Frank's International (FI)

Date: January 16, 2014

Franks International (FI)
Stock Price: $24.50
Diluted shares: 190.4MM
Market cap: $4.7BN
Working capital surplus: $771MM
Debt: $0
EV: $3.9BN
2013E EBITDA: $428MM ($329MM through 3Q13, and $260MM rev in 4Q13 x 38% EBITDA margins = $428MM)
Multiple: 9.1x EBITDA

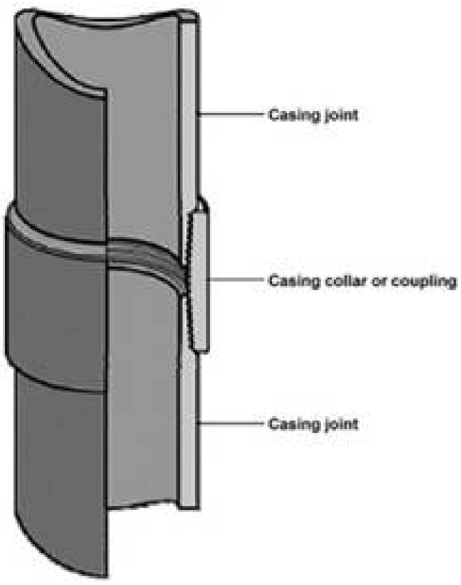
Brief overview: After operating for 75 years as a family owned business, Franks went public in August 2013. Following a successful IPO (priced at $22; opened at $26.50 and traded up over $32 in October), the stock got hit in Nov-13 after its first earnings announcement as a public company (analysts were expecting top-line growth; FI revenues declined 8% sequentially and were up only 1.4% Y/Y as 1 customer pushed an order back to 1H14). The recent drop provides a much better entry point into a truly great business (EBITDA margin of 41.3% in the first nine months of 2013; 2 companies – Franks and Weatherford – control >50% of the global tubular services market) with significant scale (90 sales and support offices in 60 countries on 6 continents), a management team that knows what they are doing, barriers to entry via intellectual property (104 U.S. patents and 136 related international patents; 37 U.S. patent applications pending and 111 related international patent applications pending), and operations in a niche that should grow double-digits over the next couple of years.

Given these characteristics, this business deserves a low-teens EBITDA multiple. Minimum.

An explanation of Franks' business:

Franks International provides oil services to E&P companies – specifically, they specialize in tubular services. Tubular services play a vital role in the structural integrity, reliability and safety of an oil and gas well. Really, they are key to a safe and successful well completion. Here's some background:

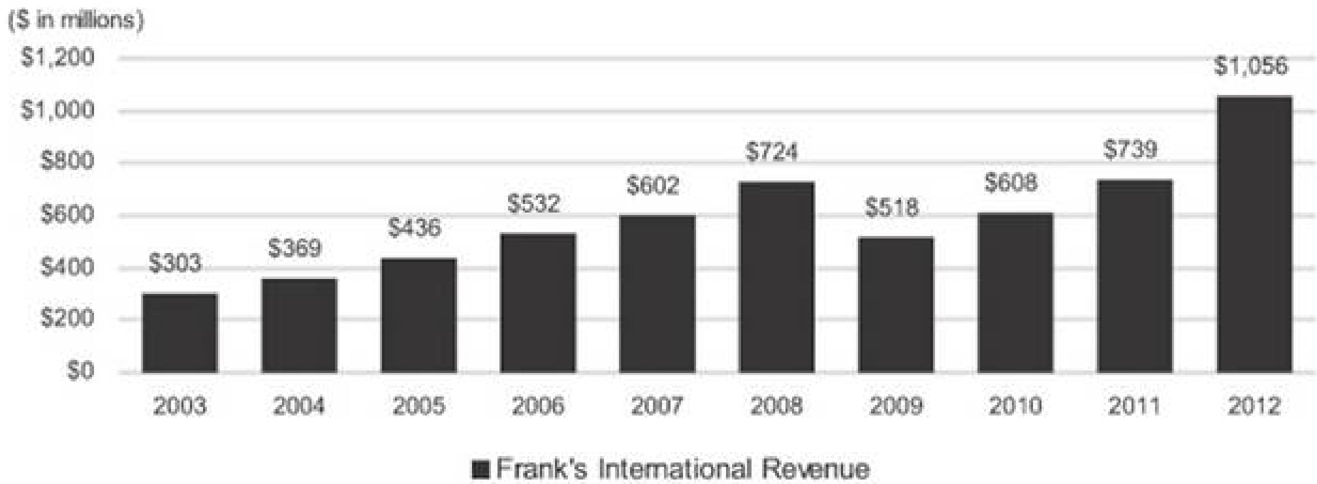
The oil drilling process creates an open borehole through numerous rock formations that reaches the targeted reservoir. Left alone, the raw surface of the borehole typically cannot support itself. Casing is a tubular steel open-ended pipe run into the borehole. One of its main functions is to provide the structural and pressure integrity to the well. Once cemented in place, the casing serves as the rigid wall of the well from the wellhead down to the bottom of the well.



