Helmerich & Payne
Fiscal Fourth Quarter 2021 Earnings Call Transcript
11/18/2021 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 an opportunity to ask questions during the question-and-answer session. You may register to ask a question at any time by pressing the * and 1 on your touchtone phone. Please note this call may be recorded, and I will be standing by should you need any assistance. It is now my pleasure to turn today's program over to Dave Wilson, Vice President of Investor Relations.

Dave Wilson: Thank you, Brittany, and welcome, everyone, to Helmerich & Payne's Conference Call and Webcast for the fourth quarter and fiscal year ended 2021. With us, today are John Lindsay, President and CEO; Mark Smith, Senior Vice President and CFO; and John Bell, Senior Vice President, International and Offshore Operations. John Lindsay 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 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 any 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 operating income 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. Good morning, everyone, and thank you for joining us today. I'm excited to be in Abu Dhabi this week, having just participated in the ADIPEC Conference which has provided a unique occasion to meet face-to-face with colleagues, customers, and, of course, our strong partner, ADNOC Drilling.

Also joining Mark and me today in Abu Dhabi is John Bell, Senior Vice President, International and Offshore Operations; and he'll be available for international and ADNOC-specific questions.

Before getting into our traditional discussion topics, I wanted to first mention that ADIPEC, which is a global energy conference in Abu Dhabi, this week there were over 150,000 attendees, 33 energy ministers, and representatives from over 50 energy companies. I've been impressed with the focus on ESG and especially the discussions of the impacts on energy security for the globe.

In addition to industry leaders sharing their focus on sustainability and ESG, there were also leaders of countries from around the globe that were present to give their perspectives on the energy transition and the importance of ongoing investments to ensure a smooth transition.

Dr. Sultan Al Jaber, the ADNOC Group CEO and UAE Minister of Industry and Advanced Technology, gave a very compelling speech at ADIPEC's opening ceremony. He started with a reminder that energy transitions take multiple decades, and I quote, "Rewiring the energy system is a multi-trillion dollar business opportunity that is good for humanity and good for economic growth." He also had a call to action stating, "What the world really needs is to hold back emissions, not progress. Let us together drive that progress. Let us always keep in mind our industry must play a pivotal role in the energy transition. We have the knowledge, the skills, and the people to make a difference in our world."

Now, that statement really resonates with me. Working with our customers to reduce emissions and our collective environmental footprint is a major area of focus for us here at H&P.

The strategic alliance we signed with ADNOC is a great opportunity to deliver rig technology through the sale of eight high-spec H&P FlexRigs, as well as to make a significant $100-million investment in their initial public offering. ADNOC has a 2030 oil production target of 5 million barrels per day and a goal to achieve natural gas independence. We believe H&P can make significant contributions towards helping ADNOC achieve those goals through this new partnership, while also providing additional opportunities for us to expand in this pivotal and growing energy region. We're delighted with the reception H&P has received this week, and we want to thank the ADNOC team for their hospitality.

Looking at the rest of our international activity, historically, we've experienced a lag compared to the U.S., so we are expecting activity to improve in these markets in the coming quarters. A recent example is a couple of new agreements with YPF as we will put four rigs back to work under term contracts in Argentina during fiscal 2022. We continue to pursue other international opportunities and look forward to improving activity.

Shifting to North America Solutions, it is hard to believe that a year ago H&P had only 80 active rigs running, and today we have 141 active FlexRigs. The response of our people and their leadership through the pandemic has been nothing short of amazing. Particularly impressive is their service attitude in responding to customers as rig demand has been recovering. Our folks are resilient and deliver on safety, efficiency, and reliability for our customers each and every day.

We expected that the rig activity increases would be more measured during our fourth fiscal quarter as we realized more rapid rig churn among customers who are sticking to their disciplined spending plans. Given that, we were pleased with the 5% incremental rig count increase experienced during the quarter, and are even more optimistic as we look ahead to the fourth calendar quarter where we expect to see our rig count increase sequentially and at a higher pace as E&Ps reset their annual capital budgets. We believe our customers will remain disciplined and similar to 2021, the budgets for 2022 will be adhered to, but the new budgets will be reset at higher levels based on a higher commodity price environment, meaning more active rigs in 2022.

As evidenced by our rig count growth to date, we expect the rig count will have a significant increase in calendar Q4 of 2021 and Q1 of 2022. As mentioned, our U.S. land rig count stands at 141 rigs today, up from 127 at September 30, our fiscal year-end, and we expect to add roughly another 10 to 15 rigs by year-end of calendar 2021.

To summarize North America Solutions, during calendar fourth quarter, we expect to add 25 to 30 rigs. To put that in perspective, this is approximately the same number of rigs we added in the preceding nine months. Further, we are also readying several more rigs during the first fiscal quarter that we expect to commence work in the first half of January. This activity increase is exciting as our customers are investing in their calendar 2022 budgets. It does, however, cause near-term margin compression due to the one-time expenses incurred to reactivation. Mark will discuss the details more in a moment, and I'll add that we are pleased with the future cash generation these rigs will have post reactivation as we return to greater scale operations driving both pricing higher and leveraging our fixed costs.

Given the well-publicized challenges in what we hope is finally a post-pandemic environment, it's not surprising to see rig reactivation and field labor cost increasing. All of the super-spec rigs that are available to work today have been idle for well over a year, which equates to higher start-up costs. Competition for quality people is also escalating, and we will be increasing field labor wages accordingly, and, as a reminder, those cost increases are passed through to the customer.

