Cactus, Inc. (NYSE: WHD)
Q3 2018 Earnings Call Transcript
Thursday, November 1, 2018 @ 09:00 Central

Call Participants

EXECUTIVES

Scott Bender
President, CEO & Director
Brian Small
Chief Financial Officer
Joel Bender
Senior VP, COO, Secretary & Director
Steven Bender
Vice President, Operations
Stephen Tadlock
VP and Chief Administrative Officer
David Isaac
General Counsel and Vice President of Administration
John Fitzgerald
Director of Corporate Development and Investor Relations

ANALYSTS

David Anderson
Barclays
Scott Gruber
Citigroup
Kurt Hallead
RBC Capital Markets
Martin Malloy
Johnson Rice & Company
Sean Meakim
JP Morgan Chase & Co
George O'Leary
Tudor, Pickering, Holt & Co
James Wicklund
Crédit Suisse

Presentation

Operator
Good morning, ladies and gentlemen, and welcome to the Cactus Third Quarter 2018 Earnings Call. My name is Grace, and I'll be facilitating the audio portion of today's interactive broadcast. [Operator Instructions] At this time, I would like to turn the show over to Mr. John Fitzgerald, Director of Corporate Development and Investor Relations. Sir, the floor is yours.

John Fitzgerald
Director of Business Development and Investor Relations
Thank you, and good morning everyone. We appreciate your participation in today's call. The speakers on today's call will be Scott Bender, our Chief Executive Officer and Brian Small, our Chief Financial Officer. Also joining us today are Joel Bender, Senior Vice President and Chief Operating Officer, Steven Bender, Vice President of Operations, and Steve Tadlock, Chief Administrative Officer. In addition, David Isaac is also joining us, having recently joined Cactus as General Counsel.

Yesterday afternoon, we issued our third quarter earnings release, which is available on our website. Please note that any comments we make on today's call regarding projections or our expectations for future events are forward-looking statements covered by the Private Securities Litigation Reform Act.

Forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties can cause actual results to differ materially from our current expectations. We advise listeners to review our earnings release and the risk factors discussed in our filings with the SEC. Any forward-looking statements we make today are only as of today's date, and we undertake no obligation to publicly update or review any forward-looking statements.

In addition, during today's call, we will reference certain non-GAAP financial measures. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measures are included in our earnings release.

With that, I will turn the call over to Scott.

Scott Bender
President, CEO & Director
Thanks, John and good morning to everyone. Before we commence our comments regarding the quarter, I want to take this opportunity to acknowledge and welcome two new additions to our management team. John Fitzgerald, who provided the introductions this morning, has joined us from Barclays as Director of Corporate Development and Investor Relations. David Isaac, most recently Vice President and General Counsel for Rockwater Energy Solutions, joins us in the same capacity with extensive experience in Human Resources and corporate governance. These two key appointments provide critical skill sets required as we complete the transition from a private to a public company.

Moving on to our operating results, I am pleased to report a strong third quarter having delivered topline sequential growth of just under 9%, with revenues in all three of our business lines up by 8 to 9% from the second quarter. Our growth meaningfully exceeded the trajectory of the U.S. land rig count, which was up only 1% sequentially. During the period, average market share in our Products business, which we define as percentage of rigs followed, increased from 26.0% to 27.4%, and we were also able to deploy incremental rental equipment to our existing customers. The quarter again highlighted our ability to execute, as we were able to drive higher margins for the business.

Our operating results once again exceeded our expectations. Here are a few of the highlights:

- Revenues rose 8.7%;
- Adjusted EBITDA increased 11.1%; and
- Adjusted EBITDA margins rose from 39.8% to 40.7%

It was a solid quarter, and we are proud to have reported record results.

I'll now turn the call over to Brian Small, our CFO, who will review our third quarter financial results. Following his remarks, I'll provide you with some thoughts on the outlook for the near-term before opening the lines for Q&A. Brian?

Brian Small
Chief Financial Officer
Thanks, Scott. As Scott mentioned, Q3 revenues at $150.7 million were 56.9% higher than the equivalent period last year and 8.7% higher than in the second quarter. Our growth was largely consistent across the business, with all three of our business lines up 8 to 9 percent sequentially.

