NOV, Inc.
Third Quarter 2021 Earnings
Conference Call Remarks

BLAKE MCCARTHY
Vice President, Corporate Development & Investor Relations

Welcome everyone to NOV's third quarter 2021 earnings conference call. With me today are Clay Williams, our Chairman, President, and CEO, and Jose Bayardo, our Senior Vice President and CFO.

Before we begin, I would like to remind you that some of today's comments are forward-looking statements, within the meaning of the federal securities laws. They involve risks and uncertainty, and actual results may differ materially. No one should assume these forward-looking statements remain valid later in the quarter, or later in the year. For a more detailed discussion of the major risk factors affecting our business, please refer to our latest Forms 10-K and 10-Q filed with the Securities and Exchange Commission. Our comments also include non-GAAP measures. Reconciliations to the nearest corresponding GAAP measures are in our earnings release available on our website.

On a U.S. GAAP basis for the third quarter of 2021, NOV reported revenues of $1.34 billion and a net loss of $69 million. Our use of the term EBITDA throughout this morning's call corresponds with the term "Adjusted EBITDA" as defined in our earnings release. Later in the call, we will host a question and answer session. Please limit yourself to one question and one follow-up to permit more participation. Now, let me turn the call over to Clay.

CLAY WILLIAMS
Chairman, President, and Chief Executive Officer

Thank you, Blake.

For the third quarter ended September 30, 2021, NOV once again posted strong orders, with consolidated book-to-bill of over 150%, reflective of steadily strengthening commodity prices and oilfield activity. However, NOV's consolidated revenue declined 5% sequentially, and EBITDA fell to $56MM during the third quarter.

I'll start by reminding everyone that our second quarter financials included credits related to a project cancellation settlement within Rig Technologies, which contributed $74MM in revenue and $57MM in EBITDA. We excluded those credits from our discussion on our last call, and excluding these credits again from the sequential comparison today points to consolidated third quarter revenues that were essentially flat- down only $2MM sequentially, and EBITDA that was up, with EBITDA margins on this basis rising from 3.5% to 4.2%.

Through the quarter, we continued to face logistical and supply chain challenges, which our teams are managing pretty effectively day-to-day. Nevertheless, these weighed on results in certain areas, most notably in Southeast Asia. We recognized a $12MM charge stemming from a combination of COVID disruptions and execution challenges on a large offshore project within our Completion & Production Solutions segment, which I'll describe more fully in a moment.

If we look beneath the surface, the trajectory within our business is somewhat more positive, in our view, than the headline numbers suggest, and our outlook for 2022 and beyond continues to strengthen. In fact, given 1.) stronger oil and natural gas prices lately; 2.) the emergence of many of our key offshore drilling customers from bankruptcy; 3.) the significant reductions in costs that NOV has achieved through the past two years; 4.) our third quarter in a row of sequential double-digit top line growth and solid flow-throughs for our Wellbore Technologies segment; and 5.) book-to-bill's in excess of 100% for the second quarter in a row for both the Completion & Production Solutions and Rig Technologies segments- I am decidedly more positive about the outlook for the coming year.

Nevertheless, global supply chain issues are making business challenging in the short run, which leads me back to the project for which we took charges.

Our Completion & Production Solutions segment has been working on a large project in a Southeast Asian shipyard that ran into COVID-related operational disruptions; specifically, a combination of shipyard shutdowns, labor quarantines, and shortages of critical components. Additionally, our sub-suppliers in the region have faced similar disruptions, which also affect project execution. Our team is working closely with our customer to figure out how to get this vessel built and online as efficiently and as safely as possible, while recognizing the need to be resilient as challenges shift and change daily.

Across the company, we are intently focused on executing effectively in the face of persistent supply chain challenges globally. Most COVID operational disruptions have been in Southeast Asia and continue to disproportionately affect the Completion & Production Solutions segment, owing to its large bases of operations there.

