Cactus, Inc. (NYSE: WHD)
Q4 2018 Earnings Call Transcript
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Call Participants

EXECUTIVES

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

ANALYSTS

Chase Mulvehill
Bank of America Merrill Lynch
J. David Anderson
Barclays
J. B. Lowe
Citigroup
Martin Malloy
Johnson Rice & Company
J. Marshall Adkins
Raymond James & Associates
Tommy Moll
Stephens, Inc.
George O'Leary
Tudor, Pickering, Holt & Co

Presentation

Operator
Good morning and welcome to the Cactus Fourth Quarter and Full Year Earnings Call.
My name is Mary and I will be facilitating the audio portion of today's interactive broadcast. [Operator Instructions] At this event, I would like to turn the show over to Mr. John Fitzgerald, Director of Corporate Development and Investors Relations. You may begin.

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; Steve Tadlock, Chief Administrative Officer; and David Isaac, our General Counsel and Vice President of Administration.

Yesterday, we issued our fourth 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'd 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.

And with that, I'll turn the call over to Scott.

Scott Bender
President, CEO & Director
Thanks, John and good morning to everyone. 2018 was an outstanding year for Cactus with revenues of $544 million, up nearly 60% from 2017. In addition, adjusted EBITDA at $213 million, rose almost 90% year-over-year. I'm proud to report we successfully managed the transition to a public company and our team is excited about the future.

The fourth quarter, while challenging for well-documented reasons, further validated our value proposition. Although our customers delayed completions to a greater extent than expected, our business demonstrated resiliency with total company revenues declining by only 7% sequentially during the quarter. During the period, average U.S. market share in our Products business, which we define as percentage of onshore rigs followed, increased from 27.4% to 27.8%. Further, we were pleased with our ability to hold margins relatively stable in both our Product and Rental businesses.

So in summary, revenues fell 7.2% sequentially, adjusted EBITDA decreased 12.7% sequentially and adjusted EBITDA margins declined from 40.7% in the third quarter of 2018 to 38.3% in the fourth quarter of 2018.

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

Brian Small
Chief Financial Officer
Thanks Scott, and good morning.

Q4 revenues at $139.8 million were 33.4% higher than the equivalent period last year and 7.2% lower than in the third quarter, as Scott mentioned. Drilling-related activity was relatively flat, while completions-related activity witnessed a decline during the quarter. Product revenues, which include consumables used in both drilling and production were 38.1% higher at $78.9 million than the equivalent period in 2017 and 0.6% lower than Q3. Product gross margin at 42% was 760 basis points higher than Q4 2017 and 100 basis points higher sequentially, the latter due largely to product mix.

Rental revenues at $31.2 million were $6.7 million greater than Q4 2017 and $6.9 million lower sequentially. The decrease was attributable to reduced completion activity from our customers toward year end, while the increase compared to last year is due primarily to the increased investment in our Rental fleet allowing us to increase market share.

Field Service and Other revenues in Q4 at $29.7 million were $6.6 million higher than Q4 2017 and $3.4 million lower than Q3 2018. Lower revenues versus the third quarter were driven by a decrease in billable hours for our work tied to completions-related activity and the typical Q4 seasonality during the quarter. The movement compared to last year is due to an increase in billable hours made by adding service technicians and related ancillary equipment. Field Service revenues represented approximately 27% of combined Product and Rental related revenues during the quarter.

SG&A at $10.5 million for the quarter was $3.9 million higher than Q4 2017 and $0.5 million lower than Q3 2018. The sequential decrease was primarily from lower professional fees, while the majority of the increase compared to 2017 was due to additional payroll expenditure and other costs associated with being a public company. We would expect SG&A in Q1 2019 to be in the $12 million range due in part to an increase in professional fees and stock-based comp.

Net income at $38.7 million declined from $43.6 million in the third quarter. Our income statement reflects the net income attributable to the non-controlling interest owners and public owners of Cactus, Inc.

Fourth quarter adjusted EBITDA was $53.5 million. This was 52.7% greater than the equivalent period last year, but down 12.7% compared to Q3 2018. Adjusted EBITDA for the quarter represented 38.3% of revenues, which compares to 33.4% in Q4 2017 and 40.7% for Q3 2018.

