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WFT - Q2 2016 Weatherford International PLC Earnings Call

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PRESENTATION

Operator

Good morning. My name is Kim and I will be your conference operator today. At this time, I would like to welcome everyone to the Weatherford International second-quarter 2016 earnings conference call. (Operator Instructions). As a reminder, ladies and gentlemen, today's call is being recorded. Thank you. I would now like to turn the conference over to Ms. Karen David-Green, Vice President of Investor Relations, Corporate Marketing and Communications. You may begin your conference.

Karen David-Green - *Weatherford International PLC - VP, IR, Corporate Marketing & Communications*

Thank you, Kim. Good morning and welcome to the Weatherford International second-quarter conference call. I'd like to thank everyone for accommodating the earlier start to this conference call. As you know, we wanted to avoid an overlap of our call with one of our peers.

With me on today's call, we have Bernard Duroc-Danner, Chairman, President and Chief Executive Officer and Krishna Shivram, Executive Vice President and Chief Financial Officer.

Today's call is being webcast and a replay will be available on Weatherford's website for 10 days. Before we begin, with our opening comments, I'd like to remind our audience that some of today's comments may include forward-looking statements and non-GAAP financial measures. Please refer to our second-quarter press release, which can be found on our website for the customary caution on forward-looking statements and a reconciliation of non-GAAP to GAAP financial measures. We welcome your questions after the prepared statements. And now I'd like to hand over the call to Krishna.

Krishna Shivram - *Weatherford International PLC - EVP & CFO*

Thank you, Karen and good morning, everyone. Let me start with a recap of our operating performance in the second quarter. Overall, our revenue of $1.4 billion declined 11% or by $183 million sequentially while our operating income before R&D and corporate expenses reduced only marginally by $11 million reflecting the beneficial impact of the large cost-reduction actions taken this year. Sequential operating income margins deteriorated by 168 basis points to reach negative 8.3%. Sequential decrementals were excellent at 6%. Loss per share for the quarter before charges and credits was $0.28, which was $0.01 better than the first quarter, while EBITDA was flat with the first quarter at $58 million.

North America revenue declined 26%, outperforming a 35% reduction in average rig count and continued pricing headwinds. Seasonal activity reductions due to the spring breakup in Canada coupled with pressure pumping activity hitting new lows with two fewer crews operating at the end of the quarter compared to the start of the quarter. Having said that, operating losses reduced substantially by $27 million with the aggressive cost actions taken this year resulting in resilient margins albeit negative of minus 25.2% and sequential incrementals of 19%.

Internationally, our revenue declined 3% on a sequential rig count reduction of 7%. Latin America bore the brunt of the decline with sequential revenue dropping 18% due to steep customer spending cuts in Argentina, Mexico, Brazil and Colombia. Operating income margins also fell sharply as cost-reduction actions that were taken late in the quarter while benefiting future quarters were not enough to mitigate the drop in revenue. Operating income margins dropped to just 1%, but with the recent cost actions, they should improve going forward.

Eastern Hemisphere revenue increased by 4% sequentially. In the Europe/Caspian/Russia/Sub-Sahara Africa region, sharp activity reductions in offshore West Africa were only partly mitigated by a seasonal recovery in Russia resulting in a sequential revenue reduction of 5%, while operating margins improved to make the region profitable again.

In the Middle East/North Africa/Asia-Pacific region, the sequential revenue increase of 11% reflected the final contract settlement of the Zubair project and higher activity in Algeria more than offsetting declines across several Asia-Pacific operations. Operating income margins declined 180 basis points to essentially a breakeven level reflecting the full impact of pricing concessions given to customers in prior quarters. Revenue for the land rigs business declined 9% with lower sequential utilization rates. However, strong cost-reduction actions, which are structural and enduring in nature, allowed us to improve the operating income by $9 million.

On the cost side, as of last week, we have completed 97% of the previously announced reduction in force exercise of 8,000. This means that we have reduced our total payroll by 42% over the last 18 months since January 1, 2015. Given the current market context and the anticipated increase in activity levels, we have chosen to preserve capability to address the upcoming growth, which are in excess of the requirements of current activity levels. Such additional costs included in our quarterly results amount to $50 million representing 350 basis points of margin and $0.05 in EPS terms.

I want to be clear on the cost reductions front. Should the industry environment abruptly change back to February levels and persist at those levels, we can eliminate this additional annualized retained cost of $200 million and furthermore collapse our operating structure materially to save even more costs. Such steps would be extreme and would impair our capability to grow in the future without additional investments.

Below operating margins, R&D costs reduced by $5 million sequentially while corporate costs were down $8 million reflecting spending cuts in line with the reduced budgets. These levels are sustainable going forward. The tax benefit recorded in the second quarter of 21% reflected the tax benefit on the losses primarily in the US partly offset by tax provisions internationally. The tax rate for 2016 will be dependent on the geographical mix of earnings and will be heavily weighted by results in the US, but could swing widely as a percentage rate as the levels of income are quite low.

The second-quarter results also included net after-tax charges of $312 million.

Let me go to the key charges. We took a charge of $101 million in litigation charges mainly related to advancement in negotiations with the SEC regarding our income tax restatements from previous years. A charge of $84 million was taken to reflect the fair market value adjustment of a note receivable from a customer in Venezuela. While we intend to hold this note to maturity and collect on the entire face value and the associated interest, accounting rules mandate the write-down of this note to reflect its current market value. Over time, this value should continue to increase as commodity prices recover and maturity dates get nearer.

