OVERVIEW:
Co. reported 1Q16 consolidated revenues of $2.2b and loss per share, excluding certain items, of $0.06.
Operator

Good day ladies and gentlemen, and welcome to the National Oilwell Varco first quarter 2016 earnings conference call. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will be given at the appropriate time.

As a reminder, this conference is being recorded. I will now like to turn the conference over to Loren Singletary, Vice President, Investor and Industry Relations. You may begin your conference.

Loren Singletary, National Oilwell Varco Inc - VP of IR and Industry Relations

Thank you, Nicholas, welcome everyone to the National Oilwell Varco first quarter 2016 earnings conference call. With me today is Clay Williams, President, CEO, Chairman of National Oilwell Varco and Jose Bayardo, Senior Vice President and Chief Financial Officer. Before we begin this discussion of National Oilwell Varco’s financial results for its first quarter ended March 31, 2016, please note that some of the statements we make during this call may contain forecasts, projections and estimates including, but not limited to, comments about our outlook for the Company’s business.

These are forward-looking statements within the meaning of the Federal securities laws based on limited information as of today, which is subject to change. They are subject to risk and uncertainties, and actual results may differ materially. No one should assume that these forward-looking statements remain valid later in the quarter or later in the year. I refer you to the latest Forms 10-K and 10-Q National Oilwell Varco has on file with the Securities and Exchange Commission for a more detailed discussion of the major risk factors affecting our business. Further information regarding these, as well as supplemental financial and operating information, may be found within our press release on our website at www.NOV.com, or in our filings with the SEC.

Additionally, you will likely notice that we made a few changes in the presentation of our results, which were published this morning, including the incorporation of adjusted EBITDA. Please be aware that the use of the term, adjusted EBITDA, throughout the call this morning will correspond with the term adjusted EBITDA as defined in our press release.

Later in this call we will answer your questions, which we ask you to limit to two in order to permit more participation. Let me turn the call over to Clay.
Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

Thank you, Loren. National Oilwell Varco's first quarter 2016 financial results reflect the painful financial stress that our oil and gas customers are operating under. As WTI prices marched steadily downward to bottom at $26 per barrel in mid-February, customers simply stopped spending and oilfield activity plummeted further. Consequently, our first quarter revenues fell 20% sequentially to $2.2 billion, and are down 62% from the fourth quarter 2014, when the current down cycle started.

The company posted a $0.06 per fully diluted share loss for the first quarter 2016, excluding severance, restructuring and other items, totaling $0.26 per fully diluted share. EBITDA was $127 million for the quarter, or 5.8% of revenue, and operating loss was $48 million, or negative 2.2% of revenue, excluding restructuring and other items from both.

Sequential EBITDA decremental leverage was 37% on a 20% revenue decline, and year-over-year EBITDA decremental leverage was 29% on the 55% revenue decline, excluding restructuring and other items from all quarters. In a moment, Jose will take you through a more detailed discussion of operating results.

Our restructuring efforts accelerated during the quarter, as we continue to aggressively manage costs downward. We have closed, or are closing, 200 facilities since the downturn began, and we reduced our workforce by nearly 6,000 employees during the first quarter of 2016. SG&A expenses declined $31 million in the quarter sequentially and is down $180 million or 34% from late 2014.

Importantly, while we downsize, we are also maintaining our investment in the future. Including $110 million invested in the first quarter on engineering, research, and development into emerging technologies and products which will further reduce production costs, increase access to reserves, improve safety and reduce the impact on the environment for our customers. We closed four small acquisitions in the quarter, which collectively bring new technology to our portfolio, specifically surface rig instrumentation, downhole measurement while drilling technologies, and drillpipe asset tracking utilizing RFID chip technology. Each of these acquisitions complement our own internal organic investments that advance our long-term strategic plans.

I would like take a moment this morning and share with you just how we see our future unfolding, and how these investments in our long-term strategic plan articulate with that future. First, horizontal drilling and geo-steering are key enabling technologies of the shale revolution. 90% of US land rigs drilling today are drilling horizontally, or at least directionally, a share which has actually increased from 79% since the downturn began the fourth quarter of 2014.

Horizontal drilling, which opens up much more of the reservoir to the wellbore, will expand globally, and be applied more widely in the inevitable upturn. Therefore, NOV has developed a new low-cost rotary steerable tool, which will be run commercially in our customer's hole for the first time next week. This new product complements our comprehensive bottom hole assembly, or BHA offering to the directional drilling industry. Our Tektonic family of abrasion resistant fixed cutter bits are gaining market share, as is our new ERT downhole drilling motor and we added new MWD products to an acquisition in the first quarter as well. These tools work with our jars, shock subs, drill collars and premium drill pipe engineered to withstand the considerable rigors of horizontal drilling. Our long-term strategic plan in this area is built on our view that the next up cycle will see even greater demand for drilling tools for horizontal drilling, which will be provided by the directional drilling service industry that NOV will continue to equip.

Second, North American shale plays endured lengthy gestation periods before they evolved to profitability. As the E&Ps experimented with drilling techniques to arrive at the most cost-effective methods to drive marginal cost per barrel sufficiently low to be financially attractive investments. In the next up cycle, NOV can help short-circuit that empirical technique, using our closed loop automated drilling service, which has proven it can materially reduce drilling costs by making microsecond level adjustments to the drilling rig through our proprietary rig control system and software.

