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CLB - Q4 2012 Core Laboratories Earnings Conference Call

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## OVERVIEW:

CLB reported full-year 2012 revenue of \$981.1m, net income of \$216.1m and diluted EPS of \$4.54. 4Q12 revenue was \$254.5m, net income was \$54.8m and EPS was \$1.17. Expects full-year 2013 revenue to be \$1.30-1.70b and EPS to be \$4.96-5.22. Expects 1Q13 revenue (taking into account normal seasonal effects) to be approx. \$240-250m and EPS to be \$1.12-1.18.



## CORPORATE PARTICIPANTS

**David Demshur** *Core Laboratories N.V. - Chairman, President, and CEO*

**Dick Bergmark** *Core Laboratories N.V. - EVP and CFO*

**Monty Davis** *Core Laboratories N.V. - COO*

## CONFERENCE CALL PARTICIPANTS

**Jeff Spidell** *Private Investor*

**James West** *Barclays Capital - Analyst*

**Kurt Hallead** *RBC Capital Markets - Analyst*

**Rob MacKenzie** *FBR & Co. - Analyst*

**Veny Aleksandrov** *FIG Partners - Analyst*

**Joe Hill** *Tudor Pickering, Holt & Co. - Analyst*

**Blake Hutchinson** *Howard Weil Incorporated - Analyst*

## PRESENTATION

### Operator

Good morning. My name is Felicia, and I will be your conference operator today. At this time, I'd like to welcome everyone to the Core Lab Q4 2012 earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

(Operator Instructions)

Thank you. Mr. Demshur, you may begin your conference.

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### David Demshur - *Core Laboratories N.V. - Chairman, President, and CEO*

Thank you, Felicia. I'd like to say good morning in North America, good afternoon in Europe, and good evening in Asia-Pacific. We'd like to welcome all of our shareholders, analysts, and most importantly, our employees to Core Laboratory's fourth-quarter 2012 earnings conference call. This morning, I am joined by Dick Bergmark, Core's Executive Vice President and CFO. Also this morning, we are again joined by Core's COO, Monty Davis, who will present the detailed operational review.

The call will be divided into five segments. Dick will start by making remarks regarding forward-looking statements. Then we'll come back and give a brief investor update, and highlight the three financial tenets by which Core's executive management team executes the Company's gross strategies. We believe these three tenets have produced industry-leading shareholder returns, and returns on invested capital. We will also discuss Core's long-held philosophy of returning excess capital back to our shareholders.

And then Dick will follow with a detailed financial overview, and additional comments regarding building shareholder value and Core's 2013 outlook and a general industry outlook as it pertains to Core's continued growth prospects in 2013. This outlook confirms our confidence in the trends of increasing activities in international and especially deepwater activities tied to crude oil and large LNG developments, and unconventional oil reservoirs in North America.



Then Monty will go over Core's three operating segments, detailing our progress and discussing the continued successful introduction of new Core Lab technologies, and then highlighting some of Core's operations and major projects worldwide. And then we'll open the phones for a Q&A session.

I'll turn it back to Dick now for remarks regarding forward-looking statements. Dick?

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**Dick Bergmark** - *Core Laboratories N.V. - EVP and CFO*

Thanks, David. Before we start the conference this morning, I'll mention that some of the statements that we make during this call may include projections, estimates, and other forward-looking information. This would include any discussion of the Company's business outlook. These types of forward-looking statements are subject to a number of risks and uncertainties relating to the oil and gas industry, business conditions, international markets, international political climate, and other factors including those discussed in our '34 Act filings that may affect our outcome. Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may vary in material respects from those projected in the forward-looking statements.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. For a more detailed discussion of some of the foregoing risks and uncertainties, see item 1A, Risk Factors, in our annual report on Form 10-K for the fiscal year ended December 31, 2011, as well as the other reports and registration statements filed by us with the SEC.

Our comments include non-GAAP financial measures. Reconciliation to the most directly comparable GAAP financial measures is included in the press release announcing our fourth-quarter results. Those non-GAAP measures can also be found on our website.

With that said, I'll pass the discussion back to David.

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Okay, thanks, Dick. I'd like to give a brief investor update. Core's operations produced the Company's most profitable quarter ever, as the Company continued to benefit from our continued focus on international and deepwater activities, and unconventional oil plays in response to relatively high oil prices and dwindling global spare-oil-producing capacity. The focus on crude-oil-related projects continued to build in 2012, as Core's revenue mix is now 80% oil and 20% related to natural gas developments, a shift from the previous 70/30 mix.

Moreover, most of the natural-gas-related projects emanate from the international theater, and are LNG related with major projects in eastern Mediterranean, east Africa, and western Australia. Reviewing the Company's fourth-quarter results reveals that Core's gross strategy of progressively working in more and new established fields while continuing to offer new technologies and services, will lead to revenue growth of 200 to 400 basis points higher than the increase in worldwide activity levels.

Year-over-year quarter revenue and operating profit growth for the fourth quarter of 2012, with flat to down worldwide activity levels, is a testament to the validity and robustness of the Company's gross strategies, and they are underpinned by our operational excellence. We believe these trends to outperform market activity levels to hold into 2013. Therefore, our gross strategies and the execution by our operating units continue to serve our clients, our employees, and our shareholders well.

Core's continued focus on high-return international crude-oil-related developments, especially those in deepwater environments and unconventional oil resource plays, and the continued internal development of new technologies and services, has led to multiple years of sustained growth and increased profitability. The evidence of this trend can be seen in our Reservoir Description segment, which saw its year-over-year operating margins increase for the ninth consecutive quarter, establishing a fourth-quarter record high, up 200 basis points from a year ago.

Core has always followed, and will continue to follow, three key investment tenets that have led to our industry-leading returns. These three important tenets, which usually receive only scant attention in our oilfield services sector, are -- number one, maximizing free cash flow through



fiscal discipline. Core follows a strict discipline for allocating capital for investment in growing our business. Unless certain return-on-invested-capital standards are met or exceeded, the capital expenditure is disallowed.

