Cactus, Inc. (NYSE: WHD)
Q1 2019 Earnings Call Transcript
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Call Participants

EXECUTIVES

Scott Bender
President, CEO & Director
Stephen Tadlock
Vice President, Chief Financial Officer and Treasurer
Joel Bender
Senior Vice President, COO & Director
Steven Bender
Vice President, Operations
David Isaac
Vice President of Administration and General Counsel
John Fitzgerald
Director of Business Development and Investor Relations

ANALYSTS

Tommy Moll
Stephens, Inc.
J. David Anderson
Barclays Capital, Inc.
George O'Leary
Tudor, Pickering, Holt & Co Securities
Scott A. Gruber
Citigroup Inc
Chase Mulvehill
Bank of America, Merrill Lynch
J. Marshall Adkins
Raymond James & Associates, Inc.
Martin W. Malloy
Johnson Rice & Co. LLC
Kurt Hallead
RBC Capital Markets LLC

Presentation

Operator
Good morning, and welcome to the Cactus Q1 2019 Earnings Call. My name is Marcella, and I will be facilitating the audio portion of today's interactive broadcast. All the lines have been placed on mute to prevent any background noise. For those of you on the stream, please take note of the options available in your event console.

At this time, I'd like to turn the show over to John Fitzgerald, Director of Corporate Development and Investor Relations.

John Fitzgerald
Director of Business Development and Investor Relations
Thank you, and good morning everyone. We appreciate your participation on today's call. The speakers on today's call will be Scott Bender, our Chief Executive Officer and Steve Tadlock, 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 David Isaac, our General Counsel and Vice President of Administration.

Yesterday, we released our first 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
Okay, thanks John, and good morning to everyone. I am pleased to report strong first quarter results, having delivered top line sequential growth of nearly 14% and all-time revenue highs for all three of our business lines. Our growth significantly exceeded the trajectory of the U.S. land rig count, which was down 3% sequentially, and U.S. completions activity.

During the period, average U.S. market share in our Products business, which we define as percentage of onshore rigs followed, increased from 27.8% to a record 29.1%. Further, we generated attractive margins despite lower commodity prices to start the year, rising costs associated with Section 301 tariffs, and a strengthened Chinese currency in response to reduced trade tensions.

In summary:

- Revenues increased 13.6% sequentially;
- Adjusted EBITDA increased 10.4% sequentially; and
- Adjusted EBITDA margins were 37.2% in the first quarter

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

Steve Tadlock
Vice President, Chief Financial Officer and Treasurer
Thanks, Scott.

Q1 revenues at $159m were 38% higher than the equivalent period last year and 14% higher than in the fourth quarter of 2018 as Scott mentioned. We reported record revenue for all three of our business lines, despite the broader sequential decline in the U.S. land rig count.

Product revenues, which include consumables used in both drilling and production, were $87m, 47% higher than the equivalent period in 2018 and 10% higher sequentially. Product gross margin at 39% was 170 basis points higher than Q1 2018 and 320 basis points lower sequentially, due largely to the more fully realized impact of Section 301 tariffs and changes in FX rates, as Scott mentioned.

Rental revenues were $39 million, 32% greater than Q1 2018 and 23% higher sequentially. The increase was attributable to continued investments in our asset base and demand for our differentiated equipment during the quarter as our customers' budgets reset in January.

Field service and other revenues in Q1 were $34m, 25% higher than Q1 2018 and 14% higher than Q4 2018. Higher sequential revenues were driven by an increase in billable hours for our work tied to both drilling and completions activity and a recovery from the seasonally impacted fourth quarter. The movement year-over-year is due to an increase in billable hours as a follow-on effect of our Product and Revenue growth over this time. Field service revenues represented approximately 27% of combined product and rental-related revenues during the quarter, in-line with expectations.