We are bidding or executing over a dozen closed loop automated drilling projects currently, utilizing our proprietary IntelliServ wired drill pipe. We are also seeing more interest from drilling contractors wishing to differentiate their rigs by outfitting them with IntelliServ wired drill pipe. In fact, we know of an idled rig that was recently put back to work solely because it was outfitted with IntelliServ pipe -- a big win for its owner. Our
long-term strategic plan is built on the view that E&P companies will prospect new shale plays globally using rigs capable of closed loop automated drilling, tier 1 AC rigs, wired IntelliServ drill pipe, bottom hole assembly components and NOVOS software -- all of which NOV can provide today.

During the first quarter, NOV as awarded a major five year project in North Africa for a real-time technology center to track drilling rig operations and we're currently bidding other similar projects. NOV has provided real-time remote monitoring of equipment for many years. A few weeks ago, we announced the industry's first predictive capabilities for monitoring BOP components through our RIGENTRY remote condition based monitoring services. We believe that condition-based remote monitoring of oilfield equipment and predictive data analytics will grow in importance in the next upturn, as the industry increasingly employs more sophisticated equipment in more demanding environments. The Internet of Things is coming to the oilfield and NOV will continue to lead the way. And will benefit from the largest installed base of drilling equipment and drilling control systems in the world.

Hydraulic fracture simulation is another enabling technology with proven value to the industry. We are investing in new technologies which we believe can reduce the capital equipment on-site, the number of truckloads required, the power requirements and the operating costs of conventional frack fleets. Our long-term strategic plan has us investing in better ways to hydraulically stimulate reservoirs. Again, the next upturn will see more widespread application of fracture stimulation and we plan to provide the next generation of tools.

The oil and gas industry has invested billions in deepwater exploration, chalking up more than 400 undeveloped discoveries, and our strategic plan targets improving floating production technologies to lower the development costs of these reserves. We are targeting a new fully [concosted] production solution to offer to owners of marginal deepwater fields by early 2017. Preliminary discussions with IOCs around our new innovative concepts have been met with high levels of enthusiasm.

Specifically, these are smaller standardized units which can operate efficiently across a broader range of production, which utilize standardized disconnectable turrets to increase asset utilization and efficiency. On the seafloor we are expanding our offering ain flexible pipe, connectors and other hardware, along with seawater treatment technologies for subsea seawater injection, which increases of the ultimate recovery from reservoirs through pressure maintenance, ultimately lowering cost per barrel.

We continue -- we are continuing to expand our offering of composite materials into both offshore and land markets, partly through an acquisition we closed in the fourth quarter. Composite materials offer superior corrosion resistance in the flowlines we supply, and lighter weights, which drive down offshore vessel construction costs. Our long-term plan continues to advance these technologies which will see increased uptake in a recovery. As the largest provider of fiberglass and composite tubulars to the oilfield in the world, NOV is well positioned to continue to drive corrosion resistant solutions.

Onshore we're focused on other technologies which help our customers reduce their cost of production. The US is really a 60 million barrel per day water industry that produces 9 billion -- 9 million barrels a day of oil as a byproduct. Our WaterWolf technology offers superior oil-water separation and complements our proprietary sand separation technologies and extensive production pump business. Our long-term plan also invests strategically in key productive regions like Saudi Arabia and Russia where we began fabricating our first land rig and downhole tools at a new plant we opened in the first quarter.

NOV is an innovative, entrepreneurial organization resolutely focused on improving the cost per barrel position of our customers through technology, improved supply chains, standardization, and industrialization. Our experience is that business models such as these, built on sound fundamentals of focus on our customers needs, are long-term winners. They are in contrast to new business models, which seem to rise during downturns, which focus on either providing our customers with increasingly valuable capital they cannot access elsewhere, or business models wherein we shoulder more of our customers' risks. Prior cycles have demonstrated that these models frequently do not turn out so well.

As we approach the bottom of this sharp downcycle, our customers are struggling to make money right now, and the oilfield services industry is being radically disassembled to cope with commodity prices far below levels required to return to production growth. This is not sustainable and will change. Investors are understandably focused on optionality of enterprises in an eventual recovery. The handful of strategic plans I just outlined rest on specific, promising technologies our customers can apply across the globe. They will continue to evolve the industry to higher levels of efficiency and safety and lower costs of production.
NOV is positioning itself to capitalize on the inevitable upturn, and I am excited about the optionality embedded in our initiatives, and more so the creativity and ingenuity that our teammates here at NOV continue to apply to our customers’ challenges. While we are not planning for a recovery in 2016, we are encouraged by reports from some customers that they are beginning to think about a potential upturn in the second half of the year, as oil production is finally begun to rollover and demand continues to march upward.

We will continue to manage cost to the reality of the marketplace in the short-term, which is becoming more challenging as very low volumes present rising absorption challenges for us. Even with a rebound in oil prices, it will take time for our customers to repair balance sheets, to complete their drilled but uncompleted wells, to work down oil inventories and excess capital to resume drilling. But the industry will navigate these challenges and NOV will be here with an enhanced offering and greater levels of efficiency.

