NOV, Inc.
First Quarter 2023 Earnings
Conference Call Remarks

BLAKE MCCARTHY
Vice President, Corporate Development & Investor Relations

Welcome everyone to NOV's first 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 first quarter of 2023, NOV reported revenues of $1.96 billion and net income of $126 million or $0.32 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

Thanks, Blake.

For the first quarter of 2023, NOV reported revenue of $1.96 billion, down 5% sequentially on seasonality and project timing, and up 27% compared to the first quarter of 2022. The Company posted fully diluted earnings of $0.32 per share for the first quarter, up $0.45 YOY. EBITDA was $195MM, or 9.9% of revenue, up $92MM YOY.

Demand remains strong. Our consolidated orders exceeded revenue out of backlog for the 8th consecutive quarter, yielding a book-to-bill of 109%.

For most of our business units, it was a good quarter, but overall EBITDA came in softer than we expected due to a couple of discrete charges – one related to an environmental accrual top-up and another related to litigation, along with a significant supply chain issue we encountered in our drill pipe business. This led to an EBITDA shortfall and a significant build in inventory for the WellBore Technologies segment. Revenues and EBITDA for our other two segments, Rig Technologies and Completion & Production Solutions, were generally in-line with our expectations for the quarter.

Unplanned events at one of our vendor's steel mills within the past few months led to a lack of raw materials for drill pipe-specifically, bar stock for tool joint material, which goes into the connections at each end of every joint. Lack of raw materials disrupted our production schedules and impacted our manufacturing efficiency, as we were required to double the number of production line set-ups we typically perform each quarter, in order to conform our manufacturing schedule to the materials we had on hand. Consequently, we lost valuable manufacturing time and faced higher costs as we scrambled to secure more expensive supplies from alternative vendors, which led to far fewer shipments and a roughly $10MM EBITDA shortfall versus our earlier expectations for the unit in Q1. Drill pipe inventory increased significantly as green-tubes and other raw materials continued to arrive as per our original plan but couldn't be converted. While some disruptions are continuing to affect the unit's second quarter results, we are working closely with our vendor to catch up and expect the situation to be resolved by the time we get to the third quarter.

Elsewhere around the business we are generally seeing steady improvement in supply chain challenges, as freight reliability and costs have improved, and certain raw materials supplies are becoming more reliable. While many exceptions to this remain (engines, electrical components, certain elastomers remain scarce and deliveries elongated, for example), other components are catching up quickly. Rig Technologies saw inventory rise as castings and forgings, which are needed to support the group's high backlog of spares, rig refurbishment and equipment repair, began to flow at a greater rate. This inventory will support revenue growth in Q2 and beyond. Much of our inventory growth in the Completion & Production Solutions segment came in our flexible pipe manufacturing operation, which was required to buy out the rest of its 2022 allocation from our polymer vendor to secure our 2023 allocation required to meet our 2023 production schedule. These increases, along with other modest growth in Wellbore Technologies apart from drill pipe, are pegged to specific orders and projects that will contribute positively to the remainder of our 2023 performance.

Notwithstanding our drill pipe manufacturing challenges, our Wellbore Technologies segment executed very well, as it continued to advance several new technologies leading to market share gains in bits and digital products. Customers running our Kaizen™ Artificial Intelligence drilling optimization software are delighted with its results, and we are preparing to spud wells for two new wired drill pipe customers in the Middle East. Interest in our new shale shakers and waste management technologies for drill cuttings is rising too, as the offshore market puts more rigs back to work.

Turning to our later-cycle segments, first, Completion & Production Solutions has line of sight on several large projects we are bidding that are tied to higher levels of offshore FID's expected later this year. We foresee tightening industry capacity in flexible pipe for deepwater developments, and rising demand for gas processing technologies from NOV in support of global LNG demand.

