



Helmerich & Payne
Fiscal Second Quarter Earnings Call Transcript
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Operator: Good day, everyone, and welcome to the Helmerich & Payne Fiscal Second Quarter Earnings Call. At this time, all participants are in a listen-only mode. Later you will have the opportunity to ask questions during the question-and-answer session. You may register to ask questions at any time by pressing the * and 1 on your touchtone phone. You may withdraw yourself from the queue by pressing the # key. 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 the call over to Dave Wilson, Vice President of Investor Relations. Please go ahead.

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

John Lindsay:

Thank you, Dave. Good morning, everyone, and thank you for joining us today. Since August of 2020, oil and gas industry has been undergoing a record recovery from the worst downturn in its history. Just when we thought the environment was beginning to normalize, another geopolitical event, Russia's invasion of Ukraine, unleashed immediate and lasting ramifications. This has provided a sharp reminder to everyone how critical, abundant, cost effective, and secure energy is to sustaining security and a broader global economy.

Given the industry's negative experience in recent years, it should be no surprise to anyone that US producers have remained cautious, rational, and disciplined with regard to their capital expenditures, even in the face of spiking commodity prices. H&P's strategy is to also maintain capex budget discipline and holding that line is something we believe is crucial to creating a healthy and sustainable company over the longer term.

The industry rig count increase in the March quarter continued to shrink the availability of super-spec rigs that have worked at some point in the last two years. This has compounded the pre-existing supply demand tension in the market. We are pleased with our progress and momentum during the quarter which saw our active North America Solutions rig count increase in line with expectations, exiting the quarter at 171 rigs after re-commissioning 17 FlexRigs in the second quarter and 27 in first fiscal quarter.

From here, we expect to see our rig count growth moderate in the coming quarters as there is more rig churn developing in the market. We expect to maintain responsible capex spend given the budget we set for the year. You may recall in November, we set our 2022 capex budget range of \$250 million to \$270 million. That budget was set at a point in time where we expected to end fiscal 2022 with around 160 active rigs. If everything goes as planned, we now expect our rig count to peak early in the fourth fiscal quarter at 176 rigs while remaining within our capex guidance.

Like 2021, we have frontloaded our rig activity for our fiscal year in Q1 and Q2, positioning us well for the rest of 2022. Accordingly, we remain laser-focused on improving pricing and creating returns for our shareholders and not on chasing the rig count or market share. That said, we plan to remain the leader in the US land rig market by continuing to deliver great outcomes to customers and receiving the appropriate margin for the value we deliver.

Like our customers, we are requiring more from every capex dollar spent and we note a similar trend occurring within the oilfield service industry. This and other factors could lead to the persistence of a tight supply demand environment for super-spec rigs in the US, which in turn should help move rig pricing to levels more in line with the value we deliver.

The economics for our spot contracts are improving at a rapid pace and we expect similar improvements for our term contracts as they are renewed or moved into the spot market in the coming quarters. As I mentioned on our last earnings call, we believe these conditions could provide a pathway to achieve average spot contract economics in excess of \$30,000.00 per revenue day. We already have many instances of achieving this pricing level in today's contracting activity.

Given the increased cost structure of the industry over the past several years, attaining this level of revenue is necessary to garner 50% gross margins, which we haven't experienced since 2014. Assuming the market remains strong, this margin will enable H&P to generate returns in excess of our cost of capital to the benefit of all of our stakeholders. I want to thank our operations, our sales, and our marketing folks that are working hard to help H&P provide and get paid for the value proposition we deliver.

As we've previously noted, the value proposition H&P brings to its customers is enhanced through technology-driven efficiency and wellbore quality. This, combined with the current market dynamics, is differentiating our performance and accelerating improvements in our contract economics. Mark will touch on our capital allocation strategy but at this juncture, let me underscore that the company remains fully committed to its fiscally sound and disciplined approach to capital allocation. By continuing to do this, we can maintain our longstanding dividend and pursue opportunistic share buybacks. This also positions us to explore other ways of returning cash to shareholders as more cash is accreted on the balance sheet.

Now shifting to the international markets, the outlook remains positive with additional developments and prospects progressing, even though at a much slower pace than we are experiencing domestically. In our South American operations, Argentina and Colombia remain focus areas and we have begun to contract additional rigs in those countries. In the Middle East, our strategy and opportunity sets are a bit different. We have delivered

some of the FlexRigs we sold to ADNOC drilling and are moving forward with the strong business alliance we established with them.

We are also actively pursuing opportunities to export some of our idle super-spec capacity into the region. In fact, we plan to start moving a rig into our Middle East hub during the second half of 2022. While we're optimistic about our strategy in the Middle East, we're also keenly aware that this is a long play, and it will take time for opportunities to emerge and fully develop.

We don't often discuss in great detail or get a lot of questions about our Gulf of Mexico offshore segment. Our offshore operation has been an important part of our company for 50-plus years and will continue to play an important role in H&P's future.

We've achieved many successes over the years and delivered exceptional service to our customers. In fact, some of our most impressive operational and safety accomplishments took place in our offshore operations during the pandemic. On the pricing front, we expect that the margin improvements we are experiencing in the US will begin showing up in our offshore segment in the coming quarters.

