National Oilwell Varco, Inc.
First Quarter 2019 Earnings
Conference Call Remarks

LOREN SINGLETARY
Vice President, Investor and Industry Relations

Welcome everyone to National Oilwell Varco's first quarter 2019 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 first quarter of 2019, NOV™ reported revenues of $1.94 billion and a net loss of $77MM or ($0.20) per share.

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, Loren.

In the first quarter of 2019, NOV generated $1.94B in revenue, a decrease of 19% sequentially and an increase of 8% year on year. EBITDA was $140MM, down $139MM sequentially, representing 30% decremental leverage as EBITDA fell by half.

Late last year we witnessed one of the sharpest and fastest declines in oil price on record, as WTI fell to $45/bbl, along with rising demands from investors that oil companies exhibit more capital discipline and austerity. Oil companies responded by signaling their plans to trim capex and reduce activity as we entered 2019. NOV's largest customers, the oilfield service companies that execute well construction plans for these oil companies, in trying to divine what the new year would hold, all seemed to decide that discretion is the better part of valor, and they threw the brakes on their spending for the tools they buy from NOV. Oilfield service companies are skilled at slashing spending during market slowdowns, and our phones went quiet in December and January. Our poor first quarter financial results reflect the sharp air pocket that arose from this latest round of capital austerity following that oil price dip. Broadly speaking, the factors we cited on our last call underpinning our revenue guide down to be down in the low-teens, ended up hitting with more ferocity than we expected, leading revenues down 19% sequentially instead.

While the outlook remains uncertain, WTI rebounding into the $60 range, and Brent into the $70 range, has helped improve our outlook, particularly in the offshore and international markets. Our investor day analysis showed just how physically asset-intensive oilfield operations are and the amount of equipment that gets consumed for every barrel developed. That physical linkage between equipment and oil means that while oilfield service companies can cut spending and cannibalize idled equipment and make due in the short run, eventually they need to repair and replace their capital equipment stock and must start spending again. After a very quiet start to the year, we saw orders begin to flow in again in late February and March to support activity. Book-to-bills in excess of one for Completion & Production Solutions (which booked half its orders in March), Rig Technologies, and drillpipe provide a much more constructive backdrop for the remainder of the year, and we expect our second quarter results to be significantly improved. Nevertheless, the impact of capital austerity on the speed and nature of the more robust oilfield recovery we have been hoping for remains unknown and out of our control. Therefore, we are renewing our focus on controlling what we can—our costs. NOV underwent significant downsizing between 2015 and 2017, which took out $3 billion in annual costs and helped the organization generate over $2 billion in free cash flow over the same period. However, given the current market and outlook, the Company's earnings are insufficient, and good stewardship dictates we undertake additional cost reductions.

For context, our businesses are highly decentralized—purposefully and strategically organized in a way that promotes a degree of autonomy for the teams that run them, who are closest to the coal face and best equipped to make the day-to-day operating decisions to maximize their performance. We have terrific, entrepreneurial leaders who we trust to manage these businesses within a collaborative network. Following our significant downsizing, our next opportunity to reduce costs will come from a reexamination of the degree of centralization of certain support functions within our organization, some of which we expect to move more toward a shared services model, to drive further efficiency. This is a heavy lift. It will take a few quarters to accomplish but is necessary to drive further profitability. While we are formulating our plans and refining savings estimates currently, we see a preliminary path to capture $120MM/year in savings, and would not be surprised for our final plans to meaningfully exceed this.

Before Jose takes you through our first quarter results, I'd like to share with you some of the trends we see developing, starting in the North American pressure pumping market.

In response to the uncertain outlook, our pressure pumping customers stopped ordering and scaled back maintenance at the end of 2018, leading to a 58% sequential decline in U.S. pressure pumping sales. Similarly, wireline and coiled tubing operators also cut spending, but the sequential decline was less severe for these, and North American coiled tubing units that customers deferred delivery have begun to move out the door in April. Despite slow demand, we are finding interest in new products we are introducing, plus we see some demand for replacement blenders, mixers, and other frac support equipment. International markets, in contrast, are strengthening, as demand for higher capacity coiled tubing, wireline, and pressure pumping units rises, which helped our book-to-bill exceed 140% for the first quarter, albeit on lower sequential volume.

