NOV, Inc.
Second Quarter 2023 Earnings
Conference Call Remarks

BLAKE MCCARTHY
Vice President, Corporate Development & Investor Relations

Welcome everyone to NOV's second quarter 2023 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 second quarter of 2023, NOV reported revenues of $2.09 billion and net income of $155 million or $0.39 per fully diluted 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, Blake.

For the second quarter of 2023, NOV reported fully diluted earnings per share of $0.39 and EBITDA of $245 million, on revenues of $2.1 billion. Adjusted EBITDA was the highest we've seen since 2019, and earnings per share were the highest since the third quarter of 2015.

Second quarter revenue increased 7% sequentially and increased 21% compared to the second quarter of 2022. EBITDA margin was 11.7% of revenue, up 180 basis points from the first quarter of 2023. Sequential EBITDA leverage was 38% and YOY leverage was 26% on the 21% top line gain. Measuring from our pandemic low point in the first quarter of 2021, revenues have improved 68% off the bottom, driving 29% EBITDA leverage. Combined book-to-bill came in just shy of one, but overall combined orders in the second quarter were up slightly compared to first quarter levels.

While lower gas prices and tepid oil prices drove North American activity and ordering lower in the second quarter, international and offshore activity continue to gain momentum. Our customers are mobilizing for significant offshore and international drilling campaigns over the next few years, which will require NOV's support.

We were pleased to see progress continue around the normalization of our supply chain in the quarter, but rapidly compressing delivery schedules for certain raw materials we buy led to higher inventories this quarter, up $163MM sequentially, as inbound inventory receipts jumped. While revenue grew 7% sequentially, inventory increased 8% sequentially, with the work-in-process portion of inventory growing 13% sequentially.

There are three reasons for the increase. First, we are catching up on receipts of castings and forgings. The pandemic shutdown drove many foundries out of business, foundries which cast high-strength steel in specialized molds to make custom, critical parts for our specialized products. Specifically, steel castings arriving during the second quarter accelerated for top drive main-shafts, IBOPs, spherical BOPs, Mission flow products, and elevators, which underpinned high production levels at certain Rig Technologies plants. We will continue to reposition our supply chain for castings for additional product lines like pumps and iron roughnecks through the remainder of the year, which we expect to keep inventories elevated through the third quarter before rolling over in the fourth quarter, which should see substantially improved cash flow as a result.

Second, Wellbore Technologies' inventories increased sequentially as we received bar stock and heavy-wall green tubes related to the drill pipe disruptions we had in the first quarter. With drill pipe backlogs up nearly $90MM YOY, these inventories will flow out over the next couple of quarters, also contributing to improving cash flow. Finally, while supplier reliability and lead times are broadly improving, we are still fighting to catch up in certain component categories. We can't ship products unless they are 100% complete. So if we have only 99% of components for one of our products in-hand, it cannot be completed; instead, it will reside in work-in-process inventory until the final part arrives. This supply chain challenge also increased our contract assets, another contributor to working capital, by $67MM sequentially, as milestone payments on large projects were delayed pending receipt of final components.

While we were pleased to see more critical inputs arriving at our plants, these supply-chain related increases contributed to a disappointing rise in consolidated working capital and working capital intensity, which increased from 31.1% of annualized revenue in Q1 to 32.7% in Q2. Since our backlogs are strong and demand high, we expect this to be a temporary condition related to the normalization of our supply chains, which should begin to turn around later in the year.

Turning back to the P&L, we can see the benefits of improving supply chain rolling through our results. Wellbore Technologies posted 8% sequential growth, at 53% leverage, on sharply improved sequential steel receipts and corresponding drill pipe shipments, which helped push EBITDA margins up to 20.4%. The Completion & Production

Solutions segment posted 5% sequential top line growth, at 43% leverage, which improved EBITDA margins by 170 basis points from the prior quarter. YOY the group was up 18% at 33% leverage. Supply chain improvements within our XL Systems and Fiber Glass businesses helped drive the stronger results out of the Completion & Production Solutions segment.

