S&P Global
Market Intelligence

Tidewater Inc. NYSE:TDW

Earnings Call

Tuesday, November 7, 2023 2:00 PM GMT

CALL PARTICIPANTS 2

PRESENTATION 3

QUESTION AND ANSWER 10

Call Participants

EXECUTIVES

Piers Middleton
Vice President Sales & Marketing

Quintin V. Kneen
President, CEO & Director

Samuel R. Rubio
Executive VP & CFO

West Gotcher
Vice President of Finance & Investor Relations

ANALYSTS

Gregory Robert Lewis
BTIG, LLC, Research Division

James Michael Rollyson
Raymond James & Associates, Inc., Research Division

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Presentation

Operator

Thank you for standing by. My name is Eric, and I will be your conference operator today. At this time, I would like to welcome everyone to the Tidewater Incorporated Q3 2023 Earnings Call. [Operator Instructions]

Thank you. I would now like to turn the call over to West Gotcher, Vice President of Finance and Investor Relations. Please go ahead.

West Gotcher
Vice President of Finance & Investor Relations

Thank you, Eric. Good morning, everyone, and welcome to Tidewater's Q3 2023 earnings conference call. I'm joined on the call this morning by our President and CEO, Quintin Kneen; our Chief Financial Officer, Sam Rubio; and our Chief Commercial Officer, Piers Middleton.

During today's call, we'll make certain statements that are forward-looking and referring to our plans and expectations. There are risks and uncertainties and other factors that may cause the company's actual performance to be materially different from that stated or implied by any comment that we are making during today's conference call. Please refer to our most recent Form 10-K and 10-Q for additional details on these factors. These documents are available on our website at tdw.com or through the SEC at sec.gov. Information presented on this call speaks only as of today, November 7, 2023. Therefore you're advised that any time-sensitive information may no longer be accurate at the time of any replay.

Also during the call, we'll present both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP financial measures can be found on our website at tdw.com and is included in yesterday's press release.

And now with that, I'll turn the call over to Quintin.

Quintin V. Kneen
President, CEO & Director

Thank you, West. Good morning, everyone. Welcome to the third quarter of 2023 Tidewater earnings conference call. In my prepared remarks today, I'm going to focus on our success of integrating the Solstad fleet, discuss the share repurchase program that we announced yesterday and how that fits within our broader capital allocation framework, and then provide some highlights of the third quarter and on our outlook for 2024. Piers will give you more detail on the markets around the world, and then Sam will explain the financials in more detail and provide some more specifics on the 2024 guidance.

Quarters in which you integrate a large acquisition are readily as eloquent as one would prefer. So, another objective today is to provide you with some information that allows you to bridge the balance sheet and income statement movements resulting from the acquisition. We announced the completion of the 37 Solstad vessel acquisitions shortly after the end of the second quarter. We are thrilled with the quality of the vessels and the more than 1,000 personnel who are now a part of Tidewater. We remain excited about what the addition of this high-specification PSV fleet means for our shareholders over the coming years as the market continues to recover.

The team here put in a lot of work prior to the closing to ensure that Tidewater's regulatory, administrative and information technology systems were adequately staged and prepared to accept the vessels and that we were ready for the required customizations and configurations to the onboard operational applications for the equipment on the newly-acquired vessels. Given that these vessels are all active, the physical integration process has transitioned 1 vessel at a time, and a schedule was designed to roll in vessels over time as they become naturally available to go through the roughly 1.5 day change of management procedure.

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

As of today, we have completed 32 of the 37 vessels through the full change of management procedures, and these vessels are fully integrated onto the Tidewater administrative and technology infrastructure. The scope encompasses the vessels fleet-wide systems and onboarding vessels to Tidewater's HR, [approving] payroll, financials, purchasing and everything, AP, customer billing. We currently expect the remaining 5 vessels to be completed by the end of the month. And I want to extend a special thank you to the Tidewater and Solstad teams, as well as our third-party providers such as UniSea and Ocean Technologies Group were all involved and dedicated to the successful integration. This is an amazing global team accomplishment to successfully transition all 37 vessels within 5 months of their acquisition date.

