



Helmerich & Payne
Fiscal Fourth Quarter 2022 Earnings Call Transcript
11/17/2022 11:00 am ET

Operator: Good day, everyone, and welcome to today's Helmerich & Payne Fiscal Fourth Quarter Earnings Call. At this time, all participants are in a listen-only mode. Later you will have the opportunity to ask questions during the question-and-answer period. You may register to ask a question at any time by pressing *1 on your touchtone phone. I will be standing by should you need any assistance. It is now my pleasure to turn today's call over to Vice President of Investor Relations, Dave Wilson. Please go ahead.

Dave Wilson: Thank you, Ashley, and welcome, everyone, to Helmerich & Payne's conference call and webcast for the fourth quarter and fiscal year ended 2022. With us today are John Lindsay, President and CEO; and Mark Smith, Senior Vice President and CFO. John and Mark will be sharing some comments with us, after which we'll open the call for questions. Before we begin our prepared remarks, I'll remind everyone that this call will include forward-looking statements as defined under the Securities Laws. Such statements are based upon current information and management's expectations as of this date and are not guarantees of future performance. Forward-looking statements involve certain risks, uncertainties and assumptions that are difficult to predict. As such, our actual outcomes and results could differ materially. You can learn more about these risks in our annual report on Form 10-K, our quarterly reports on Form 10-Q, and our other SEC filings. You should not place undue reliance on forward-looking statements, and we undertake no obligation to publicly update these forward-looking statements. We will also be making reference to certain non-GAAP financial measures such as segment direct margin and other operating statistics. You'll find the GAAP reconciliation comments and calculations in yesterday's press release. With that said, I'll turn the call over to John Lindsay.

John Lindsay:

Thank you, Dave, and good morning, everyone. I appreciate you joining us on our 2022 fiscal year-end call. We're pleased with our fourth quarter results and are optimistic about fiscal '23. My primary themes will focus on three areas this morning - North America Solutions pricing and margin cycle dynamics, H&P international opportunities, and our technology and sustainability investments.

Our financial results improved substantially quarter over quarter as pricing increases and better contract economics took hold across more of our FlexRig fleets. You may recall from our previous earnings calls this year, we made the point that our rig pricing needed to improve to a level that provides at least a 50% gross margin in order to achieve returns above our cost of capital.

I'm encouraged to report that our leading-edge pricing levels are now delivering margins in line with that goal. These are results not seen since the 2012-2014 upcycle. Strong demand from customers, coupled with rollovers of term contracts, should help drive average pricing higher across our active fleet and we believe there is significant momentum heading into fiscal 2023.

We plan to maintain a posture of fiscal discipline in our North America Solutions segment and continue to move our average rig margins toward leading edge pricing and margins. As such, we expect our financial results for the first fiscal quarter of '23 to follow the improving trend of the past two fiscal quarters.

We're also seeing continued demand for our technology solutions. These solutions have and are anticipated to continue to add significant value for our customers. Many of our technology products and automation solutions are in high demand and are quickly becoming integral parts of the bid process, daily operational workflows, and performance-based contracts. These solutions are contributing to H&P becoming the leading drilling solutions provider to many of our customers.

Our technology team is creating an exciting future where digital technology will be the key determinant that drives customer value by enabling safer, more efficient, and reliable operations. In short, our people are actively carrying culture. Our rigs' technology in commercial models will continue to differentiate H&P's drilling solutions.

Let me now turn to some observations on pricing and margins in our asset intensive business. A key metric to be mindful of here is how much of our customer demand can be satisfied by contractual churn rather than by introducing additional supply into the market. We've talked about churn on previous calls. In this instance, we define churn as the situation where a rig is released from one customer and then re-contracted to another customer within an economically reasonable amount of time, enabling the rig to maintain a high level of activity.

During the past two quarters, the demand for FlexRigs has primarily been satisfied with readily available hot rigs. This allows us to postpone the investment of bringing a rig out of stack in this exercise capital discipline.

Here's an example. In our fourth fiscal quarter, only one rig was reactivated out of stack in the quarter. That same quarter, however, we experienced a churn of 14 rigs and in the third fiscal quarter, our churn was 18 rigs with three rigs reactivated. The takeaway is that the majority of customer demand in the past couple of quarters has been satisfied by rig churn, not rig reactivations. The reasons for higher or lower churn in the market have typically revolved around acquisitions, efficiency gains, acreage, budgets, and supply chain delays. We are seeing churn from both large and small customers, and we suspect this is happening across the market.

Currently, while much of the rig demand is being satisfied through churn, there appears to be enough incremental demand growth to reactivate some rigs out of stack as we move into 2023. We mentioned in our October press release announcing our supplemental shareholder return plan and fiscal 2023 capex budget that we would reactivate up to 16 rigs. This would allow us to attain a maximum of 192 active FlexRigs for fiscal '23 sometime during the second fiscal quarter.

Regarding these planned reactivations, we are requiring term contracts of at least two years. As of today, roughly two-thirds are already committed with the majority of those rigs going to large publicly traded E&Ps. As in prior years, we expect most of these 2023 rig adds to begin working toward the front half of our fiscal year. Having said this, we also still anticipate contractual churn throughout the year similar to what we experienced in 2022, possibly averaging around 15 rigs per quarter.