Rig Technologies segment grew 10% sequentially, but only had 4% leverage, due to a couple of items. First, sequentially higher expenses related to the full consolidation of our Keystone wind turbine tower startup business in the renewable energy space was a significant drag. Additionally, poorer mix within capital equipment, specifically more offshore crane revenue and less offshore rig revenue associated with 20K psi upgrades, and a poorer mix within aftermarket, which saw a higher mix of lower-margin service and repair revenue, contributed to the low leverage. Nevertheless, growing availability of castings, forgings and other components are expected to lift Rig Technologies' Q4 exit margins up into the low- to mid-teens.

While it was encouraging to see NOV's consolidated EBITDA margins improve sequentially, margins still remain below where they should be. In a moment Jose will offer you forward guidance which points stronger performance in the back half of the year, particularly in Q4. Nevertheless, we see opportunities for further improvement and have begun executing additional cost reduction measures which will run throughout the next four quarters, which we estimate will contribute another $75MM annually, to drive better margins and returns upon the completion of our cost reduction program.

Many of our challenges have been symptomatic of the later-cycle, capital equipment sales nature of our business. While oilfield service companies have pledged not to spend on capital, their customers, the E&P companies, like what they see when they look at the technologies we've developed. They are requiring, and some demanding, their well construction service providers enhance the efficiency of their operations and reduce their greenhouse gas emissions with NOV technology. The result is that momentum in our business is building. Post-pandemic demand has been rising as a result: backlog is up 32% for Rig Technologies (excluding the large Saudi order for 50 rigs we won in 2017) and up 96% for CAPS since the low point of Q1 2021.

Wellbore Technologies is benefitting from high offshore and international interest in more environmentally-sound drill cuttings management and greenhouse gas reduction technologies by E&P's, which helped drive significant top-line growth and leverage for our Wellsite Services business unit. Turning to drill bits, advancements in PDC cutters have produced many record bit runs for Reed Hycalog, resulting in significant market share gains in a number of key markets at premium pricing, including wellbore enlargement reamers offshore during the second quarter. Our mechanical lock cutter technologies have reduced our cost and improved our utilization of underreamers. For PDC bits, we expect the proprietary graphene cutter technology we have been developing for the past few years to drive further gains through better performance, at reduced cost, for our bits- while also allowing NOV to capture premium pricing.

NOV's presence in the digital space continues to grow, as one of our major North Sea E&P customers extended its contract for wired drill pipe high-speed data transmission from their bottom hole assemblies. It, along with other offshore E&P operators, continue to standardize on our proprietary wired drill pipe service for drilling efficiency and safety.

Our cloud-based edge computing services also continue to gain traction—18 coiled tubing customers are using our Max Completions technology to monitor and optimize 169 units in the field, and users of this product more than doubled in the quarter to nearly 1700. More major oil companies are utilizing our edge-to-cloud products to manage remote operations in real-time, with nearly 1200 assets connected to the cloud between E&P and OFS customers.

Rig Technologies continues to see strong demand for real-time monitoring of rigs around the world, including performance optimization tracking required by some IOCs, and automation lifecycle management for drilling contractors to achieve better asset efficiencies. Rig is also seeing high interest in its automated robotics products, having sold packages for 6 rigs, with the first offshore system installed and commissioned in Q2. Operators are pressing for reduced greenhouse gas emissions, leading to high interest in our Powerblade product, which significantly reduces power consumption and diesel costs for offshore drillers.

Looking ahead in the near term, we believe North America land operations will continue to slow in the third quarter pending higher commodity prices, but our drilling contractor customers here are keeping rigs ready for a resumption of higher activity in 2024. Importantly, we expect international and offshore markets to overcome these near-term North American headwinds, as most NOCs and offshore-focused IOCs are pressing forward with aggressive campaigns. Specifically, we are pleased to see growing activity in West Africa, Asia, the North Sea, and offshore Mexico, and continued strength in the Middle East, Guyana, Brazil, and North Africa. As major project FIDs grow, we see a strong sales pipeline emerging for our gas processing and FPSO products, which typically lag FIDs by 6 to 18 months. Having delivered our fourth new land rig into the Saudi market, and with a lot of interest in NOV digital technologies across the region, we are ready to drive substantially improved drilling efficiencies for NOCs around the Gulf.

