Helmerich & Payne
Fiscal Fourth Quarter 2020 Earnings Call Transcript
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Operator: Good day, everyone, and welcome to today's Helmerich & Payne Fiscal Fourth Quarter Earnings Conference. 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. It is now my pleasure to turn today's program over to Mark Smith.

Mark Smith: Thank you, Christine. Again, our sincere apologies to all those on the telephone. We've had technical difficulties here with our webcast portion of this conference call although the telephonic portion is working just fine. So again, we do apologize. We appreciate your patience and your interest in H&P. In order to cure the problem, we will be posting the audio recording from this conference call within two hours from the conclusion. We will be restarting from the top. We apologize again. We will conduct a full on hour conference call. We hope you are available to stick with us and join us as we give you our fourth quarter fiscal '20 results and look ahead to fiscal 2021. I'd like to turn the call over now to our Investor Relations Director, Mr. David Wilson. Dave?

David Wilson: All right. Thanks, Mark. I'd like to re-welcome everybody to Helmerich &Payne's conference call for the fourth quarter and fiscal year ended 2020. Vice President and CFO. Both John and Mark will be sharing some prepared comments with us after which we'll open the call for questions.Before we begin our prepared remarks, I will remind everyone that this call will include forward-looking statements as defined in 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 place no 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 now to John Lindsay.

John Lindsay: Thank you, Dave, and good morning, everyone. This is yet another example that this fourth fiscal quarter is unprecedented in many ways and really challenging during the company's 100 year history. The destruction of oil demand induced by Covid is well documented and in terms of drilling activity, our rig count hit bottom in August. Despite the challenging quarter, our strong financial position has enabled us to remain focused on our long term strategies. Our people are developing new commercial models and innovative drilling and digital technologies that we believe will help transform the customer experience and shape the future of this business. These efforts have progressed despite this difficult environment and will serve as the foundation from which the company will build as the market continues to recover.

Our customer centric approach is one that prioritizes providing customized solutions by employing a combination of people, processes, rigs, and automation technology to deliver more value and lower risk for our customers. This approach is distinctive in the industry. It resonates well across our customer base and with further developments on the horizon, will be a major driver of growth as activity levels improve.

Excluding our two idle but contracted rigs, our current US FlexRig activity has improved to 80 rigs and we expect our active rig count will exit the first quarter at approximately 90 rigs. This is almost double the number of rigs turning to the right compared to the lowest level reached in August. The Permian has led the industry rig count recovery and H&P has earned approximately two-thirds of the incremental work in that basin. As we anticipated, our rig count growth has exceeded that of our peers coming off of the bottom, allowing us to recoup four to five points of market share. We believe that the quality of our field leadership, our rig crews, our FlexRig fleet, and our digital solutions will continue to advance this trend.

Concurrent with this increase in near term activity, we're also experiencing increased customer utilization of our performance based contracts and our rig automation software, AutoSlide. We expect adoption of both to increase and become more prevalent in the industry. H&P's touch of a button autonomous drilling approach is designed to optimize drilling in the vertical, the curve, and the lateral. These automated solutions include real time automated geosteering, rotary, and sliding execution and improved weld work quality and placement.

The uniqueness of our automated solutions is backed by a patented economic driven approach where the software not only makes optimal cost benefit decisions, but also directs the rig to execute thosedecisions without the need of human intervention. This improves reliability, enhances value, and reduces risk for our customers.Let me give an example of the H&P value proposition autonomous directional drilling provides. When customers use AutoSlide on our FlexRig, directional drilling personnel are no longer required at the rig site. This is possible because the directional drilling decisions are being calculated using an algorithm in our patented bit guidance system which can accurately process through thousands of variables in seconds rather than relying on the manual calculations of the traditional directional driller. The software enables FlexRig to allow the curve to be landed more accurately and reliably and the lateral to be placed more precisely in the shale which results in lower drilling cost, improved production, reduced long term maintenance cost for our customers, and lower environmental impact.

Commercial models that reward performance, coupled with rig automation software that enhances value, are being adopted across the spectrum of the industry. Mark will give additional details on performance contracts but we've been successful in expanding our customer base with a wide range of EMPs from super majors to small private companies. Today, H&P owns more than a third of the estimated 635 super spec rigs in the US market. With many rig count forecast ranging from 450 – 550 rigs over the next couple of years, we see significant further super spec FlexRig market share growth and opportunities for improved pricing.

H&P continues to invest in new and diversified technologies for the long-term sustainability of the company. Recently we have made investments in and are supporting the efforts of a few companies driving the evolution of the geothermal industry. The core of this evolution is a transition from geographically concentrated and naturally occurring hydrothermal resources to enhance geothermal systems and closed loop systems. The technologies and techniques these companies are exploring are expected to improve project economics leading to the ultimate scalability of geothermal as a source of energy. The growth potential of unconventional geothermal energy applications represents a new opportunity for H&P to increase the utilization of its install FlexRig asset base along with our digital technology solutions.

Our leadership position at the drilling solutions provider is a natural fit for the evolving geothermal markets. This is driven in part from our technology offerings that have already been utilized by some geothermal companies in Europe and our proven success in unconventional oil and gas drilling in the US and internationally. Modern geothermal drilling applications require the benefit that autonomous drilling and digital technology deliver for weld work quality and placement.