SG&A at $12.7m for the quarter was $3.6m higher than Q1 2018 and $2.2m higher than Q4 2018. The sequential increase arose primarily from higher stock-based compensation expense and increased professional, audit and tax fees. The majority of the increase compared to 2018 was due to additional payroll expenditure and other costs associated with becoming a public company. We would expect SG&A in 2Q19 to be roughly flat sequentially, with stock-based compensation expense slightly under $2m per quarter for the remaining nine months of 2019.

Depreciation & Amortization expense during the quarter totaled $8.9m, up $0.6m sequentially. We would expect similar sequential increases for the remainder of 2019.

Net income at $48 million increased from $39m in Q4 2018. This included $1m in costs associated with the March follow-on offering as well as an Income Tax benefit of $8 million. You'll recall that our income statement reflects the net income attributable to the non-controlling interest owners and public owners of Cactus, Inc.

First quarter Adjusted EBITDA was $59m. This was 38% greater than the equivalent period last year and up 10% sequentially. Adjusted EBITDA for the quarter represented 37% of revenues, which compares to 37% in Q1 2018 and 38% for Q4 2018.

We reported a total tax benefit of $1 million during the quarter which was inclusive of a specific $8 million tax benefit. In conjunction with the March secondary offering, we released a previously booked valuation allowance and recorded a tax benefit related to the realizable portion of the associated Deferred Tax Asset. Our public ownership averaged 52% during the quarter. At the end of the quarter our public ownership was 62%, which should result in an effective tax rate of approximately 15% barring further changes in our public ownership percentage.

Internally, we prefer to look at adjusted earnings per share, as it eliminates the impact of changes in public ownership throughout the quarter. It assumes the public entity held all units in our 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 million and an effective tax rate of 24.0%, our adjusted earnings per share this quarter was $0.49 per share, compared to $0.45 per share in Q4 2018, an increase of 9%. We estimate that adjusted earnings per share in Q2 will have an effective tax rate, similar to Q1, of 24.0%.

Our cash position increased by $17m during the first quarter to $88 million at March 31st. For the quarter, operating cash flow was $34m, and our net capex spend was $14m. Additionally, we spent $2m on finance lease payments in the quarter and repurchased about $2 million worth of shares associated with a restricted stock unit vesting event in February, following the one-year anniversary of our IPO.

Net working capital increased by approximately $20 million during the quarter, broadly in-line with the increase seen in revenues. While accounts receivable increased by $16m sequentially, DSO remained in the low 60s. We continued to receive product from China in January that had been purchased in anticipation of possible year-end tariff increases. Net working capital at the end of the first quarter expressed as a percentage of Q1 annualized revenues was flat compared to December 2018. While the rate is still higher than historical norms, we would expect to see further reductions as the year progresses.

Our full year 2019 capital expenditure expectations are unchanged, as we still expect to spend in the low $60m range. This includes $45m to $50m for growth capital in our Rental business, with a significant portion going toward our new innovations.

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

Scott Bender
President, CEO & Director
Thank you, Steve.

Further increases in wells drilled per rig and larger pad sizes continue to benefit our business. That said, the U.S. land rig count has moved lower thus far in the second quarter. While our rigs followed is likely to decline quarter-over-quarter, we believe our Q2 Product revenues may be relatively unchanged based on preliminary results through April. Looking to the latter part of the year, we are cautiously optimistic regarding modest increases in overall drilling activity from Q2 levels, as crude prices have now stabilized at levels above $60 per barrel, particularly following the decision to cease Iranian oil waivers. We have noted renewed interest from private operators while our larger publicly traded E&P customers are broadcasting capital spending discipline while exerting pressure on suppliers more consistent with a $50 per barrel price environment. In point of fact, our market share gains during the quarter can be attributed to an increase in activity from privates and pre-existing customers in a declining rig count environment. Market share gains were recorded despite limited progress with the majors.

On the Rental side of the business, our customers have maintained their level of completion activity thus far during the second quarter while we have expanded our market penetration with the majors. We expect to maintain Rental revenue in Q2 despite the declining rig count environment as we’ve seen increased demand for higher pressure large bore valves already reflected in our 2019 capex budget.