The tightening supply of readily available rigs coupled with these cost increases have already begun to move contract pricing effort in the market. Based upon what we are experiencing today, we expect price increases will become even more pronounced in the coming months as rig demand picks up heading into 2022.

Mark will talk about our strong balance sheet in his remarks, but I wanted to mention one of our goals was to generate free cash flow, and we are encouraged that we believe that is achievable in the back half of 2022 with the rig count and revenue expectations we have. These market conditions demonstrate further potential for H&P’s new commercial models and digital technology solutions. Our digital technology solutions deliver value through improved efficiencies, reliability, lower cost, and better overall outcomes.

Today, approximately 35% of our FlexRigs are on performance contracts, and several customers are experiencing the powerful synergies a combination of performance contracts and digital technology can deliver. Adoption continues to improve and is driving economic returns higher, not only for our customers but for ourselves as well.

In closing, we are encouraged heading into 2022 and fully expect that the demand for H&P’s drilling solutions will continue. E&P capital discipline, rising commodity prices, and a collective vision to play our crucial role in a smooth energy transition will strengthen the industry. There are still many challenges, but I’m confident that our people and solutions have the company well positioned to deliver value for customers and shareholders in this improving environment.

Now, I’ll turn the call over to Mark.

Mark Smith: Thanks, John. Today, I will review our fiscal fourth quarter and full-year 2021 operating results, provide guidance for the first quarter and full fiscal year 2022 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, 2021.

The company generated quarterly revenues of $344 million versus $332 million in the previous quarter. The increase in revenue corresponds to a modest increase in our rig count during the quarter. Correspondingly, total direct operating costs incurred were $269 million for the fourth quarter versus $257 million for the previous quarter.

During the fourth quarter, we closed on two transactions with ADNOC Drilling. First, H&P sold eight FlexRig land rigs, including two already in Abu Dhabi and six from the United States for delivery during 2022. Consideration received for this sale was $86.5 million and any gains above book values, together with required investments to prepare and deliver the rigs, will be recognized as each rig is delivered.

Second, H&P made a $100-million investment in ADNOC Drilling in conjunction with its initial public offering in early October. General and administrative expenses totaled $52 million for the fourth quarter, higher than our previous guidance due primarily to professional services fees associated with the ADNOC transactions and our ongoing cost management efforts, as well as increases to the short-term incentive bonus plan accrual to reflect full fiscal year operating results.

On September 27th, we issued $550 million in unsecured senior note bonds to refinance our 487 million outstanding bonds that were due in May 2025. Our new issuance came at a coupon of 2.9% and a 10-year tenure maturing in September 2031. The additional debt of about $63 million funded the make-whole provision and accrued interest for the call of the existing bonds, as well as an associated transaction cost. This made the transaction and subsequent debt extinguishment in October liquidity neutral. Also, note that the make-whole premium and accrued interest will be recognized in the first fiscal quarter 2022 concurrently with the

October 27 redemption. Our Q4 effective tax rate was approximately 24%, in line with our previous guidance.

To summarize fourth quarter's results, H&P incurred a loss of $0.74 per diluted share versus a loss of $0.52 in the previous quarter. Earnings per share were negatively impacted by a net $0.12 per share loss of select items, which are primarily made up of non-cash impairments for fair market value adjustments to equipment that is held for sale as highlighted in our press release. As of the select items, adjusted diluted loss per share was $0.62 in the fourth fiscal quarter compared with an adjusted $0.57 loss during the third fiscal quarter.

For fiscal 2021 as a whole, we incurred a loss of $3.04 per diluted share. Again, this was driven largely by the non-cash impairments to fair value for decommissioned rigs and equipment, the majority of which were previously impaired and are held for sale. Collectively, these select items constituted a loss of $0.44 per diluted share. Absent these items, fiscal 2021 adjusted losses were $2.60 per diluted share.

Capital expenditures for fiscal 2021 totaled $82 million below our previous guidance due to the timing of supply chain spending that crossed into fiscal 2022. Relative to our original guidance range of $85 million to $105 million, the variance was primarily driven by a delay in the start of planned IT infrastructure spending that we have previously discussed. Most of that planned IT spend will now be incurred in fiscal 2022.

H&P generated $136 million in operating cash flow during fiscal 2021. Considering the pro forma impact of our recent debt refinancing, the collective cash and short-term investments balances decreased minimally by $7 million year-over-year due in part to working capital improvements achieved during fiscal 2021 as well as asset sales. I will discuss in more detail later in my prepared remarks.

Turning to our three segments, beginning with the North America Solutions segment, we averaged 124 contracted rigs during the fourth quarter, up from an average of 119 rigs in fiscal Q3. We exited the fourth fiscal quarter with 127 contracted rigs. Revenues were sequentially higher by $12 million due to the aforementioned activity increase. North America Solutions operating expenses increased $18 million sequentially in the fourth quarter, primarily due to the addition of six rigs as well as a higher material and supplies expense.

Throughout fiscal 2021, we prudently managed our expenses and inventory levels using previously expensed consumable inventory harvested during stacking activities in calendar 2020, rather than utilizing fully-costed inventory or purchasing new inventory. As rig activity increased, our level of previously expensed inventory or what we have been referring to internally as “penny stock” has been exhausted, resulting in the issuance of a higher cost inventory and the purchasing of additional inventory to replenish stock levels, replenishments go on the balance sheet.