An example of this discipline is, over the last five years, and since the end of 2007, Core's assets per operating rig have increased just 4%, while revenue has increased per rig of almost 30%. In comparison, some of the largest oilfield service companies have doubled their assets per rig over this time period, while showing slower revenue growth per rig than Core.

Needless to say, Core's operating margins are at their highest, while others' are significantly lower. This strict capital discipline produced record levels of free cash flow in 2012 of over \$206 million. In fact, Core converted more than \$1 of every \$5 revenue dollars into free cash during 2012, the highest in the oilfield service industry. Core will continue to demonstrate strict financial discipline into 2013.

The second financial tenet is to maximize our return on invested capital. Core's Board has initiated an incentive compensation program for Core's executive and senior management teams based on the Company producing a return on invested capital in the top decile for the oilfield service industry. Core's Board believes that stock price performance over time is directly related to its return on invested capital. And based on the most recent calculations available from Bloomberg, Core's return on invested capital was the highest of any oilfield service company listed by Bloomberg, and its weighted average cost of capital was the lowest.

Our third financial tenet is to return excess capital to our shareholders. During 2012, Core returned over \$228 million to our shareholders in the forms of quarterly dividends and the repurchase of shares equaling about \$4.81 per share. Since October of 2002, when Core started its repurchase program, Core has returned almost \$1.4 billion, or over \$29 per diluted share, to our owners. We will continue to follow these three key financial tenets into 2013, which should enable Core to continue to produce industry-leading returns for our shareholders.

So now, I'll turn it back over to Dick for a detailed financial review. Dick?

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**Dick Bergmark** - *Core Laboratories N.V. - EVP and CFO*

Thanks, David. If we look at the income statement for the full year, revenues were \$981.1 million, up about 8.1% from the prior year's \$907.6 million. Revenues for the quarter, \$254.5 million versus \$245.4 million in the prior quarter, and \$243.8 million in the fourth [quarter] last year. So, revenues were up sequentially by 3.7% and 4.4% year over year. Of these revenues, services for the full year were up 11.6% to \$693.9 million from \$621.8 million in the prior year. For the quarter, services were \$181 million, up 11.1% when compared to \$162.9 million last year, which was an increase of \$18.1 million. For the full year, product sales were \$287.2 million, compared to \$285.9 million in the prior year, representing about a 0.5% increase. Our product sales for the quarter were \$73.4 million, up 3.5% sequentially from \$71 million in the prior quarter.

Moving on to cost of services, for the quarter they were 59.8%, which was better than the 61.5% of revenue in the fourth quarter of last year, and 63.6% for all of last year. Cost of sales in the fourth quarter were 71.8% of sales revenues, which was better than last quarter, but off from 69.3% in the prior year.

For the full year, G&A was \$43.2 million, as previously guided, which represented 4.4% of revenues for the year, which is down compared to 4.5% of revenues in the prior year. We expect G&A to be around \$44 million in 2013.

For the full-year 2012, depreciation and amortization expense was \$22.9 million, compared to \$23.3 million in the prior year. Depreciation and amortization for the quarter, \$5.5 million, down from \$5.9 million in the prior year's fourth quarter. We expect depreciation in 2013 to total approximately \$24 million.

Other income this quarter was just \$170,000. For the year, Other was income of \$4.1 million, primarily as a result of a \$4.4 million gain from business interruption claims earlier in the year. The gain in the prior year was \$900,000.

Full-year EBIT was \$297.3 million, up \$46.5 million or almost 19% compared to EBIT earned in 2011, with margins up over 270 basis points at 30.3%. EBIT for the quarter was \$75.9 million, which was up \$3 million or 4.1% year over year. Our fourth-quarter EBIT represent EBIT margins of 30%, a

fourth-quarter high for the Company. This compares very favorably to those who have already reported this quarter who had margins that contracted both year over year and sequentially.

Interest expense was \$2.3 million for the quarter, similar to last year's fourth quarter. Income tax expense in the quarter was \$18.4 million at an effective tax rate of 25%. Full-year annual effective tax rate was 24.9%, and the expense was \$71.8 million. We expect our effective tax rate in 2013 to be in the 25% range.

Net income for the full year was up 17% at \$216.1 million, compared to \$184.7 million in 2011. And for the quarter, it was \$54.8 million, up 3.3% compared to last year's fourth quarter of \$53.1 million. Earnings per diluted share for the full year was \$4.54, up 19% when compared to EPS in 2011 of \$3.92. For the quarter, EPS was \$1.17, compared to our prior guidance of \$1.10 to \$1.17 per share, and Main Street of \$1.13 per share. Sequentially, EPS of \$1.17 is up from \$1.14 last quarter, and is up 5.4% from \$1.11 in last year's fourth quarter.

If we go to the balance sheet, cash was \$19.3 million compared to the prior year-end balance of \$29.3 million. Cash balances, our free cash flow, and proceeds from our credit facility, all in the aggregate amount of \$247.9 million, were used primarily to repurchase stock in the amount of \$175.7 million and to pay our dividends of \$52.9 million. Receivables stood at \$184.8 million, up from \$170.8 million at the prior year end due to higher sales. Our trade DSOs were 63 days at the end of the year. Inventory down year over year to \$49.3 million from \$53.2 million, indicating a slight improvement in inventory turns.

Other current assets were \$43.6 million, in line with last quarter, but up from \$33.2 million at last year end, primarily due to an increase in current income tax prepayments of \$10.8 million, reflecting the timing difference between when statutory tax payments are required to be made to the various tax offices, and the corresponding tax provision recorded under GAAP rules for our financial statements. We added \$10.1 million year-over-year increase in PP&E due to investment in our business assets. And intangibles, goodwill, and other long-term assets were up \$5.2 million, primarily from an increase of \$4.1 million in the cash surrender value of life insurance.