The Solstad acquisition transaction was an asset purchase, so it lent itself to a more streamlined realization of G&A synergies as we didn't have to onboard any personnel not immediately pertinent to the supporting the newly-acquired fleet. That dynamic played out as expected. And now that we have a substantial majority of the vessels inside of our infrastructure, we now expect the incremental annualized G&A for the new fleet to be about $3.5 million as compared to our initial view of $5 million, resulting in implied G&A synergies of $14.3 million and an incremental per day G&A cost per vessel of $260 per day. This is simply unmatched in our industry.

The company's debt agreements allow for the repurchase of up to 50% of the company's trailing 12 months' net income beginning on November 17, 2023. Accordingly, we announced in the press release that our Board of Directors has authorized the company to repurchase up to $35 million of our outstanding common stock, which is the maximum we can do at this time under those debt agreements. We will update the repurchase program quarterly based on our utilization of the program and the permitted amount available.

We are pleased to be in a position such that we are generating meaningful free cash flow and are able to institute the share repurchase program. Given the long-term outlook for the industry, we believe that the intrinsic value of our shares is well above the current trading volume. As such, we view the share repurchase program as another investment option we have to maximize value for our shareholders, in addition to value-accretive acquisitions and the solid execution of our business. Until we establish a long-term debt capital structure that is better matched to a cyclical business, we will limit our repurchases to the maximum of what is allowed under our debt agreements, which is currently $35 million, or to the anticipated net cash position 6 quarters out.

Value-accretive acquisitions remain our first priority on capital allocation. It's difficult to predict if or when any value for your deals can be completed, but we will balance the share repurchase opportunity with the opportunities from acquisitions. Our philosophy will be to evaluate the return on any given acquisitions to return on share repurchases based on our view of the intrinsic value of the business.

The positive momentum in the offshore vessel market continued during the third quarter. Tidewater continued to benefit from the global uplift in day rates, driven by the increasing demand for vessels and tight vessel supply, with day rates up over $1,800 per day and 11% movement from the last quarter. This is the largest absolute and percentage sequentially quarterly day rate increase since the recovery began. The average day rate is up now approximately $7,200 per day or nearly 70% since the recovery began around the end of 2021. Every region and every vessel class experienced a modest to quite significant day rate increases during the third quarter, which speaks to the global tightness in vessel supply driving day rates for every vessel class. The global uplift in our day rates is comprised of 2 major factors, the first of which is older contracts rolling off and recontracting at prevailing market rates, allowing us to continue to mark to market our fleet. The second factor is that leading edge term contracts continue to move meaningfully higher.

During the quarter, we executed 27 term contracts with an average rate of approximately $28,600 per day with the new contract distribution essentially in line with our vessel distribution. This compared to the leading edge day rate in Q2 of approximately $23,500 per day. This represents a nearly 22% sequential increase in leading edge term day rates, essentially double the rate of sequential growth from Q1 to Q2. Further, the Q3 leading edge term contract day rate was approximately 60% higher than the Q3 printed day rate.

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

There's always a tradeoff between utilization and day rate when you're holding out for the best prices, and this quarter, it more than worked out. We're still contracting short, but the average duration of the new contracts in the third quarter was approximately 10 months, slightly higher than the 6.5 months in the second quarter. The uptick in duration is attributable to a few long-term contracts for some of our smaller tonnage and lower specification vessel markets.

As we have talked about in the past, there is an iterative process as day rates reset, where 1 boat class moves up as the day rates increase, customers will begin to look to find adequate substitutes in adjacent vessel classes where appropriate for the given work scope. As day rates in the smaller vessel classes approach parity with larger vessels, larger vessels have taken the next leg up. We saw that dynamic play out this quarter where the most relative day rate improvement came from the mid and small vessel classes. We are encouraged by this dynamic as it's the natural progression of day rates across the vessel spectrum in a supply-constrained environment. We anticipate that as we enter the more active tendering part of the calendar in the first quarter that we will continue to see day rate momentum in all of our vessel classes.

For the third quarter, revenue increased 39% to $299 million compared to $201 million in the second quarter and ahead of the Q3 revenue guidance we provided on last quarter's call. The revenue growth was driven by the vessels acquired from Solstad, but also by higher-than-anticipated day rates and a nice expansion in utilization up over 2.5% sequentially to 82.1%. Utilization was below the expectation of 84% we laid out in the last quarter's call due to more time down for repairs than we had estimated.