Understanding these pricing dynamics, holding the line on capital discipline, and not chasing market share is something we believe is crucial to creating a healthy and sustainable company over the longer term. This discipline extends to not only exercising prudence and fiscal restraint, but also careful consideration to put in capital to work in order to take advantage of longer-term growth opportunities. Having this mindset is enabling improved returns for our stakeholders, including investors who are returning to invest in the energy space.

Moving to our International Solutions segment, the company plans to deploy capital in preparation for more substantial growth in the future. We are seeing opportunities to bid in areas of existing operations, as well as in countries that would be new to H&P. Most of the opportunities are where unconventional drilling is in its very early stages such as in the Middle East. The other opportunity here is the scarcity of digital solutions being applied in many key energy-producing regions around the globe. We believe our proven drilling solutions and technologies can provide significant value to national oil companies by jumpstarting the unconventional learning curve.

As we look to the future, we believe our international business is an important avenue of growth and serves as a potential outlet for some of our currently idle super-spec rigs in the US. International growth also adds diversification to the company's revenue streams over the long term and this current allocation of investment capital plays a pivotal role in the execution of our strategy.

Shifting to the energy transition, we continue to further our strategy of deploying capital and expertise to companies playing an active role in the transition. As an example, our investments in geothermal are helping to develop an alternative low-carbon 24/7 power source. We are providing FlexRigs and our digital technology solutions to enable enhanced geothermal systems and closed-loop drilling concepts. Notably, we have made encouraging progress in field trials with two of our geothermal investees - Fervo and Eavor. Regarding Fervo, this past September, we completed drilling their enhanced geothermal system pilot project in Nevada which involved the first two horizontal geothermal wells ever drilled in the US, and we are currently drilling Eavor's closed-loop pilot project in New Mexico. Once complete, we expect this closed-loop project to be the deepest and hottest directional geothermal well in history.

Our strategic alliances with Fervo and Eavor and all of our investees has put us firmly on the path toward the advent of next generation geothermal as H&P takes the lead in unconventional geothermal drilling. We are hopeful that these pilot projects lead to scalable, low-carbon geothermal developments utilizing FlexRig solutions.

Our second sustainability report will be published soon and we will continue to provide the transparency that is important to our stakeholders. Our team is working hard to continue to raise the bar as a responsible leader in the energy services sector.

In summary, we entered fiscal 2023 with momentum and increased confidence that our initiatives in our North America Solutions segment have gained traction and are delivering positive financial results. We are also excited about the longer-term prospects and opportunities before us, particularly in our International Solutions segment.

Finally, we believe we've achieved a balanced and responsive capital return methodology with our supplemental shareholder return plan. These actions align with the company's long history of financial stewardship by increasing the company's financial returns through long-term investment in the business and increasing cash returns to shareholders through the augmentation of our longstanding dividend commitment. For over the past 10 years, we have returned \$2.4 billion in dividends.

In closing, during my 35-year career, I have never witnessed a higher level of alignment and communication with our customers, resulting in greater transparency and value delivered. As a service and solutions company, the successes H&P has achieved and plans to achieve would not be possible without our devoted, customer-focused, and hard-working employee base which I'm proud to say continues to set the standard for our industry.

Now, I'll turn the conference call over to Mark.

Mark Smith:

Thanks, John. Today, I will review our fiscal fourth quarter and full-year 2022 operating results, provide guidance for the first quarter and full fiscal year 2023 as appropriate, and comment on our financial position. Let me start with highlights for the recently completed fourth quarter and fiscal year ended September 30, 2022.

The company generated quarterly revenues of \$631 million versus \$550 million in the previous quarter. The increase in revenue relates to continued price increases in the

quarter for the North America Solutions fleet. Correspondingly, total direct operating costs incurred were \$412 million for the fourth quarter versus \$377 million for the previous quarter. The sequential increase was driven by some structural inflation, but to a greater extent maintenance and supply expense volatility that we typically see in North America Solutions quarter to quarter, which ended up being on the higher end of the range this quarter.

General and administrative expenses totaled \$47 million for the fourth quarter and \$182 million for fiscal '22, which is in line with our expectations. In other income, expense was a loss of approximately \$9 million which was primarily driven by a lump sum distribution for participants exiting our pension plan.

Our Q4 effective income tax rate was approximately 38%, which is higher than the statutory rate of 21%, primarily because of foreign income taxes and permanent book-to-tax differences. As we crossed the line to become profitable towards the end of the fiscal year, we accrued additional US cash taxes in fiscal 2022 of which approximately \$45 million remains that we plan to pay with the extended filing of our tax return in January 2023.

To summarize fourth quarter results, H&P earned a profit of \$0.42 per diluted share versus \$0.16 in the previous quarter. Earnings per share were negatively impacted by a net \$0.03 loss per share of select items which was primarily made up of the aforementioned pension item. Absent select items, adjusted diluted earnings per share were \$0.45 in the fourth fiscal quarter compared with an adjusted \$0.27 during the third fiscal quarter.