We continued to see strong demand for intervention and stimulation equipment during the first quarter, with quotations up 31% sequentially, pointing to the need to retool the industry's toolkit with higher-efficiency, lower-emission technologies. Bookings were up 5%, including a lot of interest in our lower-emission electric equipment. Our new Max Completions™ product was introduced during the first quarter to rave reviews, as pressure pumpers and their customers are embracing the power of real-time Big Data to optimize frac jobs.

The Rig Technologies segment made significant supply chain strides during the first quarter, with record levels of centrifugal pump shipments. Shipments of spare parts into repair jobs and in support of offshore rig reactivations, as well as spares to support our Arabian Rig Manufacturing JV, all accelerated. The segment continues to see growing activity in the offshore space, with 55 recertification, upgrade and/or reactivation projects now underway in shipyards. The segment posted orders of $251MM and a book-to-bill of 140%, which included $60MM related to an offshore wind turbine installation vessel. Revenues were down sequentially, though, as expected, due to high fourth quarter shipments of jacking systems, the completion of a handful of older offshore projects, plus the Q4 sale of a land rig out of inventory that did not repeat.

Our outlook for the remainder of the year for all three segments is robust, despite recent commodity price weakness. After eight years of capital starvation that saw more than 600 bankruptcies in E&P's and oilfield service companies, the world is getting back to reinvesting in its critical energy infrastructure. The floating rig count has recovered quickly off the bottom it established during the pandemic and has now recovered more than 35%, with the current contracting pace and Final Investment Decision (FID) outlook indicating many more needed by 2024. Drillships in good working condition have already been reactivated, and, with the low-hanging fruit gone, contractors will have to go deeper into their stack to find rigs to meet growing demand. The complexity and cost of future reactivations will grow- and even more so if the owner wants to add, for instance, a second BOP stack to comply with BSEE regulations. Or our Powerblade™ technology to reduce OPEX and greenhouse gas emissions.

The rising cost of these reactivation projects has led drilling contractors to require both multi-year contracts at higher rates as well as operator-provided financing for the reactivation capital and mobilization expenses. As the original OEM for the vast majority of these rigs, NOV plays a critical role in these projects, and as more rigs go back to work, the E&P operators are now seeing first-hand how impactful new NOV technology, developed and launched during the downturn, can be. We are pleased to report that, for instance, ExxonMobil has standardized on NOV's toolkit for its offshore rigs in Guyana, including our NOVOS™ operating system with multi-machine control, our condition-based monitoring system, and our new automation offerings.

We are also pleased to report gathering momentum in the international land markets, particularly in the Middle East, and expect this to translate into tangible orders in the near future. Unlike North America, which saw its shale revolution miracle preceded by a complete retooling of its land rigs to AC technology, international land markets have seen very little rig replacement to higher levels of technology going back decades. That began to change with the decision by Saudi Aramco to establish a joint venture with us to build rigs in the Kingdom a few years ago, backed by a contract for 50 newbuild rigs that we are now building. And with production growth targets announced by the National Oil Company's (NOC's) around the Gulf slated to come from far more complex wells and reservoirs, it is becoming clear to operators that, the region has no choice but to upgrade its fleet of rigs, stimulation equipment, bits, and downhole tools.

While our customers faced lower commodity prices and global recession fears during the first quarter, they showed no signs of diminished appetite for the goods we provide; to the contrary, our orders remained strong and customer conversations robust. In all likelihood, North American activity is at best flat for a while, constrained by $2 gas and tepid oil prices. But offshore activity in Brazil, Guyana, the Gulf of Mexico, and West Africa, along with land and offshore activity around the Arabian Gulf, point to strong growth over the next several years, underpinned by expected project FID's and double-digit E&P capex growth plans. The focus of the National Oil Companies has been on: (i) satisfying their own local needs for natural gas; (ii) the recovery in global oil demand with the re-opening of the Chinese economy; (iii) their growing confidence that U.S. unconventional growth is slowing significantly; and (iv) the fact that the world has been under-investing in production for nearly a decade. Thus, we believe we are seeing growing confidence from our NOC customer base to make longer-dated capital investment decisions.

