Cactus, Inc. (NYSE: WHD)
Q4 2020 Earnings Call Transcript
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Call Participants

EXECUTIVES

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President, CEO and Director
Stephen Tadlock
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Joel Bender
Senior Vice President, COO and Director
Steven Bender
Vice President, Operations
David Isaac
Vice President of Administration and General Counsel
John Fitzgerald
Director of Corporate Development and Investor Relations

ANALYSTS

George O'Leary
Tudor, Pickering, Holt & Co Securities, Inc
Tommy Moll
Stephens, Inc.
Scott Gruber
Citigroup Global Markets, Inc.
Blake Gendron
Wolfe Research
Stephen Gengaro
Stifel Financial Corp

Presentation

Operator
Ladies and gentlemen, thank you for standing by, and welcome to the Cactus Q4 2020 Earnings Call. At this time, all participants are in a listen-only mode. After the speakers' presentation there will be a question-and-answer session. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Mr. John Fitzgerald. Please go ahead, sir.

John Fitzgerald
Director of Corporate 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 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 issued our 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. During a year in which the U.S. rig count was down 55% year-over-year, Cactus showcased its ability to outperform by recording Adjusted EBITDA margins of nearly 35% and generating Free Cash Flow of $117 million. We were able to offset a portion of the general activity decline by growing our market share from 31% at year-end 2019 to a record 43% by the fourth quarter of 2020. We were further pleased to see overall activity begin to improve during the fourth quarter, a trend which continued in early 2021.

We ended the year with no bank debt and $289 million dollars in cash.

In summary:

- 4th quarter revenues were just above $68 million;
- Adjusted EBITDA approached $20 million;
- Adjusted EBITDA margins were 29%;
- Our cash balance increased to nearly $289 million; and
- We paid a quarterly dividend of $0.09 per share.

I'll now turn the call over to Steve Tadlock, our CFO, who will review our 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, CFO and Treasurer
Thanks, Scott. In Q4, revenues of $68 million were 14% higher than the prior quarter. Product revenues of $43 million were up 20% sequentially, driven by an increase in market share and rigs followed. Product gross margins were 31% of revenues, down approximately 1,400 basis points on a sequential basis due primarily to the Q3 impact of tariff refunds. Product gross margins were up nearly 100 basis points sequentially when excluding the impact of these refunds, which declined by over $5 million from Q3 to Q4.

Rental revenues were slightly under $9 million, down from nearly $10 million during the third quarter of 2020. Gross margins declined to negative 10% due to lower revenue on a relatively fixed depreciable base, a $600,000 decrease in tariff refunds and accelerated mobilization costs.

Field service and other revenues in Q4 were over $16 million, up 17% versus the third quarter. This represented just under 32% of combined product and rental-related revenues during the quarter, ahead of expectations. We expect Field Service revenue to be approximately 30% of Product and Rental revenue during the first quarter of 2021. Gross margins were 30% of revenues, down 350 basis points sequentially. The margin decline was less than the usual seasonal drop that occurs during the fourth quarter thanks to careful management of non-productive time during the holiday season.

SG&A was up $600,000 sequentially to $9 million during the quarter, in-line with expectations. The increase was primarily attributable to higher payroll related expenses associated with an increased bonus accrual and employee additions. We expect SG&A to be slightly less than $10 million in Q1 2021, inclusive of stock-based compensation expense of less than $2 million.

Fourth quarter Adjusted EBITDA was approximately $20 million, down from $25 million during the third quarter. Tariff refunds were down nearly $6mm sequentially, accounting for more than 100% of the sequential decline in Adjusted EBITDA. Adjusted EBITDA for the quarter represented 29% of revenues, down from 41% of revenues during the third quarter, or 31% of revenues last quarter when excluding the $6mm in tariff refunds. Adjustments during the fourth quarter of 2020 included $2 million in stock-based compensation.

Depreciation expense was $9.3 million during the period, down from $9.8 million during the third quarter, due largely to lack of additions to our rental assets, field service equipment and vehicle fleet.