And now to the liability side of the balance sheet, our accounts payables were similar to prior year end at \$55.2 million. Other current liabilities of \$85.3 million were also in line with the prior year-end balance. Our long-term debt at year end was \$234 million, comprised of our senior notes at \$150 million, as well as our bank revolving credit facility, whose outstanding balance was \$84 million at year end. That balance is down \$2 million from our last earnings call. And as of today, our outstanding balance on our revolvers will be reduced a further \$8 million to a balance of \$76 million. Other long-term liabilities ended the year at \$74.1 million, up from \$63 million at the end of last year, primarily due to an \$8.8 million increase in pension liability.

Shareholders' equity ended the year at \$187.9 million, up from the prior year-end balance of \$181.7 million, and that's primarily due to additions from earnings, offset by share repurchases and dividends. Using annualized net income for the fourth quarter, our return on equity for the year was approximately 114%, up more than 10% above last year's return on equity, and this is certainly one of the highest returns earned in the industry.

Capital expenditures for the quarter were \$7 million, and for the full year they were \$31.2 million, up from \$29.9 million in the prior year, as we addressed opportunities created by the continued growth in our business in 2012. We expect our client-directed CapEx program in 2013 to be approximately \$31 million or \$32 million as a result of an expected continued improvement in industry activity, particularly internationally and in the deepwater environment.

Looking at cash flow for the full-year 2012, cash from operating activities was \$237.2 million, while free cash flow after paying for our \$31.2 million CapEx program was \$206.1 million. For the full year, we used our free cash flow and drawings under our facilities to pay \$52.9 million in dividends and to repurchase \$175.7 million of our shares. In the fourth quarter, cash flow from operating activities was \$85.1 million, and after paying for our \$7 million in CapEx, our free cash flow in Q4 was \$78.1 million. In the quarter, we used our cash flow and drawings on our facilities to pay approximately \$13.3 million in cash dividends, and to repurchase approximately 894,000 shares at an average share price of approximately \$103.32 per share.

Our free cash flow conversion ratio, which is the free cash flow divided by net income, continues to be one of the highest in the industry. We believe this is an important metric for shareholders when comparing companies' financial results, particularly for those shareholders who use discounted



cash flow models to assess valuations. In 2012, we converted \$0.95 of every net income \$1 into free cash flow. This compares to the 10-year average of the service companies in the OSX only converting \$0.45 of every net income \$1 into free cash flow.

Our use of cash continues to be designed to enhance shareholder value. Free cash flow generation such as this gives companies like Core Lab significant optionality to enhance shareholder value. For example, we just increased our quarterly dividend by more than 14% for dividends to be paid in 2013. Our dividend yield is about 1%, and our three-year dividend growth is in excess of 27%.

Another way we have enhanced shareholder value is through our long-standing share buyback program, which has reduced our diluted share count 45% below the level we would be at, had we not begun the program. Clearly, you can see that our buyback program is not designed merely to offset dilution from equity compensation like other companies in our space.

As of this call, our diluted share count is 46,566,000 shares, which is near our lowest share count in 15 years. Our program has been executed over an 11-year period, providing the Company with an overall VWAP below \$28 per share. Our VWAP for purchases in 2012 was \$111.14 versus an average share price on the stock market that year of \$118.14.

Our revenue per diluted share 15 years ago, in 1997, was \$4.62, while in 2012 it was \$20.63. But this is not just a story of reducing share count. Our revenues have more than quadrupled over that timeframe. Our earnings per shares have gone from \$0.33 to \$4.54, or an increase of almost 1,300%. But again, not just a story of reducing share count. Our net income increased by a multiple of more than 14 times, taking net income from \$15.4 million 15 years ago to \$216.1 million this past year. And our return on equity went from 13.5% to 114%, where it stood at year end. All of these metrics point to higher total shareholder return over that 15-year time period. Core Lab total shareholder return is up to 18.5% compounded annually, compared to the S&P that is up 4.5% or the OSX, which was up 5.2%.

Now for our first-quarter 2013 and full-year 2013 earnings guidance -- our outlook remains positive. With continued support from robust Brent Crude pricing and the expected delivery of additional deepwater rigs, we believe that we will continue to work in increasingly more established fields, as well as new field development projects. Additionally, as we have consistently done in the past decade, we plan to enter new fields where we currently do not have operations, and to offer new technologies and additional services in 2013.

These technologies and services will be focused on increasing daily productivity and ultimate hydrocarbon recovery rates from deepwater fields and liquids-related, unconventional reservoir developments worldwide. Therefore, we believe that our business model, with the goal of achieving a revenue growth rate of 200 to 400 basis points above the increase in worldwide activity level directed towards producing fields, remains intact with incremental margins positively impacting operating margins.

We also expect our free cash flow to remain at elevated levels in 2013, and we expect our client-directed CapEx program being roughly equal to that of 2012. And we recently announced our 14.2% increase in our quarterly dividend, as well as our intentions to continue with our share buyback program.

We anticipate 2013 North America activity levels to be flat at fourth-quarter 2012 levels, and international activity levels to increase approximately 7%, yielding a worldwide activity increase of approximately 5%. We also expect our revenue to grow at a rate faster than our expected change in industry activity by approximately 200 to 400 basis points, which would suggest our revenues could be up 7% to 9% in 2013. Therefore, for the first quarter of 2013, we expect revenue of approximately \$240 million to \$250 million, which takes into account normal seasonal effects, and EPS in the \$1.12 to \$1.18 range. The midpoint EPS is up more than 8%, compared to last year's EPS of \$1.06.

