



Cactus, Inc. (NYSE: WHD)

Q2 2023 Earnings Call Transcript

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Call Participants

EXECUTIVES

Scott Bender

Chairman and CEO

Joel Bender

President and Director

Stephen Tadlock

Executive VP, CFO and Treasurer

Steven Bender

COO

William Marsh

Executive VP and General Counsel

Thirucherai "TS" Sathyanarayanan

CEO, FlexSteel

Alan Boyd

Director of Corporate Development and Investor Relations

ANALYSTS

Stephen Gengaro

Stifel, Nicolaus & Co.

J. David Anderson

Barclays Capital

Kurt Hallead

Benchmark Co.

Saurabh Pant

BofA Securities

Presentation

Operator

Good day and thank you for standing by. Welcome to the Cactus Q1 2023 Earnings Conference Call. At this time, all participants are in listen-only mode. After the presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Alan Boyd, Director of Corporate Development and Investor Relations.

Alan Boyd

Director of Corporate Development and Investor Relations

Thank you, and good morning. We appreciate you joining us on today's call. Our speakers will be Scott Bender, our Chairman and Chief Executive Officer and Steve Tadlock, our Chief Financial Officer. Also joining us today are Joel Bender, President, Steven Bender, Chief Operating Officer, TS, CEO of FlexSteel and Will Marsh, our General Counsel and Executive Vice President.

Please note that any comments we make on today's call regarding projections or 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

Chairman and CEO

Thanks, Alan and good morning to everyone. We are understandably pleased with the company's performance in the second quarter despite a weakening U.S. land market. We are particularly proud to be in a net cash position today, well ahead of our internal plan. As you know, free cash flow generation has always been a strength of our company and has been enhanced further by the FlexSteel acquisition. On a standalone basis, each of Cactus and FlexSteel set records for both quarterly revenue and Adjusted EBITDA. This strength reflects the highly differentiated offerings in each of our segments. Today, we will walk through results in our recently introduced segment reporting format, consisting of Pressure Control (legacy Cactus) and Spoolable Technologies, which represents the FlexSteel business.

Some second quarter total company highlights include:

- Revenue of \$306 million;
- Adjusted EBITDA of \$115 million;
- Adjusted EBITDA margins of 37.7%;
- We paid a quarterly dividend of \$0.11 per share;
- Record cash flow from operations of \$108 million;
- Yesterday we announced that our Board approved a 9% increase in the quarterly dividend to \$0.12 per share; and
- As of July 31, 2023, we have repaid the full \$155 million of debt raised to finance the FlexSteel acquisition, leaving us once again free of bank debt.

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?

Stephen Tadlock

Executive VP, CFO and Treasurer

Thanks, Scott. As Scott mentioned, total Q2 revenues were \$306 million.

Pressure Control revenues of \$199 million were up 2.3% sequentially, driven primarily by increased customer activity despite the decline in U.S. land activity as the quarter progressed. Operating income increased \$5.1 million, or 10.3% sequentially, with operating margins increasing 200 basis points primarily due to lower transaction expenses partially offset by an increase in the allowance for doubtful accounts, which was primarily attributable to a single customer. Adjusted Segment EBITDA was \$69.9 million, an increase of \$0.8 million, or 1.2% sequentially, with margins decreasing slightly by 40 basis points driven substantially by the aforementioned allowance.

As a reminder, we closed the FlexSteel acquisition on February 28th, so the second quarter results represent our first full quarter of ownership of the business, while the first quarter included only March results. Spoolable Technologies revenues were \$106.7 million and operating loss was \$6.0 million. Operating loss was inclusive of \$19.3 million of inventory costs associated with the step-up in value of inventory on hand at acquisition, \$8.7 million of intangible amortization expense, and \$18.1 million of expense associated with the remeasurement of the earn-out associated with the FlexSteel acquisition. The remeasurement expense this quarter reflects the revenue outperformance versus our prior forecast. This liability will be remeasured and adjusted, if necessary, on a quarterly basis through the final earn-out evaluation date of June 30, 2024. Adjusted Segment EBITDA, which excludes all the above non-cash charges, was \$45.5 million with margins of 42.6%, an approximately 1,200 basis point increase from March levels due to the depletion of higher cost material in the prior quarter and improved operating leverage. Note that no corporate costs have been allocated to FlexSteel in the period.