Gross margin was up 1%, excluding the $4 million of one-time charges associated with the Solstad integration. We were pushing to be up 5 percentage points, but the additional time down for repair decreased revenue and increased costs. The 2% of excess downtime this quarter cost us $6 million in revenue and $6 million in costs, which would have been another 3 percentage points of gross margin. It's not uncommon for vessels to experience higher downtime as newly reactivated vessels return to high service intensity after a period of low-to-mid level intensity, but our recent experience has been higher than we anticipated.

As we look forward to the fourth quarter, we expect revenue to increase to $309 million. This sequential revenue increase is 95% covered by existing backlog, with a remaining 5% anticipated to be picked up on spot work throughout the quarter. The guidance reflects 84% utilization. The risk to this guidance is unanticipated downtime and unanticipated weakness in the spot market.

Sam will give you more details on our 2024 guidance, but our initial revenue guidance for 2024 reflects a year-over-year average day rate increase of over $4,000, in excess of the day rate increases we saw throughout 2022 and 2023, and well above the prior cycle annual increases of $1,500 per day.

In summary, we are very pleased with the continued momentum across our business with revenue, margins, day rates and utilization, all continuing to move up. We are particularly pleased with the day rate progression across all of our regions and vessel classes and the integration of the newly-acquired Solstad vessels. We remain highly confident that secular themes of the global shortage of vessels, combined with increasing demand from a variety of demand drivers, including drilling, subsea construction, existing production and offshore wind, will continue to provide vessel owners with the ability to push up day rates and improve contractual terms as we go through 2024 and beyond.

And with that, let me turn the call over to Piers for an overview of the geographic markets around the world and more color on the performance of individual vessel classes.

Piers Middleton
Vice President Sales & Marketing

Thank you, Quintin, and good morning, everyone. Before I talk about each of our region's performance, I will give a quick update on our perspective of the overall market and touch on a couple of themes we continue to focus on that we believe are important to maintain the long-term growth of the company.

The outlook for the sector remains positive with market positivity being driven by the continued upturn in project investment, a supportive energy price environment, firm demand and ongoing constraints in

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

fleet supply with demand momentum expected to build further into 2024 and 2025. None of the regions in which we operate are seeing any signs of slowdown at the present time.

Rig rates and demand continue to improve with Clarksons Research reporting that demand has firmed by an additional 3% so far this year, driven by continued improvement in the Middle East. The number of active jack-ups rose to 158 units in the Middle East, up by 37% since the start of 2022, and demand is expected to increase by a further 10 rigs by the end of 2024 just in the Middle East. In addition, the MOPU sector remains very positive with a total of 15 new build and conversion contracts projected to be awarded in 2023, driven primarily by strong activity in South America, with a further 17 new build and conversion MOPU contracts expected to be awarded in 2024, totaling an estimated $16 billion of contract investment in 2024, which is close to the record high seen in this sector in 2022, all very positive indicators for the long-term health of the OSV space.

On previous calls, we've been very clear about focusing on certain key tenets, as the market rebalanced, to enable us to maintain the long-term growth of the company. Two of those tenets revolved around discipline on how and what we bid for and the flight to quality of our fleet composition. With the Solstad acquisition completed in Q3, we continue to focus on the flight to quality of the fleet, and we now have a total of 220 ships in the Tidewater fleet, of which 197 are OSVs, and 65% or 127 OSVs, including all the 37 Solstad PSVs, are high-specification larger-deck PSVs, or over 16,000 BHP anchor handlers. These high-specification vessels [indiscernible] that are primarily driving charter rates in the global market today. So, the addition of 37 large-deck high-specification PSVs has further enhanced our ability to leverage not just OSV rates globally, but also contract terms to support the long-term growth of the business.

Discipline is another key tenet. And whilst a lot of our focus since the recovery began at the end of 2021 has been on pushing up day rates, we've also been very focused on getting our charters to agree to more equitable contracts that either remove the termination for convenience clauses completely or significantly improve the termination provisions. Whilst Tidewater is very focused on this issue, as we agree to new contracts, we believe that the industry must be equally disciplined regarding termination revisions to help build a long-term sustainable growth industry again.

