&E adjusted EBITDA was 16.3 million dollars, or 25.3% of revenue, an increase of 69% over the same period last year for the legacy companies. As these product line expansions into new markets achieve scale and operating efficiency, we are able to realize improved profitability. This was a key driver in generating additional segment EBITDA in the second quarter of 2019.

Our Production segment revenue for the second quarter was 95 million dollars which grew 10% over the same period last year as we continued to gain market share in multiple regions. The previously discussed new contract awards will be drivers of future growth as well as other contract awards we are hopeful of winning in the second half. Adjusted EBITDA for this segment totaled 34 million dollars growing 30% over the same period last year. Improved product line mix and cost reduction projects helped drive the EBITDA improvement year over year.

Depreciation increased sequentially by approximately 2 million dollars as we continue to deploy new capital expenditures. We note that our net income both now and in future quarters, will include amortization charges coming out of the purchase accounting of last year's Business Combination totaling 3.8 million dollars for the second quarter of 2019.

The YTD effective tax rate, excluding the discrete reserve this quarter related to prior year taxes of approximately $500K and other pre-tax adjustments, was approximately 19%. This increase over the Q1 rate is primarily driven by a change in the estimated mix of earnings to higher tax jurisdictions. The second quarter rate was impacted by a true-up to this new rate estimate. We continue to aggressively explore tax restructuring activities and believe they will positively impact the tax rate in the future.

Looking at the balance sheet and cash flow, for the first six months of 2019, operating cash flow was approximately $24M Operating cash flow has been impacted by delayed collections in several markets, primarily related to slower invoice approvals and delayed retention repayments due to short-term contract extension of approximately $35M. We expect these delays to collections to be received during the second half of 2019.

Capital expenditures ("Capex") for the first half of 2019 were $56.5M as we continue to invest in our growth opportunities. Most Capex for the year was ordered in the first half and will be funded throughout 2019.

As was discussed last quarter, we successfully refinanced our debt in the second quarter, which expanded the capacity, simplified the structure and improved tax efficiency. Cash and cash equivalents increased to 70 million dollars as of June 30, 2019 while debt increased to 367 million, yielding a net debt increase of 20 million since December 31, 2018. Elevated cash levels, drawn from our facilities, were needed to transition certain bank guarantees temporarily from the prior credit facility to the new facility. The incremental net debt was used to finance the temporarily elevated level of receivables. Interest expense was impacted by both the write-off of unamortized costs of the prior facility as well as the debt to fund the guarantee transition and receivables. As of June 30, 2019, our net debt to EBITDA ratio was 1.6 but should reduce in the second half as working capital reduces.

We are very optimistic as we enter the second half of 2019. We continue to aggressively pursue new market share with our existing service lines as well as explore opportunities to provide new service lines to our existing customers. With this, I would like to pass back to Sherif for his closing comments.

SHERIF FODA

Thanks, Chris. Before I open for questions, I would like to discuss a very important topic:
what NESR is doing on ESG, which was discussed extensively in our recently concluded board meeting in London. We have stated from the beginning that we are committed to maximizing the social and economic value we bring to the communities we operate in especially that we are the National Champion of the MENA region. We are also committed to minimizing the negative

impact of our operations on the environment. In order to maximize our positive impact in the region and create shared value, we developed a corporate ESG strategy that allows us to leverage our core strengths and capabilities, and the interests of our people, to address the community needs of the MENA region.

Our ESG initiatives will focus on the economic empowerment of the communities in which we operate and on promoting equal opportunities for all. This is particularly important in the MENA region where gender diversity in the Oil and Gas industry is low and employment opportunities for people with disabilities are limited. We intend to address these problems through strategic initiatives that empower women and people with disabilities at NESR and beyond. At the same time, we will leverage our HSE expertise to promote safe practices and environmental stewardship in the region. We are also about to start building our R&D center in Saudi Arabia, where we will host the brightest minds to develop technologies that will help the communities of the region. Finally, we are building a strong and healthy corporate environment in order to become the industry’s employer of choice in all the countries we operate in. We believe that we have a role to play in the development of the communities of the MENA region and that in doing so, we will enhance the sustainability of our business.