Our public, or Class A ownership, was relatively stable in Q4 and was 63% at the end of the quarter. This should result in an effective tax rate of approximately 19% in Q1 2021, assuming no changes in our public ownership percentage.

GAAP Net income was $6.1 million in Q4 2020 versus $10.9 million during the third quarter of 2020.

Internally, we prefer to look at adjusted Net Income and earnings per share, which were $6.3 million and 8 cents per share, respectively, compared to $9.5 million and $0.13 per share in Q3 2020. Again, the 3rd quarter was aided by $6 million in tariff refunds, which contributed approximately $4mm in additional adjusted net income during the quarter, or 6 cents per share. We estimate that the tax rate for adjusted EPS will be 26.5% during the first quarter of 2021.

During the fourth quarter, we paid a quarterly dividend of $0.09 per share, resulting in a cash outflow of $5 million. As publicly announced in late January, the board has also approved a dividend of $0.09 per share to be paid in March of this year.

Our cash position increased by nearly $15 million during the quarter to approximately $289 million at year-end, highlighting the continued free cash flow generation of the company, above and beyond our current dividend. For the quarter, operating cash flow was $22 million, and our net capex was $2 million.

Capital requirements for our business remain modest and we will continue to exercise discipline with regards to growth capex. As such, our Net capex guidance for 2021 is for a range of $10 to $15 million.

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

Scott Bender
President, CEO and Director
Thanks Steve.

We noted on our last call a strong management conviction that further market share gains were forthcoming. This certainly proved accurate as we achieved record Product market share of 43% during the fourth quarter, setting the Company up well for 2021 given the loyalty of our customer base, our strong track record of execution, and our reputation for delivering innovative products and services that meet customer demands in changing markets. On this call, I will provide an update on our near-term outlook excluding the impact of the recent winter storms that paralyzed much of the Southern U.S. before providing our current best estimate of the storm's effect on our first quarter financial results.

As mentioned earlier, customer rig activity continues to generate positive momentum, and we currently expect Cactus' rigs followed to increase by approximately 25% during the first quarter of 2021. Excluding the impact of the aforementioned winter storms, we expect product revenues to increase 20% or more on a sequential basis. Continued strength in production tree shipments may have indicated slight upside to this outlook, but the aforementioned weather-related delays provide reason for caution.

Product EBITDA margins are expected to remain in the low 30s percentage during the first quarter, despite pressure from rising steel prices and ocean freight costs.

On the Rental side of the business, we have been reluctant to chase low margin work and accordingly maintained our position that customers compensate us for the value our equipment and services provide. As such, revenues declined during the quarter as customers chose to award work to lower cost suppliers. However, we noted on our last call that we were optimistic regarding increased demand for higher-end providers in 2021, and that has certainly been the case to start the New Year.

For the first quarter, again excluding any weather-related impacts, we expect Rental revenue to be up more than 50% on a sequential basis. As we have seen historically, the redeployment of assets temporarily weighs on EBITDA margins, which we expect to be approximately 60 percent for the first quarter.

Revenue from our innovations in January was nearly equal to the total amount generated from that source during the fourth quarter, offering encouragement that customers are re-validating several of these technologies now that their budgets have been reset.

Regarding Field Service, revenues in this segment continue to be driven by both our Product and Rental activity. We expect to see EBITDA margins in the low-to-mid 30 percent range during the first quarter, down sequentially as we adjust wages to more appropriately reflect market activity, but still higher than we've typically achieved over the last few years. Utilization, however, remains a concern for the reasons mentioned previously.

I'd like to close by highlighting a few items before opening the line to questions:

To be clear, the guidance figures provided exclude the impact of the weather-related slowdown witnessed in February. At present, our best estimate of the total revenue-related impact from the storms is in the range of $3 to $5 million during the first quarter and proportional to our revenue generated by source. Uncertainty remains regarding the speed with which our customers fully remobilize, but we have been encouraged by the recovery witnessed over the last several days.

The potential EBITDA impact associated with this lost revenue is likely to be in the range of $2 to $3 million, as we supported our associates through this challenging period and maintained some element of fixed costs during the slowdown.