So overall, we remain very positive for the long-term health of the market. And with disciplined and a high-quality fleet, we have, as mentioned by Quintin earlier, been able to move our fleet composite day rate up by over $1,800 per day compared to the prior quarter and by over $7,200 per day since the recovery began at the end of 2021. Very positive momentum, we believe, not just for Tidewater but for the whole industry.

Working through our various regions and starting with Europe, where we saw the biggest impact from the Solstad acquisition, we saw strong demand for PSVs in Norway, U.K. and the Med. However, the large AHTS market in the U.K. North Sea was slightly softer in Q3 than expected with average rates for our 2 large AHTSs in the region dropping from $36,913 per day in Q2 to $31,048 in Q3. However, even with the relative sluggishness in the AHTS sector, the team still improved our composite fleet rates compared to Q2 2023 from $18,990 per day to $19,105 per day across the whole region.

Moving to Africa, we continue to see rising demand across the whole continent. And in Q3 2023, the composite fleet rate improved by $1,303 per day from $14,469 per day in Q2 2023 up to $15,772 per day with most of the day rate improvement in the quarter coming from our 8,000 BHP to 16,000 BHP class AHTSs and plus 900 square meter class PSVs. For the 8,000 BHP to 16,000 BHP class AHTSs, we had a couple of boats roll off old legacy contracts and into new contracts with leading edge day rates in excess of $20,000 per day levels.

In the Middle East, our most challenging region competition-wise, the team managed to still push rates and increased our total composite fleet rate from $10,449 per day in Q2 2023 to $10,554 per day in Q3 2023. The Middle East traditionally has always recovered slower than other areas because of a combination of challenging competition, but also the nature of the region is to have longer-term contracts. So, it takes time to roll vessels onto new mark-to-market day rates. However, it remains a key area of focus for the fleet due to the consistent long-term utilization we can achieve in the region for some of our smaller classes of vessels.

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

In the Americas, we've seen a lot of demand in Brazil throughout the year from Petrobras with the NOC reported to have come out of the market again for another 20 large PSV tenders to commence in 2024, which added onto the contracts already awarded in 2023, will only help to tighten the global supply for large PSVs going into 2024. In Q3 2023, our Americas fleet continued to perform strongly with our team able to push composite fleet rates by $3,226 per day from $20,269 per day in Q2 2023 up to $23,495 per day in Q3 2023, most of the uptick in rates coming from the PSVs with leading edge term day rates achieving in excess of $40,000 per day in the region during the quarter. We also signed several new contracts in the region with no termination for convenience clauses with various oil majors.

Lastly, in Asia Pacific, in Q3 2023, the Asia Pacific team continued to sustain impressive rates across the region and increased the composite rates in the region by $1,617 per day from $24,250 per day in Q2 2023 up to $25,867 per day in Q3 2023. It is worth noting in this region that whilst day rate momentum has been robust over the course of the year, quarter to quarter, we do see some rate movements when we move vessels in and out of work in Australia or Taiwan, which tend to be higher day rate and higher OpEx areas compared to other countries in the region. So, during the quarter, we did see a day rate drop in the smaller class of PSVs as some vessels finished working in the wind farm summer season in Taiwan and moved onto contracts in other areas of Asia. However, overall, day rates in the region were up by 6.7%. All in all, a very impressive performance from the Asia Pac team.

Overall, we are very pleased with how the market has continued to improve in Q3, not just with significant day rates improvement over the quarter, but also with the success that our teams are achieving pushing more equitable contract terms on to our customers.

With that, I'll hand it over to Sam. Thank you.

Samuel R. Rubio
Executive VP & CFO

Thank you, Piers, and good morning, everyone. At this time, as in prior quarters, I would like to take you through our financial results and I will focus primarily on quarter-to-quarter results of the third quarter of 2023 compared to the second quarter of 2023.

The third quarter results were impacted by 2 significant events. On July 5, we completed the acquisition of the 37 platform supply vessels from Solstad for $594 million. We financed the acquisition through a combination of net proceeds from a $250 million 5-year 10.375% fixed rate unsecured Nordic bond, a new $325 million 3-year SOFR-linked floating rate amortizing senior -- secured senior bank term loan, together with $18.5 million of cash. More details of the financing are available in our recent 10-Q filed yesterday. In addition, the steep increase in the value of our common stock in July resulted in previously out-of-the-money warrants becoming exercisable prior to the expiration on July 31, 2023. This resulted in about 1.9 million shares of stock issued for a total of $111.5 million.