Regarding the commercialization of our new completions initiatives, or innovations rather, on-site performance has exceeded expectations, and we are confident we will surpass our previously indicated year-end revenue projections. While we are still in the early stages of deploying these assets in the field, our customers have already witnessed tangible efficiency gains leading to an increase in stages per day on location. Interestingly, pressure to perform in the aforementioned $50 per barrel budget environment has enhanced interest in these products. Capex for these new innovations specifically will be largely spent during the second half of the year, although we are attempting to bring this forward given demand.

Field Service, which is driven by both Product and Rental activity, witnessed its typical first quarter rebound, following the slower holiday season. Going forward, we would expect revenue from this business to remain in the 26 to 28% range of our combined Product and Rental revenue.

Regarding tariffs, the impact of the Section 301 tariffs that were set at a rate of 10% on products imported from our wholly owned foreign manufacturing subsidiary in China was more evident during the first quarter. There may be some small residual effect on margins during the second quarter, but we are confident there will be no additional impact post Q2, and we expect minimal further currency effects.

In summary, we expect revenue in the second quarter of 2019 to be at least as strong as our record-setting first quarter. We do not expect meaningful changes in overall margins, although a slight decline in Product may be largely offset by gains in Rental.

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.

We remain firmly focused on safety, execution, producing attractive returns on capital and generating a significant amount of free cash flow. So with that, I will turn it back over to the Operator and we may begin our Q&A session.

Operator?

Question and Answer

Operator
[Operator Instructions] Your first question is from the line of Tommy Moll. Your line is open.

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

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

Tommy Moll
Stephens, Inc
I wanted to start on the theme of capital discipline which has come through loud and clear from the E&Ps recently. And you mentioned how the value proposition for the new rental products fits into that. And I wonder is the pitch to customers on a per-well basis, you spend fewer dollars in addition to an efficiency gain, or is it more just on the efficiency side?

Scott Bender
President, CEO & Director
Yeah, it’s the latter.

Tommy Moll
Stephens, Inc
Okay. But did I hear you say correctly that even in the current capital austerity environment for some of the E&Ps that the uptake on those new offerings is actually aided?

Scott Bender
President, CEO & Director
It is, because there’s increased emphasis right now on reducing NPT.

Tommy Moll
Stephens, Inc
Okay. Got it. And then your commentary on the rig count, I think syncs up pretty well with what some of the land drillers have been saying. A couple in recent days have come out and pretty clearly called 2Q the

bottom. I wonder if you have any visibility into your existing customers' planning. You indicated that if crude holds and we get into the back half of the year, maybe you'd see an uptick in the rig count. Are you having any conversations with existing customers at this point about what their internal planning might look like, or is it still too early to know?

Scott Bender
President, CEO & Director
Yeah, Tommy, I'd say it's probably a little bit early, although we have pretty good visibility in terms of our wellhead business through the next – certainly through to Q2 and probably into Q3, although things can change. The comment about optimism really probably addresses more – well, first, we've had a couple of customers indicate they might loosen their belts a little bit if crude prices remain high, but also we've seen a significant increase in inquiries from privates. And privates, you know, are about 40% of this market. So, they are a significant player. So, it'd be – despite capital discipline which, as I mentioned, all of our customers are preaching the fact that oil's in the \$60 - \$65 range gives me some optimism that we'll see some rebound on the second half of the year.

Tommy Moll
Stephens, Inc
Great. Thank you. I'll turn it back.