We currently have many initiatives that are being undertaken in different countries to support our environmental and social commitments, however, we thought it best that we bring on a professional in this sphere who can then focus and expand our ESG efforts in a uniform manner and maximize the benefit for the communities we are part of. In that light, Hawazen Nassief joined us recently as part of the corporate team to lead this function. She has extensive experience in this area and being a Saudi national she understands the region very well. I am very happy she is sitting with us here as we speak during this call.

We look forward to sharing with you more information about our ESG activities in the coming quarters.

In closing, Q2 was another great quarter and I am happy that we are on the path to deliver on our objectives this year and for the future. The international market is heading for strong recovery. MENA in particular, will have a solid 2019, and I am confident in our ability to double the growth rate of the region.

With this, I would like to take this opportunity to thank everybody for joining this earnings call and if there are any questions, we would be happy to address them now. Operator?

Q&A

Operator: Thank you.

At this time, we will be conducting a question and answer session. 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 move your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key.

One moment, please, while we poll for questions.

Our first question comes from the line of Greg Coleman, with National Bank Financial. Please state your question.

Coleman: Hey, thanks a lot. Great quarter, everyone. Congratulations.

Boone: Thanks, Greg.

Coleman: Just had a couple of questions here. Wanted to start with margins. We saw margins EBITDA specifically expand 250 base points here every year or 150 bps sequentially. Can you give us a little bit of color there?. Is this seasonality and we should continue to expect to see those margins grow for the balance of the year?. You know, was it synergies working through the system? Was it customer service, geography mix or something else?. Just trying to understand how we should be thinking about margins for the balance of the year.

Foda: Yeah, thanks, Greg.

As we discussed before, if you look at our D&E segment, and we repeated this various times, you have always the mix of the revenue between drilling and evaluation services. And once you have, like this quarter, more evaluation then you will always have better margins. So, the mix of those internal segments makes a difference in our overall margins.

The countries, as well, makes a difference. So, some of these contracts have a better margin in some countries than others. So overall, you would expect, as we said many times, this range of margins as the contracts which we have, between the 25 to 35 and the more you have 35 or plus 30 contracts it will get your overall margins higher. So that range which we have today is what you expect to be for the foreseeable quarters.

Coleman: Got it.

And the mix of your activity in the countries you're operating in, as we looked at the back part of 2019, is it comparable to what you saw in the back part of 2018 or is it trending towards some of the higher margin activities?

Foda: I would say it's more or less what we're doing now.

Coleman: Got it. Okay.

On the capital spend here, in prior commentary you've got it towards about $100 million in CapEx for 2019. You're just past the halfway point there. It's about $56 million at halfway through the year, so not too far off the full spend. Is $100 million still the plan or has that number crept up at all with recent contract wins?

Foda: No, that's our plan. And we always had it inmind that we're going to front load our CapEx for the year to be ready with the customer contracts.

As I mentioned, we have two countries where we started from scratch. We are ready. Actually, we are the only new company ready in this country and the customers are extremely happy with that and that's why we're starting operations. And everybody else that got a new award is basically not going to be ready for another six to nine months.

So, this was the plan. And we front-loaded and actually you will see the same kind of pace even in the coming quarter. So, we want to have all the equipment ready, shipped to the customer, rigged up to start getting the revenue from Q3. And we are now in August and we already saw revenue start to come.

Coleman: Okay. So still thinking about that $100 million.

Foda: Yes, absolutely.

Coleman: So, the last one for me, and then I'll pass it back. It's been an interesting reporting season from our chair with really good results from our international companies, yourself included and really challenging results from our North American focused or centric companies. Is that dynamic creating any opportunities for you to deploy capital and source equipment from North America where it's struggling and then move it through to your growth opportunities in the Middle East? Are you seeing either asset or whole company acquisition opportunities rise because of this disparity globally?