Capital expenditures for fiscal '22 totaled \$251 million, which was within the range we established in November 2021. Per John's previous comment on market churn, we limited our rig reactivations mid-fiscal year in keeping with our strategy of capital discipline.

H&P generated \$234 million in operating cash flow during fiscal 2022. As we discussed last quarter, our cash flow generation fully funded capex and our base dividend in Q3 and this quarter, we were able to do the same and even added some cash to the balance sheet as well. We will discuss accretive FY 2023 cash generation later in these remarks.

Turning to our three segments, beginning with the North America Solutions segment, we averaged 176 contracted rigs during the fourth quarter, up from an average of 174 rigs in fiscal Q3. We exited the fourth fiscal quarter with 176 contracted rigs as expected. Revenues were sequentially higher by \$66 million due to pricing increases for our rigs in the spot market and continued repricing of term rollovers.

Segment direct margin was \$204 million, just below the top end of our July guidance and sequentially higher than the third fiscal quarter by \$36 million. In addition, reactivation costs of \$7.5 million were incurred during Q4 compared to \$6.5 million in the prior quarter. The Q4 reactivation costs were primarily related to the rigs being prepared for deployment in the first few months of fiscal 2023.

Total segment per day expenses, excluding recommissioning costs and excluding reimbursables, increased to \$16,453 in the fourth quarter from \$15,490 per day in the third quarter. This was above our expectation due primarily to normal maintenance and supplies expense volatility, as well as inflation that I mentioned previously.

Looking ahead to the first quarter of fiscal 2023 for North America Solutions, as of today's call, we have 180 rigs contracted and we expect to end our first fiscal quarter with between 181 and 186 working rigs with expectations for a few additional adds in early January and with line of sight for up to 192 rigs by the end of fiscal Q2.

Our current revenue backlog from our North America Solutions fleet is roughly at \$864 million for rigs under term contract. As of today, approximately two-thirds of the US active fleet is on a term contract. Our increase in term value of approximately \$235 million from June 30th to September 30th is due to, one, the reactivations in the 2023 fiscal quarter requiring term contract and, two, term extensions as well as some performance contracts for strategic customers. However, from now through March 31st, we have about 65 rigs rolling off of term contract with almost half rolling off on March 31st. As a result of these more legacy-type term rigs rolling off, a tailwind is created for the average pricing level of rigs remaining under term contract.

Accordingly, in an oversimplified example, if all of these rigs rolled to the spot market, we would expect the average pricing of our remaining term rigs to benefit roughly \$1,500.00 per day over each of the next couple of quarters as lower-priced term rigs were simply removed from the average. For reference, we expect the average revenue per day

for our term rigs in the first fiscal quarter to be about \$30,000.00 per day. We still expect the percentage of US fleet on term to be between 50% and 60% by the end of fiscal 2023.

In the North America Solutions segment, we expect direct margins in fiscal Q1 to range between \$250 million to \$270 million, inclusive of the effect of about \$8.5 million in reactivation costs. As of the recent start of fiscal year 2023, we increased field labor related rates to respond to market conditions and assist in talent retention and attraction. As a reminder, our contractor structured to pass through such labor-related cost increases over a 5% threshold. Therefore, significant labor increases are largely margin neutral at the time of adoption due to contractual protection. Also, approximately 70% to 75% of our daily costs are labor related and these recent increases are approximately \$650 per day. Our direct margin guidance is inclusive of our expectations for labor and materials inflation in the first fiscal quarter.

Regarding our International Solutions segment, as expected, International Solutions business activity increased by three rigs to exit the quarter with 12 rigs, having added two in Argentina and, late in the quarter, one in Colombia. As we look toward the first quarter of fiscal '23 for International, we expect to add another rig in Argentina and benefit from a full quarter of the recently added rig in Colombia.

In our October press release, we mentioned upgrading five Argentina rigs to super-spec. These upgrades are performed in Argentina using local currency and are intended to meet ongoing customer demand for unconventional drilling. We will have nine of 12 FlexRig3s working by December 31st and plan to upgrade the five that are not super-spec by the end of this fiscal year.

We also expect to continue to incur more expenses as we further develop our Middle East hub, inclusive of preparation to export super-spec FlexRigs that will be targeted to regional unconventional drilling operations. Aside from any foreign exchange impacts, we expect to have between \$7 million to \$10 million direct margin contribution in the first quarter.

While it will not contribute to activity until the fourth fiscal quarter of 2023, you may have read reports of our recent investment in rig contract with Tamboran Resources in Australia. Australia was on our long-term planning horizon for opportunities around the burgeoning unconventional plays globally, and we look forward to adding value by

bringing our unconventional expertise and experience to this long-term project. Our customer has key acreage in an emerging unconventional gas play in the Beetaloo Basin and there are no current super-spec rigs in Australia that are suitable for such drilling. H&P's first rig in Australia is being scheduled to ship during the first half of the year and if our customer is successful with their delineation work, we are hopeful that this will be a new region for international growth.