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

J David Anderson
Barclays Capital, Inc.
Hey, Scott, I was hoping you could talk about your business from more of a medium to longer term perspective which I think you probably prefers to do anyways. As you think about planning out over the next, call it, two to three years – I know you're doing a little bit of manufacturing expansion right now, moving some things around, and opening – adding a little – freeing up some on the wellhead side. But how do you think about, say, U.S. completions market in terms of, say, the number of wells that are going to be needed to drill annually over the next several years just to keep production flat? These decline rates are really starting to pick up, but if you think about trying to scaling up your business and kind of planning around this, kind of what are some of your baseline expectations? If you just kind of walk me through your thought process as you think about kind of the next two to three years.

Scott Bender
President, CEO & Director
Well, David, I think more about our business specifically than I do about the industry in general. We still feel like we've lots of headroom in our completion side of our business. So, I guess, I'd say two things: I believe the completion side of the business in general is going to grow faster, and I believe because of our low market share relative to our drilling market share, we're going to see additional, I think, tailwinds from that.

So, as we plan for perhaps 2021, I think you'll probably see we'll rely upon our Suzhou facility to maintain adequate capacity in terms of wellhead and we'll begin to look at perhaps greater emphasis in the U.S. on being able to maximize utilization of our rental assets. So, if you were to go – you were kind enough to visit our Bossier City facility, and you saw it was quite busy. Most of our branch locations are similarly quite busy. So, while there's no roofline expansion for this year, I would anticipate looking at 2020. We got a couple of branches that probably could use some expansion just to handle the volume of what I think is going to be some fairly attractive completion work.

J David Anderson
Barclays Capital, Inc.
So, it's less on the manufacturing capacity that you need to build out, it's going to be more on the service center side?

Scott Bender
President, CEO & Director
Yeah.

J David Anderson
Barclays Capital, Inc.
-and kind of that – kind of hand-to-hand stuff that maybe that you do differently than your competitors?

Scott Bender
President, CEO & Director
Yes David. That's correct.

J David Anderson
Barclays Capital, Inc.
So, Anadarko is one of your customers which, of course, is in the process of changing hands.

Scott Bender
President, CEO & Director
David, I didn't…

J David Anderson
Barclays Capital, Inc.
You didn't hear that?

Scott Bender
President, CEO & Director
We don't talk about customers...

J David Anderson
Barclays Capital, Inc.
Yeah. Okay. I agree. I agree. And that I wasn't getting into one customer. I was actually more getting along the line of that when a customer – a knee-jerk reaction is going to be, hey, they're going to lose share. But the other side of that would be this is also an opportunity to work your way in with that new customer and maybe another – new to the customer base. And I know some people – one of the questions is how do you break into the majors on the wellhead side. Do you see this as an opportunity? Because it seems to me – the product itself speaks for itself. This would seem to be a great opportunity to kind of showcase that product to try to get into. Is that how you view that, or maybe can you talk about maybe some of the challenges that you're faced with some of these other types of customers that maybe have a different procurement process than, say, your normal customer base?

Scott Bender
President, CEO & Director
Well, without getting into specifics, I would say that our success rate in winning customers is fairly high if we can get out on the trial. And heretofore our ability to get our equipment out on a trial for majors you know has – we have not had much success in that regard. So to the extent a major purchases – one of our customers uses our equipment, I think the trial issue will be behind us. And again, if the past is any indication of the future, we do extremely well with trials in comparison to our competitors.…

J David Anderson
Barclays Capital, Inc.
Thank you very much.

Scott Bender
President, CEO & Director
Does that answer your question, David?

J David Anderson
Barclays Capital, Inc.
Absolutely does, perfectly. Thank you.

Operator
Your next question comes from the line of George O'Leary. Your line is open.

Steve Tadlock
Vice President, Chief Financial Officer and Treasurer
Close enough.

Scott Bender
President, CEO & Director
George you changed your last name.

George O'Leary
Tudor, Pickering, Holt & Co.
Thanks. Thanks for taking my questions, guys. Just wanted to start off, as you guys look to grow the business, and I think the area where you have the most line of sight to growth is – it sounds like it's still on the rentals side and the completions side. Are there any basins where you feel like you're spending more time trying to grow there, or is it more a customer-specific conversation and you're sort of basin-agnostic?