Foda: Yes, obviously, we are in dialogue with many of our, I would say partners, other companies, looking at all the opportunistic opportunity for like equipment acquisition at a much better rate.. To give you a flavor, it's exactly like we did last year when we bought the Coil assets in Canada at approximately 20 cents to a dollar. We are looking at things of that nature.

Coleman: But there's nothing near term that we should be expecting or focusing on, it's just still steady as you go?

Foda: I mean, nothing we can really talk about now.

Coleman: Okay, fine. No worries. I will pass it back. Thanks a lot. And congrats again.

Foda: Thanks, Greg.

Operator: Our next question comes from the line of Igor Levi, with BTIG. Please state your question.

Levi: Hey, guys, great quarter.

Foda: Thank you, Igor.

Levi: So this year, it looks like you've entered three new markets, Kuwait and Chad earlier in the year and most recently, Bahrain. You mentioned that the first two contracts will begin to generate revenue in the second half. Could you give us an idea of how large of an impact they will have in the second half or even 2020? And then also, maybe touch on how the size of the contract in Bahrain and when that's expected to start up?

Foda: So Bahrain, obviously we cannot talk about the numbers exactly, as we did not talk about this with the client, but it's not going to be significant for H2 because it's in preparation stage, it's the start. We will have work this year, but the activity as such in Bahrain is going to increase from next year.

So, as you may know, this type of reservoir will require a completely different scope of rigs, activities. His Excellency Minister of Oil & Energy has been talking about new contract mechanisms. So, there is a lot of activity going on, there is a lot of discussion on how they're going to develop that reservoir. The expectation is that the revenue is going to increase and then this is going to become, you know, one of our core countries as well.

We've got awarded like three contracts, which is very good, as they give us the foothold and that you would see revenue is significant for your models, et cetera, I would say, for next year.

Levi: Great. Thank you.

And then it looks like you've renewed four of the five main contracts in Saudi Arabia thus far. And the last that are remaining, I believe, those cased hole wireline. When could we expect to hear about it? And how large is it compared to the other contracts?

Foda: Okay, so I am not sure about the five. We have much more than five. We have a lot of contracts in Saudi Arabia. The core contracts have been extended or awarded. And the biggest one, obviously, is the one which was called now. And that has a scope to even get much bigger. This contract is for all the pumping, well services, coiled tubing, cementing, stimulation. Its much bigger scope than what we used to do before. And we extended another couple last year. But we have many other contracts. We were awarded the drilling support and services business. So, we have multiple contracts in Saudi. If you talk, now, specifically about Wireline, we have a contract today and it is valid for some time.

Levi: Okay, thank you. Thank you. And one more if I could.

Foda: Sure.

Levi: You talked a lot about new markets that you've entered. You've renewed the Saudi contract. I mean, are there additional product lines that we could think about that could strategically fill the gaps and help you expand even faster?

Foda: it's absolutely right. I mean, as you saw, we are a very strong production company today in all the countries, like we have a very strong presence in all the GCC, North Africa, in all the production business lines. And this production business line or completion business line, you know, you can talk about eight, nine product line in it. But there is a couple, obviously, as well, we don't do much in them like artificial lift.

If you look now, on the other side on the D&E, as we always said, this is where we are very, very, very strong in Oman and very small in other countries. And this is what we are deploying, approving. And that's why you saw we have a 45% growth sequentially on D&E. We had the previous quarter was like almost 60%, year-over-year. This is growing at a much faster pace. And our aim is to double that. So, for us it's like a start-up.

So, if you want now to go to specifics, that's what we are doing. We are approving and qualifying a lot of like the direction drilling, bigger portfolio of the wireline, going to even new business lines, like we just mentioned about our investment in Kinetic, which basically gives us now entry into Well Control space but in an innovative manner. We don't want to go to something that is very commercialized, very low pricing, we don't want to be there. We want to do something when there is a differentiation.

And where we have a strong presence, we enlarge that footprint exactly like we're doing now with all the fishing and remedial, downhole tools, et cetera, where we are like basically the pioneer in Oman. I mean, some of this business in Oman, we almost hold 80% market share. So, we have a huge room to grow in the other countries for all this business.