Secondly, slowing drilling activity in North America and overcapacity is driving price down on certain downhole tools, surface equipment, and rigsite services. Pricing is under pressure, down mid-single-digits, on our downhole Agitator tools and shale shakers. On the other hand, we have been successful getting price increases on shaker screens, bits, and downhole drilling motors, the latter of which are up 21% YOY. We've also been able to get modest price increases in inspection services in certain regions.

Third, drillpipe demand is shifting from land to offshore. Despite land customer inventory levels within our drillpipe yard at 10-year lows, North American drillers pushed deliveries of drillpipe into the second quarter and later. This drove a sharp sequential falloff in revenue for our Grant Prideco™ business, which accounted for more than half of the total topline sequential decline for the Wellbore Technologies segment. This is not sustainable. Land drillers are demonstrating strict capital discipline, but they are consuming drillpipe daily, and they won't be able to drill when they run out.

While we're seeing land drillpipe demand slow, international and offshore markets are moving the other way, coming back to the table after years of subsisting off excess drillpipe from their stacked fleets. This quarter offshore sales increased 15% to push its mix to 39% of the total, and with three-fourths of our sales prospects now coming from offshore drillers who need to put drillpipe on rigs to reactivate them, that number is set to rise. The good news for NOV is that offshore drillers employ larger, more sophisticated drillpipe, which drives higher margins.

Fourth, the recent capital austerity and decline in the active U.S. land rig count is driving a temporary halt in land rig upgrade programs. NOV has been at the nexus of the wave of rig upgrades that continues to lift the capabilities of the active U.S. land rig fleet to be in-line with those commanding the highest dayrate—the most modern super-spec rigs. Having picked the low-hanging fruit over the past few years, however, drillers are being cautious about spending up to half the cost of a new rig to upgrade an older DC rig to high-spec AC given sliding drilling activity and flat-to-slightly-declining rig dayrates. Nevertheless, NOV's offering into rig upgrades—including NOVOS™ operating systems, low-cost drawworks, topdrive upgrades, and other enhancements—leave us well-positioned for when rig upgrades resume.

Number five. Interestingly, the pace of rig special purpose surveys and reactivations for offshore rigs is heading in the other direction. The active project pipeline we are working on has increased 30% over the past few quarters, and today we are working on more than 30 offshore rig projects, 20 of which are reactivations of stacked rigs - helping these rig owners make their assets "operationally ready" to bid on the rising number of rig tenders offshore. This is good news for Grant Prideco, as I mentioned earlier. Having offshore drilling contractors increasingly demand our low-cost-of-ownership Delta™ premium connection is as a strong signal that our market adoption is growing sustainably. Aftermarket revenues made up 54% of the Rig Technologies segment's revenues, but exhibited typical first quarter seasonal declines, despite more offshore projects. Contractors tend to deplete budgets and wrap up their repair jobs at the end of the year, and then slow activity in the first quarter until budgets are fully reset. The first quarter of 2019 saw the highest quarter of spares bookings in almost four years and a rising offshore mix, signaling continued recovery of our offshore rig business as customers replenish dwindling inventories, which were cannibalized from stacked rigs during the downturn.

Number six. Water handling and disposal is an emerging bottleneck in the Permian Basin, and produced saltwater and steel don't get along well. As the industry continues to build out the infrastructure to support the most prolific unconventional basin on the planet, operators in West Texas are calling on larger diameter spooled composite pipe and high-pressure jointed fiberglass pipe, some with diameters greater than 20 in., to handle produced water without corroding. As the largest supplier of composite pipe to the industry, this is an area NOV is very well-positioned to capitalize on. Within our TK™ fiberglass-lined downhole tubulars business, we're seeing a shift from 2⅜- and 2⅞-in. downhole tubing to 4½-in. tubing to handle higher volumes of fluids. NOV is also a leading provider of production chokes, reciprocating pumps, multiphase progressive cavity pumps, and pipeline closures into this infrastructure buildout.

Seven. North American operators are keenly focused on completions, and new technology and value are upsetting the old order of things. As completion costs have risen to exceed two-thirds of an unconventional well AFE, the potential to reduce development costs by applying newer, more clever completion tools has increased proportionally. Nimble independents are open to trying new tools and technologies that can offer a meaningful impact on their development costs and risks. In this vein, operators are partnering with NOV to cut costs. For instance, this quarter we ran our Setter composite frac plug for a major Permian operator and we demonstrated the quickest drill and wash times, and all plugs were tagged on depth. Our customer immediately awarded us a large portion of their frac plug business based on this result. We are also seeing customers around the globe test drive our liner hangers, sliding sleeves, burst port subs, and other clever completion jewelry unique to NOV.