Through fiscal 2021, we did not experience inflation in our costs. However, we are anticipating inflationary pressures moving forward, which I will touch on in a moment. Additionally, as I will expand on later, we’ve put six rigs to work in the first half of October, the first fiscal quarter of 2022, but the reactivation costs are primarily incurred in fiscal 2021. The one-time reactivation expenses associated with all of those rigs was $6.6 million in fiscal Q4.

Now, looking ahead to the first quarter of fiscal 2022 for North America Solutions, as expected, rig count growth was moderate during the fourth fiscal quarter. Publicly traded customers continued to operate within their calendar year budget plans, which are currently being reset for calendar 2022 in an oil-and-gas commodity environment that is significantly more robust than this time last year. Accordingly, we expect to see sizable spending increases, especially with our public company customers during the first fiscal quarter of 2022. As of today’s call, we have 141 rigs contracted, and we expect to end our first fiscal quarter with between 152 and 157 working rigs, with current line of sight for a few additional rigs turning to the right in early January.

In the North America Solutions segment, we expect gross margins to range between $75 million to $85 million, inclusive of the effect of about $15 million in reactivation costs. As I mentioned last quarter, there is positive correlation between the length of time a rig has been idle, and the costs required to reactivate it. Most of the rigs we are reactivating in the first quarter have been idle for 18-plus months. Reactivation costs are mostly incurred in the quarter of start-up, so the absence of such costs in future quarters is margin accretive. As John mentioned, we are expecting to achieve higher pricing in light of higher demand in tight, ready-to-work, super-spec supply.

I will now pause to comment on inflationary considerations ahead for fiscal 2022. We have seen increases in commodity pricing such as for steel. Products reflecting upward pricing due to this pressure include capital items such as drill pipe. Note that our upcoming capital expenditure guidance is inclusive of such pricing increases.

For margin-related expenditures, I will touch on two items. First, maintenance and supplies pricing is increasing across some categories, such as oil-based products like lubricants and steel-based products like fluids.

Second, as John discussed, we are increasing field labor rates to respond to market conditions and assist in talent retention and attraction. Further, our contracts are structured to pass through labor price increases over a 5% threshold. Therefore, significant labor increases are margin neutral due to contractual protections. Fair margin guidance was inclusive of our expectations for inflation in the first fiscal quarter.

As it relates to supply chain access to parts and materials to run our business, we are in constant communication with our suppliers and have placed advance orders for certain IRS categories. Our proactive approach to inventory planning, coupled with our scale and healthy vendor-partner relationships, provides reasonable assurance in supply chain issues as we see them today will not materially impact our business. We will continue to engage our suppliers and partners to stay ready to adjust as developments unfold.

Subsequent to September 30, 2021, we sold two peripheral service lines which provided rig move trucking and casing running tools services to a portion of our North America segment customers. These business lines were largely margin neutral to H&P, having collective revenues in the fourth quarter and full fiscal year of 2021 of $10 million and $34 million, respectively.

To conclude comments on the North America segment, our current revenue backlog from our North America Solutions fleet is roughly $430 million.

Regarding our International Solutions segment, International business activity increased by one rig in Argentina to six active rigs during the fourth fiscal quarter. As we look to the first fiscal quarter of 2022 for International, activity in Bahrain is holding steady with the three rigs working, and we expect to go from three to four rigs working in Argentina, as well as get the contracted Colombia rig turning to the right. Note that three of the YPF rigs John mentioned earlier will commence work in subsequent FY ‘22 quarters in Argentina.

Turning to our Offshore Gulf of Mexico segment, we continue to have four of our seven offshore platform rigs contracted. Offshore generated a gross margin of $8 million during this quarter, which was within our guided range. As we look at the first quarter of fiscal 2022 for Offshore, we expect that the segment will generate between $6 million to $8 million of operating gross margin.

Now, let me move forward to the first fiscal quarter and full fiscal year 2022 for certain consolidated and corporate items. As we increased our rig count, capital expenditures for the full fiscal 2022 year are expected to range between $250 million to $270 million. This capital outlay is comprised of three buckets similar to fiscal 2021. First, maintenance CAPEX to support our active rig fleet will be approximately 50% of the total FY ‘22 CAPEX. In fiscal 2019, we had bulk purchases in CAPEX to scale up rotating componentry for a then 200-plus working super-spec FlexRig count. In addition, we harvested components from previously impaired and decommissioned rigs to conserve capital. As such, we were able to utilize resources on hand and preserve capital in 2021, but now we have reached the end of those inventories and we are needing to recommence a regular cadence of component equipment overhauls and drill pipe purchases. This, coupled with a sharp activity increase we are experiencing, is driving our fiscal 2022 maintenance CAPEX back into our historical range of between $750,000.00 to $1 million per active rig per annum in the North America Solutions segment.

Second, skidding to walking capability conversions will approximate 35% of the fiscal 2022 CAPEX. Although our peers have walking rigs available in the market, select customers prefer certain rig design elements and commit to a conversion. For customers that need walking rigs, we will invest to convert certain rigs from skidding to walking pad capability in exchange for a term contract that will enable the new investment, which we currently estimate is $6.5 million to $7.5 million per conversion.