Levi: Perfect, that is extremely detailed and helpful. I'll turn it back

Foda: Thank you.

Operator: Our next question comes from the line of Sean Meakim with JP Morgan. Please continue with your question.

Meakim: Thanks. Hey, guys.

Foda: Thanks, Sean.

Meakim: So, I was hoping, Sherif, we could dial in a little more on the margin performance. You know, the expansion of D&E was impressive. So I was hoping we could maybe just go into some of the moving pieces there.

Could you give us a sense of how we should think about the influence of operating leverage, pricing for new contracts, the impact of higher mix of cost-plus work that's adjacent to the core contracts? You already mentioned the influence of country mix. Just where do we come out on normalized margins for D&E as the segment scales? Can it get a three handle-like margin, production, sorry, a three-handle margin-like production or his mid 20s the right level, somewhere in between? How do we think about all those influencing factors towards a normalized margin profile for D&E over time?

Foda: Thanks, Sean.

So if I go one-by -one to your question, if you look at the activity and the tendering, similar to what I said last quarter, you see some companies with disciplined approaches in tendering and we are very glad to see that, and some, unfortunately, do not. So, the customer is still going after looking at bigger scope in some of those tenders. And when they go to the huge scope and they add a lot of other stuff on it like LSTK, obviously, you will see zero discipline from the international players.

If you look at the service per product line, it's a mixed bag. And again, when the contract is huge people, obviously, tend to be more worried, understandably, to lose their footprint because there are a lot of newcomers or the clients are inviting new people. But so far, it's manageable. If you are small like us and you can choose where you want to be, then definitely, our aim is to maintain this type of margins in both production and D&E.

Now, if I move to D&E and say why the mix goes back and forth between quarter? Unfortunately, it's the nature of the beast, because there are a lot of segments and it is also affected by the mix between the countries. So, in some places, and as we, obviously, get bigger, the client will give you more of this cost-plus stuff to do, right. And you cannot say no because if you become top three provider of that segment in the whole country you will be providing camp and road, et cetera. It, again, does not deliver margin percentage overall, but dollar value it's an addition. So I would say it's going to be always like in the maybe 10% of our business

As for the margin of the D&E, I did not give you a good answer or a crisp number to put in your model. What we are aiming for is to be in that mid-20s, mid to lower 20s, I would say. It will not go to the margin of the production for the first year which is because, you know, all this fishing tools, rental stuff, does not operate at that margin.

Meakim: Right. That's exactly what I'm looking for. I've been trying to get that gauge relative to the production segment, this is helpful.

So then, as you're, you know, as you're working towards this cross-pollination strategy between the two segments, D&E is really the key in terms of the growth. So, as you think about where would you say you are in that strategy? So, in other words, obviously, the business should continue to grow with D&E growing faster than production but over time, what's the optimal business mix would you like to see between the two?

Foda: I think we're going to grow both. D&E is going to grow, obviously, at a faster pace. The key is to maintain the mix between--within D&E between evaluation and drilling, to not to dilute, obviously, the overall margins. But I think the production is going to get another kick on growth because of the larger scope of contracts we are working on and as well adding a couple of product line into three countries. So, the mix will end up the same. Even though the D&E is going to grow faster pace, the baseline of the production is bigger, and it is going to get big contracts in the coming quarters hence the mix will end up probably the same.

If we do well in direction drilling, larger scope then we might be pleasantly surprised. but for now, I think the mix will be more or less similar between both.

Meakim: That's very helpful. Thank you for that.

And then just to clean up a little bit more detail on the Capex discussion. So as you think about the balance of Capex that you have committed to for the year, we should have better EBITDA in the back end of the year, along with improved collections seasonally, how does that set you up for free cash flow for full year of 2019?

Boone: Sean, this is Chris.

So again, that $35 million should hopefully flip back and again, a little bit less Capex. So with that, and as you said, an improved EBIDTA, our expectation is we'd be back to free cash flow positive in the second half. It's hard to be as specific, because again, it's hard to be exact on all the collections.