I’m grateful to be part of such an entrepreneurial, smart organization with deep financial resources and diverse business models and bright opportunities in our future. This has always been a deeply cyclical industry and our leaders have been through many downturns before and they will again lead us through the present storm. Oilfield services is not much fun right now and I want to let all of our employees know that Jose, Loren and I appreciate you suiting up every day and fighting the good fight. Hang in there, better days lie ahead. Jose?

Jose Bayardo - National Oilwell Varco Inc - SVP, CFO

As Clay mentioned, NOV posted a $0.06 per share loss for the quarter, excluding severance restructuring and other items which totaled $147 million pretax, or $0.26 per share after-tax. Consolidated revenues were $2.2 billion for the first quarter of 2016, down 20% from the fourth quarter of 2015, and 55% year-over-year.

The sharp decline during the quarter was a result of significant E&P spending curtailment as oil prices reached new lows. The average US land rig count fell 27% sequentially, exiting the quarter at 450, the lowest count since the 1940s. And the average international rig count fell 8%, hitting a decade low at 985 rigs, with declines being across all major regions of the globe. All of NOV’s business units and global regions were negatively impacted, and all reporting segments saw revenue declines during the quarter. EBITDA decreased to $127 million, or 5.8% of sales, resulting in sequential EBITDA decremental leverage of 37% and year-over-year decremental leverage of 29%. Operating loss, excluding other items was $48 million.

Looking at some of the other line items of the P&L, SG&A decreased by $31 million, or 8% sequentially and by $138 million, or 28% year-over-year as we continue to execute cost control measures necessary to size our business with the current market environment. Interest and other financial costs decreased $2 million sequentially, and $1 million year-over-year, primarily due to bank -- lower banking fees associated with the induction of large credit outstanding.

We reported a $3 million higher loss sequentially in unconsolidated affiliates, related our Voestalpine joint venture where demand for OCTG, or green tubing, remains exceedingly low, given the dearth of drillpipe demand. Other expenses for the quarter increased $4 million sequentially driven primarily by a greater loss on disposals of fixed assets.

Our GAAP effective tax rate was 50% for the quarter. The unusually high rate was a result of combining losses in higher tax jurisdictions, namely the US, with income from lower rate international jurisdictions. Additionally, we received a tax benefit associated with reversing reserves for tax audits, which concluded with favorable outcomes. With the relatively low levels of pretax income and losses that we are currently experiencing, relatively small changes in the split between domestic and international results can have a disproportionate impact on our effective tax rate. Notwithstanding this uncertainty and anticipated volatility, our current estimate for the effective tax rate is 35% for the remainder of the year.

Turning to the balance sheet and cash flow, working capital decreased $520 million from the fourth quarter of 2015, to $4.9 billion at March 31, 2016. The decrease in working capital is primarily the result of a $714 million reduction in accounts receivable, $144 million reduction in inventory levels and an $84 million decrease in customer financing, which is the net of prepayment and billings in excess of costs against cost in excess of billings.
The reductions in working capital were partially offset by decreases in accrued liabilities and accounts payable. Our focus on collections yielded strong results during the quarter, although inventory is not liquidating as quickly as we would like, reflecting lower current levels of demand. We anticipate working capital will continue to be a source of cash as our revenues move lower, but we expect the pace of cash flow generation to slow relative to the past two quarters.

The reduction in working capital helped contribute to an exceptional quarter of cash flow generation relative to the current market environment. NOV generated $621 million in cash flow from operations during the first quarter. After paying $173 million in dividends, $84 million for non-acquisition related capital expenditure investments, and $21 million for acquisitions, and adding a foreign exchange benefit and other items totaling $20 million, we netted $363 million in free cash flow.

Additionally, we successfully repatriated another $637 million cash from overseas at a very low cost, allowing us to reduce our commercial paper balances by $683 million to a quarter end balance of $210 million. This paydown of debt was partially offset by a capital lease associated with a large new facility which came onto our books during the quarter. The building will allow us to consolidate approximately 1,600 personnel from 12 existing NOV facilities, of which 10 will be fully vacated after we finish moving into this new facility. At March 31, we had cash balance of $1.8 billion, total debt of $3.4 billion and our debt-to-capitalization was 17.1%, down from 19.2% at year-end.

As Loren mentioned in his introductory remarks, we made a few changes to the presentation of certain information in our release this morning, which we hope will enhance our readers’ ability to understand NOV and its financial performance. One of the changes relates to the presentation of our segment results. In order to provide a clear measurement of all reporting segments, we are no longer allocating certain corporate overhead cost to our segment results and we are now capturing these costs in the line item Eliminations and Corporate Costs. We have revised prior period amounts to make the segment performance comparable, and when we speak to segment results this morning, we will be referring to the reclassified results presented in our earnings release. In today’s release, we also provided the specific amounts now deemed corporate costs for each period presented, however, we do not anticipate breaking these costs out in the future.

Our Rig Systems segment generated first quarter revenue of $926 million, down 9% from the $1 billion earned last quarter. For the first quarter, the split between offshore and land-related revenue was 75% and 25%, respectively. New construction of offshore rigs accounted for $431 million in revenues, or 20% of NOV’s consolidated revenues.