As the leading independent manufacturer of equipment and technology to the oilfield, our business blossoms later in each up-cycle than other business models in the oil patch, as prosperity cascades through the ecosystem. For now, our consolidated margins remain below what we consider normalized levels, due to this late-cycle nature along with residual pandemic-related supply chain disruptions we continue to battle. As the cycle progresses, we expect supply chain issues to abate; lower margin backlog to burn off; and pricing to continue to improve, which will boost our margins and earnings.

NOV's installed base of equipment, and new automation and digital technology products introduced through the downturn place it in a uniquely advantaged position to drive higher efficiencies for its customers throughout the oilfield as capital spending and activity return. Our mission, one that we are intently focused on, is translating that unique competitive advantage into acceptable shareholder returns. We recognize we still have a way to go on this journey.

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, despite cost inflation, labor shortages, broken supply chains, and global volatility. You are simply the best and our customers appreciate you and 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.

EBITDA in the first quarter of 2023 totaled $195 million, or 9.9 percent of sales, a decrease of $36 million sequentially and an increase of $92 million year over year. EBITDA was negatively impacted by the supply chain issues and related operational disruptions in our drill pipe business that Clay described as well as $8 million in charges related to environmental reserves and legal expenses.

Cash flow used by operations was $202 million during the first quarter, driven primarily by ordinary Q1 payments, associated with, and reflected in, our accrued liabilities, as well as a sizeable increase in inventory. While Clay spoke earlier of the inventory challenges we faced during the first quarter, I think it's worth recounting why this was such a significant use of cash during the period:

- First, in several of our businesses, the limited availability and uncertainty around deliveries of certain raw materials and components prevent us from completing the manufacturing of products in a methodical and efficiently planned process. We are having to set uncompleted products to the side while we await missing materials to finish the project, resulting in excessive levels of work in process (or WIP) and assemblies in our inventories.
- Second, we continue working to build buffers of critical materials and components in order to avoid the WIP build situation I just described.
- Third, while we are still experiencing significant delays of a limited number of materials, the broader global supply chain is healing at an accelerating rate, resulting in certain materials arriving faster, and in greater quantities, than expected, including items for which we had been on limited allocations.
- Lastly, we are continuing to see growing demand for our products and services and our operations are gearing up for meaningful growth through the back half of the year.

The total effect of all this is that we built up $60 to 65 million of extra inventory during the quarter. While the inventory build was a sizeable use of cash during the quarter, we welcome the accelerated healing of the global supply chain, which will ultimately allow us to more efficiently manage our operations, improve working capital metrics, and generate meaningful free cash flow as we work through the remainder of the year. We currently expect free cash flow to total between $100 and $300 million for the full year.

During the quarter, we increased our investment in Keystone Tower Systems, which resulted in NOV obtaining a controlling interest in the business. Accordingly, we have consolidated Keystone's results into our financial statements in the first quarter. We remain encouraged by the potential for Keystone's proprietary spiral welded wind tower technology to drive efficiencies in the wind power space, but the operation remains an early-stage venture that we expect will continue to report losses in the near-to-mid-term. NOV's extensive market presence in wind tower installation offshore, heavy lift cranes, and manufacturing makes us uniquely well-positioned to capitalize on the efficiencies that taller towers bring through Keystone.

Moving on to segment results.

Wellbore Technologies

Our Wellbore Technologies segment generated $745 million in revenue during the first quarter, a decrease of $17 million or 2% compared to the fourth quarter and an increase of 23% compared to the first quarter of 2022. The sequential decline in revenue was driven by seasonal slowdowns in key international markets and shipment delays due to the previously discussed supply chain issues for our Grant Prideco drill pipe business. EBITDA declined to $133 million, or 17.9% of revenue, as the aforementioned disruptions and high-margin sales from the fourth quarter that did not repeat combined to drive outsized decremental flow-through.