Meakim: Okay.

Foda: If I comment more on this, you know. If you look at the collection for each one in this quarter, and I'm sure you heard it from all the other commentaries from the big guys, it was a challenge this quarter because, you know, we had the clients, basically, delaying some of the payment. But these are the best clients in the world, so we have absolutely no issue. They just delayed, you know, a lot of the payments for a quarter or so. Which is fine. I mean, as long as you manage your suppliers.But this is, as Chris mentioned, a couple of countries, some delayed collections like everybody else.

Meakim: Understood. You had more of a timing issue. Okay. Thank you very much.

Foda: Thank you.

Operator: Our next question comes from the line of Byron Pope, with Tudor, Pickering & Holt.

Pope: Morning, guys

Foda: Morning.

Pope: As you guys pointed out in the press releases, you recently celebrated NESR's one-year anniversary. And so, Sherif, my question is qualitative in nature. Could you just provide some context around where you feel the company is today with regard to the integration plan, everything from the Geo market structure, just where are you relative to where you want to be and what's left to be done with regard to how you think about the integration plan?

Foda: Yeah, a very good question.

We put a very detailed plan on the integration, as we mentioned on our last couple of quarters calls: of co-locating, adding, obviously, because the two companies, again, they were not overlapping, but complimentary. So, the only thing we really made sure that when they had a small footprint, we made sure that they are in the same place, but then we enlarged, enhanced dramatically the infrastructure.

So, this was to impress on the clients that we can take such a big role in some of their D&E business. So as we developed this model in Saudi, we did the same thing in Algeria, and in the UAE. We basically made sure that we have a very strong and proper setup so when the client come and say, “Are you serious, you can do D&E on that scale?” We said, “Please come and visit us. It's not only what we have in Oman, which is a state-of-the-art facility, no, please come and see what we have in those countries.” Especially in Saudi Arabia and in Algeria, the clients are extremely, extremely pleasantly surprised with our setup now. We have a full-blown infrastructure. I mean, I don't want to go through much of the technical detail, but you know, like all the overhead cranes, certification, DNV, et cetera, ISO, we've got an API too. We have all the structure and the infrastructure to take a bigger role and to be very professional in what we do in the D&E.

And we maintain this discipline that we do not take a job when we are not ready. So even if the client wants to push us, let's take this, you can do this rotary steering job in gas or something, we maintain, “No, we only want to do the job when we do it absolutely perfectly.” So to that end, I think we are done, we are almost there with the infrastructure. We have a country director in each country that is very visible. The client knows that the person is the VP or the GM of NESR for all the segments in that country, very well respected.

The last piece that we are working on, and we said this will take time, and we are working on it diligently, is the back-office ERP system. We want to make sure we get it right. And obviously, from our experience, between Chris and myself, we know that this needs to be done properly. So we need to make sure what software we're going to use, and make sure that everybody is happy with it, and that it's SOX compliant, et cetera, et cetera. And that's what we are working on. It's going to be a work in progress. Today we have the two-systems running. But we want to make sure that we have one system that everybody's happy with and it's at the right level to handle the growth of the company, because obviously, our expectation that this company is going to be so much bigger than where it is today. We have to have the system that is expandable to this type or size of segment of number of head count, et cetera. I mean, we are already today at 4,000 people, so we need to make sure that we are at that level. And that is the work in progress. Everything as I would say, customer branding, image, infrastructure is taken care of.

Boone: I'D like to add one additional, Byron, to that list is for example, we just rolled out a common equipment utilization platform across both company, you know, platforms so that we now see equipment across all countries and can really see the utilization so that as we see new opportunities we can move things more easily between countries and optimize our Capex and equipment utilization. So just lots of small things like that, that we continue to work on to optimize.

Pope: Very helpful. Thanks, guys. I appreciate it.

Operator: Our next question comes from the line of Blake Gendron, with Wolfe Research.

Gendron: Hey, thanks. Good morning for taking my question.

