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

BLAKE MCCARTHY
Vice President, Corporate Development & Investor Relations

Welcome everyone to National Oilwell Varco's third 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 third quarter of 2019, NOV reported revenues of $2.13B and a net loss of $244 million or ($0.64) 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, Blake.

In the third quarter of 2019, NOV generated EBITDA of $262MM, up $67MM sequentially, despite a modest revenue decline from our second quarter. Our third quarter benefitted from credits related to the closeout of a handful of projects in our Completion & Production Solutions and Rig Technologies segments, which contributed approximately $20MM to our results. However, the primary driver behind our improving profitability was our cost savings work, which added approximately $20 MM in EBITDA sequentially. The balance of the sequential improvement related to favorable product mix shifts; for instance, rising revenues in Rig Technologies aftermarket.

NOV made excellent progress on restructuring to drive efficiency, and, in a moment, Jose will update you in more detail on our revised cost-savings targets.

Additionally, we are pleased with progress on improving cash flow. Cash flow from operations was $352MM in Q3, reflecting improving working capital intensity arising from the organization's heightened focus on receivables, inventory, and payables. Despite the challenging market backdrop, NOV's team performed well, and I am proud of everybody's hard work.

Our third quarter revenues grew 3% sequentially, fully offset by 5% sequential declines in North America. The U.S. land rig count is now down more than 20% from its recent high in late 2018, and while this will eventually result in decelerating U.S. production growth, it is currently pressuring our domestic customer base and, consequently, our short-cycle U.S. business lines. On the other hand, international and offshore activity continues to grow at a modest pace. Both the IOCs and NOCs have used the prolonged down-cycle to pull costs out of their planned projects, and FID approvals appear to be increasing. International and offshore growth helped NOV post an overall book-to-bill ratio north of one in the third quarter.

As cross-currents and deep cyclicality continue to affect the global oil and gas business, NOV continues to benefit from:

- its broad geographic and product diversity, a key strength of our business model;
- its market leadership, which provides numerous scale advantages; and
- its enormous installed base of equipment.

These business model attributes lend NOV the necessary durability to navigate the extreme volatility experienced in oil and gas, and are, in my opinion, important to understand with regards to the investment case for NOV at a time when oil and gas is deeply out of favor. I believe there is no single greater determinant of long-term returns than a company's strategic positioning, and NOV's is unique among oilfield ecosystem participants.

Our diversity along several dimensions is a great example. We make a broad array of oilfield tools, equipment, and consumables, which we sell to more than 8,000 discrete customers—some energy services companies, some producers, and even some in unrelated industrial enterprises. We operate in exploration, development, and production phases, in both land and offshore markets, across 65 countries. Although almost all are affected by oil and natural gas commodity prices, which are cyclical, rarely do all these subsectors move exactly in lockstep. So, as North America cycles down, we can pivot and redeploy assets to areas like the offshore and international markets that are exhibiting growth. Q3 is a good example.

Our business has low capital intensity. NOV's manufacturing assets are generally not specialized, even though they are used to make specialized equipment. Machine tools, assembly plants, and rig-up yards can be repurposed to areas of highest demand. They are also relatively small capital investments, as compared to the revenues they can generate. Our ongoing maintenance capital investment needs are far lower than most oilfield participants, as measured by capex as a percentage of revenue; over the trailing twelve months, for example, our capex has been only 2.8% of sales, for instance. Lower capital expenditure requirements equate with higher free cash flows and represent another attractive and differentiating attribute of NOV versus others in the oilfield.

We focus on market leadership. Our size and scale provide us clear advantages in procurement, manufacturing, logistics, and distribution. We have built the largest installed base of equipment globally within most of the equipment categories we supply, something that would take many years for our competitors to replicate. This provides NOV the opportunity as OEM to sell spare parts and maintenance services to the owners of this equipment, even during downturns. As a result, our Rig Technologies segment saw aftermarket revenue grow to 57% of its mix in Q3. Our installed base also provides proprietary opportunities to develop and sell digital enhancements to the owners of our equipment, like the Cerberus™ and NOVOS™ operating systems, software optimization tools, condition-based maintenance programs, and predictive analytics. These are all digital enhancements we've capitalized on through the downturn, made possible by our enormous installed base.