Third, corporate capital investments will be about 15% of fiscal 2022 CAPEX. Over half of this bucket is comprised of modernization for data center, data and analytics platforms, and enterprise IT systems, most of which has moved from fiscal 2021 to fiscal 2022 and will improve our infrastructure and cyber security posture. Portions of the balance of this corporate capital investment are for Power Solutions capital associated with ESG research and development efforts, and for certain real estate matters. As part of the ADNOC sale transaction mentioned earlier, we will deliver the eight rigs to ADNOC throughout the year of 2022 with sale proceeds of $86.5 million received in September 2021 and are included in accrued liabilities on our balance sheet.

In addition to the capital expenditures just described above, we will spend approximately $25 million in cash to prepare and deliver the rigs to ADNOC.

When we incur these expenses, they, together with the net book values which among other assets are classified in assets held for sale, will collectively represent the accounting basis in the rigs for the purpose of determining gains to be recognized in the upcoming quarters upon each delivery.

Depreciation for fiscal 2022 is expected to be approximately $405 million. Our general and administrative expenses for the full 2022 year are expected to be approximately $170 million, which is roughly consistent with the year just completed. Fiscal 2022 SG&A will be partly front-loaded in the first fiscal quarter due to short-term incentive compensation payments for fiscal year 2021 results and the timing of certain professional services fees. Specifically, we expect $45 million to $85 million in Q1, with the remainder spread proportionately over the final three quarters.

Our investment in research and development is largely focused on autonomous drilling, wellbore quality, and ESG initiatives, and we anticipate these innovation efforts to yield further enhancements and solutions offerings on our technology roadmap. We anticipate R&D expenditures to be approximately $25 million in fiscal ‘22.

We are expecting an effective income tax rate range of 18% to 24% for fiscal 2022. In addition to the U.S. statutory rate of 21%, incremental state and foreign income taxes also impact our provision. Based upon estimated fiscal 2022 operating results and CAPEX, we are forecasting another decrease to our deferred tax liability. Additionally, we are expecting cash tax in the range of $5 million to $20 million.

Now, looking at our financial position, Helmerich & Payne had cash and short-term investments of approximately $1.1 billion at September 30, 2021. When considering the aforementioned 2025 bond repayment and make-whole premium that occurred in October, the pro forma cash and short-term equivalents of September 30, 2021 were $570 million sequentially, compared to $558 million at June 30, 2021.

Including availability under our revolving credit facility but excluding the $546 million 2025 bond extinguishment amount, our liquidity was approximately $1.3 billion commensurate to the prior quarter. Our debt to capital at quarter end was temporarily at 26%, given the debt overlap at the September 30 balance sheet date, accounting for the repayment of the 2025 bonds. However, pro forma debt-to-capital are just down to 16%.

Our working capital stewardship since the March 2020 downturn resulted in cash accretion. As we look forward towards the end of fiscal ‘22, we do expect to consume a modest amount of cash, given the one-time recommissioning expenses, together with net working capital increases as our rig activity climbs. Fiscal Q1 will experience lower cash flow from operations in the following quarters due to the rig ramp-up and the seasonal cash expenditures for incentive compensation, property taxes, etcetera. We do expect to end the fiscal year with between $475 million to $525 million of cash on hand and $25 million to $75 million of net debt.

In summary, we are expecting to generate free cash flow that, when combined with the modest uses of cash on hand early in the fiscal year, will cover our capital expenditure plan, debt service cost, and dividends in fiscal ‘22. The growth in rig count early in the fiscal year provides a platform for cash generation in the second half of the year that, pointing forward, fully covers our cash uses including our dividend and sets the stage for further cash accretion. Our balance sheet strength, liquidity level, and term contract backlog provide H&P the flexibility to adapt to market conditions, take advantage of attractive opportunities, and maintain our long practice of returning capital to shareholders.

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

Operator: At this time, if you would like to ask a question, please press the * and 1 on your touchtone phone. You may remove yourself from the queue at any time by pressing the # key. Once again, that is * and 1 if you would like to ask a question.

We will take our first question from Arun Jayaram with JPMorgan Chase.

Arun Jayaram: Yes. Good morning. I wanted to get a little bit more color around the fiscal year '22 CAPEX program. It looks like you're spending around $90 million or so on the walking system upgrades. You mentioned $6.5 million to $7.5-million-type upgrades. Can you give us a sense, firstly, of the 95 idle rigs at H&P? How many of those have walking systems on them? For the next batch of reactivations that you expect to do, how many more upgrades do you anticipate?

Secondly, can you comment on the amount of reimbursements up and above your day work margin? What kind of reimbursements you're getting for those investments in their walking systems?

Mark Smith: Arun, on the investments, I think we're - Dave, correct me if I'm wrong. I think we've got one a month. Is that right on the walking rig?

Dave Wilson: That's correct.

Mark Smith: Yes, that is right. John, we're planning one a month currently based on line of sight with customers, and that will adjust potentially up or down based on the customer demand. I'll come back to the pricing and term we're getting, but I'd just let John maybe start us off with a little bit of a commentary on why customers are asking us to convert.

John Lindsay: Yes. It's interesting, Arun, because there are about 214 idle super-spec rigs in the U.S. and 124 of those are walking rigs, and so we've got significant demand. All of our walking rigs are active, and so we have significant demand for walking. It's clear that there's more demand than just for walking. There's obviously demand for what H&P provides in terms of overall performance.