Scott Bender
President, CEO & Director
Yeah, it's the latter. We follow it. We follow the customer really, not the basin.

George O'Leary
Tudor, Pickering, Holt & Co.
Got it. And then I realized customers are looking at trying to limit non-productive time as they're trying to reduce their cash and maximize their cash flow. What specific issues are they – just think about your existing customers, what specific issues today are they looking for you to help solve, what the pinch points as you see them today?

Scott Bender
President, CEO & Director
You mean – I'm going to set aside drilling because I think we've spoken about that to a great extent.

George O'Leary
Tudor, Pickering, Holt & Co.
Sure.

Scott Bender
President, CEO & Director
But it shouldn't be taken for granted, George, either.

George O'Leary
Tudor, Pickering, Holt & Co.
Right.

Scott Bender
President, CEO & Director
Because once you've saved a day or so of rig time, it's a very difficult thing to walk away from. So, I think we've continued to mention that we see most of the non-productive time related to a frac location where there's a great deal of confusion, a great deal of multiple suppliers working. So, if you just think about the time spent rigging up frac equipment – when you go on location, you have the pressure pumpers, you have wireline companies, you have zipper manifolds if they use that, you have the frac trees, you have all

the hard line, all of it takes time. All of - and even though it takes time, it introduces an opportunity for safety issues and non-productive time. And then, as we go to simultaneous operations, you see the activity in moving from well one to well two to well three and back to well two and back to well one, so think about all that movement that takes place between wells. And then think about, I guess thirdly, all the maintenance that has to take place on a frac location, and that's maintenance that – you all know it starts with a pressure pumper, but there's a lot of maintenance that goes on with the pressure control equipment, the zipper manifolds and the frac valves, so those are the areas that we're trying to address.

George O'Leary
Tudor, Pickering, Holt & Co.
Great. That's super helpful, Scott. Thanks, guys.

Operator
Your next question comes from the line of Scott Gruber. Your line is open.

Scott A Gruber
Citigroup Global Markets, Inc.
Yes, good morning.

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

Scott A Gruber
Citigroup Global Markets, Inc.
Doing well, doing well. You guys had a good quarter in rental, particularly from the top line perspective. It sounds like you're making further inroads with the majors. I'm just curious why not a better outlook than the just flat in 2Q on the top line for rental?

Scott Bender
President, CEO & Director
Oh, Scott, that's a good question. Yeah. A lot of our increase during the quarter – this is the same old story – it was very large bore, very high pressure valves. And our product mix has changed in 2019 in comparison to 2018. And we've been caught without sufficient assets in that particular category, which we did see coming. I wish we'd have seen it coming a little bit earlier, so a significant part of our non-innovation-related CapEx is directed towards the higher pressure, large bore valves, and higher pressure, I mean 15K, a lot of work right now. You know the areas where 15K fracs are taking place, basically the SCOOP, the STACK and the Delaware. So, those assets will begin to come in sometime at the end of the second quarter and the third quarter by which time we should see some help. So, right now, we're a little bit capacity constrained.

Scott A Gruber
Citigroup Global Markets, Inc.
Understood. And then it sounded like there were some transitory and immobilization costs weighing on rental a little bit in 1Q. How much was that and does that roll out in 2Q, do you fully past that in 2Q?

Scott Bender
President, CEO & Director
I would say, Scott, they probably contributed 100 to 150 basis points to our reduced margin. We really fought cold weather in the first quarter. I don't ever – I try never to blame performance on cold weather but maintaining this equipment in cold weather was a challenge and particularly in January, and maybe part of February. So, we spent a lot more money making – to ensure this equipment had uptime. And then, we – because of the lack of adequate supply in 15K equipment, we were shuffling it all over the country.

Scott A Gruber
Citigroup Global Markets, Inc.
Got it. And if I could just..

Scott Bender
President, CEO & Director
So, we've now got – I've got it better positioned I think..