Connecting Joints of Casing

Tubular services involve the use of highly specialized tools to handle and install multiple strings of pipe to establish a cased wellbore coupled with the installation of smaller diameter completion tubing inside the cased wellbore to provide a conduit for produced oil and gas to reach the surface.

Historical revenue growth:



Explanation for the 2012 revenue acceleration:

Revenues for the year ended December 31, 2012 increased by $316.8 million, or 43%, to $1,055.9 million from $739.1 million for the year ended December 31, 2011. The increase was primarily attributable to higher revenues of $163.3 million and $52.0 million from our U.S. Services and Pipe and Products segments, respectively, as the ***demand continued to***

__increase after the repeal of the Macondo-related drilling moratorium.__ *Increased activity levels in our International Services segment comprised approximately $103.3 million of the increase.*

Revenue for the International Services segment increased by $103.4 million, or 28%, compared to 2011, ***__primarily as a result of additional contracts and increased demand for our services from existing customers in our Europe, Far East and Africa regions__*** *of approximately $56.7 million. In Latin America, we experienced an increase in tubular services performed on a callout basis of approximately $14.0 million. The remainder of the decrease is attributable to increased demand from our other international regions.*

You can see the Y/Y growth by region here:

	Year Ended December 31, 2010	2011	2012
Revenue:			
United States	$ 301,002	$ 361,408	$ 560,559
Europe/Middle East/Africa	182,812	215,110	287,433
Latin America	63,166	90,409	107,112
Other countries	61,228	72,148	100,821
	$ 608,208	$ 739,075	$ 1,055,925

Geographic mix:

	Year Ended December 31,			Three Months Ended March 31,	
	2010	2011	2012	2012	2013
Adjusted EBITDA by segment:					
International Services	64%	61%	49%	51%	50%
U.S. Services	20%	29%	45%	43%	42%
Pipe and Products	16%	10%	6%	6%	8%
Revenue by geographic area:					
United States	52%	51%	56%	52%	49%
Africa	17%	16%	16%	16%	19%
Latin America	11%	12%	10%	11%	10%
Europe	10%	10%	10%	10%	9%
Far East	4%	5%	5%	5%	5%
Other	6%	6%	3%	6%	8%

Franks International provides services to E&Ps in both offshore and onshore environments, with a focus on complex and technically demanding wells. International is 50% of their business, in both revenue and EBITDA contribution.