Our technology solutions continue to deliver clear differentiation and is providing very relevant value to our customers both in the US and international markets. We are continuing to grow AutoSlide, our automated directional drilling solution, as well as automated survey management in combination with our new commercial models.

Most recently, we introduced several game-changing solutions to our portfolio, Engine Management, and a suite of Failure Prevention technologies. Engine Management delivers on our commitment to sustainability efforts by autonomously minimizing excess FlexRig engine hours, lowering emissions, while also delivering reduced fuel consumption for our customers. Failure Prevention Automation, such as our newly launched StallAssist, protects expensive downhole directional tools, increasing the longevity of those tools that may be hard for operators to source in today's environment.

With current supply chain and labor constraints, it also provides consistent and repeatable execution, removing human variability and preventing expensive downhole problems. The key to these solutions is market relevancy as both of these additions are particularly

pertinent to challenges operators are currently facing and align with our focus on delivering better outcomes.

Finally, we continue to further our strategy of deploying our capital and expertise to companies playing an active role in the energy transition. We've made selective investments in adjacent industries like geothermal, companies that are looking to provide an alternative carbon-free baseload power source.

More recently, subsequent to quarter end, we made a \$33-million investment in Galileo Technologies in the form of a five-year convertible note. Galileo has a wide global presence through providing modular, scalable, and portable equipment to capture, compress, liquefy, and transport the gas as LNG, basically creating a virtual pipeline. This gas can originate from various sources including wellheads and stranded gas that may otherwise be flared.

The opportunity here lies in H&P's and Galileo's shared global customer base and H&P's various drilling sites that have the potential to assist Galileo's growth, particularly in the US. We believe their natural gas technology and equipment systems have the potential to become increasingly relevant as the global demand for natural gas is expected to increase as an important component of the energy transition.

In closing, while it is encouraging to see the industry rebound, we should be reminded of past cycles with elevated commodity prices in which the drilling industry repeatedly responded by adding excessive capacity, only to reap long-term negative consequences. So far, the cycle is different. During my career, I've never seen a more consistent focus on value creation and getting paid for the value H&P provides. I'm continually inspired by and thankful for our employees, their passion for taking care of our customers, and their innovative spirit that truly differentiates H&P's offerings in the market.

Combined with our Flex Rig fleet and automation solutions, I believe we will continue to lead the way forward in our industry and partnering with our customers to create value for both groups of shareholders.

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

Mark Smith:

Thanks, John. Today, I will review our fiscal second quarter of 2022 operating results, provide guidance for the third quarter, update full fiscal year 2022 guidance as appropriate, and comment on our financial decisions.

Let me start with highlights for the recently completed second quarter ended March 31, 2022. The company generated quarterly revenues of \$468 million versus \$410 million in the previous quarter. As expected, the quarterly increase in revenue was due in part to higher rig count activity in North America Solutions as operators continued to commit to calendar 2022 drilling activity.

Further, we've benefited from rapid execution by our sales and operations teams on the necessary price increases that John mentioned on our previous quarter earnings call. Total direct operating costs incurred were \$341 million for the second quarter versus \$301 million for the previous quarter. The sequential increase is attributable to the aforementioned additional recount as well as the full quarter impact of the wage increase mentioned in our February 2022 call.

General and administrative expenses totaled approximately \$47 million for the second quarter, higher than our previous quarter and our expectations due in part to noncash mark-to-market adjustments in deferred compensation that are correlated to our stock price, as well as increased IT infrastructure spending. That will come in on G&A guidance later in these remarks.

During the second quarter, we realized additional gains of approximately \$17 million related to the fair market value of our ADNOC drilling investment which is reported as a part of gain on investment securities on our consolidated statements of operations.

To summarize this quarter's results, H&P incurred a loss of \$0.05 per diluted share versus a loss of \$0.48 in the previous quarter. The second quarter earnings per share were positively impacted by a net \$0.12 per share of select items as highlighted in our press release, including the gain on investment securities that I just mentioned. Absent these select items, adjusted diluted loss per share was \$0.17 in the second fiscal quarter versus an adjusted \$0.45 loss during the first fiscal quarter.

Capital expenditures for the second quarter of fiscal 2022 were \$60 million, slightly below our previous implied quarterly run rate guidance. As a reminder, first quarter

capex was also below guidance at \$44 million. The timing of some spending has been pushed to the second half of the fiscal year as key suppliers continue to rebuild capacity that was taken offline during COVID restrictions. This includes the hiring and training of labor and the sourcing of long lead raw materials such as steel and copper.

H&P generated approximately \$23 million in operating cash flow during the second quarter of 2022, and I'll have additional comments about our cash and working capital later in these remarks.

Turning to our three segments, beginning with the North America Solutions segment, we averaged 164 contracted rigs during the second quarter, up from an average of 141 rigs in fiscal Q1. We exited the second fiscal quarter with 171 contracted rigs, which was in line with our guidance expectations. We added 17 rigs to our active rig count in the second quarter, including four walking FlexRig drilling rig conversions that were completed in fiscal Q2 and 13 skidding rigs.