Our effective tax rate for the quarter was 11.4%. The primary reason for this rate being lower than the federal tax rate is that the profits of the non-controlling interests are not subject to U.S. federal tax. Our public ownership remained at 50.3% during the quarter.

Internally, we prefer to look at adjusted earnings per share as it eliminates the impact of changes in ownership throughout the quarter and assumes that the public entity held all units in its operating subsidiary Cactus, LLC at the beginning of the period with the resulting additional income tax expense related to the incremental income attributable to Cactus, Inc.

With fully diluted shares outstanding of approximately 75.3 million and an effective tax rate of 22.5%, our adjusted earnings per share this quarter was $0.45 per share compared to $0.52 per share in Q3, a decrease of 14%. We estimate that the adjusted earnings per share in Q1 will have an effective tax rate of 24%.

Our cash position increased by $28.9 million during the fourth quarter to $70.8 million at December 31. For the quarter, operating cash flow was $44.8 million, and our net CapEx spend was $13.7 million. Additionally, we spent $1.8 million for finance lease payments in the quarter and $0.3 million for deferred financing costs.

Net working capital at the end of the fourth quarter represented approximately 26% of fourth quarter annualized revenues, slightly higher than in previous quarters due to the acceleration of inbound inventory shipments before year end with a view to minimizing the then expected but unrealized impact of additional Section 301 tariffs. Early indications in 2019 are that working capital relative to revenue is reverting to historical levels.

Our CapEx for the full year at $68.2 million was in line with our prior indications following the third quarter. As we look forward to 2019, we expect to spend in the low $60 million range for total CapEx. This includes $45 million to $50 million for growth capital in our Rental business, with a significant portion going toward our new innovations.

That covers the financial review, and I'll now turn you back to Scott.

Scott Bender
President, CEO & Director
Thanks, Brian.

Our Products business continues to be primarily driven by the total number of wells drilled, which is abetted by improving secular trends such as more wells drilled per rig and larger pad sizes. So far this year, our rigs followed has remained relatively stable despite the slight decline in the U.S. onshore rig count as we've successfully gained market share with new operators. Importantly, our customers have resumed completion activity and we've seen a more normalized level of production tree shipments which had declined toward the end of 2018. We now believe our Q1 2019 Product revenues should be up in the high-single-digits quarter-over-quarter.

Looking further out, we remain cautious regarding the level of overall drilling activity, despite the more modest and expected rig count decline to date. As rigs roll off contracts, we would anticipate that private and public E&Ps will reduce spending. That said, with the recent recovery in crude prices and the tightening of differentials in the Permian, we believe that the pullback, while delayed, may be more muted than previously thought within our customer base. Regardless, we believe we remain well-positioned to gain market share in 2019.

During the fourth quarter, our customers displayed a willingness to drill new wells at a fairly steady pace but were less willing to complete wells amid lower oil prices. However, as budgets have reset in the new year, growth and completion activity has exceeded the growth of our Product business during the first half of the quarter. As we look to 2019, improvements in general completion activity should outperform the change in E&P budgets due in no small part to cost deflation and large ticket service items such as pressure pumping and sand.

We believe this improving backdrop could generate an increase in our Rental revenues in the neighborhood of 15% sequentially in the first quarter. Margins in Q1 are likely to witness a slight pullback as we ramp back up and deploy additional high pressure equipment into the field following the slowdown experienced in Q4.

Turning toward our new completions innovations, we've been very pleased with the performance and reception witnessed in the field. These offerings were designed in conjunction with existing customers and the efficiencies demonstrated on site have exceeded expectations. We anticipate noticeable revenue generation during the second half of this year, as we believe we've developed some truly differentiated technologies. Based on our current forecast for growth capital to be directed towards these initiatives, we believe the year-end 2019 revenue run rate for our new innovations could represent an additional 20% to our current Rental revenue run rate.

Moreover, we continue to think the market opportunity for these offerings is as large as our existing Rental business as we build out our fleet of innovations over the next several years. With that in mind, we've chosen at this stage not to publicize more details on these products until they are more fully

brought to market. We encourage you to view this relative silence as a reflection of our optimism around these offerings, as we work to maintain and protect a competitive advantage.