Scott A Gruber
Citigroup Global Markets, Inc.
Got it. And then, if I could just squeeze one more in. We're getting questions on the potential for capital return this year. Do you think that will happen before year-end and just your updated thoughts on the process, when is that appropriate and what's your latest thoughts on the method?

Scott Bender
President, CEO & Director
If we don't see an opportunity to deploy our cash in a responsible manner, I think we'll do something by the – make someone announcement by the end of the year.

Scott A Gruber
Citigroup Global Markets, Inc.
Got it. Thank you very much.

Operator
Your next question comes from the line of Chase Mulvehill. Your line is open.

Chase Mulvehill
Bank of America Merrill Lynch
Hey good morning gentlemen.

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

Chase Mulvehill
Bank of America Merrill Lynch
Good morning. I want to kind of sort of dial in to 2Q a little bit on the product side. Maybe if you can kind of help us understand where your market share ended the quarter and if you expect that to kind of sustain that level that you ended the quarter or expect that to grow in 2Q?

Scott Bender
President, CEO & Director
Chase, I always expect it to grow. So, that's what we do. We're always chasing work. Our market share is about - I haven't looked at it this week, but it's pretty much flat with the last figures that you saw. So, we've....

Chase Mulvehill
Bank of America Merrill Lynch
Okay.

Scott Bender
President, CEO & Director
...you know we do a lot of business with the large E&Ps. Most of their broadcasted reductions have already taken place as far as we can tell. So, we think that for our most active customers, they're going to remain fairly flat. We might lose another rig or two. But, as I mentioned, we've seen a pretty significant uptake in privates and although we don't really talk about them a lot, they're an important part of our business.

Chase Mulvehill
Bank of America Merrill Lynch
Right. Okay. Right, that makes sense. And if we think about market share kind of towards the end of the year, internally do you have a market share target or a target that you'd like to share with the Street?

Scott Bender
President, CEO & Director
We do have one internally. I would not like to share it with the Street.

Chase Mulvehill
Bank of America Merrill Lynch
Does it start with a three handle?

Scott Bender
President, CEO & Director

Chase, Chase..

Chase Mulvehill
Bank of America Merrill Lynch
I'm trying, sorry. All right. I'll move on. On the product margin side for 2Q, you said margins down. Can you just walk through kind of what's contributing to the margins being down in a kind of flat revenue environment? And then, how much should we think about margins being down in 2Q?

Scott Bender
President, CEO & Director
First, I'll ask what contributes to that. It starts pretty much with tariffs and ends with tariffs. So, we're going to see the – we think we've seen pretty much the full impact of the tariffs rolling through our inventory, but we're expecting we could see another 100 to 150 basis points after which you'll see the full impact. Now, I don't know if you saw the paper this morning. There's talk about rolling back that 10% 301 tariff on the $200 billion tranche that was announced last – I think it was last July, wasn't it, folks?

Steve Tadlock
Vice President, Chief Financial Officer and Treasurer
Yeah

Scott Bender
President, CEO & Director
So, it looks like there's going to be some compromise on tariffs. I think the last thing we saw was the 25% on the Section 232 might remain in place, but the next $200 billion, which is the area most concerned to us, might roll off. So, we'll have to see how that plays out.

Chase Mulvehill
Bank of America Merrill Lynch
Okay. All right. That's some positive news there. Last one, you talked positively about the privates and inquiries. Are you seeing most of the increase in inquiries from privates on the completions or the wellhead side?

Scott Bender
President, CEO & Director
Wellhead.

Chase Mulvehill
Bank of America Merrill Lynch
Oh, awesome. All righty. I'll turn it back over. Appreciate the color.

Operator
Your next question comes from the line of Marshall Adkins. Your line is open.

J Marshall Adkins
Raymond James & Associates, Inc.
So, you guys have been kicking everyone's butt on share here in the wellhead side. At some point in time, I would think your competitors respond. Are you seeing any response from them in terms of legitimate competitive solutions to what you guys provide?