Revenues were sequentially higher by \$68 million due to the previously mentioned activity and pricing increases. Segment drag margin was \$114 million at the top end of our February guidance and sequentially higher than the first fiscal quarters, \$84 million.

Overall, OpEx for North America Solutions segment increased on a sequential basis due to the aforementioned increase in our rig count quarter on quarter and the increased wage rates. The reactivation costs incurred during Q2 were \$14.2 million compared to the \$20.5 million in the prior quarter. These reactivation costs were higher than expected as we have stated on a prior call, reactivation costs increase with the length of time a rig has been idle. Accordingly, we expect these costs when and as incurred in future quarters to continue to increase, given that the average idle super-spec has been stacked for two-plus years. Further, inflation has started to put upward pressure on the reactivation costs for rigs.

Looking ahead to the third quarter of fiscal 2022 for North America Solutions, as I mentioned earlier, we ended Q2 near the midpoint of our exit guidance range. As with the last calendar year, public customers are holding their activity within their annually budgeted plan. We believe this fiscal discipline will continue until the end of the calendar year when many of these customers commence their annual budgeting cycles for calendar

2023. Due to the rate activation, operating expenses, and capital expenditures required to reactivate long-idled rigs, we have undertaken two initiatives this fiscal year.

First, we are increasing our pricing across the active fleet; and second, we are holding the line on reactivating rigs beyond existing commitments this fiscal year to remain within our fiscal capex budget, much like our customers are doing. Further, as we get into planning for next fiscal year, we will only be reactivating rigs for pricing in terms that ensure a return on the significant OpEx and capex investments required to bring the rig back online. As of today's call, we have 173 rigs contracted and we expect to end the third fiscal quarter of 2022 with approximately 175 contracted rigs.

Our current revenue backlog from our North America Solutions fleet is roughly \$534 million for rigs under term contracts. As mentioned last quarter, this figure does not include additional rig margin above base day rate that H&P can earn if performance KPIs are met once a well is completed.

Our focus on pricing is targeted at achieving the pricing levels that John mentioned in order to drive towards 50% margins. Since the pricing peak in 2014, we have not returned to that pricing level in subsequent cycles despite rising operating cost driven by inflation, longer wells, and shorter drilling cycle times, on top of the significant capital investments required to high-grade our US fleet to super-spec capacity. Our focus on this margin level is tied to our goal of achieving blended corporate returns greater than our estimated cost of capital.

Following the unfortunate geopolitical developments since our last earnings call, inflationary pressures on costs as well as constraints on supply chain capacity are increasing. While inflation on consumable inventory may increase, these costs make up less than 20% of the daily operating cost on a rig. Our scale also enables us to work with our key suppliers to ensure access to timely deliveries of materials and supplies. In the North America Solutions segment, we expect direct margins to range between \$150 million to \$165 million, inclusive of the effect of about \$5.5 million in reactivation costs in Q3.

Regarding our International Solutions segment, International Solutions business activity decreased by two rigs to six active rigs at the end of the second fiscal quarter. As discussed last quarter, we idled two rigs in Bahrain due to changes in the customer's

drilling schedule. We added a rig in Argentina as expected, but unexpectedly had a rig released offsetting that gain. International results were above guidance due to multiple immaterial transitory items.

As we look towards the third quarter of fiscal 2022 for international, we expect to add two rigs in the Vaca Muerta region of Argentina this quarter. We further expect to add a second rig in Colombia this month, getting us to nine working rigs internationally by the end of Q3.

Aside from many foreign exchange impacts, in the third quarter, we expect to have between a \$3 million to \$1 million direct marginal loss due to expenses associated with the rig startups that I just mentioned, as well as our initial investments we made and established in our Middle East hub.

Turning to our offshore Gulf of Mexico segment, we still have four of our seven offshore platform rigs contracted, and all three of our management contracts on customer-owned rigs are now on full drilling rates versus two on full rate for all of Q2. Offshore generated direct margin of about \$8.3 million during the quarter, which is above the high end of our estimate due to lower than expected cost. As we look toward the third quarter of fiscal 2022 for the offshore segment, we expect that offshore will generate between \$7 million and \$9 million of direct margin, as we will have all three of our management contracts and full drilling rates for the majority of the quarter.

Now, let me look forward to the third fiscal quarter and update full fiscal year 2022 guidance as appropriate. Capital expenditures for the full fiscal year are still expected to range between \$250 million to \$270 million with remaining spend of approximately \$156 million at midpoint to be distributed fairly evenly over the last two fiscal quarters. Our expectations for general administrative expenses for the full fiscal year 2022 are now expected to be just over \$180 million. The increase of our prior guidance is due to the factors which drove our second quarter results, as previously mentioned. In addition, given the stronger than expected market conditions relative to our expectations in November, we have eliminated some previously planned cost-out efforts in the second half of the fiscal year to support our higher rig count and our plans for Middle East growth.

We will not be providing an estimated effective tax rate range as items impacting our tax provision in income are at levels that resulted in a wide variability in the estimated effective tax rate. With that being said, the US statutory income tax rate for fiscal 2022 is expected to be 21%. In addition, we are expecting incremental state and foreign income taxes and permanent book-to-tax differences to impact our provision. There is no change to the previously guided range of anticipated cash tax of \$5 million to \$20 million.