Market leadership positions NOV best to help our customers achieve standardization, which helps them drive better service, training, and procedural consistency across their own operations. All of this improves efficiency, which, in turn, drives greater financial performance and capital returns for our customers. Standardizing on the market leader, with global support capabilities and strong financial resources, is the logical choice for an entrepreneur in the oilfield seeking to profitably grow his or her business.

Many in our senior leadership team started our careers in the brutal 80s and 90s—another generational downturn in the oilfield. We know that diversity and strategic positioning are critical to successfully navigating a tough downcycle, but so is executing well on cost savings initiatives, and effectively managing working capital to maximize cash flow. In the third quarter, NOV benefitted from all the above. Pulling oil and gas out of the ground remains one of the most capital-intensive activities in the world, one that consumes equipment steadily, and one that will continue to be required for decades to come to as a key part of the mix of supplying rising global demands for energy. Eventually there will emerge a need for sustained reinvestment and retooling across the oil and gas value chain. That said, in the near-term, we are focused on the things that are directly within our control in this market: costs and working capital.

Our capital allocation continues to focus on strategic positioning and returns. We are using the current period to review our portfolio of businesses to ensure that we are engaged in activities where we have a clear and demonstrable competitive advantage; or, where we see a low-risk, capital-efficient opportunity to develop a new business that demonstrates competitive advantage and can be expected to generate solid financial returns within a reasonable timeframe. Some of our products won't make the cut and will be divested to free up capital. With respect to capital deployment, we remain committed to maintaining a strong balance sheet to preserve our investment-grade credit rating and ample liquidity. After our capex needs, we will continue to execute smaller M&A transactions, which enhance our business positioning and competitive moat, and which can typically be further enhanced by organic investment in technology and product development and integrated with NOV's global network. Overall, despite a very tough 5-year downturn, NOV has materially improved its positioning and its prospects, and I remain optimistic about our long-run success.

Finally, to our employees listening: your hard work, perseverance, and professionalism during these rough times humbles me. You all are what truly differentiates NOV, and I consider myself fortunate to be a part of your team. Thank you.

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

JOSE BAYARDO
Senior Vice President and Chief Financial Officer

Thank you, Clay.

NOV's consolidated revenues were essentially flat sequentially as the continued momentum in our international and offshore operations was offset by deteriorating conditions in the North American market where revenue decreased 5%. Revenues from offshore markets improved 7% sequentially, bringing the percentage of our consolidated revenue from offshore markets to more than 40% for the first time since the first quarter of 2017. Improving conditions in the offshore and international markets also helped us achieve our third quarter in a row with a company-wide book to bill over 100 percent.

EBITDA increased $67MM sequentially to $262MM, reflecting a great progress on our restructuring efforts, a more favorable business mix, and some favorable project completion variances.

As noted, we made great progress on realizing incremental cost savings, which totaled roughly $80MM on an annual basis. To date, we are realizing greater savings than initially anticipated on certain of our restructuring initiatives and we are continuing to find additional opportunities that will help make the organization more efficient. We now believe we will realize a total of approximately $200MM in annualized cost savings from our restructuring efforts by the end of 2020. For the fourth quarter we expect to realize an incremental $40MM of annualized cost savings.

During the third quarter, we also made great strides in our efforts to reduce the capital intensity of our operations by reducing our working capital and improving our cash flow. We generated $352MM in cash flow from operations and after deducting $69MM in capital expenditures, we netted $283MM of free cash flow. During Q3, we also collected a $65MM note receivable related to a divestiture we completed a few years ago. Even though the $65MM was on our balance sheet as a current asset, and therefore part of working capital, it flowed through cash flow from investing activities on our cash flow statement. If you included the $65MM in our free cash flow number, it would total $348MM. No matter how you look at it, we're well on our way to achieving our target of between $300 and $500MM of free cash flow in the second half of 2019.

A couple quick housekeeping items before we jump into our segment results. SG&A declined $124MM during the quarter, returning to a more normalized level relative to the second quarter. Additionally, during the third quarter our intercompany eliminations fell to a lower than normal level due to the timing of projects. In the fourth quarter, we expect eliminations and corporate costs to return to levels in line with what we saw during the second quarter.