Product revenues at $79.4 million were 47.9% higher than the equivalent period in 2017 and 8.3% higher than Q2. Product gross margin at 41.0% was 410 basis points higher than Q3 last year and 240 basis points higher than Q2 this year. The improvement was due largely to greater volume of higher value wellhead and production equipment and the continued successful execution of our supply chain strategy.

Rental revenues at $38.1 million were $16.9 million greater than last year's third quarter and $3.2 million higher than Q2 this year. The increase was attributable to growth in the capacity of our rental fleet.

Field service revenues in Q3 at $33.1 million were $12.0 million higher than Q3 17 and $2.8 million higher than Q2 18. Higher revenues versus the second quarter were driven by an increase in billable hours for our work. Field service revenues continued to represent approximately 28% of our combined product and rental-related revenues during the quarter.

SG&A came in at $11.1 million for the quarter and was $4.0 million higher than Q3 17 and $1.2 million higher than Q2 18. The sequential increase arose primarily from higher payroll expense related to increased headcount, as we successfully recruited personnel to support our growth as well as additional requirements associated with being a public company.

Net income came in at $43.6 million, up from $41.5 million in Q2. Our income statement reflects the net income attributable to the non-controlling interest owners and public owners of Cactus, Inc.

Third quarter Adjusted EBITDA was $61.3 million. This was 79.5% greater than the equivalent period last year and up 11.1% compared to Q2 18. Sequential incremental adjusted EBITDA for Q3 represented 50.7% of the incremental revenue in the period. Adjusted EBITDA for the quarter represented 40.7% of revenues, which compares to 35.5% in Q3 last year and 39.8% for Q2 this year.

Our effective tax rate for the quarter was 15.8%. The primary reason for this rate being lower than the federal rate is that the profits of the non-controlling interest are not subject to US federal tax. The effective rate increased versus Q2 18 given the follow-on offering completed in July, which increased our public ownership from 35.3% to 50.3%. We would expect the effective tax rate for the fourth quarter to be approximately 12.5%.

Internally, we prefer to look at adjusted earnings per share, as it eliminates the impact of changes in ownership throughout the quarter. Assuming the public entity held all units in its operating subsidiary Cactus LLC, with fully diluted shares outstanding of approximately 75 million and an effective tax rate of 24.5%, our adjusted earnings per share this quarter was $0.52 per share, compared to $0.46 per share in Q2, an increase of 13.0%.

Our cash position increased by $13.6 million during the third quarter to $42.0 million at September 30. For the period, operating cash flow was $41.6 million, and our net capex spend was $23.1 million. Additionally, we spent $1.7 million for finance lease payments in the quarter and $1.6 million for tax distributions to pre-IPO members.

Net working capital at the end of the third quarter came in at 23% of third quarter annualized revenues. We expect this percentage may increase slightly in the fourth quarter, as we accelerate inbound shipments before year end to avoid possible additional Section 301 tariffs.

We accelerated our capex for the quarter and now believe that our capex for the full year will be in the range of $65-$70 million, above our prior indication of $60 million. As with inventory items, we have and expect to continue to pull forward shipments in response to potential tariff changes and direct additional capital toward our new completions innovations in the fourth quarter.

That covers the financial review and I will now turn you back to Scott.

Scott Bender
President, CEO & Director
Thanks Brian. At our core, we remain a manufacturer of highly engineered and differentiated consumable products with exposure to drilling, completion and production phases of a well's lifecycle. Our Products business continues to be primarily driven by the total number of wells drilled and secular trends surrounding increased rig efficiency, including more wells per rig and batch drilling. Whereas our market share growth in the first two quarters of 2018 was adversely impacted by increases in the rig count from smaller operators, with whom we do less business, we believe we will benefit from several of our large clients adding rigs that have been released by these smaller operators. As a result, we expect we could see 5% or more growth in our rigs followed versus the Q3 average by the end of the year. So, while we remain steadfast in our goal to gain market share with majors, we continue to be highly successful with larger independents with significant drilling campaigns. We believe there remains further room for Product growth on this front due to our compelling value proposition.