We took a charge of $69 million from bond tender premiums that were paid related to the repurchase of our senior notes; a charge of $62 million primarily from write-downs in inventory and other assets as we continue to resize the business; a charge of $41 million in severance and restructuring charges; and finally, a credit of $45 million of income relating to the Zubair legacy contract reflecting the favorable terms of a settlement reached with our customer.

The good news is that, as of this print, the construction phase of this contract has been completed and is now in the routine operations and maintenance phase where we hand over the project to our customer while training them to operate the facilities. So it's quite routine now. So from now onwards, you will never again hear us talking about the Zubair contract.

Moving on to the near-term outlook, we expect a modest recovery in activity levels in the US, which has already seen a 7% quarter-to-date increase in rig count on land augmented by the post-breakup seasonal recovery in Canada. Signs of increasing activity are already manifesting in the US with two additional pressure pumping crews being deployed in July. In fact, we made 77 job offers last week to manage the staffing of these crews. It takes about three weeks currently to re-equip a stacked fleet with minimal CapEx, but it takes up to six weeks to re-staff the fleet crew.

Already there are signs of a tightening labor market in the US with many laid-off workers having left the oilfield workforce permanently to move to other sectors of the economy. While the initial recruitment will comprise experienced oilfield hands, beyond a point, re-training will be needed. All of this is going to reverse the pricing trend in the US, albeit gradually, as operators will have to pay more to access high-quality service capability. Additionally, with customers working through the DUC or drilled but uncompleted inventory, our completion in artificial lift activity levels will get a disproportionate boost on US land.

Internationally, we expect to see some flattening in Latin America, modest growth in the Europe/Caspian/Russia/Sub-Sahara Africa region with a continued seasonal recovery into the summer in both Russia, but to a lesser extent in Europe, aided further by marketshare gains in the Middle East and in some Asian markets. Pricing will not deteriorate any further from second-quarter levels, but costs will continue to trend downwards. Based on this, we expect to see a gradual improvement in our second-half result; although on an overall basis, we do not expect to break even by year-end. Bernard will comment in more detail on the operating results, contract activity and wins and the outlook later on in this call.

Moving onto cash flow and net debt, free cash flow in the second quarter was a disappointing negative $160 million while still improving on the first quarter's free cash flow by $56 million. The shortfall can be explained quite simply. Customers in general, but particularly national oil companies, have begun to manage their cash flows actively thereby delaying payments to contractors.

We missed about $150 million in specific projected collections reflected in the 9-day increase in our DSO this quarter. Obviously, these customers have solid credit and recoverability is not in question. Just the timing is delayed. As our customers will benefit from better oil prices going forward, we expect them to improve the payment cycle in the second half of the year and into next year.

Secondly, with the reduction in product sales, we could not hit our inventory reduction targets in the second quarter, and while we did reduce inventory levels in the quarter, we fell short by $50 million.

Thirdly, the tender offer we made on our 2017, 2018, 2019 and 2020 bonds resulted in a settlement on June 30 accelerating payment of accrued interest of $27 million, which would otherwise have been paid in the third quarter.

And lastly, we also accelerated the reduction in force program and incurred an additional $28 million in cash severance payments. These factors impacted our second-quarter free cash flow by about $250 million.

Our current forecast for free cash flow for the year is in the range of positive $100 million to $150 million. This implies a seasonal recovery in our cash flow generation in the second half of the year, which is normal for our industry. Our second-half cash flow will be bolstered by improved results, stronger customer collections, lower inventory levels, much lower severance cash costs, absence of employee annual bonus payments and continued discipline in capital spending.

CapEx is now targeted to be $200 million for the year, down another $50 million from the previous guidance. This low level of CapEx should not alarm anyone. Our CapEx is divided into three buckets -- manufacturing capacity, infrastructure capacity and technical equipment for our services business.

In terms of manufacturing capacity, we are currently running at just over a third of available capacity. In terms of service infrastructure, we are well-built out globally and are materially underutilized currently.

And finally, on the technical equipment front, we have objective utilization metrics for each productline in place be it drilling services, wireline logging or pressure pumping, and based on detailed analyses, we believe we can support about 2.5 times the current levels of activity without adding any meaningful higher CapEx. As we grow into the upcycle, we can and we will maintain a tight lid on CapEx.

Net debt increased by $187 million in the quarter to reach $6.8 billion. In the second quarter, we successfully upsized and issued $1.27 billion of convertible notes and $1.5 billion in five-year and seven-year senior debt at very good interest rates. A big part of these proceeds totaling $1.9 billion were used to buy back debt maturing in 2017, 2018, 2019 and 2020 pursuant to the tender offer and the rest of the proceeds were used to pay down the revolver.

As a result of these transactions, our maturity profile has changed substantially, derisking the liquidity profile of the Company materially. Prior to these transactions, we had $2.1 billion of maturities over the next three years. Today, this number is a mere $639 million with only $88 million due in 2017 and only $66 million due in 2018. The success of these transactions reflects investor confidence both in the recovery of the sector as a whole and in Weatherford's strong performance in the backdrop of such a sector recovery. We are grateful for our investors' faith in us and we expect to exceed their expectations.