That's the key. I think that's a key element. We are getting - I think the last contract, we probably had an 18-month term contract, and I think it's 25,000 a day, actually.

Mark Smith: Yes.

John Lindsay: Specifically, to your point, Arun, we're getting term. We're shooting for two. The typical payback on these is three years and commanding a premium price for doing so.

Arun Jayaram: Great. I think in the start…

Mark Smith: I wanted to clarify something though, Arun. I thought I heard you - and maybe I misheard. You said $190 million on the walking rig upgrades. Did you say…?

Arun Jayaram: No. I said $90 million.

Mark Smith: $90 million. Okay. Yes. I thought it was, yes, $84 million to $90 million, but I thought you said $190 million. I misheard.

Arun Jayaram: Yes, okay. Yes, it's $90 million. Just my follow-up would be on the ADNOC rig, Mark, $86.5 million of proceeds from that. Obviously, you also get the $100-million investment, but could you comment on the CAPEX required in fiscal year '22 to get those rigs in the condition to be sold?

Mark Smith: Well, as I mentioned, it's about $24 million, $25 million I think in the prepared remarks, and it's a couple of things. There are some specific technical components that our partner wanted, one. Two, we're going to be recertifying everything so that, for example, the BOP leaves with a five-year certification and the top drive leaves with seven years, etcetera, etcetera, but there's also the transit costs, so the shipping or mobilization cost to get those rigs across the water.

What I have not commented on is the net book value by rig. Obviously, the eight have different values and two are already in Abu Dhabi, the six in the U.S., two and six were super-spec as we've previously stated.

Arun Jayaram: Great. Thank you very much.

Mark Smith: Thank you.

Operator: We will take our next question from Derek Podhaizer with Barclays. Your line is now open.

Derek Podhaizer: Hey, good morning, guys. I wanted to talk more about the ADNOC deal. Obviously, the news just came out. We saw they just announced pretty significant tender just to support the growth of the 5 million barrels per day. You talked about expanding into the region. Can you just maybe expand to us a little bit more about what you're talking about? Are these going to be more HP-owned rigs going in there? I think you talked about consultancy work. Just any more color you can give us on how you see yourself growing with ADNOC in this new partnership.

John Lindsay: Yes, Derek. This is John. I'll start and I'm going to hand it over to John Bell to give additional color, but I think in general, the strategic partnership with ADNOC is very important. Our hope is that we can continue to expand internationally, both with ADNOC Drilling, as well as there are some areas that make sense that the H&P operation would be there. Go ahead, John.

John Bell: Yes. John, as you said, we have, but now we're focused on just getting the rigs ready and getting the people on board to start up the rigs, but also support that we're in the process of fine-tuning a rig and then what framework we're doing with that will give us the structure we need to provide ADNOC with the support they need in areas like maintenance, supply chain, operational efficiencies, and so forth. That's really what we're focused on. We have had discussions with them about different ways we might approach certain countries and customers in the region, and we're open to looking at that, but there's nothing that we've firmed up at this point. Was that helpful?

Derek Podhaizer: Okay. Yes. No, I appreciate it.

John Lindsay: Yes. I think there's a real opportunity though on the partnership. I mean, I think this week has been a great example. We've had excellent meetings with ADNOC Drilling and they're very excited about the future. There are some obviously different service contracts and technology opportunities that we have to explore. Again, you said you saw the announcement, 5 million barrels, and they have a goal of getting to natural gas independence. A lot of that work is unconventional, and that really is a sweet spot obviously for H&P. Our hope is to be able to work closely with them to help them to achieve those goals, so it's a really exciting opportunity.

Derek Podhaizer: That's great. Switching over to the North America side, the contract coverage had stepped up pretty significantly quarter over quarter. Maybe if you could just talk to us about the confidence from your side and the willingness from the customer side to start locking in that pricing and term instead of keeping contracts on short term. It looks like you're now extending that out and getting more contract coverage across your total fleet, so maybe just spend some time walking us through that.

John Lindsay: Well, there are several factors. One is which has been talked about on reactivations. We want to make certain that when we're reactivating a rig, and these are $300,000.00, $400,000.00, $500,000.00 reactivation fees, and we want to make certain that we're either getting some lump sum or we're getting some term coverage to cover that cost. I think in general, customers are willing to lock in, and I think part of the reason why they are is because of the efficiencies and the start-ups that our people are able to provide. It's not unusual to see historically rigs start up and really struggle for several months, and our teams are doing a great job just starting right off the bat and, in some cases, even drilling record wells right out of the box. There are a lot of reasons why customers are willing and entering into these term contracts.

Again, we're going to continue to push on pricing. It's a really tight market as it relates to super-spec availability in terms of anything being ready to go. There's really nothing ready to go right now. Everything has been idle for well over a year. Does that answer your question?

Derek Podhaizer: Yes, very helpful. I appreciate it, guys. Thanks.

John Lindsay: Okay. Thank you.

Operator: We will take our next question from Ian Macpherson with Piper Sandler. Your line is now open.

Ian Macpherson: Hi. Thank you. Hello, John and Mark. How are you?

John Lindsay: Hi, Ian. Good. How are you?