First quarter EBITDA for the Rig Systems segment was $137 million. After four quarters of exceptional decremental margin management, our Rig Systems segment saw a significant decline in margins in the first quarter. Margins fell 630 basis points to 14.8% of sales, representing 87% decrements on 9% lower sequential revenues. Operating profit was $119 million, or 12.8% of sales. Lower margins arose from the much sharper than anticipated fall in spare parts sales in our aftermarket business. Meaningfully impacting absorption within Rig Systems segment’s facilities that manufacture those products.

Additionally, while cost reductions are underway, there pace simply can’t always keep up with sharp volume declines, particularly when you’re trying to be thoughtful in your actions while treating people as well as we reasonably can during this difficult time. Bottom line, is that the lower anticipated margins were the result of lower throughput in our manufacturing facilities, combined with a slowdown in cost reduction efforts relative to the fall off in volumes.

On a year-over-year basis, first-quarter revenue is down 63% at only 25% decremental margins. The solid year-over-year decrements in the face of a nearly two-thirds’ revenue decline have been accomplished by significant insourcing from our external supply chain, but these opportunities are diminishing. New orders were $97 million in the first quarter, representing a book to bill of only 13% when compared to $770 million shipped out of backlog. Q1 bookings were composed entirely of discrete capital equipment, including cranes, pressure control and jacking systems. For the second straight quarter, we received no new rig orders.

As we note in our press release, effective March 31, 2016, we have deducted the backlog we previously disclosed for rigs being constructed in Brazil to reflect Sete’s shareholder approval to file for bankruptcy protection last week, along with other orders for which we have not been paid in over a year, totaling approximately $2.1 billion. Although our contracts with the three yards remain in place and are enforceable, work on all of these projects has been suspended pending payment and will remain so until customers make funds available to advance the projects, leading us to
We noted a number of wins in our press release and in Clay's remarks, but I'd like to further highlight some of the recent successes.

Our Rig Aftermarket segment generated $391 million of revenue during the first quarter of 2016, down 31% from the $569 million in the fourth quarter of 2015, and down 46% from the $719 million in the first quarter of 2015. Revenue declines were anticipated in the first quarter, due to deteriorating market conditions and the normal falloff of year end service and repair work. However, sharper falloff in activity levels versus expectations amplified the decline and further eroded demand for spare parts as our drilling contractor customers, offshore in particular, cut their expenditures on repairs, services, and spare parts dramatically across the board.

EBITDA was $82 million, down 43% sequentially and down 62% from the prior year. Decrementals were 35%, driving EBITDA margins down to 21%, while a mix shift from spares to service and repair and some pricing pressure contributed to the profitability decline. The largest driver was reduced volumes, which resulted in lower absorption in our facilities and lower utilization of our service and repair personnel.

Operating profit was $77 million, or 19.7% of sales. Special periodic survey work continuous but we are seeing significant reductions in the scope on these surveys and other long planned SPS projects are being canceled lately, in view of grim prospects for these offshore rigs winning contracts anytime soon. Additionally, we are seeing pricing pressures continue to mount. Looking forward, we expect revenues to come down in the mid-single digit percentage range, with sequential EBITDA decrementals in line with Q1 results.

Thinking longer-term, we believe rig aftermarket will be an early beneficiary of activity recovery, as we work with our customers to provide the necessary parts, service, repair and maintenance required to put their rigs back to work. Additionally, we believe new US offshore BOP regulations will drive additional demand for condition-based monitoring services, which we have provided for over five years.

Our Wellbore Technologies segment generated revenues of $631 million during the first quarter of 2016, down 17% sequentially from $757 million and down 46% from the $1.2 billion posted in the first quarter of 2015. Revenue mix by destination was 46% in North America, and 54% international. 70% of the segment’s decline came from international markets, which declined 22% sequentially, most acutely in Asia and Latin America. The US declined 16% sequentially, better than the 26% decline in the US rig count, indicating that despite intense pricing pressures, the group’s revenue per rig improved on market share gains.

EBITDA for the segment was $43 million, or 6.8% of sales, down 44% from the previous quarter and 82% from the prior year. Sequentially, EBITDA decremental leverage was limited to 27% on the $126 million in revenue decline. As the group experienced the full benefits of cost reductions we made last quarter and continues to eliminate substantial portions of its cost structure, including the closure of more than 20 facilities during the first quarter of 2016. Operating loss for the segment was $53 million.

[Portation] activity from the downhole tools segment is increasing, and we believe that even a leveling of activity will bring more work as customers are depleting their stocks of equipment and tools coming in from jobs not being repaired. Therefore, expect -- we therefore expect repair work and motor relines to begin to rise through the year as customers run out of tools. We began manufacturing downhole tools in new plants in Saudi Arabia and Russia during the first quarter. Drillpipe demand remains very low and we have mothballed much of our capacity as a result. But Q2 benefited from a high mix of large diameter premium threaded drill pipe.

Our Tuboscope unit saw pipe mill and processor activity fall, owing to 12 months of OCTG inventory on the ground in North America, five to six months the normalized average. However, we are beginning to see some interesting completion and workover activity, which may drive demand for coating and inspection work in the back half of the year, along with higher demand for sucker rod services for artificial lifts.