One point of particular note here is that the springing maturity clause in our revolver linked to reducing the 2019 $1 billion bond maturity to less than $500 million by the fourth quarter of 2018 has already been neutralized as the outstanding amount on the 2019 bond is now only $485 million. This means that the revolver now extends out to July of 2019 with no problems.

Another noteworthy item is that all of our banks recently unanimously approved an amendment to our revolver agreement to iron out kinks and to ease certain restrictions that make it easier for Weatherford to operate. Additionally, an accordion feature of up to $250 million was added to the agreement to allow existing and new lenders to extend more capacity to the Company going forward. All of these changes are positive for Weatherford and demonstrate the continuing support from our banking group.

Our long-term net debt will trend down. Our current intention is that in 2021 when the convertible debt becomes due, we expect to issue shares to our debtholders in exchange. This will structurally reduce our debt by $1.27 billion. Additionally, positive free cash flow from operations and the proceeds from the eventual sale of the land rigs business will also reduce net debt materially. All of this goes to further delever and derisk the company. Longer term, we continue to target a 25% to 30% debt-to-cap ratio and recover our investment-grade credit rating.

As of June 30, available liquidity was $1.8 billion, including $1.3 billion of revolver capacity and $452 million of cash balances. Operating EBITDA for the quarter was flat with Q1 at $58 million. As to specified EBITDA as defined in our revolver agreement, it came in at $130 million for the quarter. The key specified debt to specified EBITDA ratio at June 30 was 1.0 times versus a covenant of 3.0 times, meaning we have ample headroom on the covenant. The same ratio, including LCs, was 2.04 times, which is also well below the covenant of 4.0 times. Our projections for the rest of the year suggest that we maintain the substantial headroom on the covenant.

In conclusion, Weatherford is now materially derisked from a liquidity standpoint, has a clear, achievable plan to delever over the next several years and the Company is now at the takeoff point as the market recovers with industry-leading earnings and cash flow incrementals. With that, I will now turn the call over to Bernard.

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

Thank you, Krishna. Good morning, everyone. A few comments on Q2. The second quarter evolved as we expected. We thought NAM would trough and we did. In spite of a devastated Canada in Q2 making a severe activity drop that much worse for NAM, operating income actually improved significantly. This is entirely due to cost management and excellent operating execution.

We thought the Eastern Hemisphere would not deteriorate further in Q2 and this was correct. We have cross current in Q2 for the Eastern Hemisphere. Pricing concessions given out in prior quarters impacted the quarter. This conflicted with some early startups and powerful cost cuts. The end result was marginal declines in overall revenues and flat profitability.

We viewed Latin America as having a very weak prognosis. This proved also and unfortunately correct. Mexico, Colombia -- our largest market -- Brazil and even Argentina all weakened further, in some instances dramatically. By way of an illustration, our largest client in our largest national market, Colombia, moved their drilling activity in late 2014 from 30 rigs within plan for over 40 to zero in this second quarter. In the course of the quarter, the client went actually down to zero drilling rigs.

Q2 showed an exemplary decremental of 6% on 11% decline in sequential revenues. We expect these will be industry-leading decrementals. They reflect above all the very aggressive cost actions taken from day one of the downcycle. We have had the best, as in lowest decrementals, consistently.

Lastly, Q2 was to be the last quarter with the ongoing Zubair project and it was. Zubair is completed. You won't hear of Zubair anymore. It is a closed issue.

On cash flow, a long-term focus and objective, profitability, CapEx, inventory and cash payment of the 15 operating bonuses traditionally paid in Q2 all were by and large as planned. We had two unexpected events -- accelerated Q3 payments into Q2 and delayed receivables collection. The acceleration of payments for severance execution was one of the two accelerations. Almost all of Q3 was placed into Q2 as we accelerated our payroll cuts to end the layoff program earlier., the acceleration of prepayments of Q3 interest expense, in addition to Q2's scheduled interest payments. This was a byproduct of the debt-tender offer.

Delayed receivables collection. As Krishna mentioned, the delays were all NOCs, a few IOCs too. This isn't a credit or a collection issue. This is an industry phenomenon. Why did large clients slow down payments? Because they could. In Q2's extremely depressed environment, it was possible. The net result was a significant shortfall in scheduled collections at quarter's end. All this added up to a $200 million-$250 million swing in our free cash flow. The swing isn't lost. It will benefit the second half of 2016.

Q2 synthesis and forward views. Looking at Q2, a few conclusions are clear to us. NAM troughed in Q1 profitability-wise and Q2 revenue-wise. NAM is now turning, however slowly, but turning it is. Eastern Hemisphere troughed in Q2. Same observation. Eastern Hemisphere as a whole is turning, however slowly, but turning it is. Latin America will continue to remain challenged. We don't see it turning, not in 2016.

More details on forward views. These comments apply to Weatherford. They incorporate market trends, but with idiosyncratic specificity. We are a little different from the others. When you have our productlines overlap the big three, essentially completion and formation evaluation, and our recent marketshare history is also different. First half of this year reflected the psychology of a $25 oil market, which is essentially a forced liquidation of the industry's capabilities. Volume activity worldwide and pricing conditions reached levels unseen in any management's lifetime, including this one.

Second half of this year will reflect a $40, $45 oil market psychology, which will make it the beginnings of a recovery, albeit from extraordinarily low levels. The oilfield will slowly pull out of the extreme operating conditions it was placed under. Progress will occur, but step-by-step and not everywhere.