For the full-year 2013, we expect revenue to range between \$1.03 billion and \$1.07 billion, with operating margins averaging approximately 31%, and incremental margins ranging from 35% to 45%. This operational guidance excludes any foreign currency translations, and assumes a 25% effective tax rate for the year. This would drive midpoint EPS to a range between \$4.96 to \$5.22, with an EPS midpoint of \$5.09. The midpoint of revenue guidance suggests revenue growth of approximately 7% in a range up to 9%. And the EPS guidance suggests EPS growth of approximately 12% in a range up to 16%. And those are all using the midpoint of the guidance, and are all somewhat higher than the current Street estimates for 2013.



Now with that review, I'll turn the conversation over to Monty.

**Monty Davis** - *Core Laboratories N.V. - COO*

Thank you, Dick. Fourth-quarter 2012 revenues of \$254 million is a new quarterly record, and represents growth of 4.4% over Q4 2011. Operating earnings of \$76 million yielded operating margins of 30%. 2012 annual revenue of \$981 million set a new record, growing 8% over 2011 revenue, which was our previous high. 2012 operating margin improved 270 basis points to 30% margin. These records are a result of our 5,000 employees providing industry-leading technical services and products to aid our clients in producing more hydrocarbons daily and over the life of their reserves. I congratulate and thank our employees for another great year.

At an event just last weekend, a customer spoke to a group of clients and Core Lab executives, stating that even though his company was a small independent, all of their work goes to Core Lab, and always has. Our team always made them feel like their work was important, and did a great job for them. Statements like this make us really proud of our people.

Reservoir Description revenue for the fourth quarter of \$129 million is a record for the quarterly revenue, and grew 4.3% over Q4 2011. Operating earnings of 37% grew 6% over Q4 2011, for operating margin of 29% for the quarter, which is a record Q4 margin for Reservoir Description. 2012 annual revenue of \$496 million grew 5.5% over 2011. Operating earnings grew 17.1%, as operating margins grew 290 basis points to 29%.

Our Reservoir Description Advanced Technology Center in Aberdeen is working on a project in Africa for our client to evaluate a new discovery. In the fourth quarter, our scientists analyzed cores with routine testing by Scanning Electron Microscope, X-Ray Diffraction techniques, and Thin Section analysis, and began planning for Advanced Rock Properties testing. Saturation monitoring by attenuation of x-rays will be used to quantify relative permeability of oil, natural gas and formation water.

Also during Q4, we have been conducting reservoir fluid analysis for pressure, volume, and temperature regimes, and flow-assurance studies on fluids from these discovery wells. These studies combining rock and reservoir fluid analysis give our clients the best evaluation of their newly discovered reservoir.

Our Aberdeen ATC is working on projects for deepwater reservoirs from both coasts of Africa. These, like most deepwater projects, involve extensive analysis, including routine rock properties, petrology, SEM, XRD, Thin Section analysis, and the SMAX relative permeability flow work. These deepwater projects also involve our reservoir fluids testing at high pressures and temperatures for a complete evaluation.

Our Houston ATC is working on a major project in west Texas analyzing core for both conventional and unconventional potential reservoir targets. Our client is evaluating opportunities with core-based petro-physical measurements and geological evaluations. These studies will be used by the client to grade their prospects, and allocate budget expenditures for exploitation.

Our Houston ATC scientists have begun a program to evaluate deep, tight, over-pressured conventional reservoirs in the Far East for a national oil company. This evaluation started with Core handling at the well site, and is proceeding with several Core Lab proprietary technologies in our Houston ATC. This client needs a more complete understanding in their prospects, and Core Lab will help them with the evaluation of these prospects.

Production Enhancement 2012 fourth-quarter revenue of \$107 million was a record, and yielded operating earnings of \$33 million and operating margin of 31%. 2012 was also a record year for the Production Enhancement with full-year revenue of \$404 million, operating earnings of \$124 million, and operating margins of 31%.

Our Production Enhancement engineers are working on a new UltraHPHT gun system for ultra-deep, high pressure, and high temperature wells. We have completed the testing on the guns, perforating charges, and the complete perforating gun system. The system performs successfully at 30,000 psi and 470 degrees F, and we anticipate that we will be deployed in the second quarter of 2013. The system will solve difficult completion problems for prospective clients' extremely hostile-environment reservoirs, especially deepwater reservoirs like the Lower Tertiary Play in the Gulf of Mexico, where reservoirs are at elevated pressure and temperatures.



Production Enhancement technical support personnel have worked with the client to use our HTD Blast XL system to re-complete a horizontal shale well. The HTD Blast XL system re-perforated the well in zones that were not previously perforated and fracked in the initial completion. The client then fractured these new zones to reduce the spacing of fracks in the well for improved production. The application of our HTD Blast XL system, this application opens up a new market for Production Enhancement, and brings a great value to our clients to be able to stimulate new production from existing wells.

Our Production Enhancement service specialists worked with a client in the deepwater Gulf of Mexico with single-trip, multi-zone completions. This technology allows the operator to complete multiple zones in a well in a single trip in and out of the well. It results in a significant rig-time savings on wells requiring stimulation in multiple zones. Our SpectraChem, SpectraScan, SpectraMark, and PackScan technology is uniquely suited to help operators evaluate the effectiveness of their gravel pack and their completion.

SpectraMark helps the operator ensure the tools are on depth and in the right place before the completion starts. The combination of SpectraStim and SpectraScan help the operator evaluate the effectiveness of their stimulation and the gravel pack placement. PackScan also helps the operator evaluate the effectiveness of the gravel pack placement. All of this is done without adding additional rig time to the completion sequence.

Reservoir Management revenue for Q4 2012 was \$19 million, 11.3% growth over Q4 2011. Operating earnings for Q4 were \$5 million, with operating margin of 28% for the quarter. Record annual revenue of \$82 million grew 23% over 2011. Operating earnings of \$26 million were also a record, and yielded operating margin of 32%.