Turning to our Offshore Gulf of Mexico segment, we have four of our seven offshore platform rigs contracted. Offshore generated direct margin of \$9 million during the quarter, which was within our guided range. As we look toward the first quarter of fiscal '23 for the offshore segment, we expected it will generate between \$8 million to \$10 million of direct margin.

Now, let me look forward to the first fiscal quarter and full fiscal year '23 for certain consolidated and corporate items. As we increased our rig count, capital expenditures for the full fiscal 2023 year are expected to range between \$425 million to \$475 million. This capital outlay is comprised of three domestic buckets plus international and corporate spend. As discussed on the July call, our North America segment capex has three buckets - maintenance, reactivation, and conversion. Our bucket of maintenance capex cost is anticipated to push above the high end of our historical range of \$750,000.00 to \$1 million per active rig. The fiscal 2023 range is expected to be between \$1.1 million and \$1.3 million per active rig.

As mentioned in our October press release, the reasons for this are two-fold. One is due to the reduced spending during the pandemic years when the company judiciously preserved capital spending by utilizing component equipment from idle rigs. Now, we are making up for those capital spending deferrals. The second reason is the current inflationary environment and supply chain challenges.

The second bucket for our North America segment is new for 2023 and includes rig specific reactivation capex that is required for the planned redeployment of up to 16 rigs that have been stacked for some time. Much of the spend will be incurred to overall componentry that we optimally utilized during the protracted downturn. Such discrete reactivation capex was anticipated to range from \$1 million to \$4 million for each of the

16 rig reactivations planned in the first half of fiscal '23, depending on the unique rigs' particular componentry involved.

The final bucket for NAS is the conversion bucket, which relates to the continuation of our walking rig conversion program. We plan to convert one rig a month for the first six months of fiscal 2023 for reactivation in the US market. As a reminder, our skidding to walking conversions are approximately \$7 million per rig.

The International segment also has three areas of spend concentration. First, we are converting six stacked rigs in the US from skidding to walking in the second half of the fiscal year and also incurring recommissioning capex for those six conversions which will be exported. Second, as mentioned earlier, we are upgrading five total rigs in Argentina to super-spec, and third, maintenance capex for the International and Offshore segments are collectively expected to be \$1 million to \$2 million per active rig.

Finally, corporate capital investments are expected to be about 10% of our fiscal 2023 capex. Two-thirds of this is information technology-related, including hardware lifecycle replacements, enhanced data capabilities, and further improvements to our infrastructure communications and cyber security. Depreciation for fiscal 2023 is expected to be approximately \$400 million.

A few overarching comments on capital expenditures are in order. First, capex is up year-over-year as we are investing to maintain our US fleet with modest growth this year, as well as investing in international growth for a future-year margin generation as well as geographic margin diversity. It is important to note that after our planned 16 US rig reactivations and our planned six international rig exports, we will have 32 remaining stacked super-spec FlexRigs located in the US for future growth domestically or internationally in upcoming years.

Second, if you exclude the pandemic years of 2020 and 2021, capital intensity which we measure as capex as a percentage of revenue should be among the lowest it has been in the last 10 years in fiscal 2023. This reduced capital intensity results in return in cash flow generation which I will comment on more in a few minutes. Finally, like fiscal 2022, we are committed to our capex guidance for fiscal 2023, barring any unexpected investment opportunities in international markets.

Our general and administrative expenses for the full fiscal '23 year are expected to be approximately \$195 million, which is up from the year recently completed which had an average of 163 rigs working. While this annual G&A spend is just under the \$50 million per quarter run rate we had going into the pandemic when we had approximately 195 rigs working, we are expecting to operate about the same number of rigs in an inflationary environment and at the same time, we're building capabilities to support future international growth. In essence, we are doing a bit more with a little less for support cost. Specifically, we expect about \$50 million of expense in Q1, with the remainder spread proportionally over the final three quarters.

Our investment in research and development remains largely focused on solutions important to our customers, such as drilling automation, wellbore quality, and power management. We anticipate R&D expenditures to be approximately \$28 million in fiscal 2023.

As a result of our return to profitability, we are once again becoming a US quarterly estimated taxpayer. We are expecting an effective income tax rate range of 23% to 28% with the variance above US statutory rate of 21% driven by state and foreign taxes. Based upon estimated fiscal 2023 operating results and capex, we are projecting a consolidated cash tax range of \$190 million to \$240 million of which \$45 million relates to fiscal '22 taxes to be paid in fiscal '23, resulting in a cash tax range of \$145 million to \$195 million related to fiscal '23 activity. Of note, we currently estimate that the impact of our deferred tax liability roll-off for fiscal '23 is less than \$10 million. It should be noted these ranges do not include approximately \$28 million of federal tax receivables on September 30, 2022, of which about \$25 million were subsequently collected in October after the fiscal year end.

Now, looking at our financial position, Helmerich & Payne had cash and short-term investments of approximately \$350 million on September 30, 2022, versus \$333 million in June 30th. Including availability under involving credit facility, our liquidity remains approximately \$1.1 billion. We again expect changes in the components of working capital to reduce cash in fiscal 2023, as was the case in fiscal '22. Whenever revenue increases as we expect with pricing uplifts across the fiscal year, rising receivables create a use of cash. Fiscal Q1 is expected to experience lower cash flow from operations in the following quarters due to the planned rig reactivations and ongoing price increases.