Oil bears need not fret. The recovery will be short with the minimum activity levels required to sustain let alone grow a flat worldwide oil production capacity. This means on the whole our clients in the second half will continue to lower their oil production overall and de facto capacity. In effect, second half of this year, we won't be able to overcome decline rates either. Worldwide oil production capacity will lower at year-end than it was at the end of Q2.

Geographically, activity gains will be predominantly land and concentrated in three regions -- North America, MENA and Russia. The rest will by and large flatten out. NAM will slowly rise in activity with all segments benefiting. Completion and lift will be the strongest first beneficiaries, as will pressure pumping. The capacity overhanging that segment limits the near-term potential. Our completion is seeing for the first time in many quarters an increase in orders and activities on a number of US land plays.

On lift, we have seen recent improvements in orders for new equipment suggesting both the end of our client destocking and some activity increases. Lift prognosis matters for us in NAM. It is a very large and normally very profitable productline with low beta. But when conditions deteriorate to an extreme as they recently have, lift, our lift, becomes a much higher beta than understood.

Let me explain further. We are the largest player worldwide, including North America, in all forms of lift except ESPs. Normally lift is an island of resilience and stability. With the unprecedented collapse of North American activity, lift experienced high beta with major client destocking of new and parts inventory, as well as severe curtailment of the new well market. This deterioration was much worse in the ESP segment because the types of wells ESPs address keep their low beta. As a correlation, our lift and our non-ESP lift peers have much more to recover with a turn in the market. De facto in this particular cycle, our NAM lift productline has become high beta.

Eastern Hemisphere will arrest its decline volume-wise and experience a modest recovery. Expect the first manifest rise in activity late in Q3 and squarely in Q4. This will not apply to the entire hemisphere. Russia and MENA will show by far the most improvements, both a combination of activity increases and marketshare gains in our case. The Gulf countries, Saudi Arabia, Kuwait and the Emirates, are the prime movers for us. Middle East will be an island of strength in the second half.

There are also some Eastern Hemisphere markets that will lag, but at a minimum, these markets will stabilize with no further declines. Latin America on the whole will start the second half weak. It will flatten before year-end. The activity declines will rest, but it will not experience much if any recovery, not this year. There will be shifts in national markets and clients, but overall the prognosis for the market is for a soft followed by flat outlook for the second half. That makes Latin America the laggard.

Two targets we will strive for. We may reach breakeven profitability operating income in North America by first half of next year, first half 2017, on the back of high expected volume incrementals and the full effect of cost cuts. We assume in this respect very little improvements in pricing in that turnaround timeframe.

Two, Eastern Hemisphere may return to double-digit operating income margin, albeit just low end of the double digit. In Q4, this is, therefore Q4 of this year, Q4 2016, on the back of high expected incrementals. And again, much of the strong incrementals expected after the credit of the cost revolution at Weatherford, which brings me to costs and organizational change. I want to touch on a number of operational issues because I believe we are at a turning point in the cycle, the turning point of two-year cost and operating transformation and I believe it portends to strong performance at Weatherford.

The first half of the year, we have reduced our global employee count by another 7,800. Our total employee count stands today at just 32,000, down from 55,300 on January 1, 2015, 18 months ago. This is a 42% contraction of our total payroll in 18 months. The organization has been delayered on average by a third. The support ratio, indirect to direct labor, dropped further to 37.8%. Early in 2014, it stood at near 60%. No other statistic tells the story like the support ratio. This almost cutting in half was accomplished in the midst of a very sharp decline in direct headcount. That is extremely difficult to get done.

Simply said, we have step changed, as in made efficient, our support structure. We did this in addition to direct cost action even though direct labor was hammered very hard. This is important because future incrementals will benefit immensely when activity turns. Our lower support ratio will drive powerful absorption with volume increases.

Responsibility and accountability has been pushed to the sand face, as close to the field as possible, which means less Dubai, Singapore, Moscow, Houston, etc.; more Dharhan, Sakhalin, UK and Midland, etc. Supply chain, manufacturing, procurement, logistics have been restructured with efficiency gains at all levels. We've made large gains in procurement and logistics already. Manufacturing is still in the process of being restructured, but metrics for workcenter rates and time to delivery have already improved.

Operating and financial management have been upgraded thoroughly from the leadership through the ranks. It is self-evident that the leadership level runs deep through the ranks. HR has been empowered at all levels of the organization with an emphasis on training and career development. Operational compensation is geared towards free cash flow, returns, quality and safety. With the turn, return metrics will become increasingly important as will quality.

Q3, but even more so Q4, will capture the full benefit of all the cost actions taken, which brings me to forward operating priorities. Other than a few local exceptions, people and delayering cost reductions are completed. We are calling for an end to the payroll-related cost drive. There will not be any further contraction. The current level of 32,000 worldwide employees will be our low point.

We are also calling for an end to all price discounting. This is a companywide formal decision and process. No tender or bid submission will be priced lower than Q2 levels effective now. This is the first step towards price recovery. Over time, price recovery will be a powerful driver of financial results. Pricing worldwide, not just North America, reached levels which we have never experienced before, not by a wide margin. Pricing levels are unsustainable long term for our industry.

We are not banking on pricing alone to drive margin improvements. The level of support cost ratio at end of Q2 of 37.8% is so far from its historical levels of a few years ago, in our view very high incrementals when high activity comes through, view it as a particularly powerful absorption booster of high business volume.