Number eight. Following a slow first quarter start, the Eastern Hemisphere may be shaping up for incremental growth as the year unfolds. For starters, the increase in coiled tubing demand in international markets is helping offset North American declines and is signaling the adoption of technologies upon which the North American shale revolution was founded in new basins—pressure pumping equipment, wireline units, and completion tools are seeing increased adoption in Argentina and the Middle East. We held a ribbon cutting ceremony for our new fiberglass composite pipe facility in Dammam, Saudi Arabia in early April, and we also secured a substantial $50 million order there. We anticipate that the composite pipe and corrosion-resistant technologies coming out of this state-of-the-art facility will proliferate into additional markets across the region. We're continuing to see certain international land rig tenders intending to replace aging fleets in places like Argentina, which now has several of our high-end AC drilling rigs posting records. Other large rig tenders in India and the Middle East also continue to creep forward, while contractors employing higher-tech rigs in foreign markets are drilling circles around incumbents who've built their rig fleets with the cheapest iron.

Number nine. Our subsea production business remained challenged in the first quarter. While things are looking up, it continues to be a slow grind. Flexible pipe revenue fell precipitously in the first quarter, partially due to the pull-forward in deliveries at the end of the year. Encouragingly, though, first quarter orders were higher than they've been in a year, and the customer and project mix is pointing to more greenfield projects. We also expect second quarter orders for subsea projects to be strong, and we are encouraged by the improving outlook for LNG projects globally. NOV is a leading provider of gas treatment and hydrate inhibition technology, for example, offering mono-ethylene glycol reclamation units that can handle a ton of salt an hour and can cost over $100MM on a large project. We are a leading provider of loading and offloading equipment for LNG, along with the technologies that support the drilling and completion of gas wells to supply these projects.

So overall, while the first quarter was very disappointing, and our outlook remains less certain than we'd like, we see emerging pockets of demand and signs of recovery that provide a more constructive backdrop for a potential recovery later in the year. Nevertheless, the first quarter is also a reminder that we can only control what we can control and that a renewed focus on costs is warranted—all while we continue to position the company to take advantage of the opportunities that present the greatest returns.

To our dedicated employees, thank you for all you do to continually improve our organization and our industry. You are tough and resourceful, and our team and our shareholders are counting on you to help drive better results.

With that, I'll turn it over to Jose.

JOSE BAYARDO
Senior Vice President and Chief Financial Officer

Thank you, Clay.

Before jumping into the results of our operations, I would like to cover a couple items related to our balance sheet.

Effective January 1, 2019 we adopted the new U.S. GAAP lease accounting standard, resulting in a $590MM addition to our assets and an equal amount to our liabilities.

In the first quarter of 2019, working capital increased $162MM primarily due to a $145MM build in our inventory. Finished goods that we expected to ship and translate into revenue during the quarter did not make it out the door due to customer deferrals, and we took receipt of raw materials in anticipation of future orders. Declines in AR were largely offset by declines in current liabilities. While we are not pleased with the magnitude of the increase in working capital, we are confident that in Q2 we will resume progress toward realizing our goal of working capital as a percentage of annualized revenue run rate below 35% by year-end.

Turning to results of our operations.

Wellbore Technologies

Our Wellbore Technologies segment generated $807MM in revenue in the first quarter of 2019, a decrease of $77MM or 9% sequentially. Lower volumes and pricing pressure in North America for certain products drove decremental EBITDA margins of 49%, resulting in a $38MM decrease in EBITDA to $117MM or 14.5% of sales.

The segment's short-cycle, activity-driven product offerings performed as anticipated during the quarter, but the capital equipment components within this segment, namely our drillpipe business, suffered the same customer-driven equipment deferrals and slow-to-develop order book that impacted our other segments. Customers deferred first quarter deliveries of new drillpipe into the second quarter due to the sharp fall in oil prices during Q4 and the corresponding reductions in U.S. land drilling activity. The result was a much sharper than anticipated falloff in revenue, snapping Grant Prideco's streak of three straight quarters with double-digit percent revenue increases.

Improving commodity prices, a less-than-feared pullback in drilling activity, and drillpipe inventory levels that remain at historic lows brought back orders from North American customers in late Q1, albeit at a slower pace than in the last few quarters. Any momentum lost in the North American market was more than offset by a meaningful pickup in orders for international and offshore markets. Despite breaking our revenue growth streak, we achieved our fifth straight quarter with bookings in excess of $100MM and realized our highest quarterly bookings since 2014. While we're still quite far from achieving the average order intake we saw during the prior peak, we're seeing more indications of a sustainable recovery in demand for our premium drillpipe.