Ian Macpherson: Great. Thanks. I wanted to ask if we could peek a little bit past fiscal Q1 towards the trajectory of your margins in U.S. because we see with the more expensive reactivations, it looks like your average reactivation cost per rig day is more than doubling in this quarter, but that should have improved with time, with better absorption and a deceleration of those costs. Then you have your rates being pulled up especially by the premiums are getting on expensive upgrades for walking rigs. I would imagine those dynamics should point us towards a pretty good inflection in your average daily margins. I just want to get more comfortable that will you see that happening in fiscal Q2, or do you see cost pressures or other dynamics maybe pushing that out into a later point in the year?

Mark Smith: Well, I appreciate the question, Ian. I think if I remember right, looking at consensus estimates had us adding 10 rigs in this quarter that we're giving guidance on, but we're going to be adding three times that. There's a directional factor of the sheer volume of reactivation expenses with that really heavy increase in activity.

To your point, coupled with the fact that, as I mentioned in the prepared remarks, we're also getting ready this quarter several rigs that will actually commence work right after the turn of the calendar year, so that's loading in some extra. On a per rig basis, I think we'll be pretty consistent at the end of the day.

As we look forward, we do expect the absence of that to be accretive. It just depends on how you do the math, but you could see anywhere from 500 to 1,000 at least per day accretion from the absence of that. Directionally, it's looking good for potential cash accretion, but there's going to be a question mark there, and that is we still expect more rig accretion in the first calendar quarter. It's just too early to have clear line of sight through to March 31, what that volume will be, but then we expect that our customers, especially public company customers, will hold the line pretty steady and maintain these new budgets from April through September of next year.

Ian Macpherson: Yes. That's very helpful, Mark. That's all I have. Appreciate it, guys.

Mark Smith: Thank you.

Operator: We will take our next question from Neil Mehta with Goldman Sachs. Your line is now open.

Neil Mehta: Yes. Thanks, Team. I appreciate the visibility on '22 capital spending, and I know 2023 is a really far away way and it's hard to get visibility but just how was – when we think about that CAPEX budget which was a little higher than consensus, how much of that is one time-ish in nature? As you look at '23, do you get more to a maintenance type of program that would [unintelligible] cash flow comes through in a more powerful way? Does that make sense? Any color that you can provide on the long term as opposed to just next year?

Mark Smith: Thanks, Neil. Great question. There are several things to consider when you consider the question. I think we're back into that. As I mentioned, historical $750,000.00 to $1 million per active rig range, but where that might go through time, who knows for certain, but I hope it's a little bit more muted through time. We're experiencing the obvious inflation that we're including in guidance for this year related to steel cost, etcetera. Plus, we had really, if you will, taken a holiday from operating our FlexRig Machinery Center in the last calendar year and we're having to get back in business recertifying top drives, BOPs especially, etcetera. Kind of a crank-up of work there that might normalize a bit through time as well.

Then the big question mark is what do our customers want to do related to walking rigs, as John and I went through a few moments ago? We've had interestingly in the churn of rigs this year, even the rig count stayed pretty steady and modestly increased in calendar Q2 and Q3. We had some customers that picked up skidding rigs and actually exited walking rigs, while other customers quickly absorbed those walking rigs. As has been evidenced by commitments, we're still seeing customers who want our design of a walking rig and commit to those, despite the availability of them in the broader market.

It's really just going to depend. As we move towards better term and better pricing for those commitments to get the right return on capital and the new investment, those can be easy decisions to make. It's just going to depend, Neil. Is that helpful?

Well, I will add one thing. Let me just add one footnote, that corporate CAPEX will come down. Once we get these IT projects done that has shifted from year-to-year, they're done, and some of these real estate matters will be done as well.

Neil Mehta: Yes, that is helpful. As we are all trying to figure out what normalized free cash flow power is, that's good clarity.

On the positive side, I want to talk about market share. Your market share levels, I think it's up to 26% now, which is above historical level. Can you just provide us your perspective on your ability to continue to maintain that market share? What are the key competitive threats that you're monitoring, and what confidence you can give to the market around your ability to sustain these types of [unintelligible]?

John Lindsay: Well, fortunately, we've had a track record coming out of downturns where we capture market share, so we fully expect that, at least, there's a management team. The company in general felt like we had the opportunity to do that. It's interesting over the last year, there has been about 235 net adds to the market rig-wise and 180 of those were from private companies, so 75% of the adds were private companies.

Now, we're the largest – and we still had the largest market share of the private company, and I think we were up to 16% of that share. The public companies – and, of course, they've only had 25% of that - we think it's probably going to go the other direction at least through Q4 and Q1 where we're going to see, at least based on the commitments that we have, about 60% of our commitments are public company, so there's a little bit of shift there and we've got about 31% of the public company market share.

Our hope is, is that we can continue to gain share. You say, well, why is that and how can you continue to do that? Well, I think a lot of - part of what I've already touched on is the ability to start up safely and efficiently and being able to really hit the ground running. We haven't talked about performance contracts this morning with the exception of our prepared remarks, but we have a lot of customers that are really interested in entering into win-win contracts. They see just like we do that the day rate contract really isn't structured to drive outperformance. Fortunately, we've had customers that are willing to enter into those new types of contracts.