On a total company basis, second quarter Adjusted EBITDA was \$115 million, up 45% from \$79 million during the first quarter. Adjusted EBITDA margin for the quarter was 37.7% of revenues, an increase from the first quarter due to operating leverage and higher contribution from the Spoolable Technologies segment.

Adjustments to Total Company EBITDA during the second quarter of 2023 included approximately \$2.2 million in transaction-related fees and expenses and non-cash charges of \$5.3 million in stock-based compensation, \$18.1 million related to the FlexSteel earn-out liability, and \$19.3 million of purchase accounting related step-up in inventory, which impacted Spoolable Technologies cost of sales.

Depreciation and Amortization expense for the second quarter was \$22 million, which again includes \$9 million of amortization expense related to intangible assets booked as part of purchase accounting. Total Depreciation and Amortization expense during the third quarter is expected to be approximately \$15 million, \$7 million of which is associated with our Pressure Control Segment and \$8 million of which is associated with Spoolable Technologies. This figure is inclusive of an expected \$4 million of intangible amortization expense within Spoolable Technologies during the third quarter. Intangible amortization expense is expected to remain relatively stable at \$4 million per quarter for the next several quarters as the longer-lived acquisition intangibles amortize at a steady rate.

Net interest expense during the second quarter was approximately \$5.9 million. Interest expense increased sequentially due to the debt level and accelerated amortization of deferred financing fees, which contributed approximately \$3.3 million to interest expense as we paid down debt faster than our forecast and recognized these expenses in the second quarter. We expect interest expense of approximately \$1 million during the third quarter.

Income tax expense during the second quarter was \$10 million. Tax expense increased due to higher expected earnings and the elimination of the benefit related to a release of our valuation allowance utilized in the first quarter.

During the second quarter, the public, or Class A ownership of the Company averaged 81% and ended the quarter at 81%. Barring further changes in our public ownership percentage, we expect an effective tax rate of approximately 21% for Q3 2023.

GAAP Net income was \$32 million in the second quarter versus \$52 million during the first quarter. The decrease was driven by higher income tax expense, higher interest expense, increased inventory step-up expense, increased purchase price intangibles amortization, and the expense related to the remeasurement of the earn-out liability associated with the outstanding performance of FlexSteel.

We prefer to look at Adjusted Net Income and earnings per share, which were \$67 million and \$0.84 cents per share, respectively, during the second quarter versus \$51 million and \$0.64 cents per share in the first quarter. Adjusted net income for the second quarter applied a 26% tax rate to our adjusted pre-tax income generated during the quarter. We estimate that the tax rate for adjusted EPS will be 26% during the third quarter of 2023.

During the second quarter, we paid a quarterly dividend of \$0.11 per share, resulting in a cash outflow of approximately \$9 million, including related distributions to members. The board has also approved a 9% increase to the quarterly dividend to \$0.12 per share, which will be paid in September. Additionally, we repurchased approximately 4,000 shares of Class A common stock in the final days of the second quarter under our new authorization for approximately \$159,000.

We ended the quarter with a cash balance of \$64 million and gross bank debt of \$55 million. Since the end of the quarter, we repaid the entirety of our bank debt outstanding and are once again in a net cash position. Looking ahead to the third quarter, we expect to make our 2022-related TRA payment and distribution, which will be approximately \$34 million, along with an estimated 2023 cash tax payment of \$9 million and quarterly dividend of \$10 million.

Net capex was approximately \$6 million during the second quarter of 2023. We are reducing our full year 2023 capex outlook to \$35 to \$45 million on lower expectations for near-term growth spending at Pressure Control given moderating activity levels. This range is inclusive of planned investments in low-cost supply chain diversification, but excludes investments in the Middle East which we now believe will occur in early 2024.

That covers the financial review, and I will now turn the call over to Scott.

Scott Bender
Chairman and CEO

Thanks Steve. I'll now touch on our expectations for the third quarter based on our reporting segments.

During the third quarter we expect Pressure Control revenue to be down approximately 10% versus the \$199 million reported in the second quarter as the decline in drilling activity impacts our business, which remained resilient through the declining rig count in the first half of the year. As of last Friday, the Baker Hughes U.S. land rig count is down 17% from year-end 2022 levels and down 14% from Q1 2023 average levels; our differentiated Pressure Control business continues to outperform this activity decline. We expect the rig count may continue to be pressured in the third quarter, although customer indications suggest activity will be flat to up in the fourth quarter if commodity prices remain constructive. Our larger, well-capitalized customers remain committed to investing in their business through commodity cycles, and our revenue outperformance of the declining rig count year-to-date is reflective of this commitment.