In order to better respond to growth in our Products business, we spent approximately $2 million in the third quarter in addition to roughly $3 million spent in the second quarter to expand and enhance our domestic manufacturing facility in Bossier City, Louisiana. In addition, we completed the acquisition of a new facility in Hobbs, New Mexico for just under $5 million which has just recently begun to service the Delaware Basin. This highlights our continued faith in Permian activity growth, particularly in the Delaware, once takeaway issues are resolved late next year.

During the early part of the third quarter we were able to increase the deployment of rental assets given the strong demand from our customers. However, at this point in the fourth quarter, we see three main factors at play which are reducing demand. First, in areas outside the Permian, we are seeing evidence of exhausted budgets and already-achieved production goals. In the Northeast, Eagle Ford, STACK/SCOOP and Bakken customers have arrested completion activity for the year or have reduced crews with plans to increase in 2019. Secondly, in the Permian we are not seeing evidence of budget exhaustion from our core customers, but we are seeing postponements to new completions starts driven by delays on location for a variety of reasons. Although we continue to generate revenue on the pads that are taking longer, this trend affects our utilization and our ability to use the staged equipment to take on new work with existing clients or pursue new clients. And finally, consistent with historical seasonal softness in Q4, we see customers slowing activity and postponing frac well starts. As we've noted before, this part of our business provides the least visibility into customers' plans, but all signs point to moderation in Q4 in favor of increases in the beginning of 2019.

For all of these reasons, we believe our Rentals segment could be down as much as 15% sequentially from the third quarter. Field service, which is driven by both product sales and rental revenue, will likewise be impacted by the completions slowdown. Finally, this business traditionally has higher non-billable hours due to holidays, and we would expect typical margin compression during the fourth quarter.

Notwithstanding any short-term decline in completion activity, we continue to work towards the goal of building a larger moat around our Rental business, similar to what we have achieved on the wellhead side. During the quarter, we made significant progress with regards to our new completions innovations.

We expect all four innovations to be in field trials within the next 30 to 45 days and remain confident in the commercial viability of these offerings as they address both non-productive time and the need to reduce human intervention. These innovations are complementary and not alternatives to our existing rental offerings as they replace or enhance existing methods of flow control at the wellsite. The total market opportunity for these new innovations could likely exceed that of our current rental offerings, with similar returns.

We expect to have further details regarding the commercial acceptance of these innovations following the fourth quarter with the potential buildout of our fleet in response to anticipated customer demand in 2019. So while we have yet to set our 2019 capital budget, the total expansion of our rental fleet, with an emphasis on the buildout of these new innovations, will likely be in the same ballpark or below our 2018 anticipated spending of $45 to $50 million in rental-related assets. We anticipate no substantial roof-line expansions in the coming year.

Regarding tariffs, while Section 232 steel tariffs implemented prior to the third quarter have not directly impacted our operations, we witnessed increased input costs as domestic suppliers raised the price of steel. We were successfully able to minimize any resulting negative margin impact.

In late September, the USTR finalized Section 301 tariffs on $200 billion of Chinese imports with an initial rate of 10%, which will impact the bulk of the items we bring in from our Chinese supply chain. We expect a negligible impact on our results. Should negotiations between the US and China fail to resolve the outstanding trade issues by year-end, these latest tariffs could rise to 25%, a possibility we continue to discuss with our customers. Inasmuch as China provides the vast majority of the imported pressure control equipment into this market, we expect to remain competitive.

In summary, we now expect Q4 revenues to be broadly in line with Q3's, but EBITDA could decline by as much as 10% from our record Q3 results due to the temporary reduction in completion activity and the usual seasonal impact on Field Service margins. As I mentioned, the three main factors affecting our rental revenue decreases for the fourth quarter are temporary in nature and expected to reverse in early 2019 while we anticipate continued growth in our rig count next year. In addition, we remain excited about the potential for the successful deployment of our new rental innovations to further enhance growth. I'll close by sharing how very proud we are of our associates and their ability to execute during the third quarter. Our differentiated products and superior level of service have us well positioned to gain further market share, despite the aforementioned temporary slowdown in activity. Finally, our Board has continued to discuss capital allocation options for 2019 but has made no final decision. With that, I will turn it back over to the Operator so that we may begin Q&A. Thank you.