As Clay mentioned, our Grant Prideco drill pipe business experienced supply chain challenges, which disrupted operations during the first quarter. While the issue has not been completely resolved, we expect much improved throughput from the operation in the second quarter and further improved results in the back half of the year. Drill pipe demand remains strong, and orders increased from already high levels in Q4, with an increasingly favorable mix of premium pipe for Eastern Hemisphere and offshore markets.

Our ReedHycalog drill bit business realized an upper single digit sequential revenue growth with solid EBITDA flow through during the first quarter. The strong results were driven primarily by the seasonal recovery in Canada as well as market share gains and pricing improvement in the Middle East and North America. While the Canadian break up and slowdown in U.S. gas basins will serve as headwinds for the business in the second quarter, we expect continued market share gains in North America, and incremental activity in the Gulf of Mexico and international markets to drive improved results for the unit in the second quarter.

Our Downhole tools business reported a mid-single digit sequential decrease in revenue, primarily resulting from large sales of fishing tools and service equipment into the Middle East and Asia Pacific during the fourth quarter that did not repeat. Partially offsetting the decline was a meaningful improvement in revenue from the operation's drilling motor business, the result of improved manufacturing throughput of our high-spec stators, which has been constrained due to challenges procuring certain high-grade steel and elastomers. These stators power our industry-leading Series 55 motors, one of which was used to drill a 4.7-mile-long section of a well in a single run, averaging 188 feet of drilling per hour. Looking ahead, we expect increased activity in the Eastern Hemisphere and our ability to recapture additional high-spec drilling motor market share, resulting from the continued ramp in manufacturing capacity, to drive solid growth for this business unit in the second quarter.

Our MD Totco™ business realized a low single-digit sequential decrease in revenue during the first quarter. Market share gains and pricing improvement drove low to mid-single digit revenue growth in the U.S. for the operation's surface data acquisition offerings but were more than offset by the seasonal decline in equipment sales into the Eastern Hemisphere. Revenues from the operation's eVolve™ wired drill pipe optimization services were flat sequentially, but the business is preparing to ramp up several new projects, which are expected to commence in the second half of the year. The business unit also expects to continue gaining wider adoption of its digital solutions through arrangements with other customers, similar to a recent global agreement signed with a major Integrated Oil Company (IOC), to provide edge computing, edge-to-cloud and cloud-based solutions that enable real-time insights to drive operational efficiencies for the customer.

Our Tuboscope pipe coating and inspection business posted a low single-digit percent increase in revenue with outsized EBITDA flow through, resulting in the unit achieving its highest level of profitability in the last four years. The business' coating operations benefitted from growing sales in the Middle East, strong backlog in North America, and solid global demand for its pipe sleeves and glass-reinforced epoxy liners. The unit continues to increase market penetration of its technologically advanced product portfolio in the Middle East and recently won a five-year contract to provide its TK236 Epoxy-Novolac™ coating system and Thru-Kote™ sleeves for Joint-Operations in the Wafra field based on the products' ability to withstand high pressures, temperatures, and aggressively sour oil and gas.

Our Wellsite Services business posted a small revenue decline, primarily due to the seasonal fall-off in capital equipment sales from Q4 to Q1. Despite softening activity in the Western Hemisphere, the business unit is gearing up for a meaningful ramp in both its solids control and managed pressure drilling businesses, with sizeable projects scheduled to kick-off in the second half of the year.

Looking forward to the second quarter for our Wellbore Technologies segment, we expect the recovery in our drill pipe manufacturing operations and activity growth in the Eastern Hemisphere will more than offset headwinds from softening activity in North America, resulting in a sequential revenue improvement in the mid-single digit percent range. Additionally, improvements in facility absorption, pricing, and project mix should yield incremental margins in the mid-forties.

Completion & Production Solutions

Our Completion and Production Solutions segment generated revenues of $718 million in the first quarter of 2023, a decrease of 3 percent compared to the fourth quarter but an increase of 35% compared to the first quarter of 2022. EBITDA for the first quarter was $54 million, down $12 million sequentially and up $44 million year over year.