As noted in our press release filed yesterday, we reported net income of $26.2 million for the third quarter or $0.49 per share on revenue of $299.3 million, compared to $22.6 million of net income or $0.43 per share in the second quarter on $215 million in revenue. In the quarter, the acquisition of the Solstad vessels played a big role in the increase in revenue. Active utilization also increased, which contributed to the increase in revenue. Active utilization increased from 79.4% in Q2 to 82.1% in the current quarter. The utilization increase was driven by higher utilization of the Solstad vessels, lower mobilization days, offset somewhat by slightly higher drydock and down for repair days. Also contributing to the increase in revenue was an increase in average day rates, which increased by 11.4% from $16,042 per day in the second quarter to $17,865 per day in the third quarter. Vessel margin in Q3 was $132.7 million compared to $92.1 million in Q2, while vessel margin percentage increased to 44.7% in Q3 from 43.8% in Q2.

Adjusted EBITDA was $117.2 million in Q3 compared to $72 million in Q2. Vessel operating costs for the quarter were $164.2 million in Q3 compared to $118.3 million in Q2. The Solstad vessels contributed $35 million to the increase. In the quarter, we did see an increase in days down for repair and idle time as vessels moved to new contracts, which added approximately $6 million of unplanned costs, and we also incurred an additional $4 million in incremental costs associated with the Solstad integration.

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

In the quarter, we sold 3 non-core vessels, 1 from our assets held for sale, 2 from our active fleet, for net proceeds of $945,000, and recorded a net gain of $863,000 on the sale of these vessels. We generated operating income of $55.7 million for the third quarter of '23, compared to $38.9 million in Q2. The increase is due primarily to the higher revenue.

As we look to Q4, we now estimate total revenues to be approximately $309 million and a gross margin of 47%. For 2024, we are now projecting our revenues to be between $1.4 billion and $1.45 billion and a gross margin of 52%.

G&A cost for the quarter was $21 million, which was lower than last quarter. Q2 included $2.4 million in bad debt expense related to a customer's receivable balance that we determined was uncollectible. In addition, we also incurred $1.2 million in transaction expenses related to the Solstad vessel acquisition. We expect our total G&A cost for 2023 to be approximately $95 million, which includes approximately $6.2 million of transaction costs related to the Solstad vessel acquisition, $1.7 million of bad debt expense and $9.6 million of non-cash equity compensation. Excluding the items, our overall G&A cost for 2023 will be approximately $87.1 million and our cash G&A cost will be approximately $85.4 million.

Over the years, we've done extremely well in maintaining a very low industry-leading G&A cost per marketed day. Our cost per day for 2023 will be about $1,300 per day. We see that number marginally increasing in 2024 to about $1,355 per day, as the amortization of our equity-based stock compensation related to the performance of our stock will grow year-over-year due to the substantial increase in our stock price. For 2024, we project our non-cash equity compensation to be [$30 million] and our cash G&A cost to be about $93 million, which includes $3.5 million related to the Solstad acquisition.

In the quarter, we incurred $20.6 million in deferred drydock costs compared to $21.4 million in Q2. In the quarter, we incurred 880 dry dock days, which affected utilization by 4 percentage points. In Q4, we will be pulling forward a couple of drydocks that were projected to be done in 2024 to take advantage of the idle time before they start the new contracts. With that change, we now estimate our drydock costs for the full-year 2023 to be about $91 million.

In Q3, we also incurred $5.7 million in capital expenditures related to IT infrastructure upgrades and vessel modifications. For the full-year '23, we expect to incur approximately $28 million in capital expenditures, $5 million of which has been reimbursed by our customers. 2024 will be another heavy drydock year, as we incorporate the Solstad vessels into our system. We project our drydock expense for 2024 to be approximately $125 million, including carryover costs from 2023 ongoing projects. In addition, for 2024, we anticipate capital expenditures to be about $23 million.