Earlier, I mentioned the cash flow generation expected for fiscal 2023. As John mentioned, moving through fiscal '23, our returns as measured in ROIC should be back in line with levels seen in 2014 and earlier. These levels are expected to be well into the double digits as an average across the fiscal year and, therefore, an excess of our estimated weighted average cost of capital. As announced in our October press release, subject to ongoing board approval, we plan to pay supplemental dividends across fiscal 2023 of approximately \$100 million, which is approximately 50% of the remaining cash flow after capex and after our established base dividend. In essence, this results in a full two-thirds of cash flow after capex return to shareholders with one-third retained for flexibility.

As of today, with this flexible \$100 million unallocated, we would expect to end the fiscal year with between \$430 million and \$490 million of cash and \$60 million to \$120 million of net debt. However, that is not the intention. Rather, going forward, we will reassess this allocation throughout the year with an eye toward opportunistic share repurchases, additional dividends, and/or accretive investment opportunities. That said, our current plans for capital allocation will further add to our longstanding priority of returning cash to shareholders and add to the roughly \$2.7 billion of cash that we have returned to shareholders during the past 10 years through dividends and share repurchases.

That concludes our prepared comments for the fourth fiscal quarter. Let me now turn the call over to Ashley for questions.

Operator: Thank you. At this time, if you would like to ask a question, please press *1 on your touchtone phone. You may withdraw your question at any time by pressing the # key. Once again, that's *1.

We'll take our first question from Derek Podhaizer with Barclays. Please go ahead.

Derek Podhaizer: Hey, good morning, guys. I just want to first ask about the leading-edge day rates and moving the average up to that level. Maybe you could just talk to me about how long that lag is to close that gap. I think you just got it to about \$30,000 of day rates for fiscal 1Q. Leading edge sounds like it's in the upper 30s, or has it hit \$40,000? Just maybe walk us through how you can roll the term contracts over to reach that level and when we can see it in the financials.

John Lindsay: Good morning. This is John. I don't have the exact timing on that, Dave, or Mark may have more color on that, but you've nailed it. That is our focus and we are seeing the results of that. Quarter over quarter, we'll continue to move those averages both in the spot and term closer to that leading edge, and that's really our focus. That's where the real opportunity set is there.

Mark, do you have some - any further color on that?

Mark Smith: Well, our average spot is about - what is it, Dave? About \$33,000 per day

Dave Wilson: Yes, and that's not including ancillary or technology, so that's day rate.

Mark Smith: Revenue average is about \$37,000?

Dave Wilson: Yes.

Mark Smith: The delta, if you think of legacy, ancillary, and technology all-in, our revenue per day and the spot is about \$37,000 a day. Our term, as we mentioned earlier, is about \$30,000 revenue per day, and I think leading edge is getting up to around \$41,000 a day.

Dave Wilson: Derek, that's why we mentioned the 65 rigs we have rolling off between now and March 31st kind of give you an idea of that progression and how you can model that into the year.

Derek Podhaizer: Got you, okay. No, that's helpful. I want to jump over to International. Obviously, a lot of moving pieces going on. Can you walk us through your - you just exited about 12 rigs, you said. Where do you expect to exit fiscal 2023? Just trying to get an idea of the cadence of the rig activations between Argentina, Middle East, and Australia. Then what can we expect as far as earnings and margin power in the international region, how much that's going to contribute to the total company?

Mark Smith: Well, I think we just got it to somewhere around 13 rigs at the end of December with the one we planned to add in Argentina, but as you move through fiscal '23, we'll have an eye on the three remaining Flex3's in Argentina that will be upgraded to super-spec and trying to deploy those. Importantly, we also have the one that's moving to Australia, as we mentioned, and that looks to spud in the summer of '23. It was originally, by the way,

earmarked to go to the Middle East hub, but it has been redirected for this Tamboran opportunity.

Then the six rigs that we have mentioned that are being recommissioned and converted to walking in the second half of the year, those are all geared towards various bid tenders we're participating in with an eye towards the Middle East. There are several burgeoning Gulf Coast country unconventional plays where those rigs can differentiate, and as we have talked about in successive quarters on these calls, we've been working in increasing our brand presence in the region which was aided by our transaction and partnership with ADNOC, and we are actively participating in looking to differentiate in the unconventional plays in gas and oil. I think the real focus in several of these countries is currently on natural gas.

Derek Podhaizer: Okay. Anything on what we could expect from these rigs when they're fully contributing on as far as a daily margin or just the earnings power on these rigs?

Mark Smith: I think the earnings power on these rigs would be equivalent with what you're seeing today and more and again, that's yet another year away before those six would actually beginning to turn to the right. More to come, but we certainly target returns for these, just like we do for everything and item it, too.

Derek Podhaizer: Okay. Appreciate the color. I'll turn it back.

Mark Smith: Thank you.

Operator: We will go next to David Smith with Pickering Energy. Go ahead, please.

David Smith: Hey, good morning. Thank you for taking my questions.

Mark Smith: Good morning, David.