Core's Reservoir Management scientists initiated a new consortium project in the fourth quarter for E&P companies exploring for and exploiting the tight oil Missourian sandstones in the Anadarko basin. Initial production results for these sandstones have been excellent. We currently have nine members in this consortium.

Internationally, we continue our focus on deepwater, Atlantic margin, joint industry projects in the southern Atlantic where our current focus is directed at the emerging pre-salt carbonate play in west Africa, and the exploration programs in Namibia and South Africa. In the transform margin areas, three corporations were added to our equatorial basin studies of northeast Brazil and in the Ivory Coast. A major expansion of our deepwater data set was announced.

We will open the call for questions.

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Felicia, we will go ahead and take questions now.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions).

[Jeff Spidell].

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**Jeff Spidell** - *Private Investor*

If we could start out with the margin progression and how things play out, the Reservoir Description and Production Enhancement, can you walk us through the seasonal factors as we get into the first quarter and any other things we need to be aware of? I would assume things will start kicking up again across both of those segments in the first quarter?



**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Yes, if we look at the margin progression for Reservoir Description, in the year 2012, those margins were up year-over-year of 440 basis points. We believe that that margin progression will continue into 2013. This business is being enriched by looking at deepwater plays, and of course the data intensity in these deepwater plays is much higher. When we're spending \$100 million, \$200 million, \$300 million to drill a well, you're going to generate reams and reams of core analysis and reservoir fluids data which generate higher incremental margins. So look for a continued progression in our Reservoir Description margin set, and as we look at the first quarter, year-over-year, that margin probably will increase again.

For Production Enhancement, we see further penetration of our HTD Blast and HTD Blast XL technologies, as Monty had mentioned the effectiveness of these in vertical and horizontal wells. Plus we are going to have the impact of our high-pressure, high-temperature perforating charges and gun sets come into play in the second quarter of 2013. So again, those margins should continue to progress. All in all, we look at Company-wide incremental margins ranging from 35% to 45% equally distributed on our three business segments. So as we look forward to 2013, a good margin to use would be a progression from 30% operating margin to 31% operating margin.

If it's weighted more towards deepwater, those margins could be better than that, but as it stands right now, in our outlook, just use those, Jeff, and I think you'll be fine.

**Jeff Spidell** - *Private Investor*

Great, thanks, David. And then maybe a conceptual question. As we think about the shale plays starting to mature a little bit in North America, stage intensity, I would imagine, still a tailwind. Particularly in some of the newer plays. Particularly given the comments about re-completion opportunities. Is it also very beneficial for your business, as people get in a play like the Bakken, where maybe stage intensity isn't as much of a tailwind, but they're concentrating, maybe not as much on recompletions, but fine-tuning the fracks? Maybe could you weigh in terms of magnitude which tailwind is a little bit more beneficial for your business.

**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Yes, Jeff. We actually don't think that the shale plays are well understood at this point. Just over the last couple of quarters, we've been able to determine through our fracture diagnostics technology that additional stages, closer spaced, so you have more and greater contact with the reservoir face, is going to proliferate more stages and more closely spaced stages. Moreover, we think that pumping excess proppant into these fissures as well will create two things. Number one, greater initial production, but moreover and more importantly, the ultimate recovery from these well bores, especially in crude-oil-related plays, will be higher. So we think, in all plays, especially those related to crude oil, we will see more stages, we will see them more closely spaced, and we'll see more proppant being pumped.

**Jeff Spidell** - *Private Investor*

Great stuff. Congrats on a great quarter, guys.

**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Yes. Thanks, Jeff.

**Operator**

James West.



**James West** - *Barclays Capital - Analyst*

Dave or maybe Monty, you were describing some new technologies in your prepared commentary. And then I think Dick mentioned that was going to be part of what helps growth for Core exceed your expectations of global E&P spending. On these technologies, the new technologies you introduced, are they limited to what you just described? Or should we expect some additional technologies? And could you maybe, if we should, what kind of product lines are they going to be focused on? Or are they going to be game changers? Or is more the typical Core Labs incremental new adds?

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Yes James. As you know, we tend to be more evolutionary as opposed to revolutionary. The technology pipeline that we have here at Core is still very strong and robust. I would say most of that is related to looking at enhanced recovery. Whether that be in Reservoir Description or Production Enhancement. We are looking at capturing that incremental barrel. We think this is the most important technology to focus on. So you will see it mainly coming out of Reservoir Description and Production Enhancement. So those two segments will benefit over the next several years with some new technologies coming out.

On the Reservoir Description side, look at that being weighted to miscible gas floods and miscible gas technologies. On the Production Enhancement side, look at that being related to more hostile environments. So higher pressure, higher temperature regimes. As Monty pointed out, when we look at this lower tertiary play, you had a well last week TD at 34,000 feet. So you are looking at extreme pressures and temperatures. And to be able to complete and stimulate those wells, we are going to need evolutionary technology. And our ultra HP-HT technology we know will have to evolve over the next several years because pressures are only going to get higher, and temperatures are only going to get higher. And we want to be there before the crowd gets there.

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**James West** - *Barclays Capital - Analyst*

David, what percentage of your business now is coming from deepwater?

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

If we look at Core Lab, 30% of all oil is produced offshore. 40% of our revenue comes from offshore. 50% of that is from deepwater. What is interesting, only 5 million barrels, or somewhere on the order of 7% of the world's oil, is currently produced in deepwater, and yet 20% of the Company's revenues comes from deepwater. That shows you how important it is. And you can tell the them on this call, as will be our annual report for 2012, will be deepwater.

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**James West** - *Barclays Capital - Analyst*

If I could slide one more in here, Dave. You mentioned in your opening comments -- I can't resist here -- but about dwindling spare capacity globally. You guys are obviously peak oil enthusiasts. Where do you think spare capacity stands today?