Just honing in on the technology partnerships for a second. Just wondering what the ideal equity versus cash split would be from your perspective, and maybe what you're sensing as far as appetite on the part of these technology start-ups?

And then I noticed that Kinetic Pressure Control recently signed a partnership with Transocean. Just wondering how you think about exclusivity when you enter into these agreements? Is it regional exclusivity that you're striving for at country level or are you just trying to be an open platform for whatever technology provider wants to get an in with a large of scale service provider in the MENA region? Thanks.

Foda: Thanks, Blake.

So it's very specific to the technology and it's very specific to the country or what exactly we want to do. And we said, we have so many options. Today we have almost more than a dozen agreements. For e.g. on chemicals, we have a chemical agreement with two suppliers and we have exclusivity on some of the products we did together. And we supply this to the customer, to the country. And we have an infrastructure, obviously, facility that they use our facility. We import the chemicals and we provide it to the customer.

So there are a lot of models. And I'm repeating, it's an open platform for innovation. And once we have something that adds value and we are credible in front of the customer, we go and say, “We think this is very good for you because we developed A, B, C,” right. We are not an agent and we are not here only to facilitate them getting there, we are just making sure that technology-wise this is something that adds value to the customer.

Now, the business model is, obviously, depending on the company, depending on the size of the company, depending on the investment. So now, if I talk specific about Kinetic, which we announced because we have an agreement with them. We think is extremely innovative, so we wanted to put money in it as well. So we invested in it and now we are a shareholder, obviously, on a much smaller scale.

But when we say specifically, we have the exclusivity with the customer for our business in that region. We want them to also grow everywhere else. Some of the stuff we don't do so we are not going to ask for it. We're not in deep water. We're not drilling offshore. They can do this differently without needing us. Right?

So with what we facilitate and with what we help them what we have is exclusivity primarily in the MENA region as that is what interests us. And, when you talk about BOP, you're talking here about three types, right, you have the wireline, slickline, you have the coiled tubing and then you have offshore, and then you have the deep water, right. So, there is a lot of scope within that when you say we need to define exactly what exclusivity you are operating at in those countries, right.

So we are, again, an open platform because that's our whole philosophy. We are not building our own R&D. We have an R&D facility that is going to be an integrated facility in Saudi where we can have a lot of companies and already some of them have booked spaces and we're going to have joint research teams between us, them, the clients, and the universities to develop those technologies, which are specific for the reservoir of the MENA region.

Gendron: That's, really helpful color.

And then if you look, you know, into the pipeline of both technology, JV, and M&A opportunities, any chance you can give us, you know, somewhat of a size of that and maybe a timeline? Are they, you know, a lot of smaller deals or should we expect a couple beer deals here in the near to medium term? And then, you know, just in the interest of share liquidity, what is your sense for the appetite as you enter these conversations of your partners taking equity when you do enter a JV or something like that?

Foda: Yeah, look, at again, very mixed, it's obviously, very generic. And I don't want to give you gray answers. But if you look at the technologies, we are working on three or four unique, I would say very highly IP type of technology that goes to the second level of innovation in some of those technology. For obvious reason, I cannot mention them.

The second part is the well-established technology companies we are working with mainly on no equity or financial stake. Obviously, these companies are very well established, very big, and in this case, it's going to be a model of deploying in that region with exclusivity contracts. So, there is no financial position here in that form.

The key, obviously, is we are working on all this on consignment, so it's very good for our cash flow, it's very good for our working capital because all these agreements we make with big companies they are all on consignment. So, we do not buy anything. We do not pay for anything. We do not keep inventory. We ship everything to that country and then once we operate, we get paid, we pay ourselves and we pay them.

So, on the M&A front, we are working on a couple. I don't know the timing. I cannot give you the timing. But it is something that we want to conclude on them, it's always going to be a regional type of companies to add to the portfolio, to add to the geographical, and to add to the strong footprint. Obviously, we're going to be very opportunistic on the timing and on the stock price.