Internationally, we have been working to establish relationships with several players in the Middle East and made our first shipment of Rental equipment into the region early in 2021. We believe this initial shipment will be able to generate revenue once travel restrictions ease and we can provide the required supervisors. We further believe that this initiative will provide a platform for further growth in Product sales as well, which would be more of a 2022 event.

On the new technologies front, we are now capable of converting and enabling Cactus equipment to run on internally or externally sourced electric power at the well site, thereby reducing the need for diesel power generation during completion and promoting a more environmentally-friendly operation.

Given our close relationships with many of the largest E&P operators and our ability to drive efficiency gains, customers have traditionally viewed us as key figures in the quest for a more environmentally friendly wellsite. As a result, some of our largest customers view Cactus as an important ESG partner, tasked with aiding our clients in conducting their operations in a safer, faster and cleaner manner. We believe this development and the offering of our new technologies as a differentiator will enable us to gain share from some of the lower-priced providers against whom we most often compete.

I will remind investors that we are developing these new technologies and beginning our international expansion carefully. As evidenced by our full year 2021 net capital budget of $10 to $15 million dollars, our team will continue to evaluate capital deployment with returns and free cash flow as our main priorities. We frankly hope that conditions will improve beyond current expectations, justifying a modest upward revision in spending.

Regarding M&A, we continue to believe that consolidation within our industry makes the most sense where there is scope for significant and tangible synergies.

In summary, we remain optimistic about the opportunities that the upcoming activity recovery presents and are ready to take advantage of our favorable positioning. I'd be remiss in not acknowledging the outstanding performance from our Associates in this last year. Their commitment to safety and attention to execution excellence have been directly responsible for our success, particularly in light of their financial sacrifices. Our partial rollback of the 2020 wage reductions was in recognition of the same and reflects our increasing optimism regarding the macro environment. With that, I will turn it back over to the Operator and we can begin Q&A. Operator?

Question and Answer

Operator
Thank you. [Operator Instructions] Our first question comes from the line of George O'Leary with TPH & Company.

George O'Leary
Tudor, Pickering, Holt & Co Securities, Inc
Guys.

Scott Bender
President, CEO and Director
Good morning, George.

George O'Leary
Tudor, Pickering, Holt & Co Securities, Inc
Super quick one, I just want to make sure I heard the rental guidance number, right. Did you say up 15% or up 50% quarter-over-quarter?

Scott Bender
President, CEO and Director
Five-zero.

George O'Leary
Tudor, Pickering, Holt & Co Securities, Inc
Five-zero. Okay. I wanted to make sure I heard that right and not get over my skis in the model. Great number. Thanks for that clarification. And then a little bit more of a thoughtful question. When you spoke about the new technology offerings you guys are working on, reducing emissions, reducing methane emissions in particular is a clear focus. You guys always collaborate, or often collaborate, with your customers throughout your process and working with them. I wonder how much of that was Cactus identifying an opportunity and how much of that was E&P customers coming to you and saying, hey, we need to lower emissions to court ESG type investors? What – just what that process was like and what was the impetus for going that way on the technology front?

Scott Bender
President, CEO and Director
Yeah, George. So unlike most of our innovations this was really a Cactus concept. We looked at how many generators are on location and not only the number of generators but the resulting maintenance issues with generators and started to scratch our heads, try to determine if there was not a better way and we came up with what we think is a significantly better way of providing power.

George O'Leary
Tudor, Pickering, Holt & Co Securities, Inc
Okay. Great. Thanks for answering my questions. I'll turn it back over.

Operator
Your next question comes from the line of Tommy Moll with Stephens.

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

Scott Bender
President, CEO and Director
Good morning Tommy. How are you?

Tommy Moll
Stephens, Inc.
Doing great. Thanks. Congrats on the market share record. Scott, in the past you've given us some insight into some of the different customer dynamics that drive that just with trends that sometimes vary among majors, independents, privates, et cetera. Any context you can give us there on the fourth quarter record or what the trends might look like in the first part of this year?