Scott Bender
President, CEO & Director
Marshall, I think I've probably said before. I think that without patting ourselves on the back too much, I think that we probably raised the benchmark in the industry. I think everybody's products today are better than they were a couple of years ago, and some of that clearly is a response – in response to our market share gains. So, yeah, we have a big target on our back, and their products are getting better. I think that if you had a chance to maybe go through our plant, you'd see that that really is a – while it's a very important part of our business, the execution part of our business is really important. So it doesn't do you any good to have the greatest product in the world if you can't show up on location on time and if you can't install it and test it without problems.

And so while we talk about innovations because it's a lot easier I think for our audience to grasp, I cannot overemphasize the importance of our unique supply chain and our ability to make a delivery when we promise. And then on our staff of field service techs, we've got, I don't know, 350 or so scattered around the U.S. who perform every single day. So that's just part of the equation. Look, Cameron's got outstanding equipment. I don't normally like to mention competitors, but we've got some very, very good competitors out there with great equipment. I just feel like we're much better focused on this business.

J Marshall Adkins
Raymond James & Associates, Inc.
Right. Well, your results certainly bear that out. Let me shift gears over to the rental side. You've been commercializing – are in the process of commercializing a bunch of these new frac innovation products. You're going to be, I presume, putting a lot of money into those here in the back half of the year. Are you ready to tell us – I know you guys haven't really been – wanting to be too forthright in terms of what you're doing, but at what point in time will we start to see exactly what that is and how that's going to be added to the rental business?

Scott Bender
President, CEO & Director
Marshall, you're going to see it the last possible time.

J Marshall Adkins
Raymond James & Associates, Inc.
I figured you'll say that.

Scott Bender
President, CEO & Director
Well, I mean, the fact is I am – when people ask me what keeps me up at night, the two things that keep me up are safety concerns and competitors. And the last thing I want to do is open this up to our competitors. They're going to see it increasingly and I just don't intend to help them.

J Marshall Adkins
Raymond James & Associates, Inc.
Let me come at it a different way. It does - I heard earlier and just maybe correct me if I'm wrong, but it seems like the – you're maybe a little bit ahead of schedule that it's progressing extremely well. Maybe update us on timing when you think these things will start to hit if you could? I know you mentioned it a little bit earlier, but just a little more color on that.

Scott Bender
President, CEO & Director

Okay. Marshall, they're in the field right now. The problem is we don't have enough of them to move the needle, and we're not going to have enough of them to move the needle until the third quarter.

J Marshall Adkins
Raymond James & Associates, Inc.
Right.

Scott Bender
President, CEO & Director
That's the problem. It's not a question of acceptance. It's not a question of demand. It's not a question of the value proposition. Right now, we're doing everything we can to bring forward the receipt of these goods. So, I'm going to stand by our earlier comment that you need to look at Q3 and Q4, and you know we mentioned an exit rate of, I think, 20% by the end of the year. I think that we're going to surpass that.

J Marshall Adkins
Raymond James & Associates, Inc.
All right. And are there bottlenecks in terms of manufacturing? Is that just more – just the whole process where by the time we get to the next year, you're going to be blowing and going on putting more of the stuff out in the field.

Scott Bender
President, CEO & Director
Yeah. It's manufacturing bottlenecks, Marshall.

J Marshall Adkins
Raymond James & Associates, Inc.
Good. Guys, thank you all very much.

Scott Bender
President, CEO & Director
Yes sir.

Operator
Your next question comes from the line of Martin Malloy. Your line is open.

Martin Malloy
Johnson Rice & Co. LLC
Good morning.

Scott Bender
President, CEO & Director
Hey, Marty.

Martin Malloy
Johnson Rice & Co. LLC
Just on the manufacturing side, I think you've got two new CNC machines coming online relatively soon at Bossier City. Do you have other plans beyond that to add capacity?