Before turning the call over to Mark, I wanted to thank all of our teams that are fully engaged with our customers and working hard to deliver on several strategic objectives that I have described. We are encouraged by the successes but we are also cognizant that a substantial amount of uncertainty remains in the markets surround the impact of the pandemic. It may take several quarters to understand what the new normal activity environment will look like. That said, I continue to be impressed with our team’s ability to manage through this difficult time and particularly the diligence they have demonstrated in keeping our employees’ and customers’ health and safety top of mind. Now I’ll turn the call over to Mark.

Mark Smith: Thanks, John. Today, I will review our fiscal fourth quarter and full year 2020 operating results, provide guidance for the first quarter and full fiscal year 2020 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, 2020. The company generated quarterly revenues of $208 million versus $317 million in the previous quarter. The quarterly decrease in revenue is due to further declines in our rig count caused by the energy demand destruction associated with the Covid-19 pandemic as well as lower early termination revenues compared to the prior quarter. Correspondingly, total direct operating costs incurred were $164 million for the fourth quarter versus $207 million for the previous quarter.

General and administrative expenses totaled $33 million for the fourth quarter, lower than our previous guidance. During the fourth quarter we closed on the sale of a portion of our real estate investment portfolio comprised of six industrial developments in Tulsa, Oklahoma for $40.7 million which had an aggregate net book value of $13.5 million. The resulting gain of $27.2 million is reported as a sale of assets on our consolidated operations. As mentioned in the press release, the sale of these properties was contemplated well ahead of the pandemic however, the pandemic did delay the sale process. Our Q4 effective tax was approximately 28% as we recognize an Oklahoma tax benefit related to the sale of our industrial properties in the state net operating losses.

To summarize this quarter's results, H&P incurred a loss of $0.55 per diluted share versus a loss of $0.43 in the previous quarter. Fourth quarter earnings per share was positively impacted by a net $0.19 gain per share on select items as highlighted in our press release and this primarily pertains to the industrial portfolio real estate sale. Absent these select items, adjusted diluted loss per share of $0.74 in the fourth fiscal quarter versus an adjusted $0.34 loss during the third fiscal quarter.

For fiscal 2020 as a whole, we incurred a loss of $4.60 per diluted share. This was driven largely by the $563 million non-cash impairment announced in our second quarter, as well as other select items including our restructuring charges and marked to market losses on our legacy securities portfolio. Collectively, these select items constituted a loss of $3.74 per diluted share and absent these items, fiscal 2020 adjusted losses were $0.86 per diluted share. Capital expenditures for the full fiscal 2020 totaled $141 million, below our previous guidance due to a combination of ongoing capital efficiency efforts as well as the timing of the small amount of supply chain spending that crossed into fiscal 2021. This annual total is a reduction of $145 million from our initial fiscal 2020 budget and a reduction of over $315 million from fiscal 2019 capex.

H&P generated $539 million in operating cash flow during fiscal 2020, representing a decrease of approximately $317 million. I will note that our cash and short term investments balance increased by $176 million sequentially year over year, which I will discuss in more detail later in my remarks.

Turning now to our three segments beginning with the North America Solutions segment. We averaged 65 contracted rigs during the fourth quarter. Approximately 15 of which were idle but contracted and on some form of cold or warm stack rate. I will refer to idle but contracted rigs with the acronym IBC hereafter. This contracted average was down from an average of 89 rigs in Q3. During the fourth quarter we bottomed at 62 rigs contracted with about 16 IBC rigs, resulting in 46 active rigs at the low activity point. We exited the fourth quarter with 69 contracted rigs, of which 11 were IBC. The exit count was slightly above our guidance expectations as demand for rigs found footing from the bottom late in the quarter.

Revenues were sequentially lower by $105 million due to the aforementioned activity decline as well as the IBC count. Included in this quarter's revenues were $12 million of early termination revenue. North America solutions operating expenses decreased $43 million sequentially in the fourth quarter, primarily due to reduced activity and the proactive operating initiatives at the field level that I discussed during the third quarter call. That said, the sustained decline in rig activity during the quarter did cause per day expenses to increase on a per revenue day basis.

Expenses absorbed in the field include overhead for our filed management in maintenance organizations, ongoing stacking costs, consumption of on hand average cost to inventory as we exhaust penny stock, and limited reactivation costs for rigs returning to work. Further, we had higher than expected self-insurance expenses including numerous former employees on continued health and welfare benefits that will mostly expire towards the end of the first quarter fiscal 2021.

One comment to put these self-insurance expenses in context. Our prior period self-insurance claims were generated with higher average rig activity but some of these incurred but not reported claims are just now being developed wherein current operations are much smaller. While we see both positive and negative volatility in our claims expenses as we true up the estimated liability each quarter, the percentage impact is more pronounced when our operations are smaller as they are today.