On the cost side, what will be left as a work in process are ongoing two-year productivity and efficiency internal projects centered around supply chain, maintenance cycles and invoicing processes with powerful structural costs and cash flow efficiency implications. This will benefit 2017 and later years.

You will notice we started to add a few operating news in our quarterly results, be they contract wins we view as directionally important or particular agreements such as the joint effort with IBM. We've spent much of the last two years talking about layoffs, shutdowns and curtailments. When we didn't, we talked about liquidity, banking facilities and balance sheet constraints.

Today, our capitalization is structurally safe with action taken in June. We have ample liquidity and time. This doesn't change our financial priorities. The Company's culture, compensation and focus is on free cash flow generation and returns as key metrics of performance. It is said it is ingrained in our DNA and it won't change.

Also, legacy issues, whether administrative, legal and contractual, are closed and our cost structure is at an unprecedented low level, of which much is perennial. With all this achieved and all behind us, it is time we focus on clients, technology, product development and the impact we as a company can make on the industry. With our specialization and unique tool box and technology capabilities we have, we have much to offer.

By year-end, Weatherford's maturation process, at least in our opinion, will be essentially completed. The Company had years of extremely aggressive growth and development in its formative years. It had then many years of success, but also paid a high administrative and operational price for speed and rate of growth. Even if all issues are closed, the lesson is learned.

Along the way, our industry's unprecedented depression in depth and longevity allowed us to step change faster and further on what needed to be changed. That includes our cost structure. We focus on strength, productline infrastructure and selected marketshare opportunities to the exclusion of all else. This also allowed us to adopt cash generation and return metrics for financial objectives throughout the organization and change our culture.

With the overly aggressive earlier stage of the Company, part of our history, buried and gone, all at Weatherford focus on financial priorities and operating performance. The market is turning. It feels slow, hesitant, frail, worrisome, but make no mistake, it is as frustrating as it will be powerful when some time has run. The oilfield service industry, our industry is a coiled spring, and within the industry, Weatherford is especially tightly coiled. With that, I will turn the call back to the operator for the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jim Wicklund, Credit Suisse.

Jim Wicklund - *Credit Suisse - Analyst*

Bernard, operationally, it looked like a decent quarter, especially in North America. Internationally, you mentioned that the Middle East and Russia will show improvement in the second half and you specifically mentioned contract wins. Can you tell us what productlines, what areas that you are winning contracts in in international markets, especially in the Middle East these days?

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

Saudi Arabia, Kuwait, Abu Dhabi, Oman would be essentially it. And in terms of productline, it would be essentially drilling-related, drilling and with some completion add-ons.

Jim Wicklund - *Credit Suisse - Analyst*

Okay. And Latin America, you note it's going to continue to lag. Obviously, Mexico -- Baker had a big blowup in Ecuador. Everything seems to be stalled. Do you see Latin America coming back in 2017, or is this going to be a longer-term endemic issue?

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

I think that places like Colombia, Argentina and to a more limited degree Mexico will have an awakening in 2017, nothing extravagant. Of course, depends on oil, etc. I think Brazil will take a bit longer. And I cannot speak for Venezuela because there are financing issues there, so it's an unknown.

Jim Wicklund - *Credit Suisse - Analyst*

Okay, okay, gentlemen, thanks much.

Operator

Bill Herbert, Simmons.

Bill Herbert - *Simmons & Co. - Analyst*

Bernard, could you expand on the recovery path for Eastern Hemisphere margins by year-end? We are going effectively from breakeven to low double digits by year-end. Are those basically costs that have already been taken out of the system that didn't necessarily manifest themselves on the P&L in the second quarter and should begin to blossom in Q3 and Q4?

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

I think when you look at the margin expansion we are planning to get, which I agree is a big number if we are to achieve our targets, you will see that about a large third of it is driven by simply incorporation of the cost actions we took through the P&L. It's not so much that we acted later throughout the Eastern Hemisphere; it just takes longer simply because of regulations and culture in those places.

So our assessment, we are pretty good on the cost metrics, on figuring out what will happen. Our assessment again is that it will take just about full effect in Q4 and most of the effect in Q3. So Q3 will [clearly] benefit Q4 in [full] on the cost side and then drive a large third of the margin improvements that we are hoping to see in dollar terms.

The balance at two-thirds, or a small two-thirds, is really nothing more but a measurement of the activity that we see as very -- well, not only likely, but planned for -- we are increasing the volume of activity in a number of Middle Eastern markets. It's not a large number, but it's in a number of markets. We can measure what that means. We know the profitability of the contracts and we can measure it, and if you add all of that, it provides us with just a certain dollar margin for the fourth quarter, which combined with the costs brings us to somewhere between 10% to 11% very specifically operating income margins for MENA because Asia-Pacific is combined with it. Asia will not change very much, a little bit of cost benefit, but not change very much. So it's all driven by MENA, which allows us to say that we can see that particular part of our business being driven to double-digit results.

Bill Herbert - *Simmons & Co. - Analyst*

Okay. So to be clear, the double-digit aspiration is for MENA and not necessarily Eastern Hemisphere?

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

No, it's for Eastern Hemisphere. I just covered the part of it that (multiple speakers). The rest is seasonal in the case of Russia, which is very powerful. Local cost cuts. Cost cuts is seasonal. The European side doesn't move that much in terms of activity; it's just cost. The one that was more granular was MENA. Forgive me.