Field Service, which is driven by both Product sales and Rental revenue was adversely impacted by the completion slowdown in the fourth quarter. This business traditionally accounts for higher non-billable hours around year-end holidays. Early indications in Q1 are that the margins in this business have returned toward the more normalized levels seen during the first three quarters of 2018. Going forward, we would expect revenue from this business to be roughly 26% to 28% of our combined Product and Rental revenue.

As previously noted, we expect our full year 2019 capital budget to be in the low $60 million range depending on how quickly we choose to build out our fleet of the aforementioned innovations. Maintenance CapEx should not exceed $5 million and roofline expansion will be minimal, although we will add two new high spec machines in Bossier City.

Regarding tariffs, we have largely mitigated the impact of Section 301 tariffs that were set at a rate of 10% on products imported from our wholly-owned manufacturing subsidiary in China through a combination of factors discussed during our last call. We're optimistic that the impact from tariffs will be limited to single-digit reductions in Product margin percentages going forward as we move to fully replace pre-tariff inventories. In recent days, the USTR officially announced it's postponed the increase in tariffs previously scheduled for March 2, 2019, and that the Section 301 tariff rate will remain at 10% until further notice.

So in summary, based on the first two months of 2019, we expect higher Q1 revenues across all of our business lines when compared to Q4. We're encouraged by the rebound in activity we've witnessed and optimistic regarding the potential for the successful deployment of our new rental innovations. Following our significant growth in 2018, we are now a stronger, more balanced company while retaining our flexibility and our ability to scale the business in response to market conditions. We remain returns-oriented with a focus on free cash flow.

Finally, in anticipation of questions about capital allocation in light of our increasing cash position, I can confirm that we've reviewed no suitable M&A opportunities to date and that our Board has made no decisions regarding dividends or a potential buyback program.

Before I turn it over for questions, I want to take this opportunity to congratulate Steve Tadlock, who has been appointed to the position of Vice President and Chief Financial Officer effective March 15. Steve has done a masterful job managing various corporate, operational, and finance functions as we've transitioned to a public company.

I also want to thank Brian Small, for his invaluable contributions to both the company as our CFO and to our family. Over the last 19 years, Brian developed and implemented many of the metrics by which we manage this business daily and through which we maintain our focus on operating margins. As previously noted, Brian is transitioning full time to a new role of Senior Finance Director where he will oversee various corporate, operational, and finance process improvement initiatives without the distractions inherent in a public company.

So with that, I'll turn the call back over to the operator and we may begin Q&A. Operator?

Question and Answer

Operator
Sure. [Operator Instructions] Our first question is from the line of Marshall Adkins from Raymond James. Your line is open.

Scott Bender
President, CEO & Director
Good morning, Marshall.

J. Marshall Adkins
Raymond James & Associates
Can you hear me?

Scott Bender
President, CEO & Director
Loud and clear.

J. Marshall Adkins
Raymond James & Associates
...guys? Okay. Sorry. I was getting some feedback. Let's go to the tariff impact. You gave us a lot of good detail on what you know right now. I'm curious on a couple of things. First of all, just your latest thoughts on where this ultimately goes. I'm not sure you have any more insight than I guess the rest of us, but it's a big deal for y'all. So I'm just curious on where you think it goes and secondly and probably more importantly, how are you positioned on the tariffs versus your competition? I know you have the manufacturing here in the States that probably helps you. But I'm just curious as to how that positions you in the competitive landscape given what the tariff situation is today.

Scott Bender
President, CEO & Director
Okay. Well, in terms of where this is all going, I think it's fair to say we're far more relaxed about the increase to 25% than we were during the fourth quarter of last year. And I think evidence of that is our behavior in terms of imports. So we accelerated, as Brian mentioned, our inventory receipts during the fourth quarter in anticipation of the 25% – of an increase to 25%. We have not taken similar steps this year, and I guess that decision was validated by the USTR's decision to put on indefinite hold to the increase to 25%. That's the reason also that Brian mentioned that he felt like our working capital ratios would revert back to normal over the next period of time. So I guess the short answer is it's not of, I think, a priority in terms of our concern landscape. And we were during the fourth quarter sort of aided by the three factors that we spoke about at the last call that I don't think I need to reflect upon again.