Wellsite Services saw a significant decline in revenues tied to lower rig counts, but aggressive cost control enabled the group to post higher EBITDA sequentially. We noted a number of wins in our press release and in Clay’s remarks, but I'd like to further highlight some of the recent successes...
and market share gains particularly related to our downhole tools and drilling optimization businesses. Our drillbit designs continue to set new performance records globally.

Most recently in Oman, where an operator set three new field records using our Tektonic bits to drill 8,000 feet-plus, in a single run. Since their introduction in October 2015, Tektonic bits have logged 22 field records in ten countries around the globe. Additionally, our Dynamic Drilling Solutions business continues to gain traction with eVolve optimization and closed loop drilling automation services.

In our release, we highlighted the completion of an 18-month project in the Norwegian North Sea with a major integrated oil company in developing a [field and business of] oil reservoir and several deeper structurally complex high-pressure gas and condensate reservoirs. Wells drilled in this field have a narrow pressure window that requires a comprehensive understanding of the conditions in the formation. And that leaves little room for error in order to optimize economics associated with the development of the field.

Our suite of tools provided the customer with high-speed streaming downhole data used to accurately analyze wellbore conditions, which enabled the customer to have the data required to justify extending laterals well beyond originally planned by design. By extending the wellbore, the customer significantly increased production from the wells drilled, therefore eliminating the need for the final well included in the original project plan. Given the cost of drilling in the North Sea, you can appreciate how our technologies reduced the customer's development costs substantially.

Additionally, we were recently awarded a contract for downhole drilling automation with an independent E&P customer in Western Canada, and as Clay mentioned, we were awarded a five year project by a national oilwell — oil company in North Africa for real-time data acquisition, visualization and optimization. Traction we continue to gain with new technologies indicate our customers’ persistent desire to seek new and better ways to drill and we have positioned ourselves as the leading independent provider to help them achieve those goals. Notwithstanding the many positive ongoing developments occurring within our Wellbore Technologies segment, our business is primarily driven by drilling-related activities.

With Q2 global activity already sharply lower than the Q1 average, we anticipate second quarter revenues will be down approximately 15%. Additionally, while we continue to reduce our cost structure, we do not believe we will replicate the success we had in the first quarter managing our decremental margins and anticipate the segment to be at or near breakeven EBITDA.

The Completion and Production Solutions segment generated revenues of $585 million for the first quarter of 2016, down 25% sequentially and 41% compared to the first quarter of 2015. While all businesses experience fewer sales, revenue declines were sharpest within offshore production-related groups, which were coming off record or near-record years in 2015. Revenue out of backlog was $330 million, down 28% sequentially.

EBITDA for the segment was $48 million, or 8.6% of sales, down from 11.9% in Q4 and 18.2% in Q1 of 2015. The segment was able to hold decremental EBITDA leverage to 22%, as cost savings realized from facility consolidations and headcount reductions helped soften the impact of declining revenues. Operating loss for the segment was $4 million.

Revenues for intervention stimulation and wireline equipment continued to decline, particularly across North America, while the Middle East has remained comparatively strong. Aftermarket spares and services for stimulation equipment are facing considerable headwinds as customers aggressively cannibalized fleets, including acquiring auction spreads going for $0.20 on the dollar [at port out]. However, we are encouraged by recent pickup in quotations from possible orders in the second half of 2016, when some customers believe completion activity will pick up and buy sequentially stronger order bookings.

Our floating production group posted lower revenues as well, but had excellent decrements due to aggressive downsizing. We continue to advance a half-dozen FEED studies for FPSO-related projects, but final investment decisions have been non-existent as customers recycle designs and concepts to reduce cost.

Our flexible pipe business fell sharply as our plant in Brazil ran out of orders in December. However, the group landed significant orders which will lead to revenue growth in Q2 and should load the plant through the remainder of the year. Our composite pipe business unit fell during the first quarter but again, aggressive cost control led to an improvement in EBITDA in the first quarter and orders improved.
Process and Flow Technologies also posted higher EBITDA on flat revenues, owing to significant restructuring that went on last year on favorable mix as the group won record levels of orders for production [chokes]. New orders were $328 million, up $56 million or 26%, resulting in a 99% book to bill in the first quarter. The segment ended the quarter with a backlog balance of $994 million. While we experienced a sharp quarterly decline and industry activity levels continue to fall, we believe achieving a book to bill approaching 100% is an indicator that the [cap] segment is rapidly approaching bottom. But as those orders don’t immediately convert to revenue, we expect segment revenue to decrease in the mid to upper single-digit percentage range in the second quarter.

Cost savings which positively impacted Q1 results are expected to continue, but not to the same magnitude on decremental margins as we experienced in the first quarter, which should lead to decrements in the mid-30% range. Visibility on new order intake remains cloudy, particularly in the offshore space as industry continues its deepwater cost recalibration. That said, we optimistically anticipate that new orders will see a slight tick up during the second quarter.