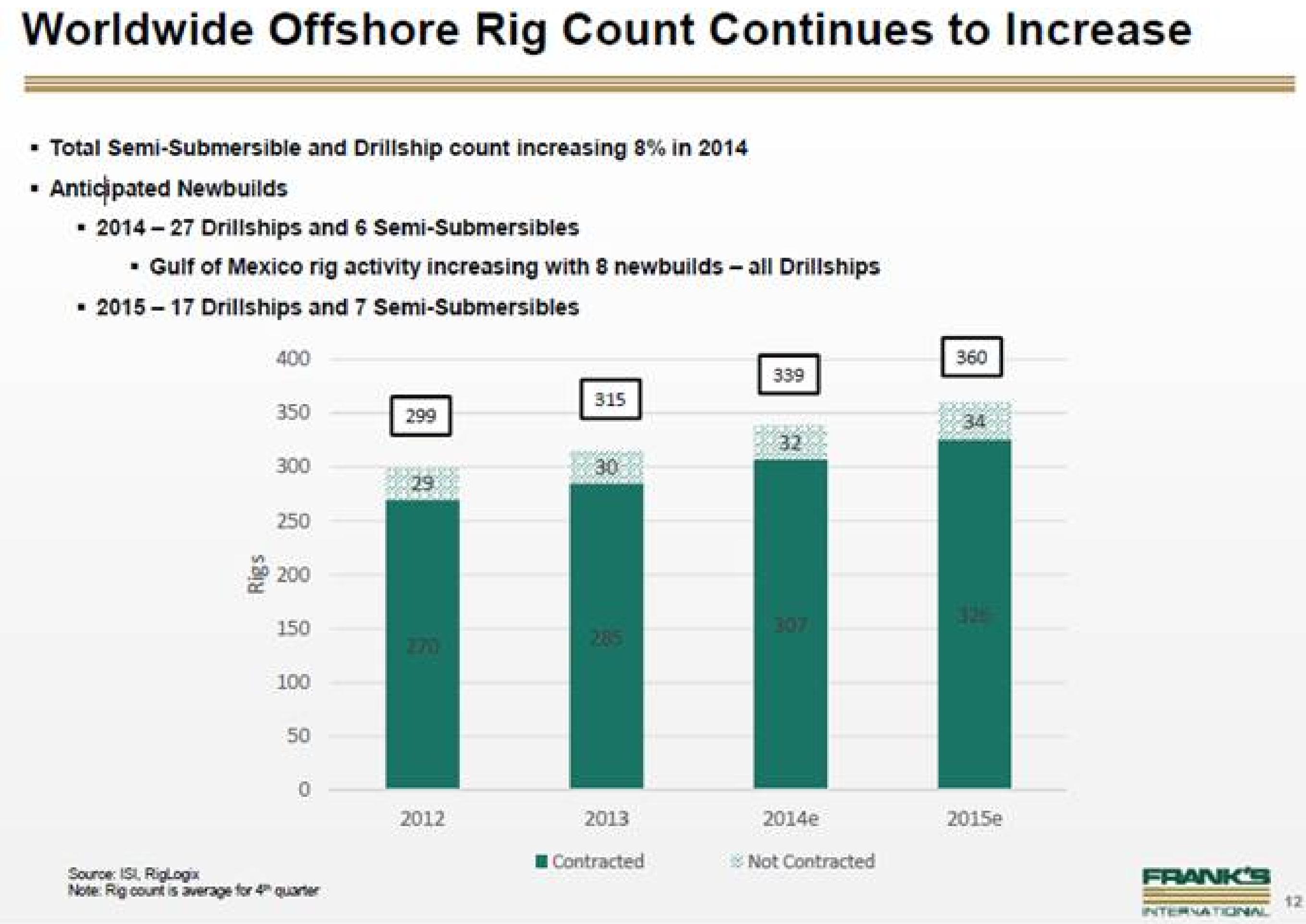
Over 80% of the International Services business segment is generated from offshore work, the significant majority of which is in deep water markets. Approximately 51% and 63%, respectively, of FI’s 2012 and first quarter 2013 U.S. Services segment revenue was generated in the deep water areas of the U.S. Gulf of Mexico. In total, offshore is 69% of the Company’s revenue.

As you can see, FI’s business is strongly correlated to the deep water and ultra-deep water. The driver of their revenue is rig count; specifically deep water rig count.