I think that's a driver, and I look at all the work that we've put in over the last four or five years organizationally and just continuing to invest in our people and our systems and processes. We're utilizing data today better than we ever have, and that helps us in terms of driving better performance. At the end of the day, that's what our customers want, is they want better performance. They want, obviously, efficiency and reliability, and then there's an ESG component. Again, the data set that we have today and our ability we believe to be able to manage ESG at a better level than what our peers are going to be able to do.

Again, I think those are some things that are better ahead that, hopefully, we can continue to take advantage of.

Neil Mehta: Thank you, Sir.

John Lindsay: Thank you.

Mark Smith: Thanks, Neil.

Operator: We will take our next question from Scott Gruber with Citibank. Your line is open.

Scott Gruber: Yes. Good morning.

John Lindsay: Good morning, Scott.

Mark Smith: Good evening.

Scott Gruber: [Unintelligible]. [Laughter]. Just a follow-up on ADNOC.

John Lindsay: Good point.

Mark Smith: How are you doing, Scott?

Scott Gruber: Yes, I'm doing well. A quick follow-up on ADNOC. What's the vintage of the rigs being sold? Just the restart CAPEX and recertification can be somewhat deceiving when you're moving the rigs abroad. Then do you think there's an opportunity to sell more rigs to ADNOC down the road?

Mark Smith: Go ahead, John.

John Lindsay: Scott, when you say vintage, are you asking about rig type?

Scott Gruber: Rig type is the main question, but if you want to throw out ability as well.

Mark Smith: Scott, just I'll jump in on the rig. The vintage, it varies across the eight, and there's less sort of recertification work that we're going to be doing for some of the componentry, and there's more sort of some of the technical spec work. Remember, two of the eight are super-specs though. A lot of this is really the cost to get some of the six to Houston and get them across the Atlantic Ocean, the Mediterranean, and the final destination.

John Lindsay: Yes, that's the majority really. The expense is just getting it ready for international and just getting it over there. In terms of selling more rigs, we don't have plans to sell more rigs, but we're going to continue to put rigs to work on a number of ways, but we currently don't have any plans to sell them more.

Scott Gruber: I got you. It's only two that are super-spec. Sorry, I think I heard that wrong. I was thinking it was two that were not super-spec, but it's only two that are super-spec?

Mark Smith: Correct.

John Lindsay: The two that are here are not super-spec and then we're sending two over, and then the rest will be non-super-spec.

Scott Gruber: Understood. Okay, that makes sense. Then with respect to the rest of the international portfolio, just to confirm that the four rigs going to work with YPF, those are the incremental in Argentina?

Mark Smith: Yes. There's one that's going to work this quarter that has been planned for a [BEP], and then there'll be one I think in fiscal Q2 and two in fiscal Q3 at this stage. That timing could be subject to change, but all the remaining three after this quarter are planned for this fiscal year.

Scott Gruber: Got it. Just thoughts on…

Mark Smith: It's starting to get a little bit of scale back in the Vaca Muerta operations there, so I think that's some exciting news for the Argentina team.

Scott Gruber: Well, definitely. Just thoughts on potential incremental demand beyond what's contracted to go back to work in Argentina and Colombia because after those go back, you still have a fair bit of spare capacity on the international side. Any color on additional rig adds over the course of 2022?

Mark Smith: I'll let John comment further on customer specifics, but we don't have anything definitive. However, I will tell you that we are participating in bidding activity in both Colombia and Argentina today. John?

John Lindsay: Yes, that's right. We've seen interest pick up in both Argentina and Colombia. We've seen the big rig work in particular be of interest in Colombia and then, of course, Vaca Muerta with the gas plant that they've recently put in place is resulting in some rigs going back to work in the Vaca Muerta.

Scott Gruber: Excellent. Always [unintelligible]. Appreciate the color.

John Lindsay: Thank you.

Mark Smith: Thanks, Scott.

Operator: We will take our next question from Taylor Zurcher with Tudor Pickering. Your line is open.

Taylor Zurcher: Hi, John and Mark. Thanks for taking my questions. The first one, I just wanted to circle back on costs in the Lower 48. Clearly, some element of the cost increases. It's transitory with elevator reactivation costs, but a piece of that's going to stick with you on the inflationary side. I was hoping you could help us understand if we just look on a per rig basis where normalized costs are on a per rig basis after some of these reactivation costs temper down a bit in the back half of the year. We had $15,000.00, $16,000.00 a day or a different range on a per rig basis?

Mark Smith: Taylor, thanks for the question. There's a lot of moving parts in here. Besides reactivation costs, there are several things to consider. There's labor cost increases that we alluded to, which will be margin neutral that we have customer protection provisions and contracts. We also have - as we've moved away from our previously harvested inventory of the "penny stock" we've talked about in prior quarters and we're having to pull out a full day cost as inventory, there are adjustments there.

I will say though that I don't anticipate a lot of working capital lockup for that sort of thing, as we have implemented a lot of processes, policies, and systems improvements so that our warehouses are live in Oracle and people across the

United States can see all the warehouses. We've put in place min-max programs to manage the amount of buying that we do. Nonetheless, we will still see a little bit of maintenance cost to go up, but maintenance is not the largest component of OPEX. As you know, labor is. I would say I guess probably closer to $14,000.00 after all those moving parts, but we still have some time to go until we settle to the final number, I believe.