J. Marshall Adkins
Raymond James & Associates
All right.

Scott Bender
President, CEO & Director
What's your next question, Marshall?

J. Marshall Adkins
Raymond James & Associates
Well, the competitive landscape, how are you positioned, let's just say it stays at 10%, how are you positioned versus all of your key competitors?

Scott Bender
President, CEO & Director
So most of our key competitors rely upon China. China, as we've remarked before, still has a competitive advantage. We felt like it has a competitive advantage even at 25%. There are not very many U.S. manufacturing facilities, as you know and you made reference to, about half of what we do, half of our cost of goods sold relates to Bossier, about half of our product cost of goods sold relates to China. So I feel like we're in pretty good shape in that regard. That's not to say we could replace China with Bossier City, we don't have nearly enough capacity to do so.

You know that our major competitors, one of them has a manufacturing facility in Western Europe. Our view is it's probably not competitive with China, although it won't suffer from the tariff risk of China. The other major competitors and certainly the Tier 2 and Tier 3 suppliers rely very, very extensively on China. My gut feeling is and Joel can maybe expand upon this, we're probably less exposed than that next tier of suppliers in terms of China.

Joel Bender
Senior VP, COO & Director
We are – I mean, I think we've done a good job on our supply base in China. We've looked at other countries as well and again the conclusion we've come to and we did this again. We've done it repeatedly over the last several years. We've looked around at other options and still with the tariff being at 10% or 25%, there's still a cost advantage to bring your product in from China which is where we continue to expand our supply base.

J. Marshall Adkins
Raymond James & Associates
Perfect. That's very helpful, guys. Last one for me is on the same issue. It appears that we're going to get some pretty – if you go back to historical levels of working capital that the buildup you had in Q4 should translate to a pretty healthy boost in just free cash flows this year. Is that the right way to be thinking about it?

Scott Bender
President, CEO & Director
Yeah. I think you're directionally correct, Marshall.

J. Marshall Adkins
Raymond James & Associates
Okay. Thanks, guys. Appreciate it.

Operator
Our next question is from the line of Chase Mulvehill from Bank of America Merrill Lynch. Your line is open.

Scott Bender
President, CEO & Director
Good morning, Chase.

Chase Mulvehill
Bank of America Merrill Lynch
Yeah. Hey, good morning. Good morning. Good morning. So, I guess, I want to come back to the guide a little bit. Obviously, you have a pretty positive guide on the top line. Do you care to kind of elaborate a little bit? How you think margins unfold in the first quarter across each segment?

Scott Bender
President, CEO & Director
Well, I mean, that's not something I really want to do, but I'm happy to give you some idea.

Chase Mulvehill
Bank of America Merrill Lynch
Just maybe directionally. I mean, you said slightly down, is that slightly down overall?

Scott Bender
President, CEO & Director
I would say for Rental and Product, the margins should be down slightly. I think for Service, they should be up considerably. And of course, Service is kind of 26%, 27% of what we do. The reason for I guess – of what I think to be a realistic approach to margins in Rental in particular is really twofold. We did bring in some rental items into the fourth quarter just like inventory to avoid the 25% potential tariff increase.

Secondly, the product mix within our legacy Rental fleet changed in the last, I'm going to say, 60 days and we expect there to be a change going forward and what that means is because we rely to a large extent on our Far East supply chain for rental items, some of the items that we had expected and were in short supply in the summer became less dear and items that we had in our existing inventory - the high pressure valves - became in much greater demand. So, we've focused a whole lot of attention on redeploying those assets.

And I can tell you having done this for quite a while and I reflected back on the end of 2016, whenever we have a period of fairly robust increase in rental valve demand, it's always manifested itself in increased repair costs as we begin to harvest the assets that we already have in stock in addition to buying new ones.

In terms of Product, the Product margin compression is largely anticipated as we begin to roll out the pre-tariff inventory that we spoke about earlier and an increasingly high percentage of the inventory that flows to cost of goods sold flows through at the higher tariffed applied costs.

Chase Mulvehill
Bank of America Merrill Lynch
Okay. Right. And maybe you could help us and I don't know if you know this off the top of your head, but in fourth quarter, how much of that high tariff costs flowed through in the fourth quarter and how much of that do you expect to flow through in the first quarter?