Adjusted EBITDA margins in our Pressure Control segment are expected to be 32.5% to 34% for the third quarter, inclusive of Pressure Control SG&A and general corporate expenses. This Adjusted EBITDA

guidance excludes approximately \$4.0 million of stock-based compensation expense within the segment as well as transaction-related expenses. Margins are expected to be down sequentially on lower operating leverage, although we have begun to see deflation in our supply chain costs after many months of inflationary pressures. We expect the benefits of this to begin to materialize in the third quarter and more significantly in the fourth quarter.

In the Middle East, we continue to work through testing and trials, which are progressing on schedule. We are also continuing our work on evaluating ownership structures in the region, and upon the completion of our evaluation, expect customer acceptance and first orders in late 2024. As mentioned earlier, we now expect to finalize our investment structure in the region in early 2024.

Switching over to our Spoolable Technologies segment, we expect revenue to be relatively flat versus the second quarter driven by continued penetration in share of wallet and share of market. This outperformance of the market highlights the benefits of the product diversification achieved with the acquisition. As discussed last quarter, our Spoolable Technologies segment was also working through some higher cost inventory during the first quarter, and that headwind is now behind us.

We expect Adjusted EBITDA margins in this segment to be approximately in the 40% range for Q3, moderating slightly from record Q2 levels with volatility in our supply chain. Note that this margin guidance excludes approximately \$1 million of stock-based compensation in the segment. Also, given the high inventory turnover, we have now completed the amortization of the non-cash step-up in value of the inventory associated with purchase price accounting ahead of plan, and we will not have that cost or add-back going forward.

As mentioned in the form 8K that was filed last night with our earnings release, we announced a few changes. Our Chairman, Bruce Rothstein, who has served in that role since the Company's founding in August 2011, has stepped down from the Chairman role after his many years of valuable service. He will remain a director and continue to contribute to the Board, for which I am very thankful. I have assumed the role of Chairman in addition to continuing my current responsibilities as CEO. Given my additional responsibilities as Chairman and my role supporting the integration of FlexSteel, Joel Bender has assumed the role of President. As President, Joel will continue to oversee our supply chain including our manufacturing and production facilities. Steven Bender has assumed Joel's role of Chief Operating Officer, where he will continue to oversee our branch and field operations, managing the majority of our associates and introducing significant technology enhancements to our service delivery and invoicing processes. Gary Rosenthal, an independent board member since 2018, has assumed the Lead Director role. You should not infer any retirement plans from these changes.

We are still in the early innings of introducing the FlexSteel product line to Cactus' much larger customer base through joint meetings and are highly encouraged by early efforts to integrate our sales organizations, both in the US and internationally. Just like Cactus, the FlexSteel team is highly technical, delivers a superior product and service, and strives to exceed customer expectations. I'm confident that, as with the Cactus legacy business, more customers will learn to appreciate the many benefits associated with the FlexSteel spoolable product, including speed of installation, total cost of ownership reduction, increased safety, and reduced emissions from more efficient field operations. We anticipate introducing new products and services in early 2024, the details of which will be discussed when appropriate.

As stated previously, our substantial free cash flow in the five months since the acquisition closed enabled us to repay all of our \$155 million of bank debt, well ahead of our plan. The debt free balance sheet and increased confidence in the strong, through cycle cash flow profile of the combined business has led us to re-evaluate our cash return priorities, as evidenced by our June announcement of the inaugural share repurchase program and the increase to the base dividend announced yesterday. Going forward, we expect to remain discerning buyers of our own stock, as we believe we will continue to be rewarded for having the flexibility to invest in attractive organic and inorganic growth opportunities with our excess cash while maintaining a strong balance sheet.

While third quarter activity levels for Pressure Control are expected to be down given the year-to-date decline in U.S. land activity, Spoolable Technologies is expected to remain stable. We are confident that our consolidated business will continue to outperform the market and we remain encouraged by the investment discipline we see from both our customers and service industry peers. Moreover, we expect that our in-process supply chain diversification will further strengthen our low cost, high quality competitive advantage in future periods. With that, I will turn it back over to the Operator so that we may begin Q&A. Operator?