After the segment achieved its highest quarterly bookings since 2014, and eight straight quarters with a book-to-bill greater than one, orders decreased to $407 million in the first quarter, resulting in a book-to-bill of 96%. The decrease in Q1 order intake is attributed to typical seasonality in certain businesses. Additionally, we are pushing pricing so that new projects are accretive to project margins in our current backlogs and to drive improving segment margins and returns. One of our business units within CAPS walked away from three projects during Q1 worth over $100 million where we were the preferred vendor and given the opportunity to match the price of other vendors. Despite this example, in a market where global manufacturing availability is mostly absorbed, we are starting to see competitors become more rational in their pricing and those who remain undisciplined will soon exhaust their capacity, and likely disappoint their customers.

Our Intervention and Stimulation Equipment business posted a low double digit percent increase in sequential revenue, and revenue is up roughly 50% year over year. The solid sequential increase in revenue was primarily driven by strong shipments of both conventional DGB and eFrac pressure pumping equipment. During the quarter, we shipped 50,000 horsepower of pressure pumping equipment, including 10,000 horsepower of eFrac units. We also sold and shipped our first all-electric Ideal™ processing plant, which can deliver more than 200 barrels per minute of water and 30,000 pounds per minute of proppant and is equipped with NOV's latest digital capabilities making it very simple to configure and operate. On its first day in use, our customer was able to exceed its average number of stages completed in a day. Despite oil price volatility and low natural gas prices, which we believe caused some customers to defer or cancel certain orders we expected, book-to-bill remained north of 100%. Our service provider customers have been running equipment extremely hard, achieving healthier returns, and generating more cash, all of which we believe will continue to drive meaningful demand for replacement equipment in the U.S. despite a slowly softening market. While we've seen customers put indefinite holds on plans to add expansion capacity, quoting activity related to replacing tired equipment with new, more efficient dual fuel or electric capabilities has remained robust.

Our Fiberglass business posted a mid-single digit sequential decrease in revenue but was up more than 50% year over year. The seasonal decline in first quarter revenue was partially offset by a backlog that remains near record highs and stronger than usual mid-quarter shipments of fuel handling related equipment, with customers eager to beat price increases that went into effect on March 1st. Orders came in just shy of a 100% book to bill with relatively soft orders from U.S. oil and gas customers. Since quarter end, we've seen U.S. customers return to the table, and the outlook remains strong across the business' various markets.

Our Process and Flow Technologies unit posted a mid-single digit sequential revenue decrease in the first quarter with a strong sequential improvement in its Production and Midstream operations being more than offset by lower progress on large projects nearing completion within the business units' Wellstream Processing and APL operations. Production and Midstream operations benefited from an improving supply chain, which led to improved manufacturing output, allowing the operation to capitalize on its strong backlog, and from continued robust order intake of production chokes, pumps, and sand traps. In the unit's offshore-oriented Wellstream Processing and APL operations, order intake has remained soft over the last few quarters as operators have been recalibrating the impact of inflation on projects and as we've passed on low margin opportunities. However, discussions surrounding large offshore project FIDs accelerated during the quarter, and we are gaining confidence in the order outlook for the remainder of the year.

Our XL Systems conductor pipe connections business experienced a sizeable sequential decrease in revenue after completing several large project deliveries in the fourth quarter. Despite several operators in the Eastern Hemisphere pushing new projects to the right, citing delays and uncertainty on the timing and availability of large diameter casing and wellheads, bookings remained solid in Q1. Offshore activity is continuing to ramp, setting a very compelling backdrop for our XL Systems business, and we are expecting significant improvement in its results as we move through the year.

Our Subsea flexible pipe business experienced a mid-single digit decrease in sequential revenue. Orders for the quarter remained solid with book-to-bill near 100%. We are continuing to obtain better pricing for new orders as global capacity remains limited and demand for subsea flexible pipe for sanctioned projects remains strong.