Bill Herbert - *Simmons & Co. - Analyst*

Okay. Thanks. And the second line of inquiry here is I think Krishna referenced putting two fleets back to work in North America in July and I just want to drill down a little bit on your frac fleet in North America. I think you have something along the order of 900,000 horsepower in North America. And first, how much of that is working? Second, what's the health of the fleet? And I'm just wondering about how much of your idle capacity can go back to work in short order with a minimal amount of CapEx.

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

I will cover some of the aspects and Krishna, fill in the blanks. We have originally 23 spreads and we would calibrate the spread at just about 50,000 horsepower a piece, so a bit more than 900,000 horsepower in the US. However, we feel today we only have 20,000 realistically. Out of the 20,000 spreads, so it would be 1 million horsepower rather than the prior number, we have 10, which is hot stacked and -- 10 market and also hot stacked, and 10 which is cold stacked. Of the 10 that are hot stacked, we went all the way down to 5 operating as recently as Q2 and the 5 become 7. So if you will, 7 out of 10 are active, 7 actually under contract, and 3 which are ready to go, assuming we can find the crews. The other 10 cold stacked are being minimally maintained. They are not being dilapidated; they are not being cannibalized and the rest of it. There is a CapEx involved for the other 10, which Krishna will cover.

Krishna Shivram - *Weatherford International PLC - EVP & CFO*

Thanks, Bernard. So, yes, first of all, to bring the 3 hot stacked fleets back on, there's minimal, absolutely. We are talking about three weeks' time to bring those fleets back to work with very, very minimal expenditure. The cold stacked fleets will roughly take about $5 million to $7 million each with about a four-week turnaround time to bring each fleet back. So we could work on all those fleets concurrently of course. So really the additional CapEx needed to bring the 10 cold stacked fleets back to work is actually quite minimal for a company of our size. And we are very cognizant of the market, working closely with our customers and we should be able to react quite quickly to any kind of upswing in the market.

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

To put it in perspective, Bill, think on the cold stack, which is half of our fleet, 10 out of the 20, about $150 of horsepower on average to bring them back to the market. They have been, again, minimally maintained. They have not been cannibalized.

Bill Herbert - *Simmons & Co. - Analyst*

Okay. Thank you very much.

Operator

Sean Meakim, JPMorgan.

Sean Meakim - *JPMorgan Chase - Analyst*

Just looking to expand on that discussion on the pumping fleet. As you think about the restart of activity and the impact of pricing, I think you noted in the prepared remarks some tightening of labor. Just curious as you think about pricing progression, do you expect to see some concessions from your customers on pass-through costs first before you can get towards the net pricing? Just curious how that dynamic would play out as activity were to pick up?

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

Sean, you are absolutely right on that. It is a utilization story. In North America, the way the recovery unfolds, which you know very well, is you start getting more fleets back to work. The overall utilization of the US fleet, not just our fleet, but the industry fleet, has to reach a certain threshold before we then start gradually renegotiating terms and conditions, which include pass-throughs, etc. That's how the pricing improvement starts manifesting and eventually at some point when the market picks up to a certain threshold then you start having a little bit of tightness both in equipment and in labor in terms of shortage. That's when you start getting a little bit more pricing power. But we don't anticipate anything in our assumptions on pricing for the rest of this year.

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

Sean, also be careful that -- be mindful more so than careful -- that in the breadth of our productlines, lift, completion, and well construction and so forth, we've had absolutely also terrible pricing and you are probably a bit more likely to see our pricing -- I wouldn't say strong pricing, no, but some pricing move in the other products and services lines rather than pressure pumping. Pressure pumping will really be an issue, by our assessment, a utilization game for quite some time until you get to a level of realization where it's more natural to get some pricing relief.

Sean Meakim - *JPMorgan Chase - Analyst*

Right. I think that's fair. And then just to circle back on the updated free cash flow guidance, there are some moving parts. I was just hoping you could give us a little more detail, particularly I was thinking around the working capital, how that component is going to help you achieve those targets for the second half.

Krishna Shivram - *Weatherford International PLC - EVP & CFO*

Right. First of all, receivables, I mentioned that NOCs are managing their cash flow actively. This is an industry thing. It's not a Weatherford thing. And we expect that to continue through the second half. We think NOCs worldwide are going to continue to manage their cash flow quite actively through to the end of the year. So the DSO will stay where it is, but obviously the collections in the second half will exceed that -- that's on a prorated basis what we saw in the second quarter.

Inventory levels initially for the first like I would say 6 to 9 months starting now will actually dip because there will be a step up in activity. That's our assumption based on what we are seeing in the marketplace. So you will see inventory levels dip a little bit before we need to start restocking. Restocking will start sometime mid next year.

So in terms of working capital, we expect to see some inventory declines. We expect to see a marginal increase in receivable balances, and payables will go with the business. If business goes up, the payables will increase as we go forward allowing us to manage the receivables from a liquidity perspective. So it will be a little bit of a mixed bag, I would say, flattish working capital for the next six to nine months and then gradually increase after that as the business picks up to a new level.

Sean Meakim - *JPMorgan Chase - Analyst*

Got it. Understood. Thank you.

Operator

Marshall Adkins, Raymond James.