Question and Answer

Operator

Thank you. We will now conduct the question-and-answer session. [Operator Instructions] Our first question comes from Stephen Gengaro of Stifel.

Stephen Gengaro

Stifel, Nicolaus & Co

Thanks. Good morning, everybody.

Scott Bender

Chairman and CEO

Good morning. How are you?

Stephen Gengaro

Stifel, Nicolaus & Co

I'm good, thanks. I'm good. So, the first question, when I think about the legacy business, and I mean, we had modeled and expected market share to grow a little bit. I know you're not going to speak directly to market share, but can you talk about what you're seeing in that business, both from a pricing perspective and just sort of what – if the competitive landscape there has changed at all. And if you want to tell me if you think we were right, you gained about 200 basis points of market share. We'd love to hear that, too.

Scott Bender

Chairman and CEO

Well, as you know, we're not going to talk about market share directly. But I will share with you that we set a record for market share during the quarter. I'm absolutely not going to talk about pricing. I never have and I certainly never will. So, sorry about that, Stephen. At least you got your market share question.

Stephen Gengaro

Stifel, Nicolaus & Co

But what about just the sort of the competitive landscape? Has there been any change in the – has the competition made progress at all, do you think or do you think your position just remains as strong as it's been for the last several years?

Scott Bender

Chairman and CEO

Well, I guess the best evidence of that is the statement that I made about record market share for the quarter.

Stephen Gengaro

Stifel, Nicolaus & Co

Okay. Okay. Thanks. And then, just the other one I want to ask you about, because you guys are out there on the front line constantly is you mentioned it earlier about rig counts in the third quarter and

maybe stabilization. Are you saying that that based on conversations, based on early orders, what gives you the confidence that we do see a stabilization, and hopefully, a recovery in 2024?

Scott Bender

Chairman and CEO

Yeah. Let me be clear even though you haven't asked this question explicitly, but I believe in transparency, as you know. From conversations with our customers, my feeling now, you may recall, like I called a trough of 650 earlier, I'm revising that 650 down to closer to 600 for the U.S. land count. I think that that's going to probably occur in the mid-to-latter part of the third quarter. After which time, we'll see some stabilization and I feel like we'll begin to see some increases, particularly coming from the privates, who have suffered the most in terms of activity decline. And they always respond first.

Stephen Gengaro

Stifel, Nicolaus & Co

Great. And since you mentioned that I'll slip one in, on the private side. You've made progress with the privates, and it seems like the last couple of quarters. Is that fair, right?

Scott Bender

Chairman and CEO

We have historically made progress with privates. The fact of the matter is, privates used to account for about 35 or so percent of our business. They're down to about 30%. But that's not terribly surprising when you consider how much the privates have dropped.

Stephen Gengaro

Stifel, Nicolaus & Co

Yes. Great. Great color. Thank you.

Operator

Thank you. One moment for our next question. Our next question comes from David Anderson of Barclays.

Scott Bender

Chairman and CEO

Hey, David.

J. David Anderson

Barclays Capital

Hey, good morning, Scott. How are you?

Scott Bender

Chairman and CEO

How are you doing?

J. David Anderson

Barclays Capital

Great. Just a follow-up on Stephen's question just a little bit. If you think about your larger customers there, is it fair to say that they've been staying the course? Just wondering what they're saying, if anything, about 2024 yet. Are you expecting them just to stay steady here throughout? And really the incremental – anything incremental comes from privates and maybe natural gas. Just bigger picture, how are you thinking about the next two or three quarters?

Scott Bender

Chairman and CEO

Yeah. So, to be clear, without mentioning customer names, the really big one that you're probably thinking about right now has maintained very robust activity in the Permian and Delaware areas. But they have released rigs in their gassier areas. Now, to be fair, that didn't represent a large portion, but it was a

meaningful percentage. So, think about where they had gas rigs drilling and those gas rigs have either stopped or are about to stop. So, it's not really fair to say that the majors have maintained their rig count.

J. David Anderson

Barclays Capital

Okay.

Scott Bender

Chairman and CEO

In terms of visibility, we have visibility, pretty good visibility through the end of the year. But I don't think and I see customers all the time, none of our customers are talking about 2024. I do believe that budgets, let's all hope that oil remains in that, say, \$78, \$82 range. I think we'll see budget resets. And that will include, I think, increased activity from privates as well as from the larger players. Now, you heard me say last time, despite all the pundits who believe that we make up for the drop in gas count by picking up oil. I think I mentioned that cash flow is cash flow. And as cash flows decrease and shareholder returns remain constant, something's got to give, and something has given. So, if we look at our – I shouldn't answer questions that you haven't asked, but....