Now looking ahead to the first quarter of fiscal 2021 for North America solutions. As I mentioned earlier, we exited Q4 fiscal 2020 with more rigs contracted and running than expected. The activity level has continued to grow as operators add rigs with oil hovering around $40.00 per barrel. As of today’s call, we have 82 rigs contracted with only 2 IBC rigs remaining. The market remains uncertain with macro Covid demand pressures, political uncertainties, and forward crude supply balances. In all but two situations, operators with idle but contracted rigs have put them back to work and we are winning select opportunities for incremental rigs. We expect to end the first fiscal quarter of 2021 with between 88 and 93 contracted rigs and we also expect the remaining two IBC rigs to return to work in late December or early January. While the decrease in IBC rigs will not increase our contracted rig count, it will be accretive to activity and margins. Almost all of these IBC rigs are on term contracts at rates entered into during the previous super spec upgrade cycle. As John discussed, our performance contracts are gaining customer acceptance and of the approximately 21 rigs we have added or are expecting to add to the activity H&P rig count, after September 30 through December 31, just over 30% are working under performance contracts.

As we mentioned in the May and July calls, our focus on solution based performance contracts has driven us to evolve the nomenclature we use to present our business with investors. We began the transition as we shifted our segment guidance to focus on the segment margins driven by our rig and technology solutions rather than individual rig rates. We will complete this transition as we move forward into fiscal year 2021 and stop publishing per day information in the segment table in our future press releases.

In the North America solutions segment, we expect gross margins to range between $40 million to $50 million, with approximately $1 million of that coming from early termination revenue. This margin guidance is greater than the prior quarter in total and further, it is not impacted in any significant way by early termination revenue. However, Q1 margins will be temporarily adversely impacted by reactivation costs as we rapidly add rigs from the recent bottom and re-commissioning costs for a couple of walking rig conversions. Our current revenue backlog from our North America solutions fleet is roughly $555 million for rigs under term contract but importantly, is not inclusive of any potential performance bonuses. This amount does not include the aforementioned $1 million of early terminations expected in Q1.

Regarding our International solutions segment, International solutions business activity declined from 11 active rigs during the third fiscal quarter to five active rigs at fiscal year-end. This decrease is the result of rig releases in Argentina and Abu Dhabi due in large part to the ongoing Covid-19 pandemic. As we look toward the first fiscal quarter of 2021 for international, our activity in Bahrain is holding steady with the three rigs working while our two rigs in Abu Dhabi and our entire Argentina and Colombia fleets are now idle.

In Argentina, we continue to work within an arduous regulatory environment, which has prevented us from reducing labor costs to levels that are more in proportion with reactivity potential. This will lead us to incur a legacy cost structure into at least the first quarter and will cause international margins to be negative. In the first quarter we expect to have a loss of between $5 million - $7 million apart from any foreign exchange impact. We still have a pending rig deployment in Colombia, but it has been delayed as our customers still waiting on other part regulatory approvals to begin work. On the marketing front, our international business development team is seeing some bidding tendering activity in Argentina, Columbia, the Middle East, and certain other markets. At this juncture these prospects are early in the process and are not included in our forward outlook.

Finally, turning to our Offshore Gulf of Mexico segment, we have four of our eight offshore platform rigs contracted. Offshore generated a gross margin of $4.6 million during the quarter, below our estimates in part due to unfavorable adjustments to self-insurers reserves related to a prior period claim. The previously mentioned gross margin also includes approximately $1 million of contribution from management contract rigs.

As we look toward the first quarter of fiscal 2021 for the offshore segment, we expect that offshore rigs will generate between $5 million to $7 million of operating gross margin with offshore management contracts contributing an additional $1 million - $2 million.

Now let me look forward to the first fiscal quarter and full fiscal year 2021 for certain consolidated and corporate items. As we discussed in our May and July calls, we implemented numerous right sizing efforts by reducing capital expenditures, reducing North America solutions overhead, right sizing selling general administrative overhead, and taking similar actions in the international segment where possible. As mentioned, we're continuing to assess our internal offices to appropriately calibrate for activity. In all areas, we will continue to identify cost reduction opportunities and drive efficiency in our daily work activities.

Capital expenditures for the full fiscal 2021 year are expected to range between $85 million to $105 million, which is a reduction of approximately 33% to fiscal 2020 capex. This capital outlay is comprised of three approximately equal buckets.

First, maintenance capex to support our active rig fleet. Given current activity levels, we have sufficient capacity to minimize new maintenance capex expenditures for the foreseeable future. As you may recall in fiscal 2019, we had both purchases in capex to scale up rotating componentry for a then 200 plus working super spec FlexRig rig count. In addition, we continue to harvest components from previously impaired and decommissioned rigs to conserve capital. As such, we expect fiscal 2020 year maintenance capex will range between $250,000 to $400,000 per active rig in the North America solutions segment; well below our prior year guidance of $750,000 to $1 million.

Second, skidding to walking capability conversions. For the customer with a want or need for walking rigs, we will invest to convert certain rigs from skidding to walking pad capability in exchange for a term contract. As opposed to competitors, our walking rig capacity is fully utilized. We have select customers who prefer certain rig design elements and are willing to enter into a contract with at least a year of term to enable that investment. We estimate walking conversions to approximate $6 million - $7 million per rig.