We generated $29.1 million of free cash flow this quarter. We did see an increase in working capital investment, primarily because of the Solstad acquisition, which lowered our free cash flow for the quarter by about $30 million. Our investment in working capital may grow marginally as revenue increases, but we will continue to manage this capital investment as tightly as we do to our other capital expenditures. We expect the cash flow performance to improve in Q4, as the business continues to improve, and we do not anticipate such a large increase in accounts receivable related to Solstad, and both drydock and capital expenditures are expected to be lower than in Q3.

In Q4 of 2019, we began reclassifying vessels on our balance sheet from property and equipment to assets held for sale. And at the end of Q3 '23, we had 1 vessel remaining in assets held for sale at the value of $565,000. This vessel was sold in Q4 for $1 million.

I would now like to focus on the performance of the regions. Our Americas region reported operating profit of $12.6 million for the quarter compared to an operating profit of $6.2 million in Q2. Vessel operating margin decreased from 41.2% in Q2 to 38.9% in the current quarter. The region reported revenue of $70.7 million in Q3 compared to $50.4 million in Q2. The region operated 37 active vessels in the quarter, an increase of 5 vessels from Q2. Vessel increase is due to the addition of the Solstad vessels to the region. Active utilization for the quarter was 86.3%, higher than the 85.4% in Q2. Day rates increased 15.9% to $23,495 in Q3 from $20,269 per day in Q2. The increase in operating income was due primarily to increased revenue from the Solstad vessels and lower bad debt expense. This is offset somewhat by increased operating cost, also due to the addition of the Solstad vessels.

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

For the third quarter, the Asia Pacific region reported an operating profit of $14.6 million compared to an operating profit of $7 million in Q2. Vessel operating margin increased from 47% in Q2 to 51.7% in Q3. The region reported revenue of $39 million in the third quarter compared to $22.6 million in the prior quarter. The region operated 18 active vessels, which was up 4 vessels on average compared to Q2. The increase in vessels was attributed to the Solstad acquisition. Active utilization increased to [91.3 million] in the quarter compared to 72.4% in Q2. Day rates also increased by 6.7% from $24,000 per day in Q2 compared to $25,867 per day in Q3. The higher operating income is due to the increase in revenue resulting from the higher day rates, higher utilization and the addition of the Solstad vessels.

For the third quarter, the Middle East region reported an operating loss of $1.1 million compared to an operating loss of $1.7 million in Q2. Vessel operating margin decreased marginally from 22.7% to 22%. The region reported revenue of $34.7 million in the third quarter compared to $31.9 million in the prior quarter. The region operated 45 vessels, an increase of 1 vessel from Q2. Active utilization increased from 76% in the second quarter to 79.8% in Q3. Day rates increased from $10,449 per day in Q2 to $10,544 per day in Q3. The improvement in operating results was due primarily to the increase in revenue, coupled with slightly lower G&A expense.

Our Europe and Mediterranean region reported operating profit of $9.6 million in Q3, an increase from Q2, where the region reported operating profit of $8.3 million. Vessel operating margin increased from 45.8% to 46.7%. Revenue doubled to $78.9 million in Q3, compared to $39.3 million Q2. The region operated 50 vessels in the quarter, 24 more than Q2, which was attributed to the Solstad acquisition. Active utilization increased to 88.8% compared to 85.7% in Q2. The increase in utilization was primarily due to Solstad vessels operating at a higher utilization rate. In addition, day rates increased to $19,105 per day compared to $18,990 per day in Q2. The increase in operating income for the quarter was mainly driven by the increase in revenue from the Solstad vessels, offset by higher operating costs encountered as part of the Solstad vessel integration.

Our West Africa region reported operating profit of $28.4 million in Q3, compared to operating profit of $25.5 million in Q2. Vessel operating margin increased from 53.6% to 55.1%. The results in this region continue to improve as the demand in the market remains very strong. Revenue for Q3 was $73.7 million, compared to $66.2 million in Q2. The region operated 69 vessels on average in Q3, 4 more than in Q2, 3 of which were Solstad vessels added to the area. Active utilization decreased to 73.9% in Q3 from 77.8% in Q2, as several vessels incurred some frictional unemployment as they came off old contracts and began new contracts. Day rates continued to increase as we saw a 9% increase to $15,772 per day in Q3. The increase in operating income from Q2 was mainly from the higher revenue.