Scott Bender
President, CEO and Director
Yes, Tommy. I think that we saw the percentage of our revenue that was derived from privates increase around 25% from 20%. So as you know, the privates added quite a few rigs in the last quarter and they continue to add rigs in the beginning of 2021. So what we've really seen has been a pretty substantial increase from privates, but now we're beginning to see a substantial – maybe not as substantial on a percentage basis, but some positive, I think, data points from some of our large publicly traded E&Ps. So between those two, I have a pretty high level of confidence that the number of rigs followed will continue to increase.

Tommy Moll
Stephens, Inc.
Shifting gears to cost inflation you called out steel as one item and freight as well. I wanted to ask what measures you've taken already to try to mitigate the impacts there. And then, as we look forward into this year if this pressures don't abate, is there some point at which they might be more difficult to mitigate in the marketplace? Or how should we think about that over the next couple quarters?

Scott Bender
President, CEO and Director
Yeah. So let me – I'm going to tie that in with market share gains because I think it's important that we understand that as we increase our market share, we look to customers who exhibit loyalty and are, obviously, willing to pay what we think is a reasonable price. And so we also have a relationship with those customers that leaves us with some confidence that we'll be able to get some – achieve cost recovery. So I think that the steel price increases that we're seeing particularly in the Far East, the ocean freight increases that we're seeing, we will be able to offset with the negotiations with those customers.

When I think about pricing in this market, and clearly this has been the worst market I've ever seen, we don't chase market share with customers who don't place some value on the products and our execution ability. As a side note, I think, in the last – I guess over the last six months, every time we've had to compete on price with a major contract, we've lost. We're just not going to lower our price. And we're going to be discriminating in terms of market share, in terms of customers that we chase. That's not to say we're – there is no limit on how much market share we want. The limitation really is on sort of customers that we chase.

Tommy Moll
Stephens, Inc.
All very helpful, Scott. Thank you and I will turn it back.

Operator
Our next question comes from the line of Scott Gruber with Citigroup. Please go ahead.

Scott Gruber
Citigroup Global Markets, Inc.
Yes. Good morning.

Scott Bender
President, CEO and Director
Morning, Scott. How are you?

Scott Gruber
Citigroup Global Markets, Inc.
Doing well. A question here on the rental side of this comparing your revenues in the outlook to the public pumpers that we follow. Obviously, you guys were very disciplined on pricing late last year and didn't see the bounce a lot of the public pumpers saw, which created something of a gap between the revenue trajectories. Obviously, that now starts to close in 1Q. But if I compare kind of 1Q outlook versus pre-pandemic your revenues are still running further below versus the pumpers. So, just curious now that customers are willing to pay for quality, willing to pay for efficiency and your new technology introductions. Yeah, how many quarters in a row do you think you're going to be able to sustain an above-market growth rates in rental?

Scott Bender
President, CEO and Director
Well, and as much as we started, Scott, from such a low base, based upon our reluctance to chase work, I'm pretty optimistic that completions offers, maybe the highest growth trajectory of all of our business segments.

Now, I don't really want to speculate beyond Q1. But I think the dynamics in the business, as I predicted, have changed to our benefit. I think that some of the lower-tier providers are struggling both in terms of delivery and equipment quality and that's sort of was the signal that we were looking for. And a lot of the decline in our rental revenue was self-inflicted. We knew it was going to be very, very price competitive and when we made that very, very draconian cuts after the first quarter we cut our frac support team more than we cut anybody else, just because our history tells us that frac is going to suffer more. We began, I guess, in the fourth quarter to add people back, add resources back as we saw that there was some opportunity. We're continuing to add resources in that area both in terms of the plant and in terms of field locations. So, yes, I feel good about the second quarter, but I don't know that I would necessarily say another 50%.

Scott Gruber
Citigroup Global Markets, Inc.
Got you. Got you. And this does seem like there's an opportunity here for the rest of the year. And then just following up on the inflation commentary, some color on your ability to pass it through to customers whether that be a partial pass-through, a full pass-through, it seems like that'd be a lot easier at $60 TI than $45 or $50, but some color there would be great too.