So, and today, definitely we will never issue shares or give shares to anybody at this level. We also have the capability and the capacity to do any transaction we want to do with cash. So at the right time we will be able to issue equity when, obviously, the share prices are at the correct level. And these companies are extremely happy to take either, but we are the one, obviously, driving what can they take and what they cannot take.

Gendron: Yep, understood. That makes sense.

And then just one more, if I can fit it in quickly. You mentioned ESG. You know, is this, basically, interwoven with your in-country value initiatives that you have with some of the larger countries that you operate in or is it driven by specific companies and countries? And what kind of resources are out there so we can get a better understanding for what the thresholds for an ESG, I guess, qualified company in that region, and maybe some of the identifiable steps you're going to take over the next several years to achieve your goals?

Foda: Yeah, it's a huge-obviously, it's an extremely important topic, in the sense morally, and obviously, from a business sense. So it is in line with in-country value, and all the initiatives each country has. So if you look at each one of them, Saudi Arabia, Qatar, UAE, Oman, everyone has a very specific program, very detailed and we are working always on that with them to make sure that if you're out there calling yourself the national champion you better be sure that you are the forefront or the leader of that.

But in addition, what we wanted to make sure that we, our team and people understand that this is our commitment to the environment, to social and governance issues. So, what are we doing as exact concrete steps in each to impact the communities where we operate? It doesn't have to be only the client. It just has to do with what are we doing, for example, for gender diversity? What is our employment rate? What is the percentage of ladies in a leading position in the company in the countries? And we know, as we are working in the Middle East, gender diversity in the oilfield is not the best, right? So, this is where we are proving and showing ourselves as taking a leading role in that space. We're looking at the impact of our employees and their families.

Today, when you look at our health safety environment, we look at our driving records, our recycling, et cetera, we are a leader in that but we want to make sure as well, we reach to the families of our employees, and then we have a sustainable impact. And that's why, obviously, we made sure that we have a professional doing that.

And that's why Hawazen joined the team and she actually gave an unique presentation to our Board to make sure that they understand exactly the steps and the long-term vision we are taking in 1 year, 2 years, 5 years, 10 years, what exactly we're going to achieve with each step, with milestones, with the deliverables, and it's just not, you know, just talking, like exactly what we're going to do with budgets put in place and people to be able to execute on that vision.

Gendron: Thanks for all the time. I'll turn it back.

Operator: Our next question comes from the line of Jeff Fetterly, with Peters & Company.

Fetterly: Hi, all.

Follow-up to that ESG. Are you seeing contract tenders or opportunities require this type of ESG structure in place or a policy or is this something that you're doing in advance or of anticipation of some of these things coming in?

Foda: No, so far, there is no contracts or any that requires a specific like, score or what you're doing in ESG, It's not framed like this. Today, all the contracts, the companies, the clients are basically asking, or the tenders is required based on what they have at in-country value scores for that business. And today, this is either an ownership structure, it's either number of national employees you have, it's a local content, basically. It's very similar to the Norwegian system, to the Brazilian system, the Malaysian system, all these companies have that.

Today, there is no like specific ESG requirement. What we did, this is an initiative from us. And I think we should take a leadership role of partnering with the communities without being as specific to any customer or any country. We should be in the leadership role in that.

Just to make sure I'm clear, if you look at this specific program of those countries for their in-country value, it already touches on all these aspects of environment, social, governance, et cetera. So, it does that. But we need to have a very concrete plan and path for our company at our corporate level to articulate what exactly we are doing for this.

Fetterly: On the Saudi side, with the contract renewals you announced last week and your comment earlier about allowing you to make additional investment in the region, what types of things would that additional investment entail and scope-wise?

Foda: You know, what we planned already. We planned very clearly since last year that we're going to be very aggressive because we are going to get awarded multiple contracts. Our ambition is bigger, and we have bigger contracts we are working on.

So you have to build the infrastructure to make sure then when it comes time to execute, you deliver. You cannot say, "Oh, I got the contract. I want two years to deliver. I get the contract, I get three months to deliver. That is the aim here". So we are building the infrastructure in the sense of the space, the employment, the training... And that's why the CapEx that you are seeing

So we all did a lot of stuff to be there on time. And we're going to build, beside the fact that we have the techno valley project that we are building. As you saw, we made an announcement last year, we were one of the core partners of the SPARK, the King Salman Energy Park, and we will have a state-of-the-art facility in that space.