Turning to our results of operations.

Wellbore Technologies

Our Wellbore Technologies segment generated $793MM in revenue in the third quarter, a decrease of $57MM, or 7%, sequentially. Excluding results from our drillpipe manufacturing business, which tends to behave more like a capital equipment business, revenue in North America declined 7%, in-line with the fall off in drilling activity. EBITDA for the segment was down only $1MM sequentially as cost saving initiatives helped limit decremental margins to approximately 2%, a testament to the efforts of our team to flex the size of our operations with the change in market conditions.

Our ReedHycalog™ drill bit business posted a slight revenue decline due to weaker domestic activity partially offset by growth in international markets. A contracting North American market is causing fierce pricing competition among our competitors, but our ability to deliver superior value to our customers through technology leadership has to date helped insulate our business from the pricing pressures without ceding market share.

Our M/D Totco™ business unit experienced a mid-single digit drop in revenue due to the same North American headwinds affecting the rest of our business. While M/D Totco is certainly not immune to the headwinds of the current market environment, we expect our list of closed-loop-automated drilling and surface optimization projects in North America, the Middle East and offshore Europe will continue to grow as operators around the world look to our digital solutions to improve their ability to generate returns.

Revenues in our Downhole business unit also declined due to lower motor, agitator, and fishing tool sales in the U.S. International revenues were mostly flat, and we are seeing rising demand for our agitators and other drilling tools in the Middle East and Europe. Part of this growing demand is coming from service companies seeking to drive additional efficiencies in their drilling operations as they execute on Lump Sum Turn Key (LSTK) contracts. We're also seeing more customers leverage our agitator technologies to improve efficiencies in completion operations. Our TerraPULSE™ coiled tubing agitator system is enabling customers to meaningfully reduce the time and cost to complete long lateral, multistage, drillout operations.

Our Tuboscope™ business posted results that were roughly flat for both revenue and EBITDA as the falloff in North American operations was offset by growth in international markets. The decline in Tuboscope's U.S. coating revenue was compounded by downtime associated with planned equipment upgrades as well as lost days in our Houston area plant, which resulted from Tropical Storm Imelda. Strong demand for coating services and an increase in deliveries of our Thru-Kote™ sleeves to the Middle East more than offset the falloff in North America. Additionally, the decrease in drilling activity in the U.S. hurt demand from steel mills and pipe processors, resulting in a slight decline in revenue from our inspection service operations.

Our Wellsite Services business unit experienced a high-single digit drop in revenue. Like the other business units in the segment, U.S. operations were impacted by slowing activity levels, which will continue to be a near-term challenge, but we did begin startup operations for projects in the Gulf of Mexico, which tend to drive higher revenue and profitability due to the sophisticated technology employed in offshore operations. We are also excited about a series of additional offshore projects scheduled in 2020 for which the team is currently preparing.

Our Grant Prideco™ drillpipe manufacturing business recorded a double-digit percent decrease in revenue as demand for new pipe has fallen sharply in North America as a result of the falloff in rig count. The decline in revenue from North America was only partially offset by increasing demand from international and offshore markets. While orders have been solid, international orders typically take more time to convert from bookings into revenue. However, for the first time in quite a while, Grant Prideco's top-line is more than 50% offshore and, while the business unit's revenue declined in Q3, bookings actually improved 30% as international and offshore orders continued to flow in at a welcome pace.

In the fourth quarter of 2019, we expect continued capital restraint across the North American E&P complex combined with the holiday season to result in further declines in U.S. activity, while international and offshore markets are expected to continue their measured recovery. We therefore expect revenue for our Wellbore Technologies segment to decline five to seven percent with continued focus on cost savings limiting our decremental margins to approximately 25%.

Completion & Production Solutions

Our Completion & Production Solutions segment generated $728MM in revenue in the third quarter, an increase of $65MM, or 10%, sequentially. Higher revenues, cost savings, and favorable adjustments associated with the completion of certain projects drove 46% incremental margins, resulting in a $30MM increase in EBITDA to $82MM, or 11.3% of sales.