Scott Bender
President, CEO and Director
So I think you're right. No customer ever likes to pay a higher price, no matter what happens to oil prices but they're very eager to pay a lower price. I think that two things are going to work in our benefit. The first is the loyalty of our customer base. I think our customer base values - I know they do – they value our ability to execute. And they're going to work with us to protect…to protect the company from these rising costs. I think the second thing - and it really is an important factor - is, I believe, at least that we're going to see a tightening up in the market and with a tightening in the market comes an opportunity to improve pricing. So, I think those are the two factors that give me confidence that we'll be able to more than offset the increased costs.

Scott Gruber
Citigroup Global Markets, Inc.
Got it. Appreciate the color, Scott. Thank you.

Operator
And your next question comes from the line of Blake Gendron with Wolfe Research.

Blake Gendron
Wolfe Research

Yeah. Hey, thanks. Good morning. I want to follow up on the market share commentary. Is there any way you can maybe quantify for us or even qualitatively – the number of new customers that have contributed to the growth in market share off bottom, say, March, April of 2020, versus the existing customer, kind of that split?

Scott Bender
President, CEO and Director
Well. I think it's – no, John, you have more data on that than I do. I think I mean I have a gut feeling.

John Fitzgerald
Director of Corporate Development and Investor Relations
I would just characterize it broadly speaking as a big chunk of the increases that we saw right off the bottom early in the recovery were smaller privates who were operating one or two rigs. And then what you saw kind of back part of the fourth quarter and are seeing some early this year is the existing customers adding new rigs – adding additional rigs.

Blake Gendron
Wolfe Research
Got it. Okay. That makes sense. And presumably if oil prices stabilize you get the existing customers to add a few more rigs as you mentioned. Moving to profitability, so the tariff refund impact is now behind you, sounds like some cost inflation as mentioned in some of the other questions. You've given incremental margins in some of your materials in the past. I'm just wondering if we can just roll all of this together and maybe frame a rough idea of incremental margins across product and rental and service, if you don't mind, just so we can understand how all these puts and takes kind of roll up.

Scott Bender
President, CEO and Director
Steve?

Stephen Tadlock
Vice President, CFO and Treasurer
Yeah. Obviously, I'll give you numbers excluding weather impacts, as Scott talked about that overall impact. But excluding weather impacts, in general, we tend to see incrementals kind of close to what our adjusted margins are - the EBITDA margins are - by the business lines. I think on rental, obviously, given some of the increased mobilization costs and to the same extent field service, those are the two areas where we've provided some caution for Q1. So, I think you'll see incrementals on rental and field service less than sort of the typical EBITDA margin. But as we kind of – for field service, for example, when you add somebody that was not with the company previously you have training costs then you have to add vehicles and tools and things like that as you kind of grow into the new rig count that you're at, that tends to work itself out and then you get back to sort of reasonable incrementals.

On the rental side, again it's about getting that equipment ready and getting it to the field and prepared and so that's what you're seeing there. On products, we really expect it to be kind of the same as the EBITDA margin really because there's not a whole lot that changes on that front. So, yeah, I don't want to give specific numbers but the product you would see about the same as EBITDA margin, rental a little bit less, field service more substantially less, partly because of the wage reinstatements we talked about.

Blake Gendron
Wolfe Research
Extremely helpful. I'll get back in queue. Thanks.

Operator
Your next question comes from the line of Stephen Gengaro with Stifel.

Stephen Gengaro
Stifel Financial Corp
Thanks. Good morning, gentlemen.

Scott Bender
President, CEO and Director
Good morning.

Stephen Gengaro
Stifel Financial Corp
So two quick things. So, one is just following up on sort of the market share discussion, on the product side, how has pricing developed? Has there been any material changes on the pricing front over the last – or do you expect that going forward?