Operator?

Question and Answer

Operator
[Operator Instructions] And our first question comes from the line of George O'Leary from Tudor, Pickering, Holt and Company.

George O'Leary
Tudor, Pickering, Holt & Co
I see the incrementals on the product side were really strong and I appreciate the color around selling higher end wellheads and production trees during the quarter helping that business out, but I wonder if you could expand a little bit on the strategy around the supply chain side, what you guys are specifically doing there and how that's benefiting margins for the products business.

Scott Bender
Vice President of Operations/President, CEO & Director
George, we spent, I guess, the last 18 months trying to enhance our ability to bring product in from the Far East. So, to a large extent, you're seeing the benefit of that.

George O'Leary
Tudor, Pickering, Holt & Co
Got it. That's helpful and makes sense. I was just curious if there was anything incremental you guys were doing on the sourcing side or just an extension, it sounds like the latter. The color you guys provided around Q4 is definitely helpful but I think about the puts and takes there, you seemed to indicate in the release that the product side of the business will continue to grow, understandable that the frac rental side will be a little bit soft. Do you expect the revenues to effectively fully offset there? And then what about the services side of the equation?

Scott Bender
President, CEO & Director
Yes, broadly speaking, we expect that our product business revenue-wise will offset the anticipated reductions in our frac rental business. I think that clearly, though, just taking this to the next step, and I know you're interested in the margins of course, the margin implications will lead us to an overall decrease in our Q4 although not nearly as severe as I think most people expected.

Operator
Our next question comes from the line of Scott Gruber from Citigroup.

Scott Gruber
Citigroup
A couple of questions on the new technology. How should we think about the cadence with which you commercialize the four new innovations? Based upon your commentary, it sounds like they're all going commercialize rather simultaneously next year. Is that the right way to think about it?

Scott Bender
President, CEO & Director
Yes, we really anticipated rolling them out one at a time, but things don't always work out the way we had them planned. So now it looks like they're going to roll out simultaneously. I would say that we're modeling, I guess, some benefit from those innovations in the second quarter of next year. And the reason for that is that we have some supply chain constraints for a portion of these innovations that we can't produce internally. So think about Q2.

Scott Gruber
Citigroup
Got it. And just some additional color on the market size. If I heard you correctly, the opportunity here, the addressable market could be bigger than the addressable market for your existing rental assets. Is that correct? And how should we think about the multiplier?

Scott Bender
President, CEO & Director
I don't know -- let me qualify that. I don't know that the total market is going to be larger but because in our frac business, there are certain customers with whom we don't expect ever to be able to do business because we're not low bid, think about these innovations as having many fewer competitors, so it's not nearly -- I think as we discussed, we're trying to build a moat around this business. So, in terms of our addressable market, yes, we do view that the potential revenue from these innovations could be in excess of the revenue for our legacy frac rental equipment.

Scott Gruber
Citigroup
Got you. I think the quote previously was that on a per pad basis, the revenue opportunity would be 40% bigger, if memory serves, but the number of pads that you think you can capture, it sounds like is larger. Is that correct?

Scott Bender
President, CEO & Director
Well, let me say that I'm really not thinking about it in those terms right now. I'm thinking more about the revenue per pad that we believe we can generate from these innovations versus the revenue per pad from our frac trees and our zippers. And that number significantly exceeds the latter. I think that in terms of our penetration because of the vastly more differentiated features in these products, we might actually be able to increase our market share for those features beyond the less than 10% we enjoy now in our legacy rental business.

Operator
Our next question comes from the line of James Wicklund from Credit Suisse.

James Wicklund
Credit Suisse
I guess I'm a little behind the curve here. What are these four innovative features/capabilities that you're commercializing? It's obviously in your frac rental equipment, but what do these innovations do?

Scott Bender
President, CEO & Director
Jim, you're not behind the curve. We've been very circumspect in terms of disclosing the nature of these for competitive reasons. --

James Wicklund
Credit Suisse
I haven't missed anything. I feel better now. Can you just describe them in some broad general terms as to what they do?

Scott Bender
President, CEO & Director
Steven, you want to add a little bit of color to that?