Now looking at our financial position, Helmerich & Payne had cash and short-term investments of approximately \$350 million in March 31, 2022 versus an equivalent \$441 million at December 31, 2021. The expected sequential decrease is largely attributable to our January share repurchases, geothermal investments, and some working capital lockup due to increased activity, including our revolving credit facility availability of liquidity was approximately \$1.1 billion in March 31. Our debt to capital at quarter end was about 17%, and our net debt was approximately \$200 million. We currently expect our trailing 12 months and gross leverage term to reach our goal of less than two times outstanding debt during the second half of this fiscal year.

H&P's debt metrics continue to be best in class amongst our peer group. As a reminder, our sole remaining long-term debt matures in 2031 and our credit rating remains investment grade.

As I mentioned on our last call, as our rig count rises, working capital shows up as a use of funds, and that was substantial during the quarter given the addition of 17 rigs. Our accounts receivable of December 31 of \$282 million grew by \$48 million to approximately \$330 million in March 31.

With that as a background, as expected, positive cash flow generation from operations resumed in fiscal Q2, and we expect that to continue to grow through the remainder of this fiscal year. Apart from operations, our first half of geothermal investments have been about \$14 million and our investment in Galileo subsequent to March 31 was approximately \$33 million. Due to these year-to-date investing activities as well as some additional potential investments within our near-term line of sight, as of today, we expect to end the fiscal year with between \$350 million to \$400 million of cash and short-term investments on hand, down from the range of \$400 million to \$450 million guided on the February call.

As I mentioned on the February call, the growth in rig count early in the fiscal year provides a platform for cash generation in the second half of the year that in our estimation beginning in fiscal Q3 fully covers the maintenance capex and our dividend and sets the stage for cash accretion. As John stated, the company is considering capital allocation strategies for any future cash build, including further shareholder returns.

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

Operator:

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

I will take our first question from Taylor Zurcher with Tudor, Pickering, Holt. Please go ahead. Your line is open.

Taylor Zurcher:

Hey, John and Mark. Thanks for taking my question. Just wanted to start on some of the market share strategic thought process comments you made. They're really interesting to me because we don't really - at least I don't really hear of well-capitalized market leaders talking about not chasing market share on the way up when pricing is at really strong levels. You typically hear about it on the way down when pricings go into bare bones level. I'm just curious if you could give us a bit more color there and flesh out for us. Are customers coming to you asking for incremental rigs to be reactivated in the back half? You're basically saying it's not going to happen this year, but check again in fiscal 2023, and maybe if it determines an economics alignment, we'll do it? Curious on all those topics.

John Lindsay:

Sure, Taylor. Thanks for the question. I'll start, and Mark and Dave can chip in. I can tell you to answer part of the question is part of the reason why we're doing what we're doing is lessons from the school of hard knocks. We've seen lots of upcycles. We've seen lots of downcycles. The reality of it is we have a tendency as an industry to oversupply the market.

At the same time, we also announced back in October, I guess we put our budget together in October and announced in November, what our capital budget was going to be. Like our customers, we think that's a very wise strategy to spend within that budget. We've

been very fortunate in that we've been able to really frontload our rig reactivations with 27 in Q1 and 17 in Q2, as we just announced.

When you think about back in October, we were hoping to achieve 161 rigs working by the end of the fiscal year, and here we are talking about 176 rigs, so we really outperformed in many ways. Again, I'm going to repeat that frontloading is really important because all those rigs that we've put to work, those that aren't turned up, that are spot, we're able to move that pricing and we're going to continue to have rigs rolling off.

We just think it's very wise for us to do that. Our expectation is that, if prices remain strong in terms of oil prices, gas prices, our customers will reset budgets again like they did in 2021 and then again in 2022, and we'll be in a position with our first fiscal quarter, fourth calendar quarter to be able to add capacity if the demand is there.

Mark, Dave, anything else?

Mark Smith:

Sure. Just a couple of things. First, kind of an editorial comment, as John really said in his opening prepared remarks, it's a more purposeful growth of margins and profit versus market share growth for growth's sake, so to speak. Our customers are disciplined, and they could grow a lot more than \$100 oil, but they're living within their budgets and maximizing their returns. We're doing the same thing, and there's a lot of churn in the market right now. So, adding capacity in the face of that, as John said earlier, just does not seem like the right capital discipline to us.

Further, I would say a little more technically, adding an incremental rig to the market is more than just about pricing and market share. You have to consider the full opex expense and the capital expenditures required to bring that rig to market together with the length of the commitment or contracts. Are you going to be able to recoup the investments through the term of the contractor that together with foreseeable pure line of sight to future work? That's a little harder in this current environment where our customers budget calendar year to calendar year, higher – and higher activation costs just have to drive higher pricing. Anyway, we're trying to get to the capital efficient rates here to reactivate rigs, and we also have to just consider the longer-term view.