As the leading independent provider of essential technologies and equipment to what is probably the world's most essential industry, NOV is positioned to benefit from years of under-investment as the industry equips itself to meet the challenge of providing energy security.

Before I turn it over to Jose, for those NOV employees listening today, I want to thank you for all that you do to take care of our customers and keep their programs on track. You are simply the best, and our customers appreciate you. I want you to know that I do, too.

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 totaled $2.09 billion, a 7 percent sequential increase, and a 21 percent increase compared to the second quarter of 2022. Revenue related to offshore activity grew 18% sequentially, and revenue from international markets grew 9%. Despite industry activity levels that declined in the U.S. and a tougher than average Canadian spring break-up, revenues from North America improved 4% during the second quarter. Adjusted EBITDA for the second quarter totaled $245 million, or 11.7 percent of sales, representing an incremental flowthrough of 38 percent sequentially.

While our margins are moving in the right direction and the later cycle nature of our business is starting to gain momentum from the significant growth in offshore and international markets, we are not content with our performance. As Clay mentioned, we are focused on improving the margins in our businesses and have begun implementing strategic actions, which will lead to approximately $75 million of annualized savings within the next twelve months. These initiatives, coupled with a strong outlook for the fourth quarter, should lift our consolidated EBITDA margins into the low teens in the fourth quarter and set us up for stronger results in 2024.

Clay covered the primary reasons for our increase in working capital, which resulted in a $72 million use of cash from operations during the quarter. This increase is transitory and should begin to unwind later this year. While working capital metrics are expected to improve by year-end, we do not expect to return to our normalized levels of working capital until mid-year 2024. We continue to expect a strong exit to the year, with revenues 5-10% higher than Q2 levels. Additionally, we anticipate up to $50 million in cash expenses related to our cost savings program. The combination of these incremental cash costs, continued top-line growth, and above normal working capital levels will likely cause us to fall short of our prior full-year free cash flow expectations. We now expect free cash flow to be roughly break-even for the year. However, this leaves us very well positioned for 2024, during which we anticipate free cash flow will exceed 50% of our EBITDA.

Moving on to segment results.

Wellbore Technologies

Our Wellbore Technologies segment generated $804 million in revenue during the second quarter, an increase of $59 million or 8% compared to the first quarter and an increase of 21% compared to the second quarter of 2022. Revenue growth was supported by activity gains in the international and offshore markets, particularly in the Middle East and Africa, and by a strong recovery from the disruptions we had in our drill pipe business during the first quarter. The segment also notched solid revenue growth in North America despite softening activity levels due to continued market share gains in several business lines. EBITDA improved $31 million to $164 million, or 20.4% of revenue, representing 53% EBITDA flow-through, resulting from strong execution by our team, which was able to capitalize on rapid, if uneven, improvements in the global supply chain and obtain more appropriate pricing for our differentiated technologies.

Our MD Totco™ business posted double-digit sequential revenue growth with very strong EBITDA flow-through, achieving record-high revenue and EBITDA. The unit capitalized on improving demand in the Eastern Hemisphere with strong sales into the Middle East, Asia, and Africa, which more than offset revenues from North America that declined in-line with drilling activity levels. The business unit continues to see growing adoption rates for its digital solutions and realized 32% sequential growth in revenues from its MAX™ digital platform and, as highlighted in the earnings release, also entered into a global cloud agreement with a major IOC that will utilize a broad spectrum of the capabilities from our Max Platform, including our Kaizen Intelligent Driller Optimizer, WellData 4.0 Remote Drilling Monitor, and RigSense 4.0 Electronic Drilling Recorder to improve its operational efficiencies.