Similar to other industrial manufacturers that you read about in the financial press, we are facing inflation in labor, raw materials, and components that we buy from subcontractors, but our teams have been diligent in pursuing alternate supplies, and we are generally able to offset most of the cost inflation with higher pricing to our customers. Supplies of resin, epoxy, and fiberglass, integral to our composite pipe and Tuboscope tubular coating businesses, remain critically low and, in some instances, have nearly doubled in cost. Lead times for forgings have extended out from six weeks to 18 weeks. And, while prices for plate steel and coiled steel are now up more than 240% year-over-year, at least we appear to be seeing some stability in steel pricing as iron ore prices have declined. We are hopeful the worst of the steel inflation is behind us.

Outside of steel, epoxy, fiberglass and other raw materials, I'd say we have generally seen low double-digit cost increases on other finished or semi-finished components that we buy. Semiconductor boards, chips, electric motors, gearboxes, and other sub-assemblies remain in very tight supply.

Freight has also been challenging. Spot container shipping rates from Asia to the U.S. are now five times what they were this time last year, 14 times what they were in 2019. Additionally, ocean freight reliability is down to 38%, about half of where it was historically, which has led to more use of expensive air-freight. It's more reliable than ocean freight but it drives costs up. One NOV business unit went two months without steel deliveries because our European steel mill supplier could not secure a vessel into port without guaranteeing it a full load. In North America, trucks and drivers can be tough to secure, and hotshot drivers are dropping booked shipments to take higher priced jobs, making even domestic land deliveries less reliable.

Labor availability, particularly in the U.S., is very tight in certain areas, and we have stepped up recruiting and are redeploying some workers into new assignments. Our customers are also encountering these challenges; in fact, we are hearing of many instances of crew availability delaying planned equipment reactivations in West Texas and elsewhere.

These challenges are affecting our customer behavior in other ways, too. NOV products like fuel handling pipes and tanks, pumps, mixers, etc., that go into larger construction projects, are facing headwinds in certain instances because our customers can't secure other complementary components, or can't secure a construction crew to install them, so they are delaying project launch and delaying orders to us.

I want to stress: thus far, NOV's team has done a good job covering inflationary cost pressures in the form of price increases. As market leader in many categories of equipment, we benefit from scale with our suppliers, vis-à-vis our competition, and we have moved raw materials across our manufacturing plants to maximize value. Some of our businesses are achieving price-driven margin expansion as they recover discounts given during the downturn of 2020. And while a few products with longer production cycles like drillpipe have struggled to stay up with raw material cost increases on orders taken in early 2021, resulting in some margin compression, most are at least able to hold margins through pricing. But all are intently focused on managing inflation risks that continue to mount.

Our businesses are reducing costs. Completion & Production Solutions identified an additional $50MM of annual cost reductions, including shuttering another half-dozen facilities over the next few quarters. While volumes and margins are clearly not yet where they need to be to generate sufficient returns, the organization's intent focus on downsizing over the past several years, together with higher orders and oilfield activity on the horizon, give us confidence that we are moving in the right direction.

We share the view expressed by others that the world is moving into a multi-year upcycle in commodity prices. The combination of significant money supply growth; economies emerging out of pandemic lockdowns; underinvestment in oil and gas exploration and development over several years; higher cost of capital for E&P's; and flattening efficiency gains for NAM shale producers, will lead to tightening petroleum supply/demand, in our view.

In its current shape, the oilfield will struggle initially to respond to calls for increased production. So far, incremental drilling activity has been cautious and measured. Our land drilling customers tell us they find it difficult to crew rigs even though the rig count is still well below pre-pandemic levels, and the green crews they can hire cost more and are less productive. The industry will have to pay more to get back the expertise that it has lost.

The industry is also paying more for the capital it employs. Following OPEC's decision to let market forces rule on Thanksgiving 2014, U.S. shales emerged as the swing source of oil, characterized by fairly rapid responsiveness to commodity prices.

This was made possible by two things: the resourcefulness, technology and efficiencies of the U.S. oil & gas industry; as well as large, easily-accessible pools of low cost capital in the form of both equity and debt from Wall Street. However, poor returns on capital investments came into increased focus by 2019, and this, coupled with a widespread move to decarbonize investments by many capital providers, led to a sharply higher cost of capital for the very capital-intensive oil & gas industry. Consequently, the U.S. operator base has necessarily embraced capital discipline as its new ethos.