Taylor Zurcher: Yes, understood on all those fronts, and thanks for the detailed response. Just a quick follow-up on pricing. So, obviously, now we're in a pretty constructive pricing backdrop. You've been champion – campaigning the performance-based model for a number of quarters now, years now, and I guess I'm curious in this sort of pricing backdrop, is it conducive to more adoption of performance-based models or do customers start going away from performance-based and back to more of the traditional pricing models in this day and age?

John Lindsay: Well, Taylor, we still have 40% of our rigs that are on performance-based type contracts and we've had that now for several quarters, obviously, much improved from when we very first went on this journey two years ago, like you've mentioned. So, we continue to have customers that are really true partners that are working. We're both working very closely together to provide greater value, improve well cycle, improve wellbore quality, wellbore placement, enabling automation solutions, lots of things that we're working on together to deliver better outcomes at the end of the day for the customer. They're willing to share in that. I will say that it doesn't always work with every customer. With some customers, sometimes it's harder, for whatever reason, to partner and we go back to a more traditional contract structure, which is fine. As long as we're able to generate the types of margins that we've talked about that are really needed for us to continue on this journey to become more and more investable as a company.

So, as you can imagine, it's a pretty large – in terms of the types of customers, but what's great about it is both large, small super majors, we've got a very wide range of customers that are participating with us in these new commercial models and it's delivering a lot of value. So, my expectation is that it's going to continue to grow and become more popular.

Taylor Zurcher: Awesome. Thanks for the answers.

John Lindsay: Thank you.

Operator: We will move next with Doug Becker with Benchmark Research. Please go ahead.

Doug Becker: Thanks. To throw in a hypothetical, if all your rigs were magically on the current leading-edge economics, what's a realistic margin per day that could be achieved, given regional

pricing differences, cost differences, rig specs, contract differences? I'm just thinking about back in 2014, there were a few quarters where we did see \$15,000.00 a day and so I'm not trying to get too far over my skis, but just want to get a little context about what's kind of realistic just with the economics we see today.

John Lindsay: I think just high level, our answer would be we would be in a position to generate 50% gross margins. Again, if you look back at 2014, we were generating, on average, 50% gross margins. The difference is the cost structure was \$3,000- \$4,000 a day less than what it is today, for lots of reasons. In 2014, we might have had a handful of super spec rigs. Today, every rig, with the exception of two, that's running for us is super spec capacity. Much more investment, the rigs are running much harder, the expendable, everything we're using, it's driving the cost, but at the end of the day, it's delivering greater value for customers. So, that's really the goal. So, I think that would probably be the answer. Mark, you can...

Mark Smith: No.

John Lindsay: Yes.

Mark Smith: I agree.

Doug Becker: That's helpful, and then I fully appreciate that market share is not a target. It's not a goal, but as we think about next calendar year, would you conceptually or high level expect to kind of maintain the market share or is it really that's just a complete secondary consideration? It's much more about getting the right type of returns on what's currently deployed.

John Lindsay: Well, Doug, you've seen us coming off of the bottom, out of the downturn. We had lost some market share based on our customers. Our primary customers were those that kept their rig fleets the most. So, we've fought back, and I think we actually have more market share today than we did. So, it's not that in certain parts of the cycle, market share isn't important. What we're saying is right now, what's most important is generating the margin that we need and living within the budget that we told our shareholders, our investors that we were going to live within. So, that's the most important. So, we've said

this all along, we said it in '21 and we're still saying it that '22, at least we expect is going to play out very similar to '21 where the fourth calendar quarter, we've got a lot of rigs going back to work. First calendar quarter, a lot of rigs going back to work, then it gets a little flatter. You get choppy, a lot of churn. Mark had mentioned something about that and we've had, I don't know, six or seven rigs that would have been given back to us for various reasons, and we've been able to place those rigs with customers that have programs. So, that's worked out really well.

Mark Smith: At much higher rates.

John Lindsay: Obviously, yes, very – at much higher rates. So, as we think about 2023, which will be here before we know it, we'll be resetting our budget in October, like we did in the past years, and our hope is that we'll be able to – to be able to add additional rigs in 2023. In calendar Q4 and Q1 again, we hope it plays out like that. Obviously, we've got a lot of work ahead.

Mark Smith: I would just footnote that, Doug, by adding that given our focus on value proposition to customers in our sheer scale with the most idle capacity, super spec capacity in the United States, we absolutely expect to maintain or increase that market share through the cycle.

Doug Becker: Makes sense. Thank you.

John Lindsay: Thank you.

Operator: We'll move next with Ian Macpherson with Piper Sandler. Please, go ahead. Your line is open.

Ian Macpherson: Thank you. Good morning, John and Mark.

John Lindsay: Good morning.

Mark Smith: Good morning.

Ian Macpherson: I'm picking up a tension here that needs to be resolved. Every quarter, what we're witnessing is that your cycle is moving up more sharply faster with activity and so far, and with pricing and margins, and at the same time, we know as recently as our conference last month that big E&Ps are loath to lock in current rates. They don't want term contracts of \$30,000 a day, but we hear resolutely from you and your peers that no one's going to build rigs, and we know we're going to run out of high spec rigs in a matter of quarters. So, that's a big gap that needs to be resolved and it probably needs to be resolved with multi-year contracts that your 50% margins are low to mid-30s day rates right now. When do you start to see some narrowing of that gap and attitude towards locking up these rates on multi-year term?