Third, corporate capital investments. The majority of this bucket is comprised of modernization for data center, data and analytics platforms, and enterprise IT systems. Our onsite data center has elements at the lifecycle renewal stage and we are seizing the opportunity to move to both co-located data centers and cloud computing configurations that will be less capital intensive prospectively. The data and analytics modernization focuses on a cloud forward approach for increased capacity and scalability. In the enterprise IT systems arena, we're implementing a new human capital management system to better accommodated how we manage our diversified and dispersed employee base including all phases of the employment cycle and employee experience. Finally, a smaller amount of corporate capital is being allocated to office build outs as we reconfigure for new flex work arrangements with enhanced office capabilities that can facilitate smaller forward office footprints.

Depreciation for fiscal 2021 is expected to be approximately $430 million. This is approximately $50 million less than fiscal 2020 primarily due to the second quarter impairments of non-super spec ratings and associated capital spares.

Our general and administrative expenses for the full fiscal 2021 year are expected to be approximately $160 million. The decrease sequentially is driven by our right sizing efforts as discussed in the July conference call. We believe our restructuring will enable us to achieve activity growth going forward without significant accretion of SG&A.

We are continuing our investment in research and development through the cycle as we push towards autonomous drilling. Such innovation efforts will yield the next solution offering from our technology roadmap. We expect R&D expenditures to be approximately $30 million in fiscal 2021.

The statutory US federal income tax rate for our fiscal 2021 year end is 21%. In addition the US statutory rate, we’re expecting incremental state and foreign income taxes to impact our tax provision, resulting in an expected effective income tax rate range of 19% - 24%. Based upon estimated fiscal 2021 operating results and capex, we’re projecting a decrease to our deferred tax liability with no resulting material cash tax.

Now looking at our financial position. Helmerich & Payne had cash and short-term investments of approximately $577 million at September 30, 2020 versus $492 million at June 30, 2020. Including our revolving credit facility availability, our liquidity was in excess of $1.3 billion. Our debt to capital at quarter end was about 13% with a positive net cash position as our cash on hand exceeds our outstanding bond. Our debt metrics continue to be a best in class measurement amongst our peer group. As a reminder, we have no debt maturing until 2025 and our credit rating remains investment grade.

Now a couple of notes on working capital. We earned cash flow from operations in the fourth quarter of approximately $93 million versus $214 million in the fiscal Q3. Our trade accounts receivable at fiscal year-end was approximately $150 million with the preponderance being less than 60 days outstanding. Our inventory balances reduced $9 million sequentially from June 30 to $104 million at September 30 as we have leveraged consumables across the entirely of US basins and it reduced our min/max curing targets to reflect the new activity levels. As mentioned in the previous call, we commenced a project to optimize our accounts payable terms and negotiate additional early payment discounts from suppliers. These efforts continue to bear fruit during the fourth quarter. We expect further benefits, but the impact will be relatively modest in comparison to what we have realized to date.

The macro environment in fiscal 2020 drove capital allocation decisions, cost management measures, and the right sizing of the company to new activity levels. These collective efforts undertaken to date are aimed at generating free cash flow that, when combined with the modest uses of cash on hand, will cover our capital expenditure plan, debt service cost, and dividends in fiscal 2021. Based on our budget for 2021 fiscal year, we expect to end fiscal 2021 with cash and short term investment of approximately $450 million - $500 million. The maintenance of our balance sheet strength and liquidity are foundational elements in our 100 year tradition of capital stewardship and they continue to be a significant differentiators in this volatile and cyclical industry.

That concludes our prepared remarks for the fourth fiscal quarter. I want to once again say thank you to all of you on the phone call for sticking with us through our technical difficulties. We look forward to answering your questions. Now let me turn the call over to Christie for those 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 to ask a question. We will take our first question from Ian MacPherson from Simmons. Ian, go ahead.

Ian MacPherson: Good morning, guys. I'll ask both of mine upfront. John, I wanted to ask if you could elaborate at all on sizing that geothermal opportunity in terms of rigs over the next couple of years. Then also for either of you, if you could just sanity check my math for me. It sounds like your gross profit per US land rig is going to be up quarter on quarter if you take out the termination revs that mostly go away. So given that and also the phasing of IBC distortions, it sounds like we had at least a temporary bottoming positive inflection of cash margins and I think that's correct. Do you see that as a durable bottom with some positive momentum going beyond this as you get into more spa day rates over the course of the coming fiscal? So just those two questions. Thanks.

Mark Smith: Ian, yes. Thanks for the questions. Good morning and thanks for sticking around for 48 extra minutes. As to your second question first, yes, we do see the coming off of the bottom and the inflection point and all the drivers you just mentioned with cash flow and margin accretive point forward. Don't know if you had any other details there you wanted to tease apart.

Ian MacPherson: Really, it sounds like it's about a $5,500 implied gross margin per rig day in Q1. You have some cost relief coming after that and do you think that's an absolute bottom this cycle for your cash margins is essentially the question.

Mark Smith: Well, given the macro uncertainties I think through, I hate to call anything an absolute [Laughter], but certainly from...

Ian McPherson: Based in the context of the free cash flow budget that you laid out. I think maybe it is, right?

Mark Smith: I think that's correct, Ian. Absolutely.