Marshall Adkins - *Raymond James - Analyst*

I want to drill down on your ability to respond in an upturn. I think, Krishna, you mentioned that the activity would need to improve 2.5 times before you need meaningful CapEx. First of all, did I hear that right? How does that apply by productline and by geographic areas? Is North America going to be the same? For example, 2.5 times where we are today is 1,100 rigs before you really need to spend any CapEx.

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

I will give some element of comment, Marshall, and Krishna will add. It's actually a little bit, even a bit more than that. The manufacturing capabilities can accommodate 3 times more volume, not 2.5. The infrastructure, which is a bit of an artificial measurement, the roofline that we developed over the years is so wide and actually is geared up for much higher volume, can also accommodate throughput at 3 times the volume that we presently have easily. The 2.5 times concerns the tools deployed in the field. Whether it's completion service tools, or whether it's LWD kits at both ends of the spectrum, that's what Krishna was referring to and all of these numbers are absolutely correct. We actually do not need to expand manufacturing or infrastructure period in the foreseeable future because 3 times the volume, even in the recovery is a lot.

In terms of the service tools that I just mentioned and all the formation and valuation tools. As you can tell also, 2.5 times is a vast number, in addition to which, I will tell you, we are improving really by larger measure the intensity of use of our tools, which if anything will tend to make the 2.5 times a bigger number and all last longer, if you will. As volume comes in, we will still have that kind of ability to accommodate more business.

So CapEx, we are not starving the business. This is not a business which is being deprived of anything. The realities we have -- we are very long assets, so we can use assets. We are using assets. We've learned how to do that intelligently and although CapEx with activity obviously will grow, you'll be surprised by how modest it is, and it's not with suppressing our capabilities at all. It's just that we spent much in past years and it has not been wasted. That's really all. Krishna, do you want to add to that?

Krishna Shivram - *Weatherford International PLC - EVP & CFO*

Yes, I'd like to add, just to give some context here as well, in the last two years or so, we have immensely strengthened the management of our productlines. The productline people in the field, they have asset-sharing objectives and that culture change has happened nicely over the last two years. So today, they all carry a global CapEx objective by productline. Every productline has got utilization metrics, which are now embedded. People understand them. And sharing of tools is one aspect of it.

The other aspect of it is to localize repairs and maintenance. So we have opened up R&M centers locally in many geographies in the last two years. What this does is that when a tool goes down after used in a job, it gets now maintained and repaired locally and is redeployed immediately back in the field from where it came as opposed to the past when it would have to come back to Houston or go back to the UK. It would take months and months of turnaround time, which means you had to have a huge number of backup tools in every country to cope with that R&M facility that we had, centralized facility that we had.

Now having localized everything, we are much more confident in telling you that we don't need that many backup tools as before. This is part of the transformation of Weatherford. That's the way we are managing our global fleet of tools, the way we are managing the deployment of tools and the repair and maintenance of tools. So all of this goes into the kind of statistic that I was talking about, 2.5 times.

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

We manage our costs down. We talk a lot about it because it's easy to measure -- people. What we don't talk as much about is the quality of the people and the priorities they have, the operating guidelines they have, the culture change. We also don't talk as much either as to the work we've done on and around the assets, understanding the asset base we have, understanding how to use it more efficiently. There's enormous amounts of headroom in us doing that. But we've done all three at the same time. We just put the emphasis on just the raw numbers, people leaving and the cost measurement because it's just easier to get your hands around it.

Krishna Shivram - *Weatherford International PLC - EVP & CFO*

So really our ability to manage the upswing in terms of physical tools and CapEx is actually very, very strong now, without meaningfully adding to CapEx and eroding our cash flow.

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

And in closing, that doesn't have anything to do with availability of capital; it has to do with returns. That was a returns-driven initiative.

Marshall Adkins - *Raymond James - Analyst*

It was a surprisingly high number and that's good color and helps me understand how you get there. The other surprising thing that I heard was, I think, Krishna, you mentioned, you are already starting to see a little bit of a tightening in the labor side, maybe six weeks to re-staff a frac crew today. If activity is let's say 30%, 50% higher than today, how long do you think it would take you to hire out and train a crew?

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

We are not alone in this. Our peers are also recruiting hand over fist right now, or to staff a few additional crews that they are putting out there. So I think frankly as an industry the first I would say there's no empirical verification of this of course, but I would say the first 25%, 30%, 40% increase, physical activity, it'll be fairly straightforward to recruit back some of the labor that have been laid off. After that, it will get really tight. So I would say up to 600 oil rigs, it should be fairly easy. After that it gets tighter, so we will reach a situation where we tell our customers we have the equipment, but we don't have people to run it. And that's what I was talking about in my prepared comments that the crunch will come on people first then it will come on equipment much later.

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

Marshall, at the end of the day, what he means is the elasticity response in North America on the oil side, meaning on the production, on the capacity side, is overstated. The simple reason that -- forget the reservoir issues and whether the other zones we can go after are as productive as the ones we are going after and blah, blah, blah. Forget that. That's one issue, but the other issue is just the sheer ability for the industry to bounce back. Of course, it will. It will take much longer.

This is not a normal depression we went through. It lasted much longer, much, much, much longer. It's already twice as long as 2009 and deeper. And there are consequences. The consequences is measured with the elasticity of response.

Marshall Adkins - *Raymond James - Analyst*

And presumably that's when pricing goes hyperbolic when you start to run into those bottlenecks?