Going forward, it stands to reason that the U.S. unconventional market will be more challenged to fulfill its role as the world's quick-cycle oil supplier now that its constituents are more focused on returning capital to shareholders and reducing re-investment rates. Further, we believe rising utilization of oilfield services assets, depletion of consummables, and higher labor costs will drive up pricing by oilfield services providers. We are hearing stories from the field of drilling contractors not willing to reactivate incremental rigs unless they can secure contracts at higher day-rates and of pressure pumpers not adding incremental crews unless they can achieve a certain degree of net pricing improvement, which is required to get a payback on incremental costs of equipment reactivation. Higher well construction costs made worse by overall diminishment of efficiency, as green crews man incremental units going to work, will impact returns on shale wells, which will reduce the industry's responsiveness to higher commodity prices, in our view.

As economies and demand recover, OPEC spare capacity trickles back into the market, and oil supply/demand gap becomes more evident, we think the industry response will be more broad-based than just U.S. shale ramping activity. Much of the world's international and offshore oilfield equipment has been stacked and neglected for some time and will require significant investment to bring it back to working order. One of the most interesting trends we observed in the third quarter was a rising number of inquiries around potential offshore rig reactivations. Despite the level of contracted offshore rigs declining sequentially, and, I'll add, a low level of actual offshore rig equipment orders for us (outside of the 20K psi pressure control equipment order for Transocean), we are being quietly asked to quote on several stacked rigs that are looking at coming back to the market. This is being driven by rig tenders currently being floated by NOC's and others, who are also looking at higher levels of activity onshore in certain international markets.

So, to sum up where the industry is now, E&P operators worldwide are enjoying new-found prosperity as their existing production commands higher prices, but they will certainly pay more for constructing new wellbores and bringing on more production in the near future. Oilfield service providers, which are NOV's primary customer base, are just now starting to claw back discounts given last year while simultaneously facing higher labor and component costs and constraints. We see them raising their prices materially over, say, the next 18 months, as prosperity trickles down to this level in the food chain. NOV's late-cycle manufacturing businesses will follow suit, as prosperity continues to trickle down. As a reminder, all three of our segments engage in manufacturing, which blossoms a bit later in oilfield upcycles given the trickle down nature of our ecosystem. Rig Technologies has benefitted strongly from its exposure to offshore wind development, which has helped offset some of the weakness it's seen in demand for traditional drilling equipment. Completion & Production Solutions has felt the brunt of the oilfield downturn, but its recent additions to backlog point to a brighter future. And although Wellbore Technologies manufactures some capital equipment like drillpipe, it tends to behave more like a traditional oilfield service provider, and it is clearly recovering quickly.

Throughout the downturn, NOV has continued to invest in technologies that improve efficiencies, reduce labor, and optimize operations. Whether it's through automating the drilling process through our NOVOS operating system accompanied by our new rig-floor robotics, delivering downhole data in real-time through our wired drillpipe, or reducing the emissions profile of a completion site with our Ideal eFrac fleet, NOV's oilfield product portfolio continues to evolve to enable our customers to achieve better operational performance.

Concurrently, we are also developing offerings that will help our customers in their pursuit of a low-carbon future. Our offshore wind installation vessel business won two packages from Cadeler and remains on track to achieve a revenue run-rate of $400MM by Q4 of next year. In addition, we were awarded our first FEED study for a carbon capture system aboard an FPSO in Asia, utilizing our extensive gas processing expertise. And as our other efforts in onshore and offshore wind, solar, geothermal, biogas, and carbon capture utilization & storage continue, NOV is positioning itself as a leading technology provider to the Energy Transition, just as it is to traditional oil & gas.

On the whole, we are increasingly confident that NOV is approaching an inflection point where the hard work our team has put in over the past several years will bear fruit in a big way. To the employees of NOV who are listening today, thank you for your extraordinary efforts. Your hard work, creativity, and dedication have set us up for success in the opportunities that are coming our way. Thank you.