John Lindsay: Hey, Ian, again on the geothermal, it is really early days, we've got several investments out there. I think what's important is that this is a new approach. It's much different than the geothermal industry that we've all dealt with for decades really in some respects. So, I think that the idea of close loop-type systems utilizing horizontal grilling being able to drill in areas that don't typically have geothermal systems, I think, will make a big difference. So, it's hard to size it at this point, but there'll be more to come on that.

Ian McPherson: All right. I'll stay tuned. Thanks, guys.

John Lindsay: Thank you.

Operator: We will take our next question from Kurt Hallead with RBC.

Kurt Hallead: Hi, how are you guys doing?

Male: Hi, Kurt. Hey, we're doing great. How about you?

Kurt Hallead: Doing well. Doing well. Thank you. I guess the – I wanted to follow up first initially just, Mark, you gave some very explicit guidance to where you thought the cash was going to be at year-end 2021 so I appreciate that, that color commentary. It looks like you expect to be at the big point of that maybe roughly free cashflow breakeven. It seems like you're going to get some positive release from working capital throughout the course of the year. At least, that's what my initial math would show. Is that going to jive with the way you're looking at things?

Mark Smith: I have, well, a little different twist on that, Kurt, because I think we've gotten through a lot of the working capital benefits. In fact, I would expect working capital to flip as activity increases. In terms of free cashflow, I share the potential year-end range you just alluded to. There are a lot of moving parts here between activity and pricing and working capital. If you think about the $577 million cash equivalent in short-term investments on hand, you back out the $108 million dividend, back out another - the midpoint of our capex range is $95 million add back asset sales which are primarily tubulars of $20 million and then the difference that you could plug there is more or less the cashflow that we'll be having from operations.

Kurt Hallead: Right. I appreciate you walking through that detail. Now, John, obviously you've – Helmerich & Payne has developed a very strong reputation over time with delivering a good value proposition for the client base. It looks like we're clearly – the marketing is shifting and underway towards shifting, and you look like you're going to be at the forefront of this value proposition whether it's on the automated filling software, or now you're kind of teasing out some context around the geothermal market. I just wonder if you can give us a little bit more color around what kind of market penetration you have seen already for the AutoSlide? What you expect to potentially get over the course of the next 12 months? Then since you've already teased the geothermal dynamic and the GT (geothermal) since it's going to be quite a bit different than what historically has been the case, what would you think the addressable market on the geothermal opportunity could be?

John Lindsay: Thanks, Kurt. I'll start with AutoSlide. The autonomous drilling platform is really powerful. You touched on it and you picked up on this opportunity early. I might stress with – we started our journey towards where we are today on automation in 2015 and '16 in terms of just trying to figure out a strategy. Then, of course, we made a couple of acquisitions Motive and MagVAR in 2017, and we've made two additional acquisitions since then. So, we're really pleased to see that it's starting to take shape in the current environment. The AutoSlide numbers continue to grow. We're pleased with that. I think the thing to keep in mind is that AutoSlide, the decision in June, for AutoSlide is the bit guiding system which was Motive product, and that's a patented process. One of the things that's really interesting about that and important for customers is that it makes economically-driven decisions. Each customer can customize the algorithm to their needs which is really important. The algorithm is making decisions on cost-benefit basis, and it's taking three costs into mind with time towards tortuosity and proximity to the pay zone.

As you start thinking about that, that's differentiated compared to what a lot of products, if you will, are talked about out in the marketplace. I think the true test of that is seeing how the adoption is going. So, obviously you have customers start with one rig and we've had many customers that go from one to three, one to five. Recently, we've had a couple that have gone, at least, their forward plan is to go to all six or all eight of the rigs that they have operating. It's still a work in progress, and we're continuing to layer on additional capabilities with AutoSlide. We'll talk more about that in the future.

Again, on geothermal, it's really early days, but what needs to happen is you need to have these new technologies and these new ideas work out. So, there is growth potential for us because these geothermal energy applications are with the focus on utilizing our installed flex rig asset base, again, which would be great. It'd be great for H&P, and it'd be great for sustainability. So, again, we'll be updating more on the progress on activity opportunities in the future.

Kurt Hallead: Great.

John Lindsay: Thanks, Kurt.

Operator: We will take our next question from Scott Gruber with Citi Group. Scott, go ahead.

Scott Gruber: Good morning.

John Lindsay: Good morning, Scott.

Scott Gruber: Just a quick follow-up on the cashflow discussion from earlier. I just want to unpack a little bit more. Mark, can you provide any additional color on the working capital range that you're contemplating in your forecast for '21?

Mark Smith: Not much more than the large amount of detail I've already unpacked, Scott. [Laughter]

Scott Gruber: All right. I thought I'd try. This is more the high-level question. You guys have introduced a number of compelling technologies, especially AutoSlide, internally, how are you measuring the return you're getting on your R&D investment as you start to layer on more and more investment on the rigs? Based upon the publicly available data that you released, especially, given the changes in recording structure, what should we be watching to think about the return you're getting on your R&D investment?