In summary, we are pleased with our Q3 results. The quarter was impacted by numerous items. We repositioned 4 vessels to different regions, had higher-than-anticipated idle time due to higher drydocks and higher repair days, and we integrated a large percentage of the 37 vessels we purchased from Solstad and plan to have all the vessels integrated by the end of this month. We are now in a stronger position to accelerate the growth of the company. We are adjusting some of our expectations, but overall, expect the fleet will continue to excel in the challenging ramp-up in activity that we expect over the next few years. We remain very encouraged by the leading indicators we continue to see. We are pleased to continue increases in revenue throughout the year, driven by our acquisitions and the higher day rates. And we're very excited to see how 2024 is developing.

With that, I'll turn it back over to Quintin.

Quintin V. Kneen
President, CEO & Director
Well, thank you, Sam. Eric, we're just going to go ahead and open it up for questions.

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Question and Answer

Operator

[Operator instructions] Your first question comes from the line of Jim Rollyson with Raymond James.

James Michael Rollyson
Raymond James & Associates, Inc., Research Division

Quintin, on the cost side of things, obviously, you mentioned a few different things went up sequentially because of Solstad addition, but part of this was the vessel downtime and costs associated with that. Just trying to frame up maybe how to think about your costs kind of on a per day basis as we move forward into the rising rate environment, rising utilization environment. Does this start to normalize at these kind of levels? Or do you think once you get through that kind of rush back to work on a steady basis that things will eventually come down somewhat on a per day basis? I know it's embedded in margin guidance but trying to think about that as we go through the next several quarters in a much higher rate environment.

Quintin V. Kneen
President, CEO & Director

Right. No, thanks. So, there's a couple of things unique to the quarter as it relates to the integration of Solstad, right? So, one was, they're just naturally higher-cost vessels. So, the average moves up a little bit, the baseline moves up just because those vessels are larger vessels and they operate in more expensive areas around the world like Brazil and Australia, as well as the North Sea. Then we had some one-time costs associated with just going through the process of the integration that I was alluding to earlier, and I think that was about $4 million in total. And then, the unknown was, we had about $6 million of costs related to vessels that went down for repair that we weren't anticipating. And I attribute that to just teething issues related to reactivating the entire fleet back in 2022. So, right now, we're in a great position where we can push costs through to our customers. And so, that's -- the upside here is, as the cost base changes, we're able to push it through to our customers and we're trying to push it through as fast as possible. I don't think -- you're not going to see the economies of scale on the per boat basis that we see on the G&A basis naturally. So, I think that embedded in the '24 guidance on inflation is about 6%. It gets us to about $8,500 per day. That will eventually just move with the general price level movements. But my hope is that at the end of the day, this is all about improving margins, and then we can push all of that through to our customers as we go through '24.

James Michael Rollyson
Raymond James & Associates, Inc., Research Division

Right. And so, if we think about what you just said in relation to the 52% kind of gross margin guidance, I presume that gradually, across the year, as rates are moving up, costs are not necessarily moving up in proportion. So, that 52% is the average for the year, but your quarterly run rate is going to be expanding as the year goes on. Is that...

Quintin V. Kneen
President, CEO & Director

Yes, absolutely. And I think -- my hope is that there is also a disproportionate push-up in day rates because quite frankly, we're still not earning our cost of capital. So, I am pushing up day rates just to get my cost of capital and I'm layering in on top of that any cost basis changes as a result of the cost structure.

James Michael Rollyson
Raymond James & Associates, Inc., Research Division

Perfect. That's exactly what I thought. Okay. And then, just one follow-up on the duration side of things, you guys have obviously been purposely keeping duration relatively short because we're in a rising rate

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

environment. I think you've mentioned 10 months this quarter. It was 6.5 months. I think it was 7 or 8 months in the quarter before that. At what level of rates or margins or returns on capital do you start to think about locking some things up on a little bit longer-term basis?

Quintin V. Kneen
President, CEO & Director

Well, I'm still optimistic right now on the business that I don't want to lock up. But I know that there is a prudent level of going long and short on your fleet that any business should address. But to me, it's really based on the outlook. I continue to see the supply and demand factors so strongly in the vessel owners' favors that I don't want to lock up. But on the lower-end tonnage -- so like these longer-term contracts that we locked up in Q3, they weren't like lower-specification tonnage. [Or anything like] 220 vessels, not that every vessel is the greatest vessel ever built. And so, on the lower side of this specification spectrum, I don't want to lock those up for long, and that's what I did in Q3. There certainly is a point, longer in the cycle, where you start locking up because of just prudency, because of cycle perceptions, the changes in the cycle and so forth, I just don't see that in the foreseeable future.