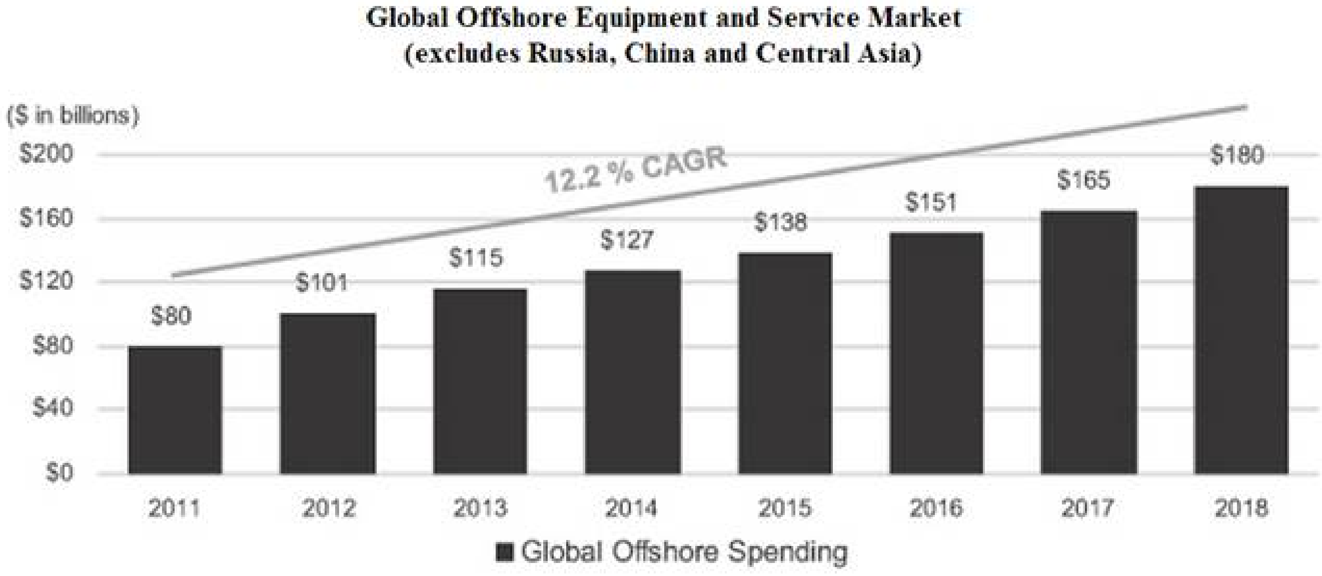
Market growth:

The rig count in the deep water US Gulf of Mexico is expected to increase to 60 by 2015 (from 40 in mid-2013).