Mark Smith: I appreciate that. I'll let John chime in here as well, but I think one of the things that to me is most interesting about that return is what we are just observing as we speak today. I mentioned that we are basically at the midpoint of our exit guidance for fiscal Q1. It's about 90 rigs. So, if we exited at 69, you're adding back 21, and we say that over 30% of those are being added back around performance contracts. We were seeing an accretion in North America Solutions market share, and that's really driven by the technology that we can deploy through these performance contracts. That's really doing our competitive position with customers and our differentiation in the marketplace to accrete market share. Then as importantly, do it in a different manner through the performance contract, which allows for potential upside performance bonuses based on the KPIs which, if they are received, and actually, the targets are met and we are paid that would be accreditive to the backlog that's booked for these contracts.

John Lindsay: I would add on to that, Scott, that – and everybody knows this, but new technologies and adoption rates are challenging in the best of markets. Then when you consider the type of market that we've seen over the last several – well, all through 2020, that's a challenge. What I'll leave you with is I can assure you the early days of the flex rig were not – it wasn't easy to see the return on invested capital that we were going to get, that we ultimately did get what the flex rig which was a technology offering. It was a differentiated offering. The good news with AutoSlide and our other digital solutions and software is that it is low-capital intensive. We fully intend to get returns, and we'll be more transparent with that over time.

Mark Smith: As John has said before, downturns are opportunities, and we really feel like we've hit a tipping point in an upturn in performance contracts and in an upturn in the actual number deployed AutoSlides that we have working. All of that, as I mentioned, with the potential to hit those performance targets is potentially margin accretive.

Scott Gruber: I understand the uptick. It seems to be really reflecting the appetite for the technology. I think the investor base just wants a little bit more color on the margin impact after we get through the contract roll. If there's any color that you guys want to provide on how it will accrete the margins for the segment, and in fact the margin profile, I think would just be helpful.

John Lindsay: It will be evident and we'll see that overtime. I appreciate that.

Scott Gruber: I appreciate the call. Thank you.

John Lindsay: Thank you.

Operator: We will take our next question from Taylor Zurcher with Tudor & Pickering & Holt. Taylor, go ahead.

Taylor Zurcher: Hey, good morning. In the US, it seems like most EMPs are targeting some sort of product maintenance budget next year, and that's driving a lot of the recent ramp in the rig count. I wonder as you look into the calendar year, 2021, how far do you think we're in that process, the process being operators ramping it up into that maintenance program. Maybe is there a different way looking beyond the 12/31 of 2020? Do you have any visibility today to further increases in the rig counts above and beyond that 90-exit rate you've pointed to?

John Lindsay: Sure. we can give you some additional color on that. I think one of the things to think about with this recent increase, and it really started at the beginning of our fiscal year after hitting the bottom in August. We were talking about this for several months that the budgets, the ultimate budgets, that customers and E&Ps had cut down to was after successive reductions to their budget. I think the budget expectation was probably set in the $25 or $30 oil price environment not with the $40 oil price environment that we've been experiencing over the last several months. I think with that, obviously, the really low activity levels we weren't surprised to see the rig count beginning to grow.

We're pleased with that customers are remaining disciplines. We felt like all along that we would be at the leading edge of that growth once customers started getting back into the game. One of the things I'm really excited about in this is that not only have put most of the idle contracted rigs back to work, the other half of the rigs we put to work have been rigs that we have competed on in the marketplace. We've done very well. We've expanded our customer base. I do think that, like we said, we're going to close the fiscal year, we hope at around the 90 range. I think there is some potential. We see additional activity in January and February possible. Again, as you heard me say over time, it's hard to see out further than 90 days, but we do think we're going to have some additional increases as we get into 2021, probably mostly in the first quarter.

Mark Smith: You said fiscal year, but I think you mean close the calendar year at 90.

John Lindsay: I'm sorry. Yes, close the calendar year. Thanks, Mark.

Taylor Zurcher: Thanks for that. My second question is on international. Some of the cost and efficiency problems in Argentina have been well-documented, and obviously that's a market that has taken it on the chin following the pandemic. Looking out over the full fiscal year of 2021, we've already seen some improvement off the bottom in Argentina industrywide. I wonder if you could frame for us what sort of demand levels as COVID starts to become more of a rearview mirror type issue. What sort of demand levels that you'd expect out of Argentina maybe exiting 2021 or what we could grow into over the course of 2021?

Mark Smith: Well, in Argentina, we have seen some interest pickup, but perhaps not as much as has been discussed in some of the industry chatter we hear, because most of the rigs going back to work that we have seen are either workover rigs or rigs that are returning to work after contract suspension due to COVID-19. The aim there really might be to get quick access to a production increase compared to any new developments. We are seeing some tendering activity take place, and these opportunities are typically a year or less in duration and have some onerous terms in compensation relative to the length of term. So, while there are some opportunities in Argentina, COVID-19 is still a factor, as is the lower commodity price environment, as well as currency issues and other issues related to that jurisdiction. So, that's really kind of our current view on it.

Mark Smith: Thank you.

Operator: We will take our next question from Chase Mulvehill with Bank of America.