Steven Bender
Vice President of Operations
The whole theory behind these innovations was to reduce nonproductive time on the frac site and remove human intervention from the exclusion zone. So when we looked at causes of nonproductive time, not related to frac trees or zipper manifolds, we started to tick down the list and we’ve developed these products that we think would most meaningfully address causes of nonproductive time.

James Wicklund
Credit Suisse
Okay. So, if we can figure out on our side what the biggest causes of nonproductive time were, we get some idea of what they might be able to do, right?

Steven Bender
Vice President of Operations
Probably.

Scott Bender
President, CEO & Director
There you go.

James Wicklund
Credit Suisse
Okay, we got to do our homework. That's all right. My follow-up, if I could, you noted in Q3 that you exceeded your expectations and we all know that Q4 isn't in a very good proxy run rate for the following year. I'm just curious, the stock market this morning doesn't seem to particularly be as wild about you beating your expectations as you are. Any feedback yet on what the issue is that people were just expecting you do a hell of a lot better than your expectations? Do you have any idea?

Scott Bender
President, CEO & Director
Well, Jim, I really don't.

James Wicklund
Credit Suisse
That's a question for Fitzgerald, I guess. The new guy.

Scott Bender
President, CEO & Director
Come on, John, your future depends upon your answer.

John Fitzgerald
Director of Corporate Development and Investor Relations
Yes, I mean, I think potentially the market maybe focused a little bit more than we are on the fourth quarter, and I think we're looking forward and excited to the potential for 2019.

Scott Bender
President, CEO & Director
Yes, Jim, I think that's really -- obviously the market hadn't been very favorable lately to any of us in the sector. I think really everybody knows that Q4 is not going to be Q3 and so perhaps because we've done as well as we have, people may have expected our Q4 to exceed our Q3. I think clearly in product shipments, it will but not much we can do in terms of completion activity. And I want to emphasize that most of the decline we're going to see in completion activity is more the result of budget exhaustion. We're really not seeing the impact of takeaways in the Permian with our existing customer base. We are seeing some pretty serious delays in terms of starting new pads, which has impacted, as we mentioned, our utilization. So if I think about 2019, and without disclosing the customers, I'm thinking now of 4 or 5 customers who have almost reduced their crew count to 1 or 0 from maybe 3 or 4 and have confirmed they're going to get back to work in Q1. So it's not a very efficient way to run a business but it is what it is.

Operator
And the next question comes from the line of David Anderson from Barclays.

David Anderson
Barclays Bank
So, Scott, you talked about -- I know you haven't set your budget for next year so I'm not pushing on it. I'm just kind of more curious in general, you talked about your frac valve business and it sounds like it will be a little light in the fourth quarter, but besides that, I mean you've generally been completely sold out in this frac valve business. Can you talk about how you think about that cadence for next year? I mean, clearly, you're going to have to build more of this, but how do you kind of plan out kind of your year in '19 if you kind of don't really know what the E&P budgets are going to be yet, but you certainly got the sense they're all coming back. So just help me kind of walk through kind of your thinking in terms of putting more capital in that business and kind of reaching out to more customers there, please?

Scott Bender
President, CEO & Director
So, you asked the most difficult part of our business to forecast as you know because of the lack of visibility and our relatively low market share, but I think that broadly speaking, we think that Q1 for frac

rentals will look more like Q3 than Q4. We think that by Q2, you're going to begin to see some of these new innovations begins to monetize. I also feel like we've just begun to approach customers that heretofore we've been unable to approach because of capacity. I think you're going to see, in fact we've added 3 new frac customers already. Their work will commence in November. In terms of additions to our legacy frac business, they'll be maybe 40%, maybe 35% of what they were in 2018. The vast majority of our spend will be on new innovations for next year.

David Anderson
Barclays Bank
And your -- it seems to me that the best business for you or the best customer for you are those who are on the larger pads. I mean, it seems if I think about kind of your wellhead business, your frac business, these new innovations, it seems like it’s all sort of potentially -- the real value comes from the pad size. Can you just talk to us kind of generally speaking, kind of what percentage of your customers – I know this is kind of a tough question, but what percentage of your customers now are kind of doing the pads, or kind of larger pads? And as we think about next year, we’re hearing about these bigger programs picking up from some of these majors really pushing larger pads and clearly the Permian is a little bit further behind in the pads. Just kind of talk about that and kind of where that business is heading for you in terms of the pad size.