Taylor Zurcher: Okay, thanks for that. Just a quick follow-up on some of the smaller divestments you made in the U.S. plant, the partnership with Parker around TRS, and it sounds like you've also exited the trucking business. Can you just talk a little bit about what the benefits to HP are in terms of why you decided to ultimately exit those businesses? I know they're not core to the Lower 48 business but do add some additional revenue margin per day to your rig business. I'm just curious if you could help us think about why you're exiting those businesses and what the benefits are to HP.

Mark Smith: I'll start with a couple of the numbers things and let John expand otherwise. As we look at these, we have approximate proceeds initially that are modest of $6 million to $7 million which we'll be seeing coming out in our 10-K later today, plus the potential for more revenue-sharing through time. These are very much margin-neutral, so there's not a lot of accretion to our day margin. If you think about it, they are very capital-intensive businesses so as we focus on our capital spend through time, that was one of our considerations. Then there's a bit of just the time and attention that such margin-neutral businesses can bring for the management team. John?

John Lindsay: Yes. Taylor, it's a great question. We've had both of those services for a long, long time and at the end of the day, if you get right down to it, we could not grow those to significant scale. We just continue to believe year-after-year that we would get to scale from our customer base. I think it's just probably a function of the competitive nature out there for those particular services.

I think that probably the biggest thing for us is it simplifies what we're doing. It removes some complication as you just think about trucking. Running trucking is very complex and, as Mark said, it's capital intensive and there's a lot of training and risk. It's different than rigs and really kind of the same way with casing. It just didn't really fit our model. We hated [they're great]. Both the trucking and the casing are best-in-class. There's no doubt about it but again, it was very hard to grow it to the extent that we need it to.

Taylor Zurcher: Yes, understood. Thanks for the answers, guys.

John Lindsay: Thank you.

Operator: We will take our next question from Waqar Syed with ATB Capital Markets. Your line is open.

Waqar Syed: Thank you for taking my question. John, in terms of the contracted day rates comparing this quarter Q3 calendar to Q2, as you've added new rig contracts, has the contracted day rates gone up or if you look at maybe the forward calendar Q4, has the contracted day rate gone up sequentially or is it still declined?

John Lindsay: Well, Waqar, as you know, we're working really hard to get out of the day rate business and obviously, we came back into it. If you were to look at it on a day rate basis and you pull out the term contracts that were entered into at an earlier date at much higher rates, then yes, the quarter-over-quarter, it is increasing. I don't know the amounts.

Dave, there may be something that you can mention if you have that information. If you combine them all together because of the rigs that are rolling off of earlier term contracts that were at much higher rates, it has a negative impact on the overall margin and revenue.

Waqar Syed: This is one other on the same topic. How does the contracted day rate for the 82 or so rigs that are in a contract compare to the spot day rate right now?

Mark Smith: Oh, that's a great question, Waqar. Let me see. Hang on. As we consider what John just said about some rigs rolling off that are signed on term in a better market than even our increasing day rate market that we have today, I think as we just alluded to with a marquee price of $25,000.00 per day for a walking rig conversion that we're getting back to some better pricing level, in fact, we've had four existing term contracts in the standing spot customers. We've been passing through rate increases. Those don't all take effect at the same time, and we're still in negotiations with some customers about what that exact rate increase will be and when it will be. Suffice it to say that we are pushing the pricing and more of that's going to be to come.

Dave, any specifics on any numbers?

Dave Wilson: Yes. I'd just add, Waqar, on the pricing, it's very region-specific. There's a couple of regions where the difference between the spot and the term isn't that great, but then there are other regions like in the West where you're seeing still a disparity between the two, a couple 1,000 per day or something like that.

Waqar Syed: Okay. John, just one last question, if I may ask you. If we go back like different cycles, H&P has always had a premium margin over its competitors. However, that seems to have gone away, and depending on how you treat the H&P Technology contribution, it doesn't feel as if right now there is a premium embedded in the numbers. Do you think that as we continue into next year that you regain that margin premium or is it going to be more in line with where the competition is?

John Lindsay: Yes. I think if you look at individual contracts that we win, we're winning at a premium but obviously, these costs that we have, the reactivation costs and other costs that we're incurring, have caused some challenges. I think if you go back to the 2017, 2018, 2019 market, we did have a premium margin at that time. Yes, I fully expect that we'll continue to have premium margins over our peers.

You mentioned technology. No doubt, technology is going to play a larger role, and we're continuing to have adoption from customers. Again, we're continuing to work very hard on executing on new commercial models performance based and KPI. We have customers that love the model and they're willing to pay for a lot of the value that we provide, so more to come. We can talk about it all day. We just have to demonstrate it, right?

Mark Smith: I would just footnote, Waqar, that we're getting with these upticks that we're just guiding to and talking about in rig activity, we're starting to get back to absorption rates with our scale, which will help with that margin accretion and historical industry-leading margin.

Waqar Syed: Yes. Great. Thank you very much. I look forward to that. Thank you.

John Lindsay: Thank you, Waqar. We are too.

Brittany, I think - was that our last question?

Operator: That was our last question for today. I will turn the program back over to John Lindsay for any additional or closing remarks.

John Lindsay: Okay. Thank you, Brittany. Appreciate it. Thanks again, everybody, for joining us today. As mentioned, we're very optimistic about the future. We thank, obviously, our H&P FlexRigs, our digital solutions, and our best-in-class people, so we're looking forward to the future and we'll talk to you next quarter. Thank you.

END