John Lindsay: Well, I'll address a couple of things. and I'll have Mark and Dave kick in additional comments. First of all, I hear what you're saying about the available super spec fleet, but the reality of it is there's still a lot of capacity out there. I don't think that we're going to be in a situation where we're going to be building or needing to build new super spec rigs. You'd mentioned a couple of quarters. I think it's going to take well over a year at the current type of activity gains. We don't know for sure how budgets are going to be reset for 2023. We have some view of the rest of 2022. So, for us today, our preference is to not lock into more term. Our preference is to continue to move pricing up in the spot market. At some point in time, I think we do have some customers that have locked into pricing above high 20s, above 30s, and you can get and start using our technology solutions to push pricing higher based on the value proposition that's delivered, but I would be surprised. Mark, what would you add?

Mark Smith: No, I think you hit it, John. I think it's a combination of we're just at the right spot in the cycle. We expect our customers to hold flat these next two quarters going into the fiscal first quarter of '23 for us the final calendar quarter of this year and sort of resetting in their new budgeting season just as they have that just as they recently did, and just as they did at the end of '20 going into '21. So, while we're at this flat level and we're seeing churn, still demand for rigs, we have to move the pricing up, as John had said, and then I think at some point in the future, once we started moving in that direction across more of our average fleet rate, at some stage then we'll have the right juxtaposition of the ability to set term based on that higher pricing, but we're just not there yet.

John Lindsay: Yes, and one other thing to add – I don't think I've said this – which is as we start thinking about 2023 and calendar Q4, we would be reactivating rigs that have been idle for over two years. So, the recommissioning cost, whatever capex – no, it's not new build, but it is additional cash that up to this point, in many cases, we've self-funded that and so we would be looking at that situation with higher prices and a term contract commitment in order to reactivate those rigs as well. I'm thinking about it right now.

Ian Macpherson: Understood. Thank you, gentlemen. Then as my follow-up, Mark, you've alluded to seeing some upside to your Gulf of Mexico operations not too far out, and I think also when you get to the end of this fiscal quarter with plus three more rigs in Latin America, that should probably have a better run rate than what you've guided for fiscal Q3. Can you describe what those upsides might be in the following quarter or quarters as you get ramped up in those secondary markets?

Mark Smith: Thanks for the question, Ian. I think it's a little early, as we've mentioned, with international adding two rigs in Argentina and one in Colombia. We're going to have a lot of costs associated with those startups in Q3, but to your point, the absence of that will help going forward. We're still in negotiations for additional rig adds in both of those countries. So, depending on how that shapes out and we can have again more abnormality, transitory costs over the next couple of quarters as we continue to add to that rig count, but build us up well for future cash flow generation in the absence of those reactivation costs, just like we've had in the US.

In offshore, I think the potential there, it really goes to John's comment on his prepared remarks and that is about how we need to work on pricing with our harvest offshore segment. Hopefully, that's helpful.

Ian Macpherson: Yes, good for now and check in on that again next quarter. Thanks, guys.

Mark Smith: Thank you.

Operator: We'll move next with Waqar Syed with ATB Capital Markets. Please, go ahead.

Waqar Syed: Hey, John. Question on new build rigs. I know we've talked about that maybe you don't have a number, but what is your expectation that if you were to order a new build rig, what would it cost today based on the current requirements of a rig? Then what kind of margin is required to justify building a new rig?

John Lindsay: Waqar, let me just jump in for a second. Thanks for the question, but I have to tell you, we haven't asked that question. We have 60 idle super specs that we'd like to put to work with a heck of a lot less investment than a new build rig, and for all the right reasons that we've talked about with returns on the capital, returns on the opex, the right pricing margins to get us to return on capital employed as a consolidated corporate entity. So, we have a lot of focus on that as we move through time here.

Waqar Syed: But let me ask the question another way that like when you get to this \$30,000 type of revenue per day, would that give your competition or somebody else in the industry or private equity, anyone else, the financial incentive to build the rig?

John Lindsay: We've seen a couple of those. Those pop up over the last 10 years. If you look at the results of those companies that have done that, not great results. So, I find it very hard to believe that we're going to see somebody jump into this business or start to invest in new builds, when there's the number – I mean, there are 150 super spec rigs that are idle on the sideline today that have been idle for over two years and so, let's face it, regardless, let's think back to the why behind the new builds that we started back in 2004, 2005 timeframe. It was a replacement cycle. We had rigs that were old that were built in the '70s and '80s. We're not faced with that today. We're faced – we've got a rig fleet – an industry-wide rig fleet that may have lots of different variations, but at the end of the day, they have a lot of capacity. Now, we're going to have to reinvest in those rigs that are idle, because a lot of that equipment has been used to maintain the working fleet. I think everybody has pretty well established that that's been going on. So, I just find it very hard to even imagine that somebody would be able to get the backing to start a new company or to build new rigs with the amount of excess capacity that's on the ground right now.

Waqar Syed: That's great. Thank you, and just my second question. You've been investing in R&D. It's clipped over around \$25 million to \$30 million a year for several years now. How do you

entirely evaluate the returns on that R&D investment, and what's your view of like how well that has served you those investments?