Scott Bender
President, CEO and Director
Stephen, I think we've hit bottom in terms of pricing. But as you would I'm sure, assume, product pricing did suffer in 2020, not nearly to the extent of frac pricing but it did suffer. As I said, I think that's behind us now and our view is that there's going to be scope for pricing increases going forward. I don't know how large that scope will be but certainly enough to cover additional the cost inflation impact.

Stephen Gengaro
Stifel Financial Corp
Okay. Thank you. And then as you think about the – you've talked a bit about your international growth opportunities and your CapEx seems fairly low in 2021. How are you thinking about returning more cash to shareholders? I'm just thinking in terms of maybe to frame it on kind of what's the cash balance that you're comfortable with to run the business and be able to drive growth but still return maybe more cash to shareholders because you're in such a strong cash position?

Scott Bender
President, CEO and Director
Well, let me first tell you that you're talking to the largest shareholders in the business. And not only are we the largest shareholders but we have the lowest salaries. So we're certainly not opposed to increasing dividends. And so the question that we ask ourselves is what's the best use of this cash. Do we increase the dividend or do we redeploy the – do we deploy the cash in other areas? I think that this year at least we feel like there are still enough potential opportunities out there that we still would like to try to deploy the cash, to grow the business. And – but failing that, of course, we would increase the dividend.

I'm not ready to say that we're out of opportunities because we're clearly not out of opportunities. In terms of how much cash do we need to run this business, this business has always been free cash flow positive. We will be free cash flow positive this year despite what we expect via increased working capital. I could tell you $100 million because it's a round number. But it certainly would be no more than $100 million.

Stephen Gengaro
Stifel Financial Corp
Okay. Great. Thanks. And if you – sort of my one more quick one, when you think about the competitive landscape on the product side, I mean, there's obviously were some changes in ownership over the last year. Are you seeing any changes on that end as far as the competition is concerned?

Scott Bender
President, CEO and Director
I have nothing that's really noteworthy.

Stephen Gengaro
Stifel Financial Corp

Okay. That's what I figured I just wanted to check but thank you.

Operator
And your next question comes from the line of Blake Gendron with Wolfe Research.

Blake Gendron
Wolfe Research
Hey, thanks for letting me back in here. I did want to piggyback up that last question. In terms of M&A, I think you've mentioned in the past artificial lift is just one potential avenue. Have you revisited that? And where could we – might expect in the oilfield, is it necessarily US shale, is it international? Just trying to get a sense for what you think the best opportunities are out there from an M&A perspective?

Scott Bender
President, CEO and Director
Yes. So I've changed my attitude since I made the comment about artificial lift. That's not to foreclose that possibility. But in terms of priorities or at least, ranking, my first choice would be a direct competitor who competes with us globally, so in the US and internationally. Behind that, would be an international player. So while we wouldn't be able to extract synergies in the US, we feel like we can take advantage and I'm sure you would agree of an international footprint, particularly, when you consider I think the strength of our supply chain which is arguably the lowest cost, highest quality in the business. So we need that opportunity to try to apply that internationally and so that would be my – that would be number two on my list. Number three would be something where we step out from our core competency, but it's a distant third.

Blake Gendron
Wolfe Research
That makes a lot of sense. And I appreciate detail there. And one more follow-up if I could. I think you've mentioned in the past that international margins are currently running not just a little bit lower but appreciably lower than those in US shale. Can you update us on that notwithstanding some of the Middle East logistical and freight challenges, in a normalized world is this still true that your product margins would be lower internationally versus US?

Scott Bender
President, CEO and Director
Okay. So, Blake, just to be clear, in the case of Cactus, the answer is yes. International margins would be less than US. In the case of our competitors, I don't believe that's the case.

Blake Gendron
Wolfe Research
Okay. Thank you so much guys. Appreciate it.

Operator
And there are no further audio questions, I'll now turn the call back to our speakers for closing remarks.

John Fitzgerald
Director of Corporate Development and Investor Relations
I would like to thank you everyone for joining the call today. And look forward to speaking with you after the next quarter.

Scott Bender
President, CEO and Director
Thanks everybody.

Operator
Ladies and gentlemen, that concludes today's conference call. Thank you for participating. You may now disconnect.