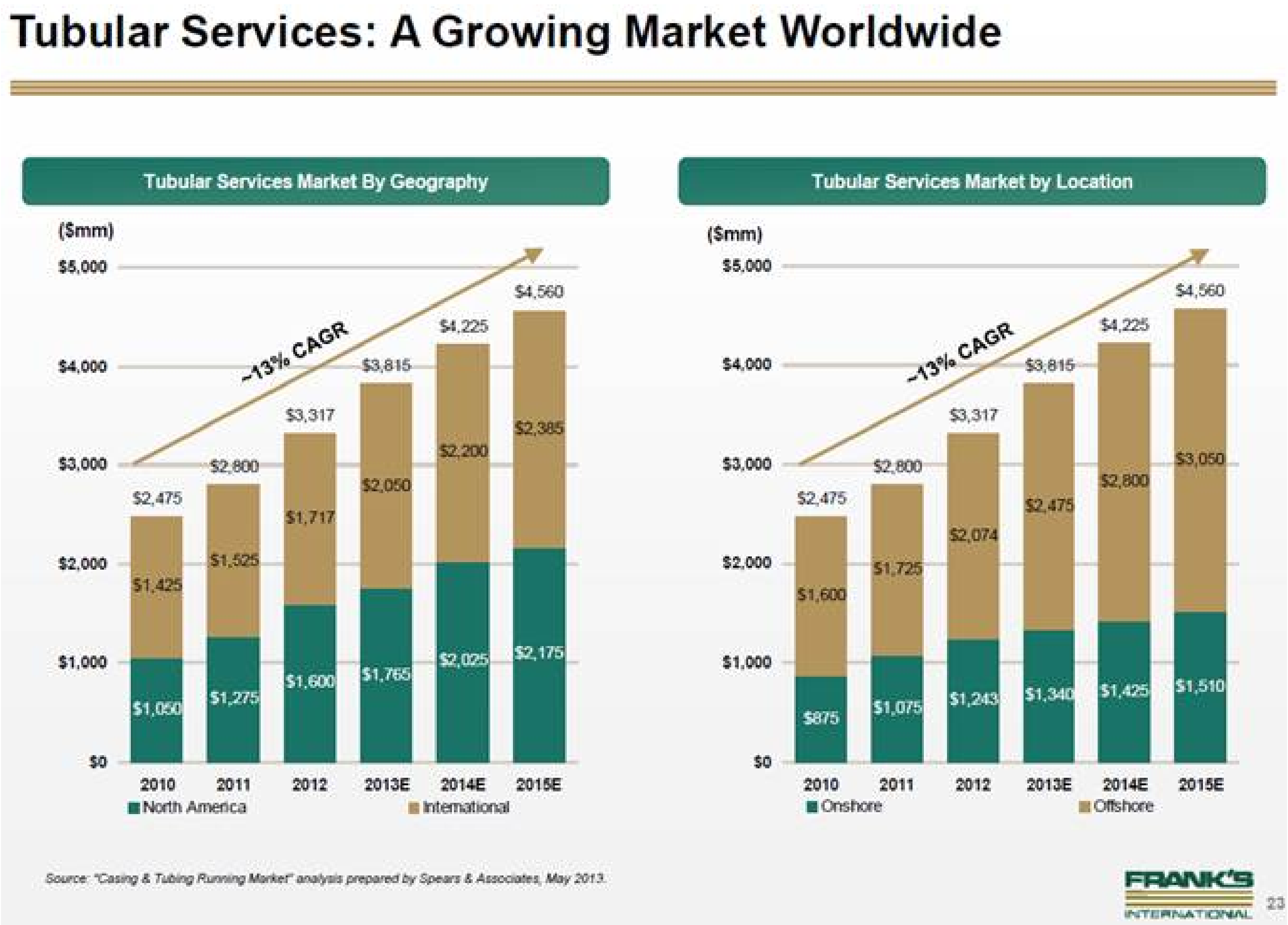
Worldwide the deep water rig count is increasing 8% next year.



Couple the increasing rig count with some pricing power and you can see how the market will grow double-digits for the next few years.



According to Spears & Associates (research outfit for the petroleum industry), the casing and tubing market is expected to grow double-digits.