Mark Smith:

Waqar, thanks for the question. I'll take a stab at that. It's that technology in that digital software that we have focusing on down hole operation and improvement for our customers, as we've long talked about straighter and better placed wellbores, which actually help with our customers overall, total cost of ownership of a well. We, as a driller, are about 20% to 25% of an AFE for a well, and we can affect a lot of the other 75% plus costs with the drilling in a better well. I think that's proved evident in our uptake in performance contracts, because in those, as we've talked about, this last year or two, if you think about it just at its basic administrative – from an administrative perspective, we used to have a rig contract and several separate forms of contracts for various softwares. Today, we have, with the performance contract, a single contract where we work with the customer to set KPIs together and pull through the technologies to achieve those KPIs and to reduce overall well costs. So, I think the uptake from a couple of years ago not having performance contracts to today having 40% of the fleet on those, and it's those contracts that are driving the \$30,000 plus revenue per day really at the top end of our fleet, and helping us to get to the margins that we've talked about we need to get to. John, if you have any.

John Lindsay:

No, I think this industry is going to continue to trend toward utilizing digital technology, algorithms, automation to do what have been relatively manually intensive. Obviously, we've focused a lot of attention on directional drilling technologies, but we've made some great acquisitions. We're going to continue to have a strong R&D budget and, hopefully, we're able to maintain a strong market going forward, as you can imagine, through – since we've been deploying this technology, we've had some pretty difficult markets, but we're starting to see even more traction.

Waqar Syed:

Right. Thank you very much.

John Lindsay:

Thanks, Waqar.

Operator:

We will move next with Derek Podhaizer with Barclays. Please, go ahead.

Derek Podhaizer: Hey, good morning, guys. Just want to continue this line of questioning. You showed considerable term contract backlog uplift. Can you talk about the dynamics on the willingness of both you and the E&P, the lock-up rigs for longer, and then coming more from your side of things or more from the E&P side, and given the backlog that you see now, do you have line of sight to reaching those 50% gross margin targets?

Mark Smith: Thanks for the question. Derek, we had some additions to term in the press release that was filed yesterday and a lot of that really took place in January, frankly. It's been a fast-moving market and those contracts that were in the queue and the press release were negotiated really in the fourth calendar quarter heading into this calendar year. So, that really up took in January, and since then and since the February call where John discussed our need to update pricing, we've really since then entered into spot contracts focus to get rates up across the fleet, and further, as terms rollover were not as likely, based on the comments we've said this morning to date, we're not as likely to re-up that term. We're focused more on getting appropriate pricing uplift with the current spot.

Derek Podhaizer: Okay, got it. That's helpful color. That makes sense. I want to switch internationally. You talked about the Middle East hub. Can you talk about the ultimate goal of that? Maybe the regions, the types of rigs you want to send over, other technology pull through, maybe what the required rig looks like in that region. Would you need to upgrade some of your idle super specs rigs, other – I'm just interested in more color and details around – I know it's a long play, but what do you ultimately see as the Middle East hub looking like?

Mark Smith: If you think about something as like the Permian, from the eastern Midland into the western Delaware, it's a long geographic space, the Gulf Coast countries. We're thinking about approaching that from a yard or a hub perspective, not unlike we do with the Odessa operation that we have; and as we look to the long term – we've spoken about this for a couple of quarters, I think – the Middle East has had a really steady rig count through – compared to the volatility of the US shale play over the last 15 years. There's not really been a rig replacement cycle there, and you couple that with what is a burgeoning gas play with several countries in the region, including for their own energy strategic gas independence reasons as well as potential LNG export reasons. So, that is a different kind of drilling. It's horizontal and we believe it really fits our super spec FlexRig quite well, provides an opportunity to shift capacity.

After the ADNOC transaction last year, we've really sort of increased our presence from a marketing perspective and hiring boots on the ground sales folks as well in the region. So, if you think about – and as you've said, international timing is hard to predict. We're still developing a lot of resources to move the ball forward, if you will, but we do plan to send over a rig during the second half of this fiscal year that John mentioned earlier, and there will be initial costs associated with that, but we were quite comfortable with this, given the longer-term opportunities. It's sort of setting up, if you will, a showroom floor to show off our product and we are, actually, today participating in several bid tenders with different players in the region. These things take a while to move through time to get settled, but if we're successful even with just one of them, that could be a three to five to six rig addition for us. So, stay tuned, we're being patient, but are really planning to look at that as a way to reduce the US concentration risk that we've had historically as of recent time.

Derek Podhaizer: Thanks. That's helpful. Appreciate the comments. I'll turn it back.

John Lindsay: Thank you.

Operator: We'll take our next question from Connor Lynagh with Morgan Stanley. Please, go ahead.

Connor Lynagh: Yes, thanks. I've got a high-level question that I, frankly, know is borderline impossible to answer, but I'm going to just get your thoughts on it anyway. You've got all of the big rig contractors reporting earnings over the last 24 hours here, and there's not a very significant activity increase contemplated in anyone's third quarter outlook. I'm curious, there's, as I can see it, three big reasons why activity wouldn't be growing given where oil prices are. One is the E&P is sticking to their capital budgets. The other is the supply chain bottlenecks that we've seen out there, and the third is the service companies sticking to their capital budgets, like you guys are highlighting you're raising pricing. So, I'm curious of those three, how big do you think each is contributing to the lack of activity growth we're seeing, given how robust oil prices are?