David Smith: Just a quick follow-up on that last question, about the six rigs you plan to export from the stacked US fleet. I think you said those are targeted to tenders you're bidding on. I imagine there's fairly long lead time in those tenders. Should we be thinking about fiscal '24 as when we could start seeing a contribution from those?

Mark Smith: That's correct, David.

John Lindsay: That's correct.

David Smith: Appreciate it. Regarding the commentary about the date and the supplemental dividend you're representing about two-thirds of expected cash flow US Capex in fiscal '23, is that roughly two-thirds figure indicative of your longer-term thinking on returning cash via the base in supplemental dividend?

John Lindsay: David, this is really – our 2023 plan is really just that. It's our 2023 plan because that's the – you've heard me say before, it's hard to see much past the quarter in this business and we're forecasting out a year and making that commitment for 2023. Our intent, our hope is that in future fiscal years, we'll have a similar not even better, but this is just the 2023. Anything to add?

Mark Smith: Yes. I'd just add, David, as John and I, the management team in discussions with the board, we think there's several capital allocation criteria and I'll just tick through these. One is maintaining a minimum liquidity for operations, which is less than the cash we had on hand in September 30th with the view as we have with our conservative stewardship of the balance sheet and the view to risk management. Also positioning for optionality, we prefer \$200 million minimum cash balance.

A second consideration in our capital allocation criteria, as we have long committed to our creditors in our fiscal stewardship, is assessing cash generation to ensure we maintain a leverage of less than two times, less than two turns. Third is we're opportunistic for accretive investment opportunities, as I said just a minute ago in a previous question, with mid to high teen returns individually and that contributes to our goals for consolidated ROIC in the same range.

Fourth, opportunistic in using the evergreen 4 million share repurchase authorization. An example of that would really be last November and December a year ago when we believed that there was a dislocation in our share price which led us to repurchase shares in the first quarter of fiscal '22. Then finally, I would say towards the end of the fiscal year and in consideration of all the aforementioned, if an excess cash balance remains and management and the board will consider further additional dividends, and then as John said, then we'll move toward and develop the fiscal '24 budget which would reassess forward fiscal year cash generation above capex at that time and above the

established base dividend to work with the board to figure out the '24 capital allocation plan.

David Smith: I do appreciate all that color and I will jump back in the queue.

Mark Smith: All right, David. Thank you.

Operator: We'll take our next question from Luke Lemoine from Piper Sandler. Please go ahead.

Luke Lemoine: Hey, good morning.

John Lindsay: Good morning, Luke.

Luke Lemoine: John, if we look at your 16 reactivations this fiscal year, I imagine there are a few things going on with incremental activity, some operators separating the super-spec rigs and maybe some market share gains as well from other super-spec rig providers. Could you talk about these buckets a little more and maybe which of these you see as the main driver?

John Lindsay: Luke, I think as we said, there are several drivers. I think you heard us, the 16, the ones that we have committed are mostly large public companies which really has been our expectation. I think most people's expectation at the private companies have contributed a lot of active rigs to the fleet over the last couple of years. We think most of that will be directed towards the larger players. We think most of that will also be in the Permian but not all. We do have Haynesville. I think there may be an Eagle Ford or some North Dakota opportunities. I think we may even have an Oklahoma rig in there, but I think the majority of it is focused in the Permian.

Going back to our discussion earlier, so much of the demand out there is being provided through this, at least in our fleet - I would have to suspect other companies run the same - is really a function of the churn that we're seeing quarter over quarter, and so a lot of that demand is satisfied there. As an example, if what we found is on the 16 that there was more churn than expected, it could be that we wouldn't put all 16 of those rigs out into the market because we're satisfying that demand through other means.

Does that answer your question?

Luke Lemoine: Well, I guess yes, partly, but maybe you talked about churn a lot and now just to - do you think maybe it's some of the churn and other people's fleets that you're gaining some market share, or do you think these are purely incremental rigs from the large public players?

John Lindsay: Yes, that's a good point. It's a mix. Some of these rigs are incremental. Some of these rigs are replacement but as you know, if we replace another peer's rig, that rig then moves over and satisfies demand somewhere else. As you just start thinking about these points of demand in the market, those are going to be satisfied in many cases from other rigs that are rolling off of one to the other. I think two-thirds are incremental and then the other third are replacement for what we have commitments right now.

Luke Lemoine: Okay, got it. Then maybe just on the overall market outlook, with two-thirds of those being incremental, you have about a quarter of the overall market share. Do you think that's indicative of overall market growth or hard to say?

John Lindsay: I think it's really hard to say at this point. We feel like that there'll be modest growth obviously from our rig count and we would consider that to be modest, whereas we've said and probably said it maybe too many times, but we're really focused on capital discipline and making certain that we don't put a rig in the market that is an excess rig, if you will, just based on the demand criteria. We can utilize a rig that's hot that's rolling off from somebody else, then we can do that, but it's really hard to say. Obviously, if you just use the math on our market share, adding 40 to 50 rigs back over the next what, 13, 14 months, I think is reasonable but it's just really hard. As you know, it's really hard to call from this point.

Luke Lemoine: Okay, very helpful. Thanks a bunch.