Wellbore Technologies' other activity-driven and less capital equipment-oriented businesses performed in line with our expectations, and their revenue in the U.S. outperformed the falloff in domestic drilling activity.

Our ReedHycalog™ business unit realized a 4% sequential decrease in revenue. The customary sluggish start to the year in international markets was partially offset by a 7% sequential increase in our U.S. drill bit business. Improved pricing and continued market share gains in West Texas drove the increase in revenue, and early wins from a cost reduction and efficiency improvement initiative resulted in meaningful incremental margins in U.S. operations. In addition to reducing the cost of our support functions, each of our business units is also working to improve operational efficiencies. ReedHycalog has identified opportunities to achieve $22MM in annual margin improvements by the end of 2019 through initiatives to reduce product costs, repair and maintenance cycle times, and supply chain inefficiencies.

While ReedHycalog's downhole measurement and steerable technologies product lines had sequential revenue declines, both businesses expanded their geographical reach into new markets around the world. Customers deployed our Tolteq™ MWD iSeries™ tools for the first time in Mexico, Turkey, and the Middle East, and we secured our first long-term rental contract to deploy VectorEXAKT™ rotary steerable tools in the MENA region.

In our Downhole business unit, revenue decreased 6% sequentially. Strong Q4 sales of fishing and drilling tools into international markets did not repeat and lower levels of U.S. drilling activity offset continued market share gains and pricing improvement in our U.S. drilling motor business. We've been able to command better pricing for our motors due to superior performance and reliability resulting from technical innovation and manufacturing quality.

Our Downhole business unit is also executing on initiatives to improve operational efficiencies. The business unit has recently optimized its global relining infrastructure, shutting down a plant in Belgium and relocating assets to remaining hubs in Dubai and Nisku, Canada, where we are focused on reducing manufacturing costs through product design and process improvement. The unit is also working to optimize field infrastructure by closing two service facilities in Canada and redeploying tools and equipment to the U.S. and other markets.

In our WellSite Services business unit, revenue decreased 9% sequentially, back to levels realized in Q3 of 2018. Strong sales of screens and capital equipment near year-end did not repeat, and job counts for our U.S. solids control operation decreased in line with drilling activity levels. Margins in our U.S. solids control business improved due to better pricing on shaker screens and better management of labor costs.

Lastly, our Tuboscope™ business unit posted a 2% sequential increase in revenue. An increase in Eastern Hemisphere OCTG pipe inspections and contributions from two small acquisitions were mostly offset by declines in our coating operations resulting from the sharp reduction in activity from Grant Prideco.

In the second quarter of 2019 we expect a meaningful recovery in our drillpipe business and improved demand from the Eastern Hemisphere to more than offset lower average drilling activity levels in the U.S. As a result, we expect revenue for our Wellbore Technologies segment to improve 3 to 5% with incremental margins in the 30% range.

Completion & Production Solutions

Our Completion & Production Solutions segment generated $581MM in revenue during the first quarter of 2019, a sequential decrease of $207MM or 26%. Revenue was below expectations primarily due to greater-than-anticipated restraint by North American oilfield service customers and a steeper-than-expected decline in our offshore businesses, with new orders not booked in time to generate expected revenue. All business units reported double-digit sequential revenue declines except for XL Systems, which is executing on the all-time high backlog achieved last quarter. The sharp fall-off in revenue and a less favorable mix of business led to 41% decremental EBITDA margins and an $84MM sequential decrease in EBITDA to $28MM, the lowest level seen through the downturn.

After a very slow start to the year, orders improved sharply in the last month of the quarter and totaled $470MM, equal to our bookings in Q4. Total segment backlog at quarter end was $1,041MM, an increase of $147MM from the fourth quarter.

Our Intervention and Stimulation Equipment business unit saw revenue fall by 25% sequentially. We anticipated a sharp decline due to a depleted backlog for pressure pumping equipment and softening demand for wireline units, but customers stepped on the brakes harder than expected and also deferred deliveries of coiled tubing and other equipment. As Clay described, customers began returning to place new orders during March and the business unit finished the quarter with its highest quarter-ending backlog since the second quarter of 2015. Despite the temporarily deferred deliveries in North America during Q1, demand for coiled tubing remains robust, and we booked sales of 22 additional units, with a notable increases coming from international markets where customers are emerging from the downturn cognizant of the contributions modern equipment and technology made to the economics of production in North America over the last decade. In Q1 our ISE business generated roughly 50% of its revenue from international markets, and we anticipate this percentage will increase over the coming quarters as the composition of our backlog looks very different today compared to the last 2 years.