Chase Mulvehill: Hey. I guess the first question I wanted to ask is about the guidance on the North America Solutions segment. I guess margins maybe came in a little bit softer. Obviously, you gave a good rig count guide, but if you think about the margin profile, maybe that's a little bit softer than some had expected. So, maybe could you just help us understand whether the softer than expected kind of margin guidance was more of a function of kind of soft day rates, or is it kind of elevated OPEX per day as you're looking to kind of reactivate rigs? Then when you answer that, if maybe you could speak to where you think that margins - I don't know if you're going to talk to margin percentages or cash margin per day, but where you think that you can get margins to overtime as the horizontal rig count kind of climbs back towards 500 rigs?

Mark Smith: I'll just share a couple of thoughts there. Thanks for the question. As I mentioned in the prepared remarks, there are a lot of transitory costs in Q1. Reactivating 21 rigs, as you know, was just over 30% of was the year ending rig count at the end of the fiscal year. So, that's a big rapid uptick, and there's a lot of cost in there related to rig reactivation and also related to, as I mentioned, commissioning a couple of walking rig conversions. As we have talked about before, we're trying to get away from per day discussions, but I will tell you, there will be some margin uplift as those rigs continue to work point forward.

Chase Mulvehill: Okay. All right. If I can just follow up on kind of the rig count? This may be the last time I can ask you on the rig counts, so I'm going to take advantage of it. You talked about exiting at about 90 active rigs. If we think about historical share of the horizontal rig count, your historical share, that would put kind of the industry rig count in about 325 horizontal rigs at the end of the year. So, that's adding another 60 or so rigs through the end of the year for the industry. Does that sound reasonable for an industry rig count towards the end of the year and your kind of 26%, 27%, 28% market share of the horizontal rigs? Then also, when we think about adding rigs through the end of the year, do you think it's going to be more weighted towards public E&Ps, or private E&Ps?

John Lindsay: Answering your second part first, I think it's going to be a mix. So far we've seen a nice mix between both the small privates, as well as our traditional customer base going back to work with the idle but contracted rigs. So, it's been a nice mix on that. I think when you think about the rig count, I think your numbers are in line. At the end of the day, it kind of depends on what H&P's market share is because that's the knowledge that we have. So, in a 90 rig count for H&P and we have 25%, obviously there are 360 rigs running. So, we think we're going to continue to capture additional market share. You've seen several reports that show 400 to 420 rigs. I think we can get there in the second or the first calendar quarter to second calendar quarter of 2021. I think as you look out a year or two, I think it's reasonable that you could see 450 to 550 rigs working again. Why that's important is because, again, back to the 630 or so super-spec rigs. With 450 to 500 rigs running, you're in that 70% to 80% utilization where historically in our industry you've seen pricing power.

I think the other thing to keep in mind is of that 630 rigs, not all of those rigs are created equal and are not going to be as highly sought after. So, I think that gives us some encouragement that we're going to, one, have rigs going back to work, and two, have some pricing. Back to the commercial models, it's so easy to fall back into the day rate conversation. What we really want to continue to focus on is new commercial models. I want to first give a shout out to our folks. I give them a lot of credit for undertaking this challenge. It's tough to think about retiring the dayrate - we've had dayrates around for decades - and to add new commercial models that are really more attractive and deliver higher levels of value for our customers.

So, we really think that we're creating an economic surplus for our shareholders and our customers together. So, we just think that there's a great opportunity for these new commercial models. Obviously, the easiest thing to do is to kind of fall back into the day rate focus and margin per day focus, but you'll be hearing more from us on that as the picture comes together.

Chase Mulvehill: Perfect. I appreciate all the color. I'll turn it back over.

John Lindsay: Thank you.

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

Waqar Syed: Thank you for taking my question. John or Mark, your guidance of 40 to 50 million dollars for gross profit margins in the US solutions, what are you assuming for what kind of benefits you're going to get from performance-based contracts in that? Is that range purely driven by activity levels, whether you end at 88 to 93 rigs, or is there something for how the performance-based contracts are going to shake out?

Mark Smith: Well, Waqar, I appreciate the question. From a GAAP perspective, if you think of backlog - and we try to do all of our work, as you know, very conservatively here at H&P. So, if you think about how the GAAP backlog calculation works, it's at the "base day rate." So, by way of example, if you get to the end of a well and you have metrics tied to that well and you get an uplift for hitting performance targets, you book at the end of a well when it's been earned. So, it's not in the backlog. So, said differently, our budgeting really focuses along a GAAP line of sight, if you will. So, we do have some upside potential with margins with the growing number of performance contracts.

Waqar Syed: Typically, these wells are taking, let's assume in a ballpark number, 20 days. Presumably, there will still be a number of wells that would have been completed in the December quarter where, if you generate performance-based contracts, you could recognize that. Is that fair?

Mark Smith: That's fair, yes. Again, it's a small but growing portion of the fleet. The potential upside there, I think we'll see more of that actually through calendar of 2021, within the first fiscal quarter.

Waqar Syed: So, then to that point in terms of your free cash flow or cash flow guidance that you provided, what are you assuming for performance-based? Are you assuming some performance-based contract contribution in 2021 in that guidance, or that is going to be that may come? When that happens, then you'll include that?

Mark Smith: Well, Waqar, in our business in good times, it's hard to see past a quarter ahead, as you know.

Waqar Syed: [Laughter]. Yes.