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Probably somewhere on the order of 1 million barrels, something like that. We believe that currently there are only one or two countries that have spare capacity. And that amount is fairly limited. If we get some robust economic growth around the world, we are going to see crude prices, Brent prices, right back at \$150.

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**James West** - *Barclays Capital - Analyst*

I agree. Thanks, Dave.

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**Operator**

Kurt Hallead.

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**Kurt Hallead** - *RBC Capital Markets - Analyst*

The last couple of years, and maybe even the projection that you have for 2013, looks like revenue growth may be 8% or so. Incremental margins in that 40% range, or averaging 40% range. If you go back a couple years, your revenue growth had been mid 15%, 14% per year. Do you think we are now in environment over the next few years where we should expect revenue growth more in the high single digits than the mid teens? That is question number one. Question number two would be, then, if not, what are the drivers that you will see revenue growth accelerate? And then just to wrap that up, if revenue growth accelerates, what do you think that we could potentially see in terms of incremental margins?

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Okay. Very good, Kurt. Really, our revenue is driven by worldwide activity. Traditionally we've always outperformed worldwide activity levels by 200 to 400 basis points. And we think that model holds up quite well. So, if we see additional spend, which would be created by higher crude oil prices, we would see growth go back into the mid teens, or maybe higher, depending on the activity levels that our clients put out there. Right now our read is, about 7% increase internationally, flat here in North America. Now, on other calls, companies had called for increases in rig count throughout 2013, and an increase in well efficiency. We actually have a little different view on that. Our view is that North American activity will be flat. And that wells will take longer to complete and stimulate. So well count will, year-over-year, be about the same. We're going to drill the same number of wells, but we're going to drill better wells because you're going to have more stages, better placed, and more efficient on initial production, and production ultimately from that reservoir.

So, when we look at Core Lab and our growth prospects, this is controlled by our clients. So if the worldwide activity level goes up 15%, yes indeed, you will see our revenue streams go up maybe 17%, 18%, 19%. Along with that, if we look at past models, you will see that incremental margins did exceed 55% and in the 60% range. So, if we see that kind of revenue gain, you probably precipitate those kinds of incremental margins. So that is controlled by our clients and worldwide activity levels. So higher crude prices -- sure, a big benefit for us.

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**Kurt Hallead** - *RBC Capital Markets - Analyst*

What is your take on this whole industry push -- and I think you guys were one of the first ones to identify the need for the industry to get smarter about how they frac their wells, and so on and so forth. And now we've heard a crescendo about that from the varying large, diversified service companies. Doesn't getting smarter about how you frac wells mean you're fracking fewer stages? And then, if that's the case, how do you see the opportunity set for your business tied to that?

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

No, actually just the opposite, Kurt. We believe that you need more stages. Because when we look at the fracture patterns that are created in each stage, we are exposing only a limited amount of that unconventional reservoir to the flow regime. So when we have more stages, more closely spaced, and well placed, we will get higher initial production. Moreover, and we think more importantly, higher ultimate recoveries, especially related to these crude oil plays. So, for 2013, we would say we're going to hold the number of wells drilled steady. We will see more stages, closer spaced, and more profit being pumped.



**Monty Davis** - *Core Laboratories N.V. - COO*

A couple years ago, there was a view that, because the fracture profile was very broad coming off of each stage, that ultimately they would use more science to place fewer stages. And what we picked up through our fracture diagnostics was, these fracks do not go out as broadly as previously believed. That they really just emanate directly outward from that stage. So therefore they need to be closer together to get that exposure to the reservoir that they need for that higher production rates. So that theory about fewer stages, that's a couple years old.

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**Kurt Hallead** - *RBC Capital Markets - Analyst*

All right. And then in terms of use of cash, can you give us some update on how you're thinking of that? A pretty good track record here, as you've indicated, of dividend increases. Seems like you're maybe leaning a little bit more towards share repurchase. When we think forward over the next couple years, is a 10% to 15% per year dividend increase still something that you guys will be comfortable with, vis-a-vis share repurchase? Just some update on your thoughts there.

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

The driver, of courses, is our free cash flow. So think of net income as a good proxy for free cash flow. We've converted \$0.95 of it this last quarter. So think of it that way. So will we do with it? We're going to honor that dividend. Good companies do always raise it over time. So I would expect that we will do that. We do not have a payout ratio as a target. We just believe that you should increase it over time. The remaining would probably continue to be used for our opportunistic share buyback program.

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**Kurt Hallead** - *RBC Capital Markets - Analyst*

Great. Thanks, guys.

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**Operator**

Rob MacKenzie.

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**Rob MacKenzie** - *FBR & Co. - Analyst*

Question for you, David. Something that you mentioned in a public appearance last night. Still talking about one, perhaps two substantial liquids discoveries yet to be made, or announced in North America. Can you give us a feel for when the mystery might go away?

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

That is up to our clients. Acreage positions are being taken. And I've got a feeling once the acreage positions are established, as which happened in the Eagle Ford and then in the Utica, announcements will be made. So, it is not up to us, it's up to our clients.

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**Rob MacKenzie** - *FBR & Co. - Analyst*

Okay. So no color whatsoever?

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

I can't help you there, Rob. You've got to go talk to the E&Ps. They're the ones that are looking at these acreage positions, and they are the ones that will announce that.

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**Rob MacKenzie** - *FBR & Co. - Analyst*

Okay. Fair enough. I wanted to also next dig into just your relative guidance among the different segments. You indicated in your comments that incremental margins will be similar across all three segments. Yet the quality of comments, and your comments about North America being flattish, would seem to indicate that the more international segment, Reservoir Description, should have higher incremental margins and relatively stronger revenue growth versus, say, Production Enhancement. Can you help me bridge the gap there?