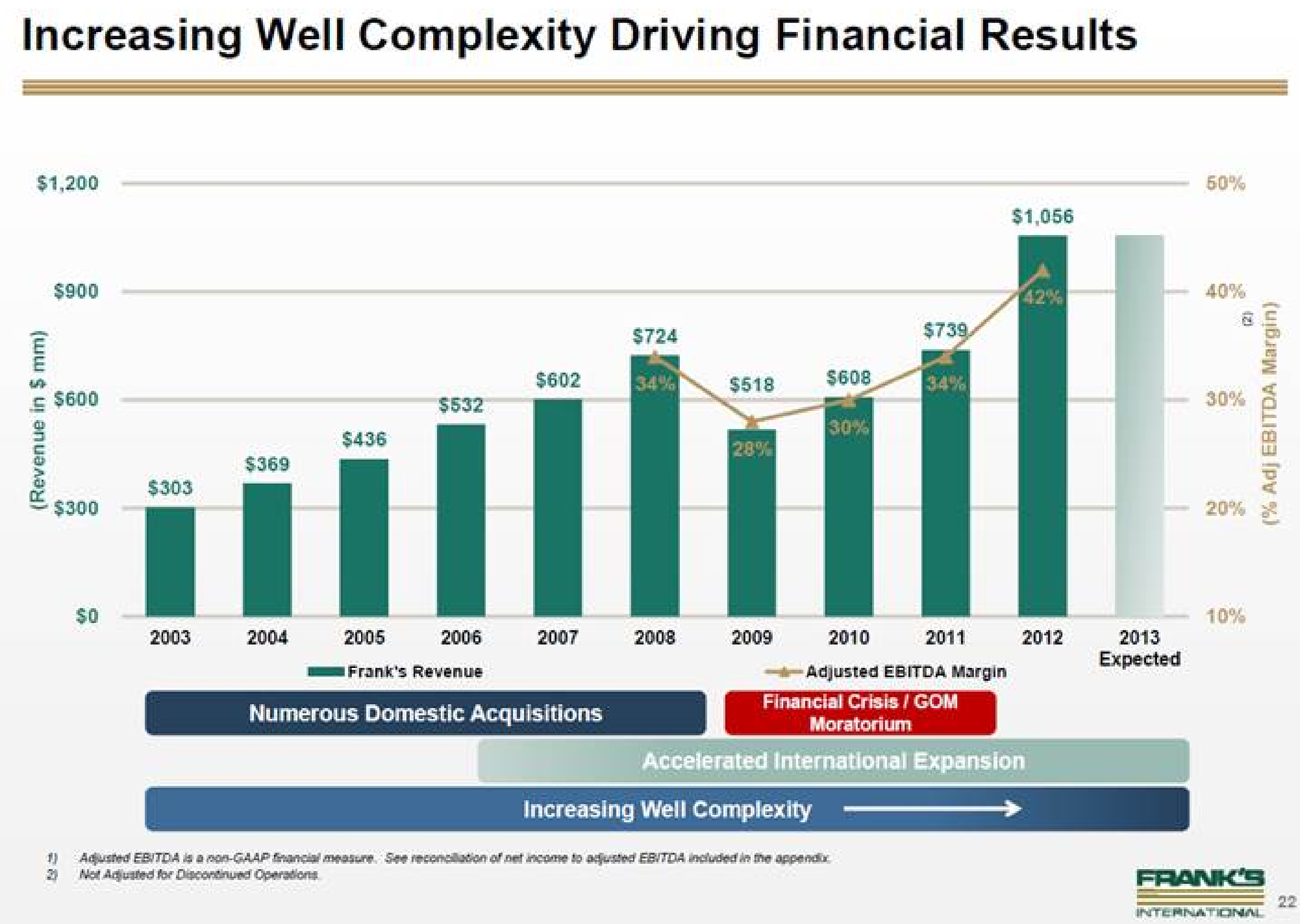


Exceptional margins:

FI doesn't compete on price. They'd rather stay away from the lower margin business (like onshore in South TX, for example, where there are 31 competitors undercutting each other). FI offers specialized tubing in remote / hostile environments and demands higher margins for their work. Most of their manufactured equipment and products use patented, advanced technologies that enable them to service complex wells. A perfect example: Franks provided all tubular services for the relief well drilled by BP to contain the Macondo spill in the Gulf of Mexico (2010).

Franks is well positioned to benefit as oil drilling / discovery moves into areas of greater depths and higher degrees of complexity (onshore: longer horizontal laterals; offshore: increasing water depths and pressure). This is a longer term trend that is not going away.

EBITDA margins in 2012 were 42%. While I wouldn't expect those margins to continue (the costs of being a public company will impact margins, as will newly implemented stock based compensation plans), I do expect FI to continue to produce industry-leading operating margins (high 30s).



FCF generation:

FI does not have a capital intensive business. Historically, maintenance CapEx has averaged 5-7% of revenue (roughly $63MM on 2013 revenue). The rest is growth CapEx (total 2013 CapEx is $200MM, of which $164MM is for the purchase and manufacture of equipment and $36MM is for the purchase or construction of facilities). In 2012, FI spent $180MM in CapEx, which was funded from internally generated funds.