Scott Bender
President, CEO & Director
I don't think I can answer that question, maybe Brian, are you comfortable, I don't know that we've broken that down.

Brian Small
Chief Financial Officer
All I can say obviously is that for Q1 2019, basically the whole of Q1 2019 is going to have product coming through with the tariff price. For Q4, broadly speaking, it could be 50/50, 50% pre-tariff, 50% post tariff.

Scott Bender
President, CEO & Director
Chase, I wish we could be more precise, we don't really track it.

Chase Mulvehill
Bank of America Merrill Lynch
Yeah, yeah, no, that's good. I guess, and we think about – you gave us some good top line guidance here especially kind of in Products and Rentals, but coming back to Product, what do you think your market share looks like quarter-to-date on the Product side?

Scott Bender
President, CEO & Director
I think it’s up slightly.

Chase Mulvehill
Bank of America Merrill Lynch
Okay. All right. Last one, I'll turn it back over. I think we're all pretty excited about what you've got coming on the completion side and I know you don't want to talk too much about it. But maybe could you just talk about barriers to entry with what you're doing, what kind of moat, I mean, how comfortable are you around the barriers to entry? And do you feel like you have a competitive moat that you'll be able to sustain in that business?

Scott Bender
President, CEO & Director
So, I'm going to let Steven maybe respond to that.

Steven Bender
Vice President, Operations
Yeah. I think you know that our goal with these completions innovations was to build a similar moat around our Rental offerings that we enjoy with our drilling products. And there's no doubt that a lot of the industry focus right now is centered on completions efficiencies and we're being purposely opaque about the technologies because we don't want to tip our hand.

But some of these technologies were developed to improve upon existing technologies, so things that we saw that were in the field that our customers came to us and wanted to try and do things better. And some technologies are just completely new to the industry. So we're in the unique position that we work collaboratively with our customers to develop these.

So it's hard for me without going into more detail to answer that question maybe, but what I'd say is, this is a focus in the completions part of our business that previously have been reserved just for wellhead and I think you're going to see similar levels of innovation on the Rental side that you've seen in drilling.

Scott Bender
President, CEO & Director
Chase, let me just – I want to just slightly elaborate on that, and then we can move on. Cactus' business model has been to innovate and execute. So you can't innovate without executing and that – I don't know how much of our moat would be attributable to innovations as respect to drilling and how much to execution, but you know it doesn't do you any good to innovate if you don't – if you can't be on time and service that adequately. So it's sort of our same philosophy. Yes, these innovations we believe are highly differentiated, but don't minimize the importance of the Cactus execution model.

Chase Mulvehill
Bank of America Merill Lynch
Yeah. All right, very helpful. Appreciate the color. I'll turn it back over. Thanks, gentlemen.

Operator
Our next question is from the line of David Anderson from Barclays. Your line is open.

J. David Anderson
Barclays Capital
Scott, that's quite the tease on the new products here, so I guess we'll just have to trust you and stay a little patient here. On a different subject, I want to ask about on the wellhead side, you've been gaining share basically every quarter – really kind of every year since 2011, I'm sure servicing, as you said, execution is a big part of that. But I also have to think you have to attribute a bunch of your share gains to differentiated offering which is ideally suited for unconventional. I guess, it sort of begs the question what your larger competitors are doing? We don't really hear them much from them on this subject. I mean, should we take that to mean that they haven't really closed that technology gap at all? I get the sense they may not even be trying. I mean, could you just kind of give us a little concept – a little color on kind of what you're seeing on the competitive side of the market?

Scott Bender
President, CEO & Director
David, somebody asked me a couple of calls ago what keeps me up at night and I said two things keep me up at night, safety and our competitors. So yes, our competitors see what we do thanks in part to being a public company now, and you have to assume and we always assume, that they're doing their best to close the gap. And that's part of what pushes us to continue to innovate. So we talk about the frac innovations. But, I want to give you some comfort from this call that we haven't stopped innovating in terms of our wellhead offerings. So the shorter answer is, yes, they're responding. I think in a large

degree, the industry is probably doing a better job overall than they did two years ago as they view our success. But, that just pushes us harder.