James Michael Rollyson
Raymond James & Associates, Inc., Research Division

Perfect. Looks like that's going to be next year for sure. Appreciate it.

Operator

Your next question comes from the line of Greg Lewis with BTIG.

Gregory Robert Lewis
BTIG, LLC, Research Division

A question for you. Realizing this was a quarter of integration, Quintin, any kind of rough guidance you can give us around, as we're looking at the larger PSV segments, as maybe where the Solstad fleet may be kept a lid on pricing in terms of reported day rates versus maybe where it was additive, if at all?

Quintin V. Kneen
President, CEO & Director

Yes. No, there is definitely a mix. The Australian contracts that we inherited were definitely below market. We priced it accordingly, but they were below market. So, when they roll off in the next year or year and a half, that should reprice quite nicely. And then, generally in the North Sea market, it's been fairly fixed. Half of it's going to roll over by the end of 2024.

Gregory Robert Lewis
BTIG, LLC, Research Division

Okay. And then, I did have a question around that -- you called out the $6 million of kind of unplanned costs during the quarter. Was that related to a few vessels or a few handful of vessels where, as you're reactivating them previously, they had to come back? And any kind of color around that and how we should...

Quintin V. Kneen
President, CEO & Director

Yes. There's about 7 in total. And I think most of them were in the Middle East this quarter, although they were somewhat spread out. We had one in Brazil as well. Unfortunately, when you put a boat to work, you do everything you think you need to do to make sure that the boat is sound. But when the equipment hasn't worked in a while, you just never know what balance is going to break or what piece of moving equipment no longer moves. So, we have some teething issues that we're working through. It is temporary. You go through this, and I think we probably have another 3 or 4 months of it. I've budgeted it into the guidance that we put into the Q4 and into '24, but my hope is that we'll be able to improve upon that even sooner than that.

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Gregory Robert Lewis
BTIG, LLC, Research Division

Okay. Great. And then, just one final one for me. As we think about the fleet, the contracted fleet, I guess, we're in the middle of Q4, are there any kind of pressure points in terms of the seasonality of the market where we should expect an outsized number of contract resets in any specific quarter as we look out over the next 12 months?

Quintin V. Kneen
President, CEO & Director

Well, generally Q1, we see most of the resetting occur because there's still a lot of companies that contract on a calendar year basis. So, you might see more in Q1 as we go through it. But let me hand it over to Piers. Piers, can you -- are you seeing any changes in the seasonality patterns over time?

Piers Middleton
Vice President Sales & Marketing

No. Not that we haven't seen in the past. When you get the North Sea obviously comes through into the summer season, so there's always a Q1 play, and a little bit, as I said earlier, because we have a fleet in the Asia Pacific, where we picked up quite a lot of work in Taiwan, that's a -- [certainly] is a sort of Q2 -- Q1, Q2 starter story as well. But no, it is not particularly seasonality. It's more of Q1 is where we will see a lot of the contracts coming through for next year.

Operator

At this time, there are no further questions. I will now turn the call back over to Quintin Kneen for closing remarks. Please go ahead.

Quintin V. Kneen
President, CEO & Director

Thank you, Eric, and thank you, everyone, for listening. We look forward to updating you again in March. Goodbye.

Operator
Ladies and gentlemen, that concludes today's call. Thank you all for joining, and you may now disconnect your lines.

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Copyright © 2023 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

These materials have been prepared solely for information purposes based upon information generally available to the public and from sources believed to be reliable. No content (including index data, ratings, credit-related analyses and data, research, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Global Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON "AS IS" BASIS. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages. S&P Global Market Intelligence's opinions, quotes and credit-related and other analyses are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P Global Market Intelligence may provide index data. Direct investment in an index is not possible. Exposure to an asset class represented by an index is available through investable instruments based on that index. S&P Global Market Intelligence assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P Global Market Intelligence does not act as a fiduciary or an investment advisor except where registered as such. S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.
© 2023 S&P Global Market Intelligence.

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.