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Yes. It has to do -- with respect to Production Enhancement, you saw a very nice year-over-year and sequential growth there. Even though we had a 5% decrease in the rig count in Q4. It's the penetration of the new technology. So, when you look at the penetration of, for instance, the HTD-Blast and 8TD-Blast XL, that more than made up for the decrease in the rig count. Moreover, we are applying a lot of our Production Enhancement services to the deepwater in the Gulf of Mexico. When we look at some of these deep shelf plays, and some of the deepwater plays there, they are using more and more Production Enhancement services. And, as we mentioned on the last call, we worked our largest job ever in Production Enhancement last quarter in the Gulf of Mexico.

One final point, as you know, Rob, we are migrating this business internationally. And so now fully one-third of the revenue in Production Enhancement emanates from international areas. So, when we see more of these unconventional resource plays taking off around the world, where you're going to use more frac technology, you're going to see more Production Enhancement revenue growth from the international theater. So it masks, a little bit, of what we are seeing on the activity side in North America. One being made up of new technology, and secondly, migrating internationally.

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**Rob MacKenzie** - *FBR & Co. - Analyst*

Okay, thanks. And my final technology-focused is centered around miscible flooding. That's something you guys have talked a lot about in the past couple of years. When I hear a lot of the E&Ps talk about recovery rates in these unconventional plays being high single, low double digits, in the best case scenarios, it would seem that that technology could have material applications. Can you give us a feel for where the science stands on that? And where and when and if we might see some commerciality, at least starting off in the domestic unconventional plays for miscible flooding?

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Yes, right on, Rob. If we look at the Bakken, because we're doing a lot of work up in the Bakken right now, we're looking at a light gas flood. Some of the associated gas being injected back into these reservoirs, and trying to push more and more of the recovery factor. Right now in our laboratory, we can increase recoverability -- and, again, this is in our lab -- some 200 to 300 basis points. So maybe from 9% to 10%, to 12% to 13%. Which doesn't sound like much, but it is huge. Now, again, that is at the laboratory scale. We are working with a client that is going to look at a larger scale light gas flood there, probably sometime in 2013. And when some of the results come out from that, and they start talking about it, we can update you further on the science. But it does look promising at this point.

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**Rob MacKenzie** - *FBR & Co. - Analyst*

Great. Thank you very much. I'll turn it back.

**Operator**

Veny Aleksandrov.

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**Veny Aleksandrov** - *FIG Partners - Analyst*

My first question is on your guidance. Having followed the Company for a long time, this the first time in a couple of years that you give the guidance. I understand activity is good internationally and everything, but can you give us a little bit of understanding behind the confidence? Now as opposed to last year?

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**Dick Bergmark** - *Core Laboratories N.V. - EVP and CFO*

Veny, it has to do with the communication coming from our clients. As David said, they really drive what our earnings growth rate is going to be. We do a survey with our clients. And we are pretty comfortable with the feedback that we received from them. And really it was in that 2008-2009 time frame when guidance was pulled, for logical reasons. But each year after that we've gained more confidence. And you can see our results have been hitting the prior guidance. So that is why we gave the full-year guidance.

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**Veny Aleksandrov** - *FIG Partners - Analyst*

That is great. That is amazing. And then my other question, Production Enhancement, even if rig count was flat in North America, you managed to perform very well in the quarter. You expanded internationally. And you gave us an answer how much of the Production Enhancement now comes from international areas. But what about total? What is your revenue percentage coming from international than from domestically?

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Yes, Veny, when we look at the rocks and the fluids that we work on, 70% of that revenue emanates from outside of the US. So when you look at our Qs and Ks, they might state that you see a higher percentage of US-based revenue. But that is really a GAAP artifact. For instance, when you've toured our facilities here in Houston, when you go back and look at those rocks there, quite often you will see that they offshore West Africa, East Africa, East Mediterranean. When we bill that revenue out of here from a GAAP standpoint, that looks like US revenue. However, we know those reservoirs and those fluids emanate from international. So when we look at our all over international revenue picture, 70% comes from reservoirs outside the US.

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**Veny Aleksandrov** - *FIG Partners - Analyst*

Appreciate it. Thank you.

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**Operator**

Joe Hill.

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**Joe Hill** - *Tudor Pickering, Holt & Co. - Analyst*

Dave, I was wondering if you could give me a sense as to what you think your share of the perforating market is today to what it was, say, a year ago.



**Monty Davis** - *Core Laboratories N.V. - COO*

Our share, we believe is increasing. This is Monty, not Dave. We believe our share is increasing with the new technologies that we are introducing. In particular, the HTD-Blast and HTD-Blast XL. Those have picked up some pretty good market share. They've also, as I mentioned in my comments, we've got some new markets opening up with these recompletion possibilities. Re-completing a fracked staged well is a technically challenging thing. With our clients, we have figured out a way to do that using the HTD-Blast XL. This is a unique to us technology, patented technology. So we feel pretty good on our growth in that market. It is hard to know exactly market share because some of the wireline companies, the large wireline companies, have a captive plant, plants, that manufacture some of their products. They all buy from us. They are all in our top 5 or 10 customers. So we are doing well with the whole market. We are by far the largest producer at this time. But exact market share I can't tell you.

**Joe Hill** - *Tudor Pickering, Holt & Co. - Analyst*

Okay. And then, Monty, just to explore that a little further, what you are talking about is different than traditional refracking or tri-fracking, right?

**Monty Davis** - *Core Laboratories N.V. - COO*

That is correct. This is going into between the spacing you originally used, putting in engineered new fracs in between the spacing. So you are increasing your spacing. Then you open up all the frac, the old and the new. And it looks to be very successful in increasing production.

**Joe Hill** - *Tudor Pickering, Holt & Co. - Analyst*

Okay. And then just more of a general question on revenue. Obviously you guys posted some pretty strong quarter-on-quarter international revenue growth. I think it was 13%. Was that an acceleration from the third-quarter level? Are things actually picking up internationally relative to where they had been prior?