J. David Anderson
Barclays Capital
Is it kind of a – kind of curious, if I could shift maybe on your frac tree side, I guess, obviously, another part of your business which is clearly differentiated. Where are you today on kind of the utilization of your frac tree assets? Are you kind of 100% utilized? And kind of a follow-up question, I'm just kind of curious, I know this is an area you've been spending some capital and building this out on your Rental fleet there, but can you just give us just kind of a rough sense of how much has grown over the last year, how much is going to grow this year? I mean, is it 10% this year and 10% next year? I'm not asking for numbers, just sort of kind of give me a ballpark of kind of how you see that business growing?

Scott Bender
President, CEO & Director
So David, are you asking about investment in... Rental…?

J. David Anderson
Barclays Capital
Right. Well, so I know it's kind of – sort of one of the areas that you've been spending money on is building out those frac trees. I'm just kind of curious despite sort of kind of the number that you can put out in the field today, kind of how much bigger is that today than it was last year and how much bigger is it going to be, say, at the end of this year - do you think - in terms of addressing that market?

Scott Bender
President, CEO & Director
Mr. Tadlock has offered to respond.

Stephen Tadlock
Vice President and Chief Administrative Officer
I think at the end of 2017 gross Rental PP&E was about $85 million and at the end of 2018 it was about $124 million. And I think we referred to about $50 million of Rental CapEx for 2019, if that gives you a sense of the totals. We really don't think about it in terms of individual frac trees because every frac tree is different. We always think about it in terms of gross PP&E as well as paybacks.

J. David Anderson
Barclays Capital
Okay. That's helpful. I guess, Scott, as a final question sort of related there we've just heard from Chevron and Exxon just came out on their Analyst Days kind of emphasizing their Permian programs. Maybe can you just talk a little bit about how that's changing your market at all, I mean maybe how this customer differs from your traditional E&Ps in terms of the technology they're requiring, how the pricing is, procurement, clearly it's a shift in sort of your customer base. I was curious what that actually means to Cactus in the next couple of years.

Scott Bender
President, CEO & Director
Well, first, let me just tell you, David, we love all current and potential customers, but I don't think it'd be any secret or any surprise if I tell you that we find that independents and the large publicly traded E&Ps embrace our innovations more enthusiastically. So we get a much better reception when we make a proposal to sort of the non-Chevron or XTO customer base. I would say that in terms – so that's on the drilling side. I'd say on the frac side, the completion side, that's not the case that we see the IOCs very receptive to innovations.

J. David Anderson
Barclays Capital

So, can you help me understand the difference, which is why on one side they like the innovations, but the other side of the business you don't. I'm kind of surprised by how they look at one versus the other.

Scott Bender
President, CEO & Director
I don't want to – this is my very, very personal feeling. Majors or IOCs are just more risk averse and so on the drilling side, if what they're using isn't broken, isn't shutting down a rig, they are less likely to embrace change where the independents are going to take execution for granted because they're very, very critical in terms of suppliers who don't perform and they focus more – they have focused at least in our brief history far more on efficiency gains and willing to take the risk of trying something new. So, I think it's really a risk profile. It's the fact that the customers with whom we do business are probably flatter organizations, less committees and drilling has always been a very, very high profile item despite the fact that it represents 1% or 1.5%.

On the frac side by contrast though I think you probably know there are maintenance issues on a frac pad and maintenance issues on a frac tree or another supplier cause an outsized impact on the economics. And so, because perhaps the failure rate or the reliability rate has been lower, the majors view that to be – that risk of change is minimized in terms of the potential reward.

So on the one hand, you have a product that may not be breaking down, but promises rig time savings. On the other hand on a frac location, you have products that are more susceptible to reliability problems.

J. David Anderson
Barclays Capital
Thanks for the insight, Scott. Appreciate it.

Operator
Our next question is from the line of J. B. Lowe from Citi. Your line is open.

J. B. Lowe
Citigroup Global Markets
Hey, good morning guys. Just to follow up on the question about the majors. The more accepting of – talking to you guys on the frac side of the business, is there any potential for you to kind of use the frac side of the business as a pull through to get them to talk to you about your wellheads and how do you go about doing that?