Mark Smith: Thank you.

Operator: We'll take our next question from Arun Jayaram with J.P. Morgan. Please go ahead.

Arun Jayaram: Yes. Good morning. You guys mentioned that about two-thirds of the 16 rigs that you plan to reactivate have been contracted. John, you mentioned that you're looking for a minimum of two years in terms of commitment to put those into the field. Just wondering if you could give us a sense of where pricing is for term contracts relative to the leading edge that you pegged in the low 40s.

John Lindsay: On the term contracts, the majority of those rigs are in some sort of a performance-based contract in that two-year term contract, and our expectation would be that again, assuming performance and that's what we're focused on with our customers, we're going to be closer to that leading-edge pricing with those term contracts. Again, they're performance based but we've been able to deliver on those. We feel good about the pricing.

In other words, we're not taking – and really it's not just for those rigs but it's all rigs. We're not entering into a term contract at a discount or entering into a term contract at leading edge or close to leading edge with the opportunity to get some additional revenue and margin based on performance and sharing in those savings.

Arun Jayaram: Great. Just to follow up, John, on the company's international growth strategy, I think a quarter your capex this year or fiscal year will be focused on the international side of the business. As we look forward to fiscal year 2024, can you give us, maybe frame some ranges of potential rigs that you could see deployed internationally? As you think about participating in tenders, are you participating with other service companies or talk to us about the bidding dynamics particularly as we think about the Middle East?

John Lindsay: Well, Arun, you know the market very well in the Middle East and these are long plays, and so thinking about 2024 I think really makes a lot of sense. We were recently in Abu Dhabi two, three weeks ago at ADIPEC Conference and a lot of excitement there. Of course, we're excited about opportunities in Abu Dhabi and Saudi, Oman, other countries that have shown some interest. The majority of that is for unconventional resource play development and, of course, nobody has drilled more horizontal wells than H&P, so I think we have a lot to add there. These tenders take a long time. You have to have a lot of patience but again, it's a long game and that's what we're focused on.

Mark, do you have anything you would say?

Mark Smith: No, I agree, John. As you mentioned unconventional and I would just add maybe a footnote, Arun, as we look at these various tenders we're participating in and a bona fide participation in them and have boots on the ground, sales folks in the region there that we have invested in the last couple of years. We're looking at some of these tenders with scale, so not one or two rigs but four, five, six rigs, and that's each. That's why you see

our investment this year is setting us up for margin generation accretive to the company in '24 and beyond.

Arun Jayaram: Right, and just a quick follow-up here is just on the frame agreement with the ADNOC drilling. How does that work relative to your H&P specific opportunity? How does that work in Abu Dhabi?

John Lindsay: Well, we've delivered the eight rigs that we talked about that we've sold. We have an agreement where we're working with them on conventional projects, and so that continues to trend well and we really don't have a whole lot more to add to that right now, but there'll be more to come as we go to the next several quarters.

Arun Jayaram: Great. Thanks a lot, John.

John Lindsay: Thank you.

Operator: We'll take our next question from Waqar Syed with ATB Capital Markets. Please go ahead.

Waqar Syed: Thank you. Good morning. John, the rig needed for unconventional drilling in the Middle East, is it the similar type of super-spec rig? Is 1,500 hp enough for that type of drilling, or do you need to have a bigger rig? Could you maybe elaborate the type of rig that will be needed?

John Lindsay: Yes. Good morning, Waqar. Now, that's exactly right. Really, our Flex3, both Flex3 skid and Flex3 walking rigs are both very well suited for the wells that we've looked at at this point, and those rigs have performed very, very well in Abu Dhabi in the past when we were drilling previously. I don't think they were doing any horizontally. We're doing a lot of really long directional type wells but no, they're very well suited for that work and I think the national companies we're talking to are very excited about the opportunity.

Waqar Syed: Great. Then Mark, your EBITDA margins in the international business were about 1% or so. In the past couple of years ago, they were as high as low 20%. Where do you think these EBITDA margins could go through this fiscal year?

Mark Smith: When you look at the fiscal year starting off with a higher rig count to begin with, I think you'll certainly see year-over-year margin expansion, but I'll just caveat that, that margin

expansion is, even with a bit of a drag on some of the expenses we're incurring in setting up in the Middle East and Australia, more focused on that Middle East hub. Even with that, you're going to see margin expansion this year.

Waqar Syed: Could you quantify those expenses in the Middle East and Australia?

Mark Smith: No [laughter]. It's really early days in Australia. There's a lot of planning work that's happening for setting up operations on the ground in summer of '23. I will tell you as I mentioned earlier that rig that's targeted to be shipped in January, much of the work was already incurred on that in fiscal '22 but as it relates to the Middle East hub, quite a bit of work is happening and you'll just see that to continue to be a little bit of drag on - as I said, the margin expansion for this segment is up simply because of the number of units working and getting better and better pricing on those units. It's just a scale thing and we think that will do nothing but grow through time.

John Lindsay: Yes, Waqar. We're excited about that opportunity, as Mark said, and there's a lot of experience on the ground there. Tamboran has guys that have done a lot of work on unconventional plays in the US, and we're excited to be working with them. We think it's a great opportunity. Again, it's really, really early days but it looks like an exciting play.