Scott Bender
President, CEO & Director
Okay. So that's a good question and I wish I had the answer to it, but I know that the vast majority of our customers are engaged in pad drilling. I'll look at Joel and Steven, and see if they have anything, you think you can quantify that? If I think about our top 10 or so customers.

Steven Bender
Vice President of Operations
We have very few customers that are drilling single well pads with the exception of maybe some exploratory stuff in the Delaware.

Joel Bender
Senior VP, COO, Secretary & Director
And a little bit of what we do in the Lafayette area. That’s really about it.

Steven Bender
Vice President of Operations
We’re seeing much more of the manufacturing nature in the main part of the Permian and the Midland basin, but I think we'll see customers move more to manufactured type well construction in the Delaware. STACK and SCOOP is multi-well, Marcellus is multi-well, Bakken multi-well, South Texas multi-well. So, I can't quantify it by percentage but --

Scott Bender
President, CEO & Director
The Midland basin is multi-well for us. It's really -- and the beauty of the Delaware for us is the Delaware is the biggest user of our recently rolled out 4T system.

David Anderson
Barclays Bank
So presumably, with these pads getting bigger and bigger and some of these bigger guys coming out there, you should see better visibility into next year, I would assume in terms. Because you just talked about kind of the biggest problem is the lack of visibility. Is sort of the hope, do you think over the next year or 2 you should get a better and better sense of what that visibility is and help kind of manage your business because it seems to me it's a problem throughout the industry. Obviously, this isn’t your issue-- but we're seeing it across sort of the supply chain in services, nobody seems to know what their customers are doing these days.

Scott Bender
President, CEO & Director
We have a really good idea, as we have mentioned before, about plans for our products business. We get -- we do get drilling schedules and the drilling departments have been very, very supportive of our need to forecast and, of course, that's because it impacts their costs of their wellhead products. I would say that we still lack good visibility on the frac side. Although, for our perhaps top 10 customers, we have far better visibility today than we did say 6 months ago. So, I haven't really thought about it until you asked this question but I think that overall, you're probably right. We will be able to gain much better visibility in 2019 than in 2018. And just a comment about pad size. Our products make sense with a pad size of 3 or more. It doesn't have to be an 8-well pad or a 10-well pad. It just needs to be more than 2 for it to make sense.

David Anderson
Barclays Bank
Okay. And presumably all these new innovations you're talking about, likewise in that same kind of realm, are sort of designed around this kind of 3 or bigger pads?

Scott Bender
President, CEO & Director
Absolutely.

Operator
And our next question comes from the line of Kurt Hallead.

Kurt Hallead
RBC Capital Markets
So, Scott, I'm curious as there's been a lot of discussion on this call about pad sizes and how that can favorably impact the opportunities for Cactus going forward. We've heard a number of different things from varying sources as to what it was, what it could be going to. So I figure I'd take this opportunity and have you educate us on what is the average pad size that you see on a go forward basis? And what would that represent in terms of overall percentage increase? And then, how do you map that back to your potential to increase your share, if you will, on the wellhead business going into next year?

Scott Bender
President, CEO & Director
I'm going to say the average pad size is –

Steven Bender
Vice President of Operations
It's really basin specific. In the Permian, 3 is probably the right number. In the areas of the Rockies, the DJ, we see pad sizes that are much larger than that. South Texas, probably larger than 3 on average, Marcellus larger than 3 on average.

Joel Bender
Senior VP, COO, Secretary & Director
It's basically 3 to 6.

Kurt Hallead
RBC Capital Markets
And is it going from 3 to 6 to like 4 to 10 or 4 to 8? I mean, what do you expect to see based on your discussions with the customer base?