Our Downhole Tools business reported revenue growth in the low single digits with outsized incremental margins. Mid-teens growth in the Eastern Hemisphere, driven by strong fishing and drilling tool sales in key Middle Eastern markets and Asia, more than offset softer results in the Western Hemisphere. Revenues in the U.S. declined only one percent, despite a five percent decrease in drilling activity levels. An improving supply chain enabled the operation to significantly ramp manufacturing throughput of its high-spec rotors and stators for its Series 55 drilling motor, enabling the business to capitalize on ample demand for the product and capture additional market share. Our motor runs per active U.S. drilling rig increased double digits sequentially, and the premium product helped drive the improved margins for the business unit. We expect continued market uptake of our premium technologies and typical seasonal activity increases to drive continued growth for this business through the back half of the year.

Our ReedHycalog drill bit business posted strong sales into the Middle East and Africa and continued market share gains in North America offset activity declines in the U.S. and Canada. Like our Downhole business, ReedHycalog's revenue per rig increased double digits, the result of the business's technology leadership, which drives better bit performance in the world's most challenging formations. As previously disclosed, we are currently pursuing litigation against several companies involving royalties due under licenses related to certain bit leaching technologies developed by ReedHycalog. During the second quarter of 2023, the Company accrued an incremental $10 million of receivables owed by non-paying licensees, which represents approximately one half of the revenues recognized during the quarter related to leaching technology licensing agreements. For decades, the ReedHycalog team has been responsible for developing generations of industry leading drill bit technology, and as Clay highlighted, we continue to push the leading edge of the bit space and expect our upcoming generation of technology to continue driving outsized performance for our customers.

Our Wellsite Services business reported high single-digit sequential revenue growth with strong incremental flow-through. Improving demand for solids control equipment and services in the Eastern Hemisphere and growing demand for our managed pressure drilling product offering more than offset a slowing North American market. As the offshore recovery continues to gather momentum, this business is very well-positioned to benefit. Recent investments in MPD and waste disposal technology, along with strategic investments in key markets such as Guyana, should result in outsized growth for this business in the coming quarters.

Our Tuboscope pipe coating and inspection business posted mid-single digit sequential revenue growth with solid incrementals. Inspection service operations posted improved revenues in all regions, including the U.S., where drill pipe that is increasingly run hard in extended lateral wells is driving greater demand for drill pipe thread machining services. Coating revenues improved on higher demand for drill pipe coating services, partially offset by lower sales of pipe sleeves and glass-reinforced epoxy liners relative to very strong shipments in the first quarter. We are also realizing strong demand for our TK-340TC low thermal conductivity coating, which was originally introduced for geothermal applications. While demand has been solid in geothermal markets, more oil and gas operators are realizing excellent value from our proprietary coating in hot rock formations. This coating protects bottom hole assemblies by maintaining lower fluid temperatures, which has led to operators realizing 20% improvements in rates of penetration in these harsh environments. While we believe lower OCTG manufacturing activity and continued softening of drilling activity in the U.S. will negatively impact the second half, key international markets, including Brazil and the Middle East, should more than offset these declines, driving modest revenue growth and a slightly improved sales mix.

Our Grant Prideco drill pipe business executed a meaningful recovery from the vendor disruption that left the operation short on bar stock for tool joints in the first quarter, resulting in the business achieving its highest revenue in the last eight years and its highest level of profitability since 2014. After an exceptional first quarter of bookings, orders declined modestly. Demand in the Eastern Hemisphere and offshore markets remain solid, but lower drilling activity in the U.S. is resulting in contractors beginning to use pipe from stacked rigs and defer new orders. Looking ahead, we anticipate a slight decline in revenue for this business during the third quarter, but a solid backlog and demand from international markets has the business well positioned to deliver a sizeable increase in revenues in the fourth quarter.

For our Wellbore Technologies segment, we expect building momentum in international and offshore activity to offset declines in the U.S., resulting in third quarter revenue and EBITDA that is approximately in-line with the second quarter. We also expect the building momentum in international and offshore markets to more than offset bottoming North American activity, resulting in the segment delivering fourth quarter revenue that is 5-10% higher than the second quarter.