Order intake remained healthy, and we captured $535MM in bookings during the third quarter. Orders exceeded shipments by 24%, providing us with our fourth quarter in a row of book-to-bill in excess of 100% for this segment. Backlog at quarter-end totaled $1.3 billion.

The sharp improvement realized by this segment over the past two quarters is further testament to the diversity of our operations. We've been able to more than offset the rapid deterioration in demand from completions service providers in the U.S. by capitalizing on improving fundamentals in the international and offshore markets, which allowed us to drive sequential revenue improvements in all but one of our business units within this segment.

Our Intervention and Stimulation equipment business experienced a 7% sequential decline in revenue resulting from the sharp falloff in U.S. completions activities that is once again causing customers to delay acceptance of equipment ready for pickup and other customers to request deferrals on more recently placed orders. Despite the sequential deterioration in performance, the business serves as a great example of how our leadership, breadth and scale enhance our ability to navigate through difficult market conditions and give us the flexibility to pivot where opportunities exist.

While the need for new pressure pumping spreads has been virtually non-existent for the past year and, more recently, we've experienced a sharp decline in orders for new coiled tubing equipment in the U.S., demand from international markets remains robust. In Q3, we booked orders for 9 coiled tubing units, 24 nitrogen units and a significant amount of other support equipment from a wide range of customers that will deploy the assets in numerous international markets. We also saw an increase in international orders for wireline and flowline including a sizeable order for our Anson 20,000 psi rated flowline destined for China. And, despite generally weak demand for pressure pumping equipment and aftermarket support, we were still able to book a few orders for blenders, control systems, and support pumps.

Our unparalleled global footprint, service infrastructure, technology, quality, and customer base can even create a safety valve, or at least some optionality, for our customers that can't be obtained from other vendors. One of our loyal U.S. coiled tubing customers was seeing rapidly deteriorating demand and was able to sell their order slot, and associated deposit, to an international service company that still sees unmet, pent-up need for more modern equipment in the markets they serve. We believe no other vendor in this space has more customers that standardize on their equipment and has an installed base as large as NOV. Our market position, global footprint, service infrastructure, technology and quality make us uniquely positioned to help our customers in ways that others cannot.

While this type of transaction could temporarily cannibalize our near-term opportunity set, it ultimately creates a healthier market over the long-run and did not prevent us from realizing a respectable 92% book-to-bill order intake for our Intervention and Stimulation Equipment business in the third quarter.

Revenue for our Process and Flow Technologies business unit was roughly flat as growing contributions from the execution on projects to build offshore production equipment booked over the past several quarters were mostly offset by a deteriorating North American market that is dampening demand for production chokes and pumps. EBITDA margins improved on a better mix, cost savings, and a favorable adjustment on a legacy project close-out.

Near-term, we expect growth from our Process and Flow Technologies' international and offshore operations to more than offset the challenges associated with North American production and midstream markets that continue to contract in response to tightening E&P capex budgets. Tendering activity for our APL and Wellstream Processing operations remains strong, particularly for large-scale offshore gas development projects, which supported the second sizeable award for a submerged turret production (STP) system in as many quarters and allowed the unit to post its third quarter in a row with a book to bill of more than 100%.

Our Fiberglass business unit posted another strong quarter of growth. Steady improvement in our core composite tubular offerings was supplemented by the first shipments from our new manufacturing plant in Dammam, Saudi Arabia, an acquisition that was completed during the second week of July, and rapid growth in demand from shipping companies for marine scrubber system components as they scramble to retro-fit vessels to comply with IMO 2020 requirements. Excluding additions from the acquisition, orders for our Fiberglass business unit improved 34%.

Lastly, in our Subsea flexible pipe business, bookings were light despite the continuation of a steadily growing opportunity set that allowed us to realize three straight quarters of improved bookings prior to Q3 and led to 22% sequential revenue growth.

Looking at the fourth quarter, we expect improving international and offshore directed activity to offset the impact from rapidly deteriorating market conditions in the U.S. completions market, resulting in fourth quarter revenues that are flat with Q3. We also expect Q4 EBITDA to remain in-line with third quarter results for our Completion and Production Solutions segment as cost savings realized should make up for the fall-off in favorable project close-out settlements.