Fetterly: And so the investments that you're making, either on a CapEx basis or infrastructure basis, is that to support the contract renewals and expansions or is that entirely for future opportunities?

Foda: For both.

Fetterly: Okay.

Foda: If we double, more than double the size of the company in a year so you have to make sure that, you continue to do that, too, if your plan is to continue to do this growth profiling for the coming years.

Fetterly: The $100 million CapEx target for 19, how much of that today would be committed and allocated to either these contract renewals or call it deployments in the second half of 19?

Foda: They're all committed. I mean, the $100 million would be all if you look at the number of contracts we have, we've won, and not announced yet, but we are aiming to win, those will be for all these contracts.

Fetterly: I guess that's what I'm trying to understand.

Foda: Not everybody, not everything was announced, basically.

Fetterly: So, as you announce additional contract awards, is that encompassed within or incorporated within the $100 million target spend this year or with those come for getting incremental capital?

Foda: Yes it is included.

Fetterly: Okay.

And so for you to increase the capital spending this year would it be derived predominantly off of M&A?

Foda: No, I mean, as I said, we have the CapEx for the plan, the $100 million is for all the contracts we are awarded and all the contracts we will be awarded. And we do not need any incremental CapEx to deliver on both. If we need something else in cash that's what we're going to use for M&A. If at the right time we will see how it's the mix of equity and cash. At this level of equity price we will never issue equity

Fetterly: And on the M&A side, your comments earlier, is your focus more on acquiring assets in North America, similar to what you've done in moving them into the region and into contracts or would you be buying standalone businesses that either expand your scope or scale from a business line standpoint?

Foda: No, I mean, obviously, when I talk about M&A, for me, I'm talking mainly M&A as you buy a company in that space in the region, or buying something like we did in Canada, But if you just buy assets at the lower price, I think this CapEx.

Fetterly: Great, thanks for clarity.

Foda: Thanks.

Operator: Our final question comes from line of Greg Coleman, with Natural Bank Financial.

Coleman: Hey, thanks for the follow-up. I know it's dragging on a bit here.

Just really quickly on the AR side, the $35 million, can you tell us is that a single customer or a handful of customers?

And then related, Chris, can you give us an idea on the working capital side, based on your view on the second half, do you have an idea of how big the working capital release could be in dollar terms? And that's it for me.

Boone: Sure. It's probably more the issue of it is spread among, you know, several customers and countries. But it's probably more than mix of what's tied up with contract retention releases versus just, I call them kind of slow pay. And it's probably about 50/50 of the number I provided. So, the contract retention releases are lumpier, rather than incremental. Hopefully, add up some approved processes that we're working on with our customers to expedite payment processes.

Coleman: Got it.

Boone: That's the best I can tell you.

Coleman: And then quantifying--

Boone: --Which is our targets, we have pretty good line of sites on the, you know, at least the largest retention releases, that's probably more like Q4. And the payments we're hoping will be--I can't claim they're all going to come in, you know, magically into Q3, but we think we'll get that other part of it back into the second half, probably even across Q4.

Coleman: And any shot at quantifying the magnitude of that release?

Boone: Well, I said, we think we're, as I said on the call, there was about $35 million that we said was certainly very identifiable that we know where it's--we had delays in. And so that's about the number, and like I said, some of that's retention, it will be a bit more lumpy, but half of it is retention. Probably, that's more of a Q4 and then the other half's slower pay and that'll probably get caught up pretty evenly across Q3 and Q4.

Coleman: Okay, thanks.

Operator: Ladies and gentlemen, this concludes today's question and answer session. And I would like to turn the call back over to Sherif Foda for closing remarks.

Foda: Thank you very much and thanks to all of you. I know it's getting late. So, we look forward to updating you on the progress next quarter. Thanks so much.

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