With that, I will turn it over to Jose.

JOSE BAYARDO
Senior Vice President and Chief Financial Officer

Thank you, Clay.

NOV's consolidated revenue in the third quarter of 2021 was $1.34 billion, a 5% decrease compared to the second quarter. Adjusted EBITDA was $56 million, or 4.2 percent of sales. Excluding the credits from the rig cancelation in the second quarter, revenues were essentially flat, with cost reductions more than offsetting charges taken for our project in Southeast Asia.

During the third quarter, we generated $105 million from cash flow from operations and $66 million of free cash flow. We ended Q3 with net debt of $36 million, comprised of long-term debt of $1.70 billion and cash and cash equivalents of $1.67 billion.

Moving to segment results.

Wellbore Technologies

Our Wellbore Technologies segment generated $507 million in revenue during the third quarter, an increase of $44 million or 10% sequentially. Revenue improved 6% in North America and 13% in international markets as the momentum of the global recovery continued to build in all major geographical regions. EBITDA improved $14 million to $77 million, or 15.2% of sales, as inflationary pressures and a less favorable mix limited incremental margins to 32%.

Our ReedHycalog drill bit business posted another quarter of double-digit revenue growth, driven primarily by strong performance across the Western Hemisphere and Middle East. Our leading-edge cutter designs and bit technologies continue to drive revenue growth that exceeds the rate of improving global drilling activity. While this business faces many of the supply chain issues faced by all global manufacturing businesses, and at times has been forced to substitute higher cost materials to meet delivery schedules, management has been successful in raising prices to offset costs with minimal customer pushback as the efficiencies gained by ReedHycalog's technology more than justify higher pricing.

Our Downhole Tools business realized a 5% improvement in revenue during the third quarter. Top line growth was constrained by shortages of key materials and therefore did not fully reflect the demand we are seeing for our downhole technologies, which continue to enable record-setting drilling performance. Our Agitator™ system was recently used to help a customer establish a new rate-of-penetration benchmark in Colombia, delivering a field record rate of penetration of 201 ft/hr. Our SelectShift™ downhole adjustable motor was used by a large operator in the Northeast U.S. during a 12 well drilling campaign and drove a 30% reduction in average drill times due to the tool's ability to change bend settings downhole, saving trips out of the hole.

Our Wellsite Services business posted double-digit revenue growth primarily driven by growing demand for solids control services and equipment sales in international markets. While the business unit saw improvements in all regions, the North Sea and Latin America were particularly strong and offshore job counts improved by 17%, sequentially despite the impact of hurricanes in the Gulf of Mexico during the quarter. Recent tendering activity points to continued improvement in the outlook for our Wellsite Services business unit.

Our MD Totco™ business realized double-digit sequential revenue growth with strong incremental margins. Higher global drilling activity levels drove demand for sales and rentals of our surface sensor data acquisition systems, and we saw a sizeable pickup in revenues from our digital solutions. We were recently awarded an additional three-year contract from a customer in the North Sea for our eVolve digital drilling optimization services, which leverage high-speed telemetry from our InteliServe™ wired drillpipe. We also secured several international contracts for our WellData remote drilling monitoring solution, which allows operators to easily analyze well performance against offset wells, identify potential upcoming trouble spots, and oversee drilling efficiency across all wells from any location. Looking forward, we anticipate our legacy data acquisition offering will continue to benefit from rising activity levels and market share gains, and we expect our digital offerings will continue to gain greater market adoption by operators looking to extract additional operational efficiencies to offset inflationary pressures.

Our Tuboscope business experienced a mid-single digit sequential increase in revenue driven by improving demand for our coating and inspection services. While demand is strong and our backlog of inspection and coating projects has grown, revenue growth was hindered in the third quarter by operational disruptions related to Hurricanes Ida and Nicholas and a Covid outbreak at a key coating facility. Additionally, constrained supplies of raw materials limited our ability to capitalize on our backlog and resulted in higher costs as we were required to air freight resin from Asia to the U.S. to meet certain customer delivery requirements. In the fourth quarter, we expect operational challenges to subside, allowing for the business unit to capitalize on its growing backlog and improved pricing to drive better results.