Scott Bender
President, CEO & Director
We try it every day. Two different departments in mind – two different departments, you have the drilling department, you have a completion and production department. It is very helpful, but it's – like it's much better to start with a customer who has used – with whom we have an MSA, you have a record in terms of safety and reliability. It makes the next sale so much easier. But, it's certainly not a slam dunk as evidenced by our market penetration or lack thereof.

J. B. Lowe
Citigroup Global Markets
Right. Got you. And then, just a question on the – you mentioned the – your exit 2019 Rental revenue could be 20% higher than your exit 2018 Rental revenue due to the new innovations. Is that assuming that your legacy frac business is flat or is the growth rate on the innovation side bigger, assuming, and that means that the legacy side is getting a little bit smaller?

Scott Bender
President, CEO & Director
It does not assume that our legacy Rental business – well, it doesn't assume suffering in our legacy Rental business.

J. B. Lowe
Citigroup Global Markets
Right. Got you. Okay. Thanks, guys.

Operator
Our next question is from the line of Tommy Moll from Stephens. Your line is open.

Tommy Moll
Stephens
Good morning and thanks for taking my questions.

Scott Bender
President, CEO & Director
Hi, Tommy.

Tommy Moll
Stephens
So, recently, you – or including this morning, you mentioned you're planning to add two more CNC machines at Bossier, so I think that brings you to 16 total. Pro forma for that, where does it put you in terms of utilization at Bossier? Or asked a different way, if you keep taking wellhead market share like you have been in recent quarters and years, how long of a runway do you see before there might need to be more growth CapEx there or is it far enough out that it's still hard to tell at this point?

Joel Bender
Senior VP, COO & Director
I mean, this was – we made this decision last year basically to provide us with additional capacity for some of the drop-in orders plus additional capacity to continue to maintain the Rental CapEx. So, I feel like we're in good shape. I don't really feel like we've got much in the way of further requirements. The facility right now runs at about, I would say, 60% to 65% of capacity. I do need some additional machine tools right now with some of these changes that Scott spoke about with the Rental CapEx fleet to be able to provide some of these higher pressure valves.

Tommy Moll
Stephens
Okay. That's helpful. Thank you. And then, as a follow-up, there's been quite a bit of discussion on the margin impact from tariffs, and then how you have mitigated that to some extent by pulling forward some orders in Q4. If 1Q margins will be pinched a little bit, how far into 2019 should we expect that trend to continue?

Scott Bender
President, CEO & Director
I don’t think you’re going to see further pinching.

Tommy Moll
Stephens
Okay.

Scott Bender
President, CEO & Director
That wasn’t very eloquently stated.

Tommy Moll
Stephens
But, perfectly clear. Thanks and that’s all from me.

Operator
Our next question is from the line of Martin Malloy from Johnson Rice. Your line is open.

Martin Malloy
Johnson Rice & Company
Good morning.

Scott Bender
President, CEO & Director
Good morning to you, Marty.

Martin Malloy
Johnson Rice & Company
Just looking at the new products on for the Rental side, would there be any impact as you ramp up through the course of the year and add field personnel related to these products on the margins?

Steven Bender
Vice President, Operations
No. In fact, all of our existing personnel on location will operate these technologies. So, there's no additional service required.

Martin Malloy
Johnson Rice & Company
Okay. Great. And then...

Scott Bender
President, CEO & Director
That provides kind of a moat as well, if you can appreciate that. So the incremental cost of the customer won't include additional personnel as it may with competitive offerings.

Martin Malloy
Johnson Rice & Company
Okay. Great. And a follow-up question, this has been asked twice earlier, but just on the IOCs, is it a matter of time do you think for them to test and accept your wellhead products and eventually you're going to start to see more inroads made?

Scott Bender
President, CEO & Director
Well, hey, Martin, that's been asked many times, not just twice. But the majors, the IOCs that are of interest to this group probably have 125, 135 of the U.S. rigs, okay? Now there are some other IOCs in there, but the ones that I guess have garnered all the attention. We wouldn't be doing our job if we weren't hot behind those prospects and we haven't stopped.

Martin Malloy
Johnson Rice & Company
Okay. Thank you.

Operator
Our next question is from the line of George O'Leary from Tudor, Pickering, Holt & Co. Your line is open.