In summary, our first quarter results reflect the fact that we are in an extremely challenging market environment. Despite current conditions, we continue to generate substantial amounts of free cash flow, even while we make meaningful investments in our ability to continue delivering better technologies and solutions for our customers in the oil and gas space. We expect the near-term environment to remain difficult, however, we are growing more optimistic that we are nearing the bottom of the cycle and we are excited about the future value that the hard-working and innovative people of NOV will deliver to our customers and our shareholders as the recovery takes hold.

With that, we’d like to open it up for questions.

QUESTIONS AND ANSWERS

Operator
(Operator Instructions)

And our first question comes from the line of Ole Slorer with Morgan Stanley. Your line is now open. Please proceed with your question.

Ole Slorer - Morgan Stanley - Analyst

Yes, thank you, and congrats, Clay, on the generating free cash flow in what’s undoubtedly one of the toughest environments I think any of us is have ever experienced.

Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

Thank you, Ole.

Ole Slorer - Morgan Stanley - Analyst

In thinking about National Oilwell -- the scale -- a division between the thoughts around your rig construction and that of your shorter cycle opportunity. I kind of remember back in the mid-late 90s, and Grant Prideco -- how it surprised all of us by its operating leverage and even National Oil before Varco, and all its motors and downhole tools, et cetera. And the early cycle characteristics of that.

I wonder if you could share your high-level thoughts on the early cycle component of National Oilwell, how it’s changed from those days, your philosophy and how you’re building it out?
Thank you, Ole. It's been a systematic, steady application of capital over the years to very attractive businesses, like Grant Prideco's drillpipe business. As you are aware, 97% of the acquisition capital we have deployed through the last decade plus has been in areas outside of rigs. We have a great franchise in building rigs, and very proud of that and have done a great job. But looking forward, I think as the cycle recovers, we're going to benefit from investments like that. Drill pipe demand comes back, that drives high, very high operating leverage and high levels of profitability, particularly for our offering which was -- which rests on a lot of premium technology in specialized drill pipe used to drill more complex well pads, for instance.

As we noted in our comments, we expect to see rising demand in downhole tools and we have been developing internally, as well as through acquisition, new offerings in that arena, and as recovery comes back I think we'll see response there. As Jose mentioned, our Rig Aftermarket business -- our customers really have cut spending to bare-bones and are relying on cannibalization of many of the fleets that are out there. They cannot last forever and so recovery I think we'll see in Rig Aftermarket.

And finally, Completion and Production Solutions -- through the last decade we've added new products there to help our customers improve economics in the deep waters for things like turret boring systems, flexible pipe that we referenced, built out our offering in composite offerings so now we are the largest provider of flexible composite piping, for instance, in flowlines. So all of these businesses -- you know, we expect, in an upturn, to benefit pretty early. So we're well poised and positioned as activity starts to come back and our customers start to invest more again to take advantage of that.

Ole Slorer - Morgan Stanley - Analyst

So going through a period where we have [recalled Raybert], but let's say it takes a few years before we get any deepwater offshore rigs ordered again. What do you think the drag will be from your facilities costs and your other costs associated with an underutilized offshore rig construction business? How well can you utilize, or take down the capacity cost?

Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

That's a great question, Ole, we are downsizing in response to what we anticipate will be lower demand for at least the next few years and possibly beyond. But to clarify, in our Rig Systems business is composed of manufacturing operations that make drilling components that support both land and offshore, as well as spare parts to support the Rig Aftermarket business. The reality is that, although we break it out to enhance our disclosure to the investing public, the Rig Aftermarket and the Rig Systems segments in many ways really constitute one big global business, and they support or aspects of drilling from offshore rigs to land rigs to spare parts, maintenance, special-purpose survey, projects, and repair -- that's out there.

So we are moving our cost structure down, retrenching. As you know, in the past we relied on a balanced mix between internal manufacturing as well as outsourcing, and so the first actions we’ve taken through 2015 was to minimize our outsourcing and bring more in-house. We're continuing to do that, but also looking at continuing to reduce our footprint to cope with lower volumes.

What I would tell you is although orders are very, very slow now, business is obviously down to subsistence levels, looking out in coming quarters we expect to see resumption of land rig projects. We've had a number of conversations underway around the globe. We expect to see drilling contractors continuing to upgrade their equipment and make their rigs more competitive in a market that is a little tougher on them.

We expect to see, and we're investing in, some new products and I don't think we mentioned them on the call, but some new products to upgrade those rigs that we’re pretty excited about. We'll, we will retrench down to fit the volume that we foresee out there for the next few years, as well as continuing to invest in our other two -- two segments that have a lot of very bright prospects in a recovery.
Ole Slorer - Morgan Stanley - Analyst

Thanks for that.

Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

You bet.

Operator

Our next question comes from the line of Waqar Syed with Goldman Sachs. Your line is now open. Please proceed with your question,

Waqar Syed - Goldman Sachs - Analyst

Just following up on the discussion. So the change in accounting, either that you have, in terms of allocating the G&A cost into individual segments, are you strategically thinking in a different way of running these businesses well in the future with more centralized control over most of the segments? Is that also part of the thinking? Or is this just a basic accounting change?

Jose Bayardo - National Oilwell Varco Inc - SVP, CFO

Good morning, Waqar, its Jose. It's really just a simple accounting change. So operationally and reporting-wise, things remain exactly the same. We just felt that it was appropriate to take out what we felt are truly corporate overhead costs from -- take that out of the segment results. So very simple change.