Scott Bender
President, CEO & Director
Joel?

Joel Bender
Senior Vice President, COO & Director
Just in terms of head count capacity right now, in terms of machine tools, these two will give us the additional capacity we need right now to continue to increase the rework and the amount of rental assets we've put back into the field.

Martin Whittier Malloy
Johnson Rice & Co. LLC
Okay. And then on the rental side, as you're able to leverage your field techs and your infrastructure out in the field over the medium to long term, how should we think about that in terms of the impact on margins on the rental side?

Scott Bender
President, CEO & Director
Well, I mean, obviously we'd increase because we don't really need a whole lot more footprint. Although I did make mention of the fact that in 2020, we have a couple of facilities that just flat need roofline expansion because of the volume of goods, but there's a high degree of incremental margin contribution from the rental business.

Scott Bender
President, CEO & Director
Yeah. And utilization, frankly. The degree to which we better utilize our assets clearly because of the – we have a fixed amount of depreciation for those assets, has a significant impact on our margin profile.

Martin Malloy
Johnson Rice & Co. LLC
Great. Thank you.

Operator
Your next question comes from the line of Kurt Hallead. Your line is open.

Kurt Hallead
RBC Capital Markets, LLC
Hey. Good morning, everybody.

Scott Bender
President, CEO & Director
Hey, Kurt, how are you.

Kurt Hallead
RBC Capital Markets, LLC
Hey. I'm great. Great. Thanks, Scott. So, Scott, just wanted to maybe circle back on the context around the dynamics where you have a pretty significant opportunity to penetrate with the major oil companies as they get larger in the Permian. Just kind of curious, as you think through that dynamic, do you have a specific timeframe as to when you'd like to kind of crack that code, and how far along you might be in potentially making that happen?

Scott Bender
President, CEO & Director
Yeah, I'd like to have cracked it last September.

Kurt Hallead
RBC Capital Markets, LLC
Fair enough. Now – but, in all honesty, is there any particular dynamics where the major oil companies really are not that interested in your value proposition, or just some insights you might be able to kind of provide us on how these majors might be different in terms of their decision-making process vis-à-vis the independents? And over time, you've had extended experience, you've sold into majors before, so just kind of looking for some additional insights on how things are proceeding there.

Scott Bender
President, CEO & Director
I can't really forecast when or even if although – I'm just as optimistic as I've ever been, and we're working just as hard or harder than we ever worked. But I really – I don't think I could opine on when the timing of that breakthrough if any will occur. Having said that, I'm pretty happy with the results of the company so far, and there's a lot of low-hanging fruit out there in terms of multi-rig players with whom we're not doing any work. And they're also on our target. So, we're not really – if you look at our list of target accounts, clearly the majors are on there, but there are an awful lot of large E&Ps that are also on that list.

Kurt Hallead
RBC Capital Markets, LLC
Yeah. That's all fair. And maybe from a – as we think maybe longer term as well and maybe a question for Stephen on this one, Stephen Tadlock. When you think about the optimal capital structure and you think about where you'd like to reside in terms of return on capital and other return metrics, could you give us some insights on how you're going to mapping that out.

Steve Tadlock
Vice President, Chief Financial Officer and Treasurer
Well, I think – I mean, honestly, I think we're doing a pretty good job. We're over 30% return on capital employed. We look at our – and that's over a long time horizon, so the recent years have been better than that. So, we're always constantly scrutinizing everything we do to make sure it's got a very high return on capital, and that's why you don't see us making acquisitions that don't make sense and spending money on rental that's not highly utilized. So....

Kurt Hallead
RBC Capital Markets, LLC
Okay. Right. Gentlemen, thank you.

Operator
There are no further questions at this time. I'll turn the call back over to the presenters.

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

Scott Bender
President, Chief Executive Officer & Director
Thanks, everybody. Have a good day.

Operator
This concludes today's conference call. You may now disconnect.