Waqar Syed: Absolutely. Then just a final question, John, would your contracting strategy change, given that you now have like this capital allocation program and you've got this \$1.94 type dividend that you're planning for fiscal year 2023?

John Lindsay: No. Waqar, I'm not completely following the change in contracting strategy.

Waqar Syed: Well, no. I'm just saying like you have about, let's say, two-thirds rigs contracted right now and that's pretty much consistent with what you've had over the last one year or so and there's like 50% over the next six months. I'm just thinking that would you carry a higher number of rigs in the term contracts in the further subsequent six months going forward, or you're okay with that despite having a high level of dividend that you'd be paying out?

John Lindsay: Yes. We're targeting in a 50% to 60% range and that really hasn't been driven by the dividend levels. The cash that we're generating is, as Mark described - well, you should have access cash outside of that plan.

Mark, what would you add?

Mark Smith: I would just say today, we talked about so many of them rolling over and doing now in the end of March in the prepared comments, Waqar. The average term length today is probably 10, 11 months, so you have to just remember that. By and large, so many of the term contracts that have existed from rollovers back from the super-spec upgrading timeframe are really in the one-year calendar period. That's why so much of our capital allocation plan is a result of the customers and they are really adhering to their annual budgets, and that really gives us underpinning in our confidence for the annual supplemental plan. Overall, where we are in this cycle and due to not having significant investments and super-spec upgrades and due to customers living in an annual fiscal year budget as opposed to cash flow, you see a lot of 12-month terms.

Waqar Syed: Okay. Thank you.

Mark Smith: Much different cycle, Waqar, than what we have experienced previously because obviously, we're not looking at new builds. We don't have all that capital outlay and as we've said, we're really focused on this, in margin generation as a margin cycle, not really a growth cycle, so we're excited about that.

Waqar Syed: Wonderful. Thank you very much.

John Lindsay: Thank you.

Operator: We'll go next to Marc Bianchi with Cowen. Please go ahead.

Marc Bianchi: Hey, thanks. Mark, I think in your prepared remarks, you mentioned a \$1,500 sequential benefit to margin. Was that met for the March quarter and then does that continue in the subsequent quarters? Was that the message just because of how the contracts kind of roll off and reprice?

Mark Smith: It's actually happening for this December quarter and then each of the next couple, but that's exactly right, Marc. That's what I was talking about, is that rollover, when you pull the lower term out, it helps the average of the remaining on term.

Marc Bianchi: Okay, but the benefit in December quarter should be better than the \$1,500 if I'm just trying to back into what's implied by the 250 to 270? Is that right?

Mark Smith: Yes, yes, it's a little bit better.

Marc Bianchi: Okay. The implication of this leading edge \$40,000 or so and John, you made the comment about the term contracts being performance based and being able to get to that \$40,000. If your cost are \$16,500, then we're getting into the \$23,500 margin per day at some point once the fleet rolls. If I just carry this out, it seems like you could be there in the beginning of March 2024. Is that the right way to think about where this ultimately goes, or are there other puts and takes that you'd call out that maybe we shouldn't mull it that way?

John Lindsay: Well, those are the numbers and again, we're focused, as I said earlier, on getting the averages for spot and term closer to leading edge. What we haven't said is how many rigs are closer to that leading edge. That isn't our focus, and so again, the numbers are the numbers.

Marc Bianchi: Yes, okay. Well, just one more for me on the walking upgrade, so just doing six for North America at this point, what's the scenario where you would be doing back on that sort of one per month cadence, and what should we think about that beyond 2023? Are you going to turn the whole fleet over to walking at some point, or what's the long-term thought on that?

John Lindsay: Well, Marc, as you've heard us say before, you just look at the fleet that's out there working today and the lion's share of that are Flex3 skid rigs, and you're right. The six rigs, we're doing six conversions to walking but that's really a function of customer demand. We've actually had more demand for Flex3 skid rigs than we have walking rigs. It's all going to be dependent upon customer demand, the types of wells that are being drilled. It's really a wide range. The other six rigs that we are converting, those are the ones that we're talking about sending to the Middle East.

We're going to do what is in the best interest of and satisfying customer demand and what's in the best interest of shareholders, but there sure won't be a conversion to the entire fleet. Again, there are customers out there that all they use are Flex3 skid rigs.

Marc Bianchi: Yes, super. Thanks so much, John. I'll turn it back.

John Lindsay: Thank you.

Operator:

All right. At this time, I'll turn the call back over to John Lindsay for any closing remarks.

John Lindsay:

Thank you, Ashley, and thanks again to all of you for joining us today. We know there's a lot going on. There are a lot of priorities that are going on out there at this time of the year, so we really appreciate your time. I'll tell you again that the H&P team - and I've said it and I'll continue to say it - we're laser focused on delivering value to customers and shareholders. We aim to deliver value to customers through top-tier performance, safety, and reliability and to our shareholders, we're going to continue to focus on improving our rig margins and growth and our returns on capital.

Thank you again for your time and have a great day.

END