J. David Anderson

Barclays Capital

Please do. Please do.

Scott Bender

Chairman and CEO

If I think about the decline that we've seen in our rig count, believe it or not, it's about 50% gas, 50% oil-related, which kind of supports my position that cash is cash.

J. David Anderson

Barclays Capital

So some are talking about natural gas rigs coming back later in the year. I know you didn't get too specific there. And I know there's this kind of LNG buildup happening at some point in 2024. Are you in that camp there or you think this is going to be more kind of privates on the oil side? Will be more sort of the uptick, 4Q into 1Q?

Scott Bender

Chairman and CEO

Yeah, the latter.

J. David Anderson

Barclays Capital

Okay. You made a comment just now about 2024 that nobody's talking about 2024. I was just curious, is this a little bit late – are you surprised you're not talking about 2024? Are your customers kind of holding off because they want to understand the cost structure? So, I'm just curious, would you normally be having talks about 2024 at this time of year?

Scott Bender

Chairman and CEO

No, I would say that when you're in the January timeframe, you normally get visibility over six months. But as you approach a budget reset period, I think that period of visibility contracts a bit. So, ask me again in September and I think I'll have a much better idea of what we can expect.

J. David Anderson

Barclays Capital

Sure. Makes a lot of sense. If I could just shift over on the Spoolable side, so margins were – the EBITDA margins were impressive this quarter, it sounds like going forward, I guess you're talking in the 40s next quarter, it sounds like your normalized number is a little bit higher than you were originally thinking. Just

curious, what's changed? You've now had the business, obviously, for four months. So, are you seeing something different? Is it more on the cost opportunities side? Are you just managing it better? Just curious, what's changed in terms of that outlook on the margins longer term?

Scott Bender

Chairman and CEO

Well, I'm not managing it. TS is managing it. TS is with us this morning.

Thirucherai "TS" Sathyanarayanan

CEO, FlexSteel

Yeah. Hi.

Scott Bender

Chairman and CEO

So I want to be clear about that. This is not a reflection of Scott Bender. But TS, would you like to maybe offer a comment there?

Thirucherai "TS" Sathyanarayanan

CEO, FlexSteel

Yeah. David, this is TS. The FlexSteel business is a very robust business. And I think you should not read too much into the first quarter to second quarter change in margins because the first quarter, Cactus had owned FlexSteel just for a month, David. And it also had a lot of, I think as we reported and went through on the last call, we've got a lot of accounting-related adjustments to inventory, etcetera. So, on a go-forward basis, the 40-plus-percent margin that Scott guided towards is near term the expectations. Business has got a phenomenal competitive advantage. The business has got really meaningful customer value proposition, it's very differentiated. And we are firing on all cylinders. So you know, I hope that provides you a little bit of an overview.

J. David Anderson

Barclays Capital

It does.

Thirucherai "TS" Sathyanarayanan

CEO, FlexSteel

Scott, anything.

Scott Bender

Chairman and CEO

That's TS's polite way of saying he's confident that he can maintain those margins.

J. David Anderson

Barclays Capital

40% plus. All right. So, look, I'm going to – let me dance around the question a little bit here. I know you don't want to talk about pricing, and I know you won't talk about details on contracts. I'm well aware of that.

Scott Bender

Chairman and CEO

Don't ask me about them David.

J. David Anderson

Barclays Capital

I'm not going to ask you about it. I've asked – it's a very general question here. I'm curious for how your customers order your Spoolable products? Does this typically come on your frame agreement? Is it job to job? And this is the – and I'm not sure if you want to answer this question, but is there a loose rule of thumb as to how much volume gets repriced every quarter? I'm asking because obviously steel prices

have come down quite a bit since March. You just said that part of it is getting that expensive inventory out. I'm just curious, just generally speaking, how does this business work from that perspective?

Scott Bender

Chairman and CEO

David, let me just help TS a little bit. You have two questions here, right? The first is how the customers place orders, is that right?

J. David Anderson

Barclays Capital

That's correct.

Scott Bender

Chairman and CEO

Or are you asking how far in advance they place orders?