John Lindsay: I think most of what contributes to the behaviors that you're saying all really go back to the E&Ps and their capital discipline. Again, if you look at how the budgets that were set in '20 going into '21, and the type of activity that we had '22 is playing out very similarly, and it's – they're setting budgets and they're sticking to their budgets, and if you look at – I've seen, I think, most E&Ps – public E&Ps set their budgets at a \$55 to \$60 oil price environment, obviously, a much stronger pricing than that, but they've stuck to it, and what's great about that is that it does enable you to plan your business better. I know, at least for H&P, we haven't – our rig count growth isn't related to this, the supply chain challenges, even though there are supply chain challenges. It's not related to people. We've done a great job with acquiring people and our folks just to continue to do a great job. It's really driven by the E&Ps, our customers at the end of the day.

Connor Lynagh: Got it, and I appreciate it's very early on this front, but just in your conversations with customers, do you feel that there is a willingness or desire to grow within their stated frameworks, i.e., grow capex within their stated allocation frameworks? Or you think they're more sort of thinking about the production growth that they've promised the street? Which variable do you think they're solving more for?

John Lindsay: Yes, I think they're intending to live within their capex budget. In that capex budget that they announced, they had a – depending on the customer, they had anywhere from no growth to 5% growth, and that's their expectation. I don't see any indication that there's any change at all with the large public players and, quite frankly, even the private companies, they're – we keep hearing about this wildcard that the privates are just going to go ramp up production and we just really haven't seen evidence of that. I think there's a lot of discipline associated with those companies as well, and again, I think it sets us up for a much better outlook as an industry, and we haven't done a good job in the past in doing that, but I really believe, like we've talked about, that we're on a course to continue to go down this path.

Connor Lynagh: All right. It makes sense. Thanks for the color.

John Lindsay: Thank you, Connor.

Operator: We'll move next with Fahad Nadeem with Goldman Sachs. Please, go ahead.

Fahad Nadeem: Hey, good morning.

Mark Smith: Good morning.

John Lindsay: Good morning.

Fahad Nadeem: So, just in light of comments on capital discipline from you all, I guess, in the prepared remarks, can you provide some color on how we should think about non-maintenance capex beyond fiscal 2022? So, would that non-maintenance capex primarily include just the walking rig conversions going forward or are there going to be ongoing other capex commitments beyond that?

John Lindsay: We're obviously not in budget season at this stage, and we really haven't made any decisions, and we're just starting to get into looking at that. So, our preference would be to hold off and talk more about that when we get into budget season. It's still really early in the game to do that right now. What I will say is just no more than what I said earlier, which is, everybody in the industry, their idle capacity has been idle for over two years, and much of that equipment has been used to maintain and upkeep other rigs that are running. Why invest new capital when you can use something you already have in the ground? So, obviously – and as we've seen through the very beginning, coming off of the downturn, the early rigs that were reactivated cost \$50,000 to \$100,000. They were ready to go, but that cost continues to get higher. So, more to come on that.

Fahad Nadeem: Sounds good. Thank you, and then just one follow-up on your customer mix. I'd imagine I guess it's more weighted to the privates now than it's definitely before the pandemic. Do you expect that mix to materially change going forward, especially as we get into the budget, refresh these into calendar 2023? Is there sort of a – how is the difference in [like], I guess, pricing and contract dynamics with your private customer base versus your public customer base historically? Is there any sort of big change now that we should see as we think about this cycle?

John Lindsay: Well, we actually have a larger percentage of our fleet working for public companies than we do private companies. I think we're probably the only or one of the few that has that in

our space, but we have grown our private company customer base significantly. We are the largest market share in rigs running for super majors for large public E&Ps as well as for privates, but there's a dramatic range between where the private company is much, much lower percentage. Anything if you want to add...

Dave Wilson: No, I just – the only thing I'd add is within the private group, customer base, there are different operating styles. Some of them will do – want to have visibility, will want to determine long-term as far as difference in contracting styles between privates and public. So, some of those contracts and styles for the privates mirror the publics, and the other ones, they just have short-term work. So, that's kind of the main difference that I see from a contracting perspective.

Fahad Nadeem: Got it. Thanks a lot. I'll turn it over.

John Lindsay: Thank you.

Operator: This does conclude our Q&A session. I will turn the call over to John Lindsay for any closing remarks.

John Lindsay: Okay, Nikki. Thank you very much. I really do appreciate everybody joining us today. Thanks for the questions. They're very helpful. As you've heard us say, we're very optimistic about the future. We're very pleased with the momentum that we've garnered this past year. As you've heard us say, we are focused on margin growth. We're focused on returns. We're focused on continuing to provide an elevated performance proposition for our customers and so we're very excited about that. We're happy to have the folks we have at H&P. Thanks for everybody's contribution and we'll talk to you next quarter. Thank you. Have a great day.

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