Scott Bender
President, CEO & Director
I don't think there's been really any indication from our customer base about increasing the number of the pad size. But again, our products make sense at 2 plus. So whether it's 3, 4 or 5, it really -- the only difference for Joel is that he wakes up one morning and has to ship out 6 sets of wellhead instead of

having to ship out 3, so that produces a little bit of stress on our supply chain, and thank goodness for Bossier City in that regard. And, I think the other point that maybe is misunderstood, those customers who have these 12 and 15 well pads really approach them like they're discrete 4 3-well pads or 5 3-well pads, things like that. So it's -- I don't really think -- we don't really think about the increase in pad sizes, only in terms of the volatility in terms of shipments.

Kurt Hallead
RBC Capital Markets
Got it. Okay, that's great info - appreciate that. Second question I had on the tariff front with Section 301 and obviously no one really knows how, what's going to evolve and whether there's going to be another 25% tariff placed. But just along those lines, right, can you give us some additional insight on how you have managed the process and how you plan to manage the process to mitigate the higher tariffs and mitigate the impact on your margins?

Scott Bender
President, CEO & Director
Kurt, I'd love to do that but I'm not going to do it. I think, look, suffice it to say, we have it under control. We have -- I have absolutely no concerns about -- certainly about this year and early next year. If the tariffs go to 25%, I think we have an excellent strategy in place to mitigate the impact on our absolute EBITDA.

Kurt Hallead
RBC Capital Markets
Got it. If I may just follow up -- one final item, if you will, I don't want to get too far into the weeds on this call, but in the context of your guidance you provided for the fourth quarter and revenue drop coming in the rentals and field services business, I guess it's safe to assume that all the margin degradation will occur in those 2 businesses?

Scott Bender
President, CEO & Director
Yes.

Operator
Our next question comes from the line of Sean Meakim from J.P. Morgan.

Sean Meakim
JP Morgan Chase & Co
Can you talk a bit more about market share for the wellhead business, maybe just the result in the third quarter and your forward expectations? Are you driving wallet share within existing customers versus those big chunky opportunities among the majors where you have really good traction on the rental side? Could we maybe just get a little more granularity on how you see things there?

Scott Bender
President, CEO & Director
Okay. I really don't want to give guidance for 2019 but I can tell you broadly the average, I think, price of a wellhead is slightly -- is going up slightly and it's really more to do with higher pressures and maybe the increased percentage of our 4-string systems in comparison to, say, Q3, so we're seeing bigger systems, higher pressure systems on the one hand. In terms of absolute rig growth, we are anticipating picking up some pretty chunky rig additions by the end of this year and into the first quarter of next year. So, you're going to see market share growth and I think you'll also see, as I said, higher pressure, larger bore wellheads.

Sean Meakim
JP Morgan Chase & Co
That's helpful. And then I guess maybe, could you elaborate on how you expect the process could evolve for a major type of customer as opposed to your existing base of independents? Meaning, the adoption rate or kind of the trial phase and picking up wallet share for a new customer. Could you maybe just

elaborate on how that process could evolve and how it could be different from what you've experienced with your traditional customers?

Scott Bender
President, CEO & Director
It's clear -- it will clearly be smaller with majors, Sean, than it is with even the very large independents, and the reason for that is their ability to make decisions is -- they're simply not as flexible in terms of their decision-making as a major, so more hurdles, I guess, to jump over when it comes to majors.

Sean Meakim
JP Morgan Chase & Co
Once you get in and get attraction, do you think that – does that also create more opportunity or just is it still a slow grind once you have proven yourself to a degree?

Scott Bender
President, CEO & Director
It will be slower than it has been with the large independents.

Operator
And the next question comes from Martin Malloy from Johnson Rice.

Martin Malloy
Johnson Rice & Company
I was wondering if you could maybe speak about international opportunities down the road and potential timing of those.

Scott Bender
President, CEO & Director
Marty, I wouldn't look at anything for 2019. I wouldn't begin to look for any meaningful international revenue contributions until 2020. And I apologize for not giving you maybe more clarity on that, but this is a very competitive business we're in.

Operator
We don't have any more questions at this time. I will now hand the call back over to Mr. Fitzgerald. Sir, please continue.

John Fitzgerald
Director of Corporate Development and Investor Relations
I'd just like to thank everyone for joining the call and for their interest in Cactus, and we look forward to seeing you on the next one. Thank you.

Operator
Ladies and gentlemen, that concludes today's conference call. You may now disconnect. Have a great day.