J. David Anderson

Barclays Capital

Well, it's more as that kind of relates to the timing of pricing. Like, is there like a loose frame agreement which you just kind of plucking it down and it gets like every once a year, you kind of looking at it. I'm just sort of trying to understand, like with steel prices correcting as much as they have. Like how much does that roll through, I guess, kind of loosely trying to understand.

Scott Bender

Chairman and CEO

Okay. TS, please.

Thirucherai "TS" Sathyanarayanan

CEO, FlexSteel

Yeah. David, just a big picture, just stepping back. One of the things E&P operators focus on is clearly managing costs, and they manage it pretty tight through their supply chain departments. The benefit we have in the FlexSteel side is business has got a really differentiated value proposition, and the value proposition is based on safety and quality. And the safety and quality, FlexSteel has got a tremendous track record. We've not had one operating field failure in the history of the business. And as a result, we're able to differentiate ourselves versus competition.

The other part, just before I answer your question that you should just keep in mind, is Spoolable products and services make up less than 2% or right about 2% of share of wallet of operator spend. So, so that's the background. All to say, operators really place callouts, it's sort of like a milk run, David. And it's just a milk run order purchase and now we do both products as well as services we deliver it all through deliver to length products and services that we offer our customers. So all to say that, sometimes we get products and services that are required to be in customer site within three days, most of the time within five to seven days. And that's how we manage the business.

J. David Anderson

Barclays Capital

Thank you very much. Appreciate it.

Operator

Thank you. One moment for our next call. Our next question comes from Kurt Hallead of Benchmark.

Kurt Hallead

Benchmark Co.

Hey, good morning.

Scott Bender

Chairman and CEO

Good morning, Kurt. How are you?

Kurt Hallead

Benchmark Co.

Good, Scott. Thanks. How are you doing?

Scott Bender

Chairman and CEO

I'm great. Thanks.

Kurt Hallead

Benchmark Co.

Awesome. So, hey, Scott, in the press release, you referenced that Spoolable Technologies would lag the Pressure Control business in terms of the revenue impact of the slowdown in activity. So, I'm just kind of curious in that dynamic, is it kind of like a quarter lag? Question number one. And question number two, do you expect that the Spoolable business would kind of see the same sort of magnitude of decline that you indicated that Pressure Control is going to see in the third quarter?

Scott Bender

Chairman and CEO

Okay. Maybe. I probably didn't characterize that correctly. And TS, you can jump in if what I say is incorrect and you can still – you'll still have your job, even if you tell me I'm wrong on the mic. In the case of Spoolable, TS's team is increasing their penetration in terms of the market and in terms of share of wallet. So, I don't think that that we're in a position right now to tell you what percent of their revenue change is due to market penetration, wallet penetration versus a lag. But look, they need for people to drill wells and complete wells and put wells online. And to that extent, their business is going to be impacted. The question is, and I think TS has answered it, is our feeling is that – is increase in share of wallet and market is going to compensate for that. Is that fair, TS?

Thirucherai “TS” Sathyanarayanan

CEO, FlexSteel

I won't disagree with you, Scott, but I'll just add to the comment, Kurt, the share of wallet is a unique market lever that we have or a company lever that we have to continue increasing penetration into our customers. And I wanted to just provide you with just a quick background to that. Unlike some of the products that are offered just in one part of the customer's value chain, Spoolable products are offered at multiple parts of the value chain. So, what I mean by that is it's used under pipe-under-pad, when they're constructing the pad. And in that regard, the business will pretty much – the revenue and the bookings particularly will pretty much mirror that of rig count movements. But then it also is installed further down the value chain. So, for instance, when you connect the well pad to the central tank battery, that's another segment. And then when you connect the central tank battery to the water disposal line, that's another segment. And then when you connect the central tank battery to the midstream takeaway lines. So, there are multiple segments. And when we say there is share of wallet penetration, what we mean by that is, when we get our customer on, it's usually on one of these segments, and then they see how well FlexSteel performs, how well the team is performing in terms of service and the value proposition is realized. And then, they begin to start using us in other segments of their operation, and that is going to continue, hopefully growing. And it's continued to grow in the last 10 years that I've been here and hopefully, we'll continue to grow in the years to come.

Kurt Hallead

Benchmark Co.