Completion & Production Solutions

Our Completion and Production Solutions segment generated revenues of $753 million in the second quarter of 2023, an increase of 5 percent compared to the first quarter and an increase of 18 percent compared to the second quarter of 2022. Revenue growth was the result of an improving supply chain for XL Systems and Fiber Glass, progress on projects in backlog, and opportunities in international markets. EBITDA for the second quarter was $69 million or 9.2 percent of sales, up $15 million from the first quarter and up $37 million from the second quarter of 2022. Sequential EBITDA flowthrough of 43 percent resulted from a better sales mix and improved project execution.

While capital equipment orders for North America have softened and certain large offshore FIDs have slipped, demand from international and offshore markets remained solid, driving $450 million in orders, an increase of 11% compared to the first quarter, and bringing the portion of our backlog related to international projects up to 75%.

Our XL Systems conductor pipe connection business continues to capitalize on the early stages of a robust offshore recovery, posting a strong sequential increase in revenues and its fourth straight quarter with a book to bill over 100%, led by growing demand from West Africa. Quoting activity remains high, which should result in continued solid intake during the third quarter. We expect results for our XL Systems business to decline modestly in the third quarter, but the operation is preparing for a significant increase in shipments in the fourth quarter that will support significant drilling programs in 2024.

Our Subsea flexible pipe business posted a low-single digit increase in sequential revenue during the second quarter. While order intake declined, we do not believe our bookings were representative of underlying fundamentals. We see rapidly growing demand for flexible pipe at a time when excess industry capacity has been absorbed. Operators are struggling to understand the rapid change in pricing dynamics, which resulted in multiple large tenders not being awarded after bids came in at pricing that was well above operators' budgets. We do not believe this reflects lost work, and these projects are expected to move forward. However, there are likely to be slight delays in the award processes as operators adjust their budgets for a flexible pipe market that has quickly gone from having ample excess capacity to industry demand exceeding capacity. We are increasingly confident that our deliberate approach on which projects we sign up will allow us to realize meaningful improvements in this operation's margin as we transition from projects that originated during the depth of the downturn to projects that are now being signed in a much healthier market environment.

Our Process and Flow Technologies business posted a mid-single digit sequential increase in revenue with improved progress on our Wellstream Processing projects, partially offset by small declines in the business unit's APL and Production and Midstream operations. Orders for the business unit increased more than three-fold sequentially, representing the best bookings quarter for this business in two years. Our Wellstream Processing operation booked an order for a sizeable mono-ethylene glycol (MEG) regeneration and reclamation unit for the North Sea, and our APL operation received an order for a submerged swivel and yoke destined for a project in West Africa. While operators remain somewhat cautious due to global economic uncertainties, the pipeline of potential offshore projects continues to grow. Similar to our Subsea business, we expect the rapidly improving market environment for this business to result in meaningful margin expansion during 2024.

Our Intervention and Stimulation Equipment business realized a slight sequential decrease in revenue with lower deliveries of pressure pumping equipment mostly offset by higher aftermarket sales and strong deliveries of coiled tubing equipment. This more favorable business mix drove a modest sequential increase in EBITDA. Declining completions-related activity in North America broke the business unit's streak of six straight quarters with a book to bill greater than one. While quoting activity declined only 4% and the average size of opportunities increased, orders for new equipment pushed out as service companies focused on their existing asset base, driving incremental demand for aftermarket spare parts and services. Demand from international and offshore markets remained healthy, which led to solid orders for our coiled tubing, wireline, and pressure control equipment.

Our Fiber Glass Systems business posted a high-single digit increase in revenue with strong incrementals. Softening demand in the North American oil and gas market was more than offset by robust sales into chemical and industrial markets, which included the business's initial shipments of FM 4922-compliant fume-and-smoke exhaust composite ducts for a major semiconductor manufacturer's chip foundry, the first of several large projects we believe our Fiber Glass Systems business will support. Additionally, the operation realized higher demand for scrubber systems in Asia. While the North American oil and gas markets have softened, demand remains robust in the Middle East and North Africa, which we expect will drive strong results in the second half of 2023 for the business unit.