Our GrantPrideco drill pipe business posted solid topline growth on higher volumes. EBITDA flow-through was restrained due to a less favorable sales mix and inflationary pressures. New orders remained solid, with a notable improvement in demand for larger diameter premium pipe. U.S. operators are showing an increasing preference for 5.5" drillpipe, which, unlike smaller diameter pipe sizes, is in limited supply. Additionally, operators are specifying specific grades of drill pipe in recent offshore rig tenders, driving additional demand for premium pipe. While fourth quarter results will be muted by ongoing supply chain challenges and cost inflation, recent orders, growing global drilling activity, and improved pricing have us increasingly optimistic regarding 2022.

For our Wellbore Technologies segment, improving global activity levels, partially offset by lingering supply chain challenges, should allow for sequential revenue growth between 3 to 6 percent in Q4. We expect improving absorption in our manufacturing facilities and better pricing to be partially offset by supply chain challenges and continued inflationary pressures, limiting incremental margins to around 20 percent in the fourth quarter.

Completion & Production Solutions

Our Completion & Production Solutions segment generated $478 million in revenue during the third quarter, a decrease of $19 million, or 4% sequentially. EBITDA for the quarter was a loss of $5 million or 1.0% of sales.

Orders during the third quarter were $384 million, yielding a book-to-bill of 144%, with all but one business realizing a book-to-bill greater than one. Backlog for the segment ended approximately $100 million higher sequentially to end the quarter at $1.1 billion. A second consecutive quarter of strong order intake along with constructive ongoing customer dialogue give us growing confidence in the sustainability of this higher level of orders as we head into 2022.

Our Intervention and Stimulation Equipment business experienced a double-digit sequential decline in revenue on lower capital equipment sales. Impact to EBITDA was limited primarily due to an improved sales mix resulting from steady global aftermarket sales activity. New capital equipment orders remained light but improved sequentially. In North America, we are seeing higher quoting activity, particularly around dual-fuel conversions, reactivations, and rebuilds, with the average size of quotes increasing as the industry is now preparing to take its "last-mile" of inventory off the fence line. We are also seeing more inquiries on bulk cementing and pumping equipment to support increasing drilling activity levels. Prospects for the international markets are equally, if not more, compelling. As one of our customers described on its conference call, lower spending by service companies in international markets for more than half a decade and improving activity is resulting in tightening supply of equipment. Although orders remain light, we're seeing growing inquiries for pressure control equipment in many regions around the world and greater inquiries around next generation coiled tubing equipment, particularly for the Middle East and in former Soviet bloc countries.

Our Fiberglass business unit saw relatively flat sequential results, as improving demand across the business' end markets was offset by continued supplier disruptions. Global supplies of key raw materials, such as resin and glass, remain extremely tight, a condition we expect to extend over the next few quarters. Additionally, while we are experiencing fewer direct effects of COVID, such as government mandated lockdowns, we are now working through derivative effects in the form of ongoing logistical challenges and even power shortages, which are occasionally shutting down our operations in China. Despite these headwinds, the outlook for the business is strengthening, driven by increasing oil and gas activity in the Middle East, improving marine and offshore activity in Southeast Asia, and continued strong demand for our fuel handling products.

Our Process and Flow Technologies business realized a high-single digit sequential decrease in revenue. Clay described the significant operational challenges this business faced during the quarter, and, while operational challenges will linger into the fourth quarter, we remain optimistic regarding the longer-term outlook for this business. We're seeing growing demand for chokes and pumps, for gas processing equipment, and for FPSO process modules. And, as Clay highlighted, we anticipate additional opportunities to showcase the carbon capture, usage, and storage skillset we've been cultivating within this business unit.

Our Subsea flexible pipe business realized a low-double digit percentage sequential increase in revenue with strong EBITDA flow through due to solid execution and a better sales mix. Indicative of the improving outlook for offshore activity, orders improved sequentially, achieving their highest level since 2019, resulting in a book-to-bill that exceeded 140% for the second straight quarter. Outlook for orders remains solid and we expect to continue replenishing the business' backlog and move prices higher.