Waqar Syed - Goldman Sachs - Analyst

Okay. And then just on the M&A side, could you highlight -- and this is something you talked about for a while -- there were some small acquisitions? Are there any opportunities for some meaningful M&A as well?

Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

Yes, we've had conversations continually with potential attractive organizations that are larger than we did in Q1. And continue to work those conversations. But as the oilfield activity has gone down every single quarter for the last five or six quarters, I think all parties are seeing how this plays out, and we are as well.

We do think its steadily become more of a buyer's market, frankly, for the past year and a half. So we're trying to be very selective, very disciplined in our application to capital, and so we're looking at opportunities but nothing to report yet.

Waqar Syed - Goldman Sachs - Analyst

Given the market environment, and your liquidity and cash flow position, what is the maximum enterprise value type transaction that you can do?
Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

I think it really depends on financing. We are fortunate in that we have a lot of liquidity and access to capital presently, but I think we would view an all-cash acquisition differently than one which may involve equity. Suffice it to say we’re looking at -- this is the kind of market that produces opportunity and so we’re looking hard at potential things that we can deploy capital into opportunistically in a downturn like this.

Waqar Syed - Goldman Sachs - Analyst

Okay. Thank you very much.

Operator

Our next question comes from the line of Bill Herbert with Simmons. Your line is now open. Please proceed with your question.

Bill Herbert - Simmons & Company International - Analyst

Thank you, good morning. Jose, forgive me for asking this question because you went through it, but it was hard to keep up with regard to the writing. So on Rig Tech, did you say that for the second quarter revenues down 30% quarter on quarter and sequential decrementals of 30%?

Jose Bayardo - National Oilwell Varco Inc - SVP, CFO

On Rig Systems.

Bill Herbert - Simmons & Company International - Analyst

On Rig Systems, sorry about that, yes.

Jose Bayardo - National Oilwell Varco Inc - SVP, CFO

That's correct.

Bill Herbert - Simmons & Company International - Analyst

Okay, so that's -- just kind of doing this on the fly here -- that seems like it's like about it 8% margin or something like that for the second quarter? A couple questions on this front. One, Clay, as it sounds like you're increasingly cautiously optimistic about the second half of the year, with regard to the visibility that you're seeing. So is that a reasonable premise to assume that Q2 margins for Rig Systems are likely to trough?

Secondly, given the mix shift in your business and prior, call it, midcycle operating margins not EBITDA margins, call it 20% to 25% -- not peak but sustainably strong margins. How should we think about midcycle margins for this business going forward given the mix shift in your business?

Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

Well, first with regards to Rig Systems, I'm not prepared to call bottom on [margins] where, as we kind of touched on a little earlier in the call, that business is frankly just more challenged as construction projects continue to wind down past Q2.
Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

And we’re managing what we can, which are costs, right, to respond to where we land. What I would say, though, is in terms of the second half recovery, my comments were more directed to Wellbore Technologies and Completion and Production Services, specifically.

Where we are getting very, very anecdotal, but a few customers really talking explicitly about the second half recovery, and quotation volumes around that potential scenario starting to go up. I’ll stress, Bill, these are quotations, not POs.

Bill Herbert - Simmons & Company International - Analyst

Okay.

Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

We will see how that plays out, but we are encouraged by that. In terms of sort of midcycle, peak cycle kind of EBITDA margins, we’ve always been attracted to sort of high operating leverage businesses and we have a lot of that in our mix, one. Two, there’s been an awful lot of cost reductions underway, both in our enterprise and around the industry. And the really great thing about the recoveries, when they come, is that it doesn’t take much incremental volume to flow in and you really have become sort of hyper efficient at generating profitability out of that. We’ve seen that in prior upcycles. When the turn comes, you’ve got a lean, mean fighting force out there executing very skillfully, very efficiently.

Then when the volume comes beyond that, you start to get a little more pricing leverage. So you can start to undo some of the discounting that happened in the prior downturn. So the earnings power of these businesses on an upslope into a recovery are extraordinary.

Bill Herbert - Simmons & Company International - Analyst

But the mix shift from offshore to predominantly onshore, that doesn’t necessarily change with the margin profile over the course of a recovery? Or is it just purely a revenue delta operating incremental –

Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

if you’re talking about the land rig business, it’s a little – in the past its been a little more challenging because it’s more competitive. But that’s in the old days of blacksmith iron. Looking forward, tier 1 AC powered rigs with sophisticated control systems are going to inherit the future. I would submit that’s probably a more attractive set of prospects in that space, so I think that will help.

With regards to that -- to the other parts of these portfolio -- it varies a lot business by business but generally, I think we’ve demonstrated pretty good operating leverage and an awareness of pricing leverage when those opportunities arise that we’ll certainly capitalize on. Again, that’ll fuel pretty strong earnings power in the recovery.

Bill Herbert - Simmons & Company International - Analyst

All right, thank you.
Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

You bet.

Operator
The next question comes from the line of Darren Gacicia with KLR Group. Your line is now open. Please proceed with your question.