For our Completion & Production Solutions segment, we expect growing demand from improving offshore markets will offset softer conditions in North America, resulting in third-quarter results that are in-line with the second quarter. However, building momentum in offshore markets are giving us growing confidence in the segment's ability to achieve low-double digit EBITDA margins by year-end.

Rig Technologies

Our Rig Technologies segment generated revenues of $606 million in the second quarter, an increase of $56 million or 10% compared to the first quarter and an increase of $144 million or 31% compared to the second quarter of 2022. The sequential increase in revenue was driven by greater levels of service and repair work in our aftermarket business and higher revenue conversion from our backlog of capital equipment projects. Adjusted EBITDA increased $2 million sequentially, and $30 million year over year, to $71 million, or 11.7% of revenue. As Clay mentioned, incremental EBITDA flow through was limited, due in part to a less favorable sales mix and higher startup costs related to our new wind tower venture.

New orders totaled $222 million, representing a book to bill of 108%, and total backlog for the segment at quarter end was $2.89 billion. Bookings declined $29 million sequentially due to a sizeable order for wind installation vessel equipment in the first quarter that did not repeat. However, orders for our rig equipment were solid, and we booked 11 top drives and 10 iron roughnecks for land rigs in the Middle East, several automation packages for offshore rigs, and 8 of our new electric lattice boom cranes for multiple operators. We are capturing a strong market position in this growing zero-emission market niche for our all-electric cranes based on our unmatched reliability.

The early phase of a robust recovery in offshore exploration and development is underway, driving an increasing pace of offshore drilling tendering activity. After numerous bankruptcies and 38 drillships (a number equal to over half the drillships working today) that were scrapped over the past eight years, available rigs are increasingly hard to come by. Consequently, we have seen offshore drilling dayrates continue to inflect higher with some of our key customers announcing drillship contracts north of $500 thousand per day in recent weeks. Expectations are for rates to continue to rise in order to incentivize additional rig reactivations as the low-hanging fruit has mostly been pulled out of the stack. Additionally, confidence in the long-term sustainability of the cycle, combined with concerns related to rig availability is also causing the length of contract terms to inflect, with a recent contract extending out to 2029.

There are a limited number of remaining drillships that are not spoken for and are either warm stacked or in yards waiting to be completed and cold stacked rigs will require significantly more capital to get back into proper working condition and to outfit with the latest technologies that operators desire. As we help our customers dig deeper into the stack of rigs to reactivate, we expect to see an increasing number of opportunities with larger scopes and expect projects to include a growing amount of associated capital equipment orders.

While the outlook is promising, our Aftermarket business is already benefitting from growing rig reactivations and the continued normalization of maintenance capital spending by drilling contractors. Spare part bookings increased for the sixth consecutive quarter and revenues from both our service and repair operations grew approximately 17 percent sequentially. With increasing manufacturing throughput, we expect to realize a greater pace of higher margin spare part deliveries in the second half of the year.

While orders for our Marine & Construction business were down sequentially due to the lack of a wind installation vessel award during the quarter, we are actively engaged in a number of tenders and are optimistic about the order outlook for this piece of the business in the second half of 2023 and beyond. Looking out to the latter part of this decade, there is still a projected shortfall in vessel capacity for the number of projects that have been sanctioned. Developers continue to list the inability to contract adequate construction vessel supply as one of their chief operational concerns, a fear we are more than happy to help alleviate.

Looking forward, we believe accelerating production and an improved mix in both our aftermarket and our capital equipment operations will translate into improved results for our Rig Technologies segment in the coming quarters. For the third quarter, we expect revenue for the segment to grow approximately 5% with incremental margins in the 30% range. We expect the segment to have an additional 5-10% sequential growth into the fourth quarter and end the year with low teen EBITDA margins.

While the midpoint of our segment level guidance implies a very modest improvement in our consolidated company results during the third quarter, we believe the combination of improving international and offshore markets and the proactive measures we are taking to improve our profitability will drive meaningful improvements in the fourth quarter, resulting in EBITDA in the $300 million range and setting us up for even better performance, and stronger cash flows in 2024.

With that, we will open the call to questions.