George O'Leary
Tudor, Pickering, Holt & Co.
Good morning, guys.

Scott Bender
President, CEO & Director
Hey, George. Hi, George. How are you?

George O'Leary
Tudor, Pickering, Holt & Co.
I'm doing well, y'all?

Scott Bender
President, CEO & Director
We're doing great. Thanks.

George O'Leary
Tudor, Pickering, Holt & Co.
I just had one question around you guys tend to be very collaborative with your customers and I think that's one of the underappreciated parts of your story. As E&Ps have pushed into more of a kind of cash flow and returns-focused business model, is there any change on the items that they want to collaborate with you on, or said another way, any areas that they're acutely focused on adding efficiencies to or reducing non-productive time?

Scott Bender
President, CEO & Director
So, George, that's a very good question and I have to answer it. There are two responses. The first is NPT has the – the focus on NPT has continued to increase which we view as a positive thing. It's harder to quantify, but it exists and so it makes a pitch towards technology that addresses that, pardon me – pardon me, much more compelling. That's one side of the equation.

When oil prices dropped to $45, as you might imagine, the collaboration gets sidelined in favor of procurement, procurement is less interested in talking about NPT and more interested in talking about price, and that of course is not terribly constructive for this business, although it does, as it did in 2016 or 2015, provide us with some introductions that we might not normally have had previously. So we'll take an introduction on any basis be it to discuss price, or be it to discuss innovation, because an introduction is an introduction. Now I wish I could be more clear, but it really is coming, I think that the level of interest comes from two different areas.

George O'Leary
Tudor, Pickering, Holt & Co.
That's helpful color and I certainly appreciate it. And then maybe just following on, from you guys gave good color on the Rentals guidance sequentially Q-over-Q in the first quarter of 2019, I was wondering if maybe you could parse out how much you think of that is – that impressive growth rate is kind of underlying completions activity improvement versus the low levels we saw most notably in December and how much of that maybe market share or maybe just talking about January versus December and February versus January would be helpful.

And then not to be too short-term, as we look at 2019, you mentioned you have completions might actually be up given some of the other moving pieces on the completion side. So if you could speak to maybe your outlook for the cadence of completions in 2019 and how that progresses, any color there would be greatly appreciated.

Scott Bender
President, CEO & Director
Let me talk to you about the cadence of completions. So we saw and in terms of – well, I'll touch on all of that and then I'll let Steven supplement my remarks. We saw a number of customers who at the end of the year had just flat, laid down their frac crews. So we saw a return of that in January, but we also saw market share gains in January. I don't think we've gone back to maybe quantify how much of it was market share gain versus how much of it was a return to just whatever normal activity levels, however you define that. But, I'm gratified to say that while we've normally maintained that our frac market share was in the 10% or below, we're comfortable on saying now we are north of 10%, south of 15%. Probably more south than we are north, but there's no question that our market share has increased in terms of the frac rental side of our business.

In terms of the cadence, well, what I think is what I would caution and I mentioned this at the last investor conference, don't look at these DUCs the way you looked at them before. I think there are a lot of DUCs

that probably will never be completed. I think there's a level of DUCs that most of our customers want to maintain in inventory for reasons of flexibility and efficiency. You know all that. So the question is what will this – the takeaway improvements, how will that manifest itself in additional completion activity. We're just not assuming a tremendous benefit from that, although I think that we all share the thought that there will be a pick-up in completion activity in the third and the fourth quarter. I don't think that it's going to be perhaps of the magnitude that a lot of people have maybe mentioned. It's not going to be a panacea. But honestly, what we're happy to slug away with slowly increasing our market share, paying attention to our capital investment, relying upon our new innovations to build a moat, so we're looking for more of a, maybe, a smooth increase I think in our frac rental business.

George O'Leary
Tudor, Pickering, Holt & Co.
Great. I appreciate the color, Scott.

Operator
There are no further questions. Mr. John Fitzgerald, I turn the call back to you.

John Fitzgerald
Director of Corporate Development and Investor Relations
Thanks, everyone, for joining and we look forward to speaking with you on our next call.

Scott Bender
President, CEO & Director
Enjoy your spring break, everybody. Take care.

Operator
This concludes today's conference call. Thank you all for joining, you may now disconnect.