Darren Gacicia - KLR Group - Analyst

Thank you for taking my question. There's a lot of talk on this call, of shifting attention towards more consumable [energy] business and shortcycle businesses with focus on wellbore and completions. What I was trying to get a sense of, if you break it down product by product a little bit, is -- what are the conversations with clients across those product lines?

When you think about lead times to delivery -- if you were actually going to see an improvement in the commodity market and see an improvement in activity, when would you have to start seeing that? For those discussions you'd have to be able to supply that activity when you think about those two segments.

Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

We have an abundance of capacity so as soon as a purchase order comes in, I think we can respond pretty quickly. From a macro perspective, though, I do think commodity prices have to go up and have to stay there a while before you really see activity and purchasing follow that. As customers repair balance sheets and basically get comfortable that commodity prices are going to stay high for a while. So the activity recovery will lag the commodity price recovery, I believe.

But when the activity recovery comes, we are very encouraged and anxious to move forward with a lot of the new ideas that we outlined in the call. And again, we think these are going to be very impactful ideas, new and innovative ways to reduce marginal cost of production from all sources of production is going to create a lot of opportunity for NOV. We're looking forward to that day and ready to go. Right now they're just conversations, not purchase orders, but the conversations with customers around applying innovation, increasing efficiency are encouraging.

Darren Gacicia - KLR Group - Analyst

Got it. If I could follow up -- just thinking about Rig Aftermarket. When you need to put rigs back to work, I'm assuming that they're going to have to -- a lot of these companies, a lot of the rig operators will have to contact you first, whether it's land or offshore, to do some work given the underspend that's been reflected in what's happened in Rig Systems and Aftermarket.

When -- have -- it sounds like there was some commentary earlier that some of those conversations at least have started to happen? Can you give a little color on that and how you would expect that to proceed in front of activity recovery?

Jose Bayardo - National Oilwell Varco Inc - SVP, CFO

Hey, Darren. I think as we mentioned, the inbound inquiries regarding -- from customers thinking about the second half of the year and beyond, trying to just make sure that they are prepared as possible for their -- to respond to their customer needs, are starting to pick up as commodity prices have picked up a little bit and as the sentiment has been a little bit more optimistic regarding a second half recovery.
So we’re certainly seeing more inbound calls from people who have numerous rigs stacked in their yard, who are thinking about what’s going to be necessary in order to put those rigs back to work. And also, related to the timing, just ensure that those parts and service capacities in place to help them out.

Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

And in a world that has more rigs than it needs right now, too, they’re thinking through, how do I differentiate my rigs? So a lot of -- in terms of the color of these conversations, a lot of this is around, can I add a new control system, can I add a new capability to my rig? (Technical difficulty) trying to differentiate their rigs in a crowded marketplace. Most of the second half recovery inbound calls that I’m referring to, although we’ve had some in Rig Aftermarket, I’d say Wellbore Technologies and Completion and Production Solutions are (technical difficulty)

Darren Gacicia - KLR Group - Analyst

If I could squeeze just one more in? For the Brazil backlog adjustments, and talks about reducing your overhead, have the overhead adjustments already taken place in Brazil or is that been sort of a drag that may go away given the fact that [you accounted for this differently]?

Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

They’ve been coming down over time. We’ve been responding. And I think we’ve disclosed, quarter by quarter our Brazilian revenue has been slowing dramatically as project by project we’ve been either requested by one of our shipyard customers or due to lack of payments have slowed work, so that’s come down.

But also I point out Brazil is still the second-largest deepwater drilling market in the world right now, and we still have significant business in Brazil. So we've made investments down there to support the program. Our expectation is we're going to sort of shift those to more support ongoing drilling activity in the future. But we've been trimming the cost position there along the way.

Darren Gacicia - KLR Group - Analyst

Thank you very much.

Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

You bet.

Operator

And our next question comes from the line of Byron Pope with Tudor Pickering Holt. Your line is now open. Please proceed with your question.

Byron Pope - Tudor, Pickering, Holt & Co. Securities - Analyst

Good morning. Just one quick question. Clay, NOV is the dominant independent provider of downhole tools in the directional drilling industry. So to think about the acquisition of Tolteq, and you are about to run your first low-cost rotary steerable tool in the hole for a customer next week, could you just speak to some of the trends that you see evolving in that business? Are we moving toward an environment where rotary steerables are going to start to compete with more conventional methods of directional drilling? Just curious how you see that business evolving over time?
Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

Well, there's -- using rotary steerable technology, I think, makes for more accurate geosteering, makes for smoother wellbores so you avoid production problems with, for instance, ponding and pooling of produced water in the low spots in the lateral, stuff like that. So it's fundamentally a better technology and but it's a previously -- it's been a very expensive technology over the years and so I do think it makes sense, since it's a better way it will continue to move forward and so we're pretty excited about the prospects.

Byron Pope - Tudor, Pickering, Holt & Co. Securities - Analyst

Okay. Good for me. Thank you.

Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

Thank you, Byron.

Operator

This concludes today's Q&A session. I will now like to turn the call back over to the speakers for closing remarks.

Clay Williams - National Oilwell Varco Inc - Chairman, President & CEO

Thank you all for joining us and we look forward to speaking with you again in late July on our second-quarter results.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program and you may now disconnect. Everyone have a great day.