Rig Technologies

Our Rig Technologies segment generated $649MM in revenue in the third quarter, a decrease of $22MM, or 3%, sequentially. Aftermarket revenues, which improved 5% were more than offset by an 11% decrease in revenues from capital equipment sales.

Growing contributions from our naval design, jacking system and pipelay tensioner offerings from our marine construction operations were more than offset by a falloff in drilling equipment project revenues associated with the completion of several projects in late Q2 and early Q3.

While revenue declined, we realized a much more favorable shift in our product mix and, when combined with project closeout variances and strong progress in our cost savings initiatives, we realized a $31MM improvement in EBITDA to $105MM, or 16.2% of sales.

Rig Technologies capital equipment orders totaled $221MM, a sequential decrease of $89MM, or 29%. Shipments of $246MM outpaced bookings, providing us with a book-to-bill of 90%. Total segment backlog at quarter end was $3.14B.

We continue to see a growing opportunity set in the renewables sector where we are able to leverage our core expertise in lifting and handling and in naval architecture to serve this rapidly growing industry. After booking a record-sized order for the jacking system of a European offshore wind construction vessel in the second quarter, we received another large order associated with a 28,000-ton offshore wind turbine installation vessel that will be constructed at the Japan Marine United shipyard for Shimizu Corporation.

NOV was awarded the design work, a telescopic leg crane and the jacking system for this 142m long, 50m wide vessel that is being purpose built to efficiently construct the next generation of offshore windmills, which will incorporate turbines with capacities of up to 12 MW and rotor diameters of up to 220 meters. NOV's proprietary telescopic leg crane will provide a unique combination of high elevation hoisting capability for turbine installation and heavy load capability for foundation installation. The crane will have a maximum lifting capacity of 2,500 tons and a maximum lifting height of 158m. The unique design of the telescopic boom also avoids protrusion outside the hull dimensions during transit, which increases the maneuverability of the vessel.

Larger, more economically efficient, ultra-large-scale wind turbines ranging from 9 to 12 MW in size will greatly improve the economics associated with the offshore wind industry. We are excited about this opportunity, which has a dollar value roughly equivalent to a full equipment package associated with a high-spec jack up rig and see the need for a healthy number of additional vessels over the coming years due to the limited fleet of installation vessels currently capable of installing wind turbines of 8MW or larger.

As offshore rig activity continues to recover at a measured pace, we continue to see steady order intake associated with upgrading and differentiating the performance of offshore rigs with a heavy emphasis on automation and multi-machine control enabled by our NOVOS™ control platform. While the number of rig contract tenders has increased, these processes remain very competitive, and operators are increasingly insisting that these capabilities are included in bid packages. We booked 4 NOVOS control platform orders associated with these automation upgrades during Q3 in addition to 2 NOVOS systems for land rigs, bringing our total number of NOVOS orders to over 130.

While land rig capital equipment orders remain challenged in the Western hemisphere as North American customers cannibalize equipment off their stacked assets and the sharp devaluation of the Argentine peso muddles the near-term outlook in that particular market, we continue to see pent up demand for cutting-edge drilling technology and equipment in other international markets, including the Middle East where we were able to secure an order for 2 land rigs during the quarter.

In our Rig Aftermarket business, the positive booking momentum continued with another double-digit sequential increase in orders, yielding our highest order flow since Q1 2015. While service and repair work were roughly flat, we continue to maintain a steady backlog of reactivation, upgrade and recertification project volumes. In addition, we are continuing to realize greater adoption rates of our condition-based monitoring solutions and total cost of ownership service model.

Looking at Rig Technologies' fourth quarter, we expect revenues to improve between 4 to 6 percent on higher revenues from land rig sales and service and repair work. EBITDA margins are expected to decline between 200 and 400 basis points due to a less favorable mix, a fall-off in favorable cost variances on project close-outs, and limited incremental contribution from cost savings between now and the first quarter of 2020.

While we expect market conditions remain challenging, we are pleased with the strides our people are making to improve our profitability, our working capital intensity and our already strong competitive positioning.

With that, we will now open the call up to questions.