Mark Smith: Where we are today, looking at that exit count for the first quarter of approximately 90 rigs, with all of the uncertainties I talked through earlier - the macro, you have the ongoing COVID demand issues with energy, supply and balances, the geopolitical concerns, etcetera, etcetera - we really for our budgeting purposes have taken that 90 rigs, and in a conservative manner in which we provide stewardship of our balance sheet, we've really flat-lined that for the rest of the fiscal year. We'll be updating that each quarter with our forecast as we move through time, but that's our conservative outlook today.

Waqar Syed: Okay. Then, John, in terms of international activity, you mentioned Abu Dhabi rigs are down right now. Any thoughts? Now those are contracted. So, would they be coming back on sometime, let's say, next year calendar year?

John Lindsay: No, I think those rigs in Abu Dhabi, their contracts either had early termination, or those contracts are closed. Those rigs are idle. We don't have any additional contract term left.

Waqar Syed: So, for the international business, the guidance that you have provided for the next quarter, that is as bad as it's going to get, and probably as you manage your cost, maybe the revenues don't change, but the cost could come in through the course of the calendar year or next year?

Mark Smith: As you move in through calendar '21, a couple of things. Yes, we're going to, as we mentioned in the remarks, work on cost, especially those costs related to the legacy-sized structure in Argentina. Also, as I mentioned, we are seeing quite a bit of potential revenue possibilities. Again, it's too early days to put any of those into our forward outlook, but we are participating in a number of bidding and tendering activities in the places we have rigs today and also in new jurisdictions where we do not.

Waqar Syed: Okay. Now things move slowly internationally. Do you think that the best case scenario if you pick up a couple of rigs, is that still from a calendar year perspective second quarter, or a third quarter kind of possibility?

John Lindsay: Waqar, as you know, it is so hard with a potential second wave with COVID. International was started late. It slowed down much later than the US market. So, it's just really hard. It's really hard to call at this stage. We don't have any indication that things are going to get better in the next couple of quarters. Obviously, we can be surprised to the upside, but we sure don't see anything right now.

Waqar Syed: Sure. Thank you. That's all I have. Thank you for your answers.

John Lindsay: Thanks, Waqar.

Operator: Once again, if you would like to ask a question, please press the * and 1 on your touchtone phone. We will take our next call from Chris Voie with Wells Fargo.

Chris Voie: Thanks. Good morning.

John Lindsay: Good morning, Chris.

Chris Voie: Hi. So, the number of term-contracted rigs has come up a little bit. Has there been much competitive bidding yet, or is it still mostly direct negotiations? If so, can you comment on whether those rates are dilutive to the average implied in the first quarter, or if maybe they're stable quarter-over-quarter of step down? I guess the context here is that it sounds like you have confidence in leading edge margins, granted there's a performance-based overlay. We have to have an estimate for that. It sounds like you have confidence in that maybe bottoming. So, I'm just curious if there is much competitive bidding that's backing that up.

John Lindsay: I'll give a little color on the bidding and the term contract. I'll have Mark give a little more color on whether that's dilutive or not. Several of the rigs that we've re-contracted were competitive bids, and we did enter into some term contract coverage. It's generally six to 12 months. So, that's a positive. Obviously, those overall margins would be lower than historically when we were getting term contracts for during the super-spec upgrade process. Overall, it has been competitively bid, and we are getting some term contract. Mark, anything else to add on?

Mark Smith: No. I would just remind you that some of those IBC rigs we have that are coming back into the active turning to the right mode are accretive to our current margins because they're on those legacy term contracts that we entered into during the upgrade cycle.

John Lindsay: Right. Some of those term contracts that I mentioned that we competed for are also on a performance-based contract. So, while there may be a base margin that we're looking at, there's a higher margin that we can attain as we work with our partners and our partnership with our customers and kind of have that win-win situation.

Chris Voie: Okay. Thanks. That's helpful. Maybe shifting to performance-based contracts. Is there any shift? Now that you've got rigs going up this year, any shift in what's popular for customers or the way you guys like to structure these contracts in terms of which KPIs are involved? I'm just curious if there's been any shift or any more color around that.

John Lindsay: It's really all over the board. I think that's what's important about these types of contracts. We're having that discussion with the customer, what's most important to the customer, what are the things that they're wanting to achieve, and how can we work with them and help them achieve that. So, again, we're seeing performance-based, KPI-based, also shared savings type contracts, even some footage type contracts. So, it's really just working closely with our customers and trying to be as customer-centric as we can in terms of what is it that they're wanting to accomplish.

Chris Voie: Great. Thank you.

John Lindsay: Thank you.

Operator: That does conclude our question and answer session for today. I will now turn our program back over to John Lindsay for any additional or closing remarks.

John Lindsay: Thank you, Christy. Again, thanks to everyone for your patience today. I know your time is valuable, and we appreciate you hanging in there with us. Just kind of closing out with looking back at this unprecedented and demanding 2020 fiscal year, we remain steadfast in our commitment to reshape our business and the industry during this challenging time. Our teams are doing great work to accelerate long-term strategic priorities, including driving efficiency across the company and evolving our digital technology and data platforms to deliver value-added solutions and services to our customers and partners. So, again, thank you again for your interest. Everybody, have a great day. Thank you.

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