That's great. Fantastic. Appreciate that. Scott, follow up in the comment you made about the Middle East kind of rollout and what you see for Pressure Control, I think you kind of referenced sometime late 2024. Again, don't want to mince any words that you mentioned, but is it late 2024 when you think you'll start to generate incremental revenue or is the real incremental revenue opportunity 2025 and beyond?

Scott Bender

Chairman and CEO

How about tell me what incremental means?

Kurt Hallead

Benchmark Co.

How about just growing the revenue base in the Middle East?

Scott Bender

Chairman and CEO

Our expectation is you'll see that at the end of 2024, and then, it will accelerate into 2025 and thereafter.

Kurt Hallead

Benchmark Co.

Got you. All right. I appreciate that. That's all for me.

Operator

Thank you. One moment for our next question. Our next question comes from Saurabh Pant of Bank of America.

Saurabh Pant

BofA Securities

Hi. Good morning. Good morning, Scott.

Scott Bender

Chairman and CEO

Good morning. How are you?

Saurabh Pant

BofA Securities

Good, good, good. Thanks for asking. Scott, and maybe sticking to the Spoolable side of things, just wanted to clarify on your answer to Kurt's question, because I think I kind of heard not in those words, but I think I kind of heard that, yes, there is a lag when Spoolable is impacted. But you think that share of wallet penetration can help you offset that. So, should we think that there's a scenario and a realistic scenario that Spoolable's revenues might not fall at all over the next couple of quarters?

Scott Bender

Chairman and CEO

Well, we never provide guidance beyond a quarter, as you know or you don't know.

Saurabh Pant

BofA Securities

Yeah.

Scott Bender

Chairman and CEO

So, I really would only like to offer you, I think, guidance on the next quarter. So, I think that our guidance stands and that is that despite this falling rig count and activity level that they're going to maintain their Q2 levels. I'm sorry, I can't be more precise.

Saurabh Pant

BofA Securities

Yeah, no, Scott, I totally understand that. But just the way we should think about the lag. Obviously, completions lag, the rig count and the production and how you carry that production to the central tank batteries and onwards that lags the completions rate. So, what kind of a lag should we think about? Is it six months? Is it nine months? Is it different than that? Or just conceptually, how should we think about that lag?

Thirucherai “TS” Sathyanarayanan

CEO, FlexSteel

Yeah, Saurabh, this is TS. Scott, if I may?

Scott Bender

Chairman and CEO

Sure.

Thirucherai “TS” Sathyanarayanan

CEO, FlexSteel

Yeah. I think, you know, look, it's incredibly hard, Saurabh, before I answer the question, just to give you a disclaimer, it's incredibly hard to predict the future, especially to do it accurately, right?

Saurabh Pant

BofA Securities

Yeah.

Thirucherai “TS” Sathyanarayanan

CEO, FlexSteel

So, predicting the customers' sort of budget spend on different segments is a little bit of an impossible task. But I'll answer the question in the spirit it was raised. I think we'd like – historically, we've seen a three to four month lag. But with the increased cross penetration capabilities that we're having with Cactus, where we sell products where we're having multiple meetings with Cactus customers as well, we're beginning to see penetration in the pipe-under-pad segment and we're beginning to see more line pipe in different types of customers. And so, historically, it's been about three to four months. It may be a little shorter this time. It may be a little longer this time, but that's where it's historically been.

Saurabh Pant

BofA Securities

Okay. Okay. No, that's really helpful. And then, a quick follow-up on the cost side of things in Spoolable. I know steel is a big cost, but you don't price your product like steel, it's value-based pricing. But can you help at all in terms of how should we think about operating leverage, fixed cost, looking at variable cost, anything you can give along those lines.

Stephen Tadlock

Executive VP, CFO and Treasurer

Yeah. Saurabh, this is Steve. We're not providing any kind of guidance into the material cost as a percent or anything like that. We'd like to keep that to ourselves for competitive reasons.

Saurabh Pant

BofA Securities

Okay, guys. Thanks for the answers. I will turn it back.

Operator

Thank you. [Operator Instructions] I am showing no further questions at this time. I would now like to turn the conference back to Alan Boyd for closing remarks.

Alan Boyd

Director of Corporate Development and Investor Relations

We appreciate everyone joining today and look forward to speaking with you next quarter.

Scott Bender

Chairman and CEO

Have a good day, everybody. Thanks.

Operator

This concludes today's conference. Thank you for participating. You may now disconnect.