**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Yes, that is correct, Joe. That was -- I would say an acceleration, but we did see a higher sequential gain internationally. And we think, again, that was biased by some of the deepwater developments around the world. We've really seen West Africa, East Africa, the Eastern Mediterranean, and the Gorgon project offshore Western Australia pick up in the fourth quarter. Does that continue through all of 2013? Don't know, but probably so.

**Joe Hill** - *Tudor Pickering, Holt & Co. - Analyst*

Okay. And then, one final question. And I'm just curious as to your thoughts. Yesterday we had a large Italian surf contractor pretty much blow up, talking about some slower development activity in some of the regions you guys look at. Africa, Iraq, et cetera. Have you seen any signs of operators slowing down their development plans in those areas? Or is that something that you simply are not seeing yet?

**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Not seeing, Joe. I think that's a company-specific issue.

**Joe Hill** - *Tudor Pickering, Holt & Co. - Analyst*

Okay, fair enough. Thanks, guys.

**Operator**

Blake Hutchinson.

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**Blake Hutchinson** - *Howard Weil Incorporated - Analyst*

Quick question on the frac diagnostics business. It mentioned it quite prominently in the release. And I was wondering if, from the field level, you're getting feedback that the slower pace in the second half of the year had companies taking a little more thoughtful approach. Whether packaging it in the completion scorecard was additive to you. And the trend toward perhaps using the frac diagnostics across all wells, rather than just type wells. So just trends for that underlying business in the US.

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Yes, demand has never been higher for fracture diagnostics. And you are exactly right. As opposed to individual wells, and trying to determine what the fracture diagnostics will tell them in that individual well, we are looking at packages of 5 and 10 wells being put together, to look at a fracture pattern throughout the field. So we are not on -- every well does not using fracture diagnostics. But, as opposed to 1 in 10, we are probably now up around 1 in 7. And we would hope to get that to somewhere around 1 in 4. We still had to do a better job of education there, Blake, but we think that is a demographic that works in our favor.

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**Blake Hutchinson** - *Howard Weil Incorporated - Analyst*

Okay. And then, what you're talking about in terms of observed intensity gains, and the fact that little is still known about the shale plays, as that plays into the Reservoir Management business, as we sit here as outside observers, there is a tendency to think that some of these studies in the US shale basins, the more mature basins, are getting a little long in the tooth. But in fact, is the same kind of analysis going on, where we're continuing to test not only the extents but the hearts of these plays? And so maybe there is a misperception of the longevity, and how long some of these early studies might play out?

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

I think that is exactly right. When we think back just a number of years ago, remember, three-stage fracs in the Barnett was a big deal. And we look at that now, and it kind of looks like child's play. And just recently here, over the last couple of years, we are looking at the progress in more stages. Better play stages are going to be needed to more effectively not capture just the initial production, which I know operators are concerned about, but more important to Core Lab, and ultimately to those operators, will be the ultimate recovery from those reservoirs. So I still think we are in the early stages of understanding certainly the unconventional reservoirs related to oil plays. But in looking at mastering what ultimately will be the recovery rate from those. As Rob mentioned earlier on the call, we are talking about 9% recovery rates out of these. When we worked for Mr. Mitchell back in 1991 on the Barnett, the average recovery rate from that shale and natural gas was somewhere around 4%. And today we've got it up to 16%, 17%. Now, do crude oil recovery rates get to that level? Probably not. But we can sure as heck get them up from 9% to 10%. We think big gains still to come over the next decade.

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**Blake Hutchinson** - *Howard Weil Incorporated - Analyst*

Great. And I want to cover a couple of data points that you guys had discussed on the last conference call. Realizing it's probably not the most intellectual way to look at the business. You talked a little bit about your 100,000 square foot expansion in the Houston facility. I take it most of that is dedicated to Reservoir Description. Is that primarily -- is the utilization of that an indicator of where deepwater activity is heading? Understanding you wouldn't build it if the business wasn't there. Can you give us a feeling for where you are in terms of utilization of that new space?



**Monty Davis** - *Core Laboratories N.V. - COO*

Sure. We are still in the building-out stage on that. That impacts Reservoir Description the most, but also Reservoir Management. We are working on those. Production Enhancement, we're increasing space there also in Houston. So we've call all three segments growing. But the biggest growth is in Reservoir Description.

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Yes, because we do get a lot of imported rock influence here because the companies are based here from international. So it's going to have its biggest impact.

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**Monty Davis** - *Core Laboratories N.V. - COO*

Yes, we are getting a lot of cores from the southern Atlantic in here. Both sides. And from the East Africa core, as well. So we've got quite a bit coming into this area.

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**Blake Hutchinson** - *Howard Weil Incorporated - Analyst*

Great. Thanks for the time, guys. I will turn it back.

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**Operator**

(Operator Instructions)

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**David Demshur** - *Core Laboratories N.V. - Chairman, President, and CEO*

Felicia, I think we have used our time so we are going to go ahead and close. In summary, Core's operations posted another solid year, but we think we can do better. We have never been better operationally or technologically positioned to help our clients expand their existing production base. We remain uniquely focused. And are the most technically advanced reservoir optimization company in the oilfield services sector. This positions Core well for the challenges ahead in 2013.

For 2013, we continue to be encouraged by recent activity trends in international, and in especially deepwater activities, the growing activity levels in the deepwater Gulf of Mexico. And remain confident in the activity levels associated with unconventional oil plays, especially those in North America. The Company remains committed to industry-leading levels of free cash generation and returns on invested capital, with all excess capital being returned to our shareholders.

So, in closing, we would like to thank all of our shareholders and the analysts that follow Core. And most importantly, as Monty Davis pointed out, we give special thanks for the 5,000 worldwide employees of Core Lab that have made these outstanding results possible. We are proud to be associated with their continuing achievements. So thanks for spending your morning with us. We look forward to our next update. So good-bye for now.

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**Operator**

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

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