For the fourth quarter of 2021, we anticipate our Completions & Production Solutions segment will continue to face COVID and supply chain challenges, but improved backlogs and growing aftermarket activity should allow for segment revenues to improve 10-15% with incremental margins in the mid 30% range.

Rig Technologies

Our Rig Technologies segment generated revenues of $390 million in the third quarter, a decrease of $97 million or 20% sequentially. Excluding the $74 million in revenue recognized in the second quarter from the settlement of the offshore rig project cancelation, revenues declined $23 million sequentially, primarily due to the timing of certain projects nearing completion during the third quarter. Adjusting for the impact of the offshore rig project settlement, EBITDA increased $7 million on improved sales mix and cost savings.

Orders for the segment increased to $300 million, yielding a book-to-bill of 190%. Once again, wind installation vessel equipment orders comprised over half of our bookings as we continue to establish ourselves as the most trusted provider of vessel designs, jacking systems, and heavy lift equipment to the offshore wind industry. As Clay mentioned, we remain on track to achieve an annualized revenue run rate of $200 million by the end of this year and a run rate of approximately $400 million by the end of 2022. Additionally, we remain optimistic that the number of offshore wind installation vessel projects will continue to grow.

Rig capital equipment orders improved for the second straight quarter, highlighted by an award for our third 20,000-psi BOP project. Last quarter, we noted a growing sense of optimism from our offshore driller customer base, which we believe continues to build. The global offshore rig count is trending higher, and rig tendering activity is growing more active in Brazil, West Africa, the Middle East, and Southeast Asia. One of our customers recently indicated that it expects to have the entirety of its fleet under contract by the end of 2021, a remarkable feat considering where the industry was just 12 months ago. With fleets of "hot rigs" approaching full utilization and operators unwilling to accept rigs that are not in near-perfect condition, a number of our customers have approached us about rig re-certifications, upgrades, and potential reactivation projects. Most of the upgrade conversations have centered around BOP equipment, automation, and emissions-reducing technology like our Powerblade™ offering. We expect most near-term reactivations to be centered around rigs that are in relatively good shape and will only require modest overhauls, but as we get deeper into the stack, the scope of these rig reactivation projects will grow significantly, and, in turn, so will the revenue opportunity for NOV.

Demand for land drilling equipment remains low, but we are seeing positive developments in land markets. As the rig count recovers in the U.S., there is clear preference for rigs that have leading edge torque, flow rate, and pressure capabilities along with larger setbacks to efficiently handle larger diameter drillpipe. Operators are also demanding the latest control systems and automation capabilities, with interest in our NOVOS and multi-machine controls growing stronger by the day. The domestic rig fleet is quickly approaching full utilization of rigs meeting the desired specifications, and day rates are rising, leading to increasing inquiries for land rig upgrades that will bring currently idle rigs into this ultra-premium rig class.

In our aftermarket business, we realized our third straight quarter of improved spare parts bookings, and, based on what we've seen to date, we expect this trend to continue into the fourth quarter. After more than half a decade of rationed maintenance, spending is beginning to normalize as offshore drilling customers gain more confidence in their capital structures and business outlook. We also saw a 30% sequential increase in the number of quotations by our field engineering group, predominantly driven by the customers I described earlier who would like help from our engineers in determining the requirements to reactivate their stacked rigs.

Looking ahead, we find ourselves becoming increasingly optimistic about the prospect of improved financial results from our Rig Technologies segment in 2022 due to several specific segment tailwinds:

1) Improving maintenance spend from our contract drilling customer base;
2) Growing pipeline of potential rig reactivation projects;
3) Ramping production from our rig manufacturing operations in Saudi; and
4) Increasing rate of converting wind installation vessel backlog into revenue.

Near-term, our Rig Technologies segment must contend with the same headwinds currently faced by all global manufacturers, primarily supply chain and labor shortage issues, which will likely blunt incremental operating leverage. For the fourth quarter, we expect revenue for the segment to grow 8 to 12 percent with incremental margins in the mid-teens.

With that we will now open the call to questions.