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

Yes, that's not what we want as an industry, but that's correct. We don't make the rules.

Marshall Adkins - *Raymond James - Analyst*

Thank you.

Operator

Waqar Syed, Goldman Sachs.

Waqar Syed - *Goldman Sachs - Analyst*

Just quickly on the Zubair, I guess, last time around. The $150 million of settlements, have you received proceeds for that, or when do you expect them, if not already?

Krishna Shivram - *Weatherford International PLC - EVP & CFO*

So we signed a settlement agreement with them, Waqar, and really they are following the settlement agreement to the letter. So we received $60 million in the second quarter, and offsetting that was operating expenses because we had operations, which have now finished, in the second quarter. But the rest of the money, most of it will come in the third quarter as negotiated and agreed. And that's part of our second-half cash flow forecast.

Waqar Syed - *Goldman Sachs - Analyst*

That's great. That's all I have. Thank you very much.

Operator

Kurt Hallead, RBC.

Kurt Hallead - *RBC Capital Markets - Analyst*

So just wanted to follow up on two things. First, focus on the cash flow dynamic you guys outlined, what you expect for the full-year cash flow generation. Just wondering how you guys are risk-assessing getting to that cash flow number in that context and maybe what percentage of working capital is going to represent that cash flow.

Krishna Shivram - *Weatherford International PLC - EVP & CFO*

So obviously there's a number of elements in our second-half cash flow guidance, right? We see an improvement in earnings, as Bernard mentioned in his comments, right, with growth both in North America and Eastern Hemisphere, excluding Latin America. Latin America is not going to grow. And there's also, of course, a working capital release both mainly from inventories really and some amount of receivables as well just flowing through from the Q2.

And I think from a risk assessment standpoint, these are the main assumptions we have because the rest of it, the severance is going to go down because we've accelerated much of it into the second quarter. Interest payments actually will go down as well in cash terms because again because of the acceleration into the second quarter. And the Zubair contract will be cash positive, more so in the second half, much more so than in the first half.

So when you aggregate all of the moving pieces, these are the things -- most of it should happen as planned. I think from a risk standpoint, commodity prices, activity levels, etc., those are the elements of it. But I'd like to mention that no matter what the numbers are, the implications are completely dampened now because, from a liquidity and capital structure standpoint, as we mentioned earlier, and the covenant management, there is no issue at all.

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

So let's summarize, Kurt. I will add a couple of things also if you want to get more comfort, which is that we will always have a large operating bonus payment in Q2, every Q2 of every year. It's in the range of $80 million, occurs in one quarter in Q2. (inaudible) routine, but it won't occur in Q3, Q4. There you are.

The other thing also as you take a look, for no particular reason other than individual agreements, payables were taken down quite a lot in Q2 also. These are all obvious things you'll see, fine. So I will mention also -- so that's one set of factors. And Krishna is right, we are not a company, which is -- has any issues of either liquidity or anything like that. We have now the kind of capital structure that we want and we do feel that we can take the net debt number down to -- if you analyze the numbers -- to $4 billion as a matter of three different events, which is free cash flow and the sale of assets, which is rigs and also in our minds, we believe the conversion of the convertible into equity takes you down just mechanically very easily to $4 billion and from there on, we will take it down further. So it's all very clear.

Do not assume though because we believe that the measurement of free cash flow is not the critical only measurement that matters at Weatherford anymore, don't presume that we don't have within the organization ingrained in everyone's metrics the importance of free cash flow. That won't change, precisely because we intend to make a go and generous free cash flow in the years ahead, not just in the second half of the year, this is perennial. So don't assume because we say this that we don't view free cash flow generation as critical in the way we run the Company. This is actually the measurement of success long term of any company.

Kurt Hallead - *RBC Capital Markets - Analyst*

That's great. My follow-up is you mentioned breakeven in a couple of different contexts, one on operating income -- I think that was related specifically to North America -- and then, Krishna, I think your reference to breakeven was on an earnings-per-share basis. Can you guys clarify?

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

What I put forth is what we see internally, which is we see a path towards North America going from what was $100 million negative operating profit in Q2, which was better than Q1, to being breakeven. That's one. And we see that occurring the first half of next year, Q1 or Q2. There are a number of reasons for that and of course, it depends also on oil being reasonable and so forth and so on. But a lot of it are things we control. This is one thing.

What Krishna mentioned separate and distinct is simply the fact that he doesn't see -- and he is right -- how we can predictably be able to make enough of a progress to be able to be breakeven this year.

Krishna Shivram - *Weatherford International PLC - EVP & CFO*

Yes, that's right.

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

Doesn't mean the numbers will not get better. (inaudible) saying. They will get better. The question is can we go from where we are at $0.28 negative to a breakeven, which is I think urgently needed. We will get there. We don't think we will get there by Q4, unfortunately, but the numbers will be better. That's what Krishna was conveying.

Kurt Hallead - *RBC Capital Markets - Analyst*

Thank you.

Bernard Duroc-Danner - *Weatherford International PLC - Chairman, President & CEO*

I thank you very much. I think we have to close the Q&A session. There's a lot of calls today from our peers and just to allow people to attend the other calls, we will just close in here. Thank you very much, everyone, for your time.

Operator

Ladies and gentlemen, this concludes today's conference call and you may now disconnect.