If you were to assume operating cash flow matches EBITDA (working capital swings make a difference quarter to quarter), this company would produce $428MM in operating cash flow in 2013. Take out 20% for taxes (using 2014 expected tax rate), $0 for interest (no debt), $63MM for maintenance CapEx, the company has $280MM to grow the business (growth CapEx; make acquisitions) and give to shareholders.

These guys have been able to generate positive operating cash flow even in the worst of times. Take a look back to 2008 / 2009 (the Great Recession) and 2010 (Macondo):

	Frank's International				
	Year Ended December 31,				
	2008	2009	2010	2011	2012
Balance sheet data (as of period end) (in thousands):					
Total assets	$ 661,740	$ 649,915	$ 710,543	$ 847,500	$ 1,107,961
Long-term debt—excluding affiliates	71,011	57,108	46,579	9,204	7,368
Long-term debt—affiliate(1)	978	810	907	3,618	469,268
Total liabilities(2)	179,136	165,608	174,530	180,372	660,973
Total stockholders' equity	482,604	484,307	536,013	667,128	446,988
Other financial data (in thousands):					
Net cash provided by operating activities	$ 209,603	$ 141,444	$ 163,414	$ 180,710	$ 344,776
Net cash used in investing activities	(83,509)	(64,520)	(69,130)	(126,655)	(182,533)
Net cash used in financing activities	(109,394)	(92,834)	(79,261)	(71,874)	(107,210)
Adjusted EBITDA(3) (unaudited)	248,325	144,290	184,623	249,472	446,604

Other info:

- According to Spears, Franks International has the number one or number two market share in each of the U.S. and international markets, both onshore and offshore.
- FI's customers include most of the world's largest integrated oil companies and many of the largest national oil companies.
- FI has no significant customer or geographic concentration.
- FI's global presence allows them to quickly expand to additional regions that experience increases in drilling and production activity.
- Even though their interests are aligned, the Mosing family (founding family) owns 83% of the stock (and voting shares).
- If you're wondering why they would IPO after 75 years, Don Mosing answered the question this way: "The Mosing family have all kind of gone their different directions. To stay on point and grow the company in the future and to attract management and to make the company grow, I think this is the right thing to do."
- At some point, FI will be added to major indices (e.g., S&P 500).
- Next est earnings date is 10-Feb-14.

A few notes on the most recent quarter / conference call:

- Impact on quarter: $65MM in deferred rev (2/3 of that is from 1 customer), up from $23MM in the beginning of the year. Expect the customer to take delivery in 1Q-2Q14 (still under contract, just a matter of timing).
- Expect $5MM in stock based compensation per quarter, $20MM / year
- Expect $54MM in G&A per quarter, or $216MM / year going forward
- 18 – 20% tax rate in 2014
- 2013 flat v 2012
- 4Q13 could be $255MM – $260MM in revenue
- Operations driven by rig count; particularly by deepwater / ultradeep water rig count; "getting our share of contracts"
- Onshore difficult (characterized by increasing competition and flat to down rig count); not chasing market downward; "we don't run the company on market share"
- No pricing pressure in offshore contracts
- Optimism in 2014; as long as rigs get deployed, should see positive upward trend. Not giving guidance.

Bottom line: Franks operates in a global duopoly business with fantastic margins and cash flow and is growing at 10% per year with pretty good visibility. What's that worth? I believe somewhere pretty far north of here.

Sources:

S-1: http://www.nasdaq.com/markets/ipos/filing.ashx?filingid=9028242#D527343D424B4_HTM_TOC527343_11

Recent Q:
http://secfilings.nasdaq.com/filingFrameset.asp?FileName=0001575828-13-000015%2Etxt&FilePath=%5C2013%5C11%5C13%5C&CoName=FRANK%27S+INTERNATIONAL+N%2EV%2E&FormType=10-Q&RcvdDate=11%2F13%2F2013&pdf=

Company presentation: http://investor.franksinternational.com/phoenix.zhtml?c=251942&p=irol-presentations