For the second quarter, we expect our Completion and Production Solutions segment to achieve a mid-single digit increase in revenue with EBITDA flow-through in the lower 30 percent range. The quality of our backlog is improving with lower margin projects winding down and higher-margin projects coming on, which should result in steadily improving margin progression for the next several quarters, and we expect the segment to end the year with an EBITDA margin in the low double digits.

Rig Technologies

Our Rig Technologies segment generated revenues of $550 million in the first quarter, a decrease of $70 million or 11% compared to the fourth quarter and an increase of 25% compared to the first quarter of 2022. The sequential decline was the result of normal seasonality in our aftermarket operations and a fall-off in capital equipment sales, which resulted from the completion of some major projects and the rush to ship equipment at year-end. The 25% year over year revenue growth better reflects the strengthening fundamentals we are seeing for our Rig Technologies segment. Adjusted EBITDA declined $19 million sequentially and improved $33 million year over year to $69 million, or 12.5% of sales.

New capital equipment orders totaled $251 million, representing a book-to-bill of 140% and driving total backlog up to $2.88 billion. The recovery in the offshore and Middle East markets is continuing to gain momentum, which helped drive our fourth straight quarter of improved bookings for conventional rig equipment. During the quarter, we received a significant capital equipment order associated with reactivating a seventh-generation drillship. The project will include installing a new 165-ton active heave compensated crane, and an upgraded control system, which includes a drilling automation system and drill pipe handling tools. We expect improving demand for rig capital equipment to continue.

Rising technical and equipment specifications in tenders for the Middle East are requiring the revitalization of drilling fleets that we've been expecting for some time. Similarly, tendering activity for offshore markets will require the need to continue re-activating rigs, and we are beginning to get quite deep into the stack. Simply getting some of these rigs back into working condition is becoming a much bigger job, but most of the rigs also require meaningful upgrades to conform with operator requirements. We expect all of this to translate into continued improvements in rig capital equipment orders through the rest of this year.

Increasing activity, reactivations, and upgrades are driving strong demand for our aftermarket products and services. During the quarter our rig aftermarket operations posted a 13% increase in spare part bookings, our fifth consecutive quarter of improved orders and the best spare parts bookings quarter since the third quarter of 2019. We expect demand from our aftermarket operations to remain robust based on the recent bookings and quoting activity we've seen from our Field Engineering group. Bookings and quoting levels in Q1 increased 31% and 40%, respectively, from average levels we saw during the second half of last year, with customers asking our engineers to help them prepare for reactivations, pressure control equipment upgrades, and the addition of enhanced automation capabilities.

While we were cautious on the offshore wind market coming into 2023 due to the impact of inflation and project delays, developers appear to have recalibrated timelines and are getting over the sticker shock, resulting in more optimism around additional FIDs. During the first quarter, we received an order for the design and jacking system of a large Wind Turbine Installation Vessel (WTIV) for a European client. This is the second order from this customer and the sixth order for our NG-20000™ vessel design, which has become the industry standard for the offshore wind installation market. Of the 15 WTIVs ordered globally, in the last three years, excluding China, 12 have been based on NOV's designs, and we are optimistic about additional orders later this year as vessel demand for planned projects in the back half of the decade continue to outstrip existing and planned WTIV capacity. Additionally, during the first quarter, we delivered the world's first telescopic heavy-lift crane, capable of lifting 2,500 tons in retracted mode and 1,250 tons in extended mode. The crane was delivered to a Japanese client and is set to install its first offshore wind turbines later this month. We have become the wind turbine installation industry's leader with a reputation as a dependable supplier with the ability to develop and deliver leading-edge technologies to drive efficiencies within the renewables sector.

For our Rig Technologies segment, we expect continued improvement in our aftermarket operations and higher levels of capital equipment revenue out of backlog to translate into sequential revenue growth of between five to ten percent with incremental margins in the mid twenty percent range. While Rig Technologies is our longest cycle operating segment and is still in the early stages of its recovery, we believe the Middle East, offshore, and wind markets are unfolding in a manner that will allow the segment to drive meaningful growth over the coming years.

With that, we will open the call to questions.