Our Fiber Glass Systems business unit also posted a sharp sequential decrease in revenue as order intake deteriorated in Q4 and remained depressed through the first 2 months of the year. Orders rebounded sharply at quarter end after international customers finalized 2019 budget decisions, and West Texas midstream infrastructure companies reemerged with strong orders as commodity prices improved and they reaffirmed the basin's enormous need for produced water infrastructure. March orders accounted for approximately 60% of bookings and resulted in the business unit achieving its highest ever quarter-ending backlog.

In our Process and Flow Technologies business unit, revenue fell sharply after the completion of major offshore Wellstream Processing projects in Q4. Additionally, large shipments of pump packages to the Eastern Hemisphere did not repeat, and the North American market was sluggish. While Canada and the mid-continent remain challenged, we are seeing renewed interest in the Permian, Bakken, and U.S. Rockies for our reciprocating pumps, chokes, and closures. International markets also came back to life as the quarter progressed, with demand for production pump packages picking up in Southeast Asia, Latin America, and Africa. Notably, roughly half of the business unit's bookings came to our Wellstream Processing operation via two mono-ethylene glycol (MEG) reclamation and regeneration units destined for Asia, which helped to replenish a depleted backlog in this operation.

Clay touched on the dynamics associated with the offshore market components of our CAPS segment. Our Subsea Production Systems business unit, Floating Production Systems business unit, and the Wellstream Processing portion of

Process and Flow Technologies each experienced sequential revenue declines of between roughly 40 and 50%. While improved bookings in Q1 give us confidence in short-term improvements and emerging signs of additional greenfield projects give us optimism longer-term, our offshore backlog remains uncomfortably low. A high level of tendering activity continues, but there is no guarantee that projects will not push to the right, as has frequently occurred over the last several years.

Looking at the second quarter, we expect revenue in our Completion & Production Solutions segment to improve roughly 15%, with incremental margins in the upper 20% range.

Rig Technologies

Our Rig Technologies segment generated $603MM in revenue, a sequential decrease of $201MM or 25%. A higher margin mix of business with a higher proportion of revenue from sales of aftermarket parts and services, as well as cost controls limited decremental margins to 23%, resulting in a $46MM decrease in EBITDA to $56MM, or 9.3% of sales.

The wind-down of certain offshore projects and customer-accelerated deliveries near year-end impacted Q1 results as expected; however, slower-than-anticipated progress on remaining projects and a loss of customer urgency for land rig upgrades resulted in a sharper-than-anticipated decline in revenue.

Our aftermarket business realized a 4% sequential decline in revenue, primarily due to the seasonal falloff in service and repair work that Clay described. Our aftermarket business realized an 18% increase in revenue year-over-year, driven in large part by increased spending from offshore drilling contractors as they replenished their spare part inventories from unsustainably low levels.

Rig Technologies segment orders totaled $271MM, a sequential increase of $152MM or 128%. Headlining the order book was a drilling equipment package for the BP Azeri Central East (ACE) platform in the Caspian Sea offshore Azerbaijan. In the recent past we've stated that we did not see many near-term offshore new-build opportunities outside of a few niche applications. We've worked closely with BP and their ACE project partners over the past two years and we are excited to work with them on this unique platform that is expected to achieve first production in 2023 and produce up to 300MM barrels over its lifetime.

We anticipate our aftermarket operations will continue to realize gradual improvements but expect continued volatility in the capital equipment portion of our Rig Technologies segment as we continue to operate near cyclical lows, limiting visibility into our mid-to-longer term outlook. However, for the second quarter, we expect improved aftermarket revenue and better progress on offshore projects to be partially offset by lower land capital equipment sales, resulting in a 5 to 10% increase in revenue with incremental EBITDA margins in the upper 20% range.

While we had a challenging start to the year across all three segments, we built momentum through the quarter and grew our backlog, positioning us well for improved financial results in the second quarter. Longer-term, growing signs of a broader recovery give us optimism for better days ahead, and we know our talented people and the product offering they developed have us well positioned to capitalize on opportunities that emerge, but we are also firmly committed to delivering improved financial results at current industry activity levels.

With that, we'll open the call up for questions.