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

BLAKE MCCARTHY
Vice President, Corporate Development & Investor Relations

Welcome everyone to National Oilwell Varco's fourth 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 fourth quarter of 2019, NOV reported revenues of $2.28B and a net loss of $385 million or ($1.01) 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.

NOV's results continued to improve sequentially during the fourth quarter of 2019, as revenue increased 7% from the third quarter and EBITDA increased to $288 million, or 12.6% of revenue. Despite continued deterioration of the North American market, all three of our segments increased EBITDA sequentially. On a year-over-year basis, NOV was able to post an increase in EBITDA during the fourth quarter of 2019 despite revenue being down more than $100 million from the fourth quarter of 2018. Aggressive cost reductions and facility downsizing contributed significantly to NOV's improving financial performance, and Jose and I will speak more to this in just a moment.

Revenues for the full year 2019 were $8.48 billion, a 0.3% improvement from the prior year. Full year EBITDA of $885 million declined 3% from the prior year.

2019 was a pivotal year for the energy industry. We entered 2019 with commodity and equity markets signaling strongly to market participants that growth for growth's sake, without commensurate returns to capital providers, would no longer be tolerated. Sources of all forms of capital to the industry- public equity, private equity, bank debt, public debt- became scarce and expensive, as evidenced, for example, by the collapse in trading multiples of oilfield public equities in early 2019. At the time we interpreted this as the evaporation of a widely-held narrative- gauzy conventional wisdom that a commodity price spike would someday soon lead us back to a more prosperous oilfield and save us all. Through the first four years of the downturn, 2015-2018, this narrative was responsible, we think, for a significant, structural option-value component in equities and asset values in the oilfield. This makes sense to me because the oil and gas industry has a 160-year history of extreme volatility, and sophisticated investors recognized the corresponding option value that goes with this volatility. And as the leading provider of capital-intensive capital equipment to oilfield service companies, we tend to watch such trends. Our customers frequently rely on external capital to buy the equipment we provide them. And by the beginning of 2019 providers of external capital to oil and gas producers and service companies were exhausted- tired of waiting patiently for a recovery that felt like it continued to slip over the horizon. So they choked back on the capital that they were previously pumping into the operations of our customers.

Now capital is to oil and gas what oxygen is to the rest of us- petroleum is arguably the most capital-intensive undertaking of all industrial enterprises, and oilfield services is probably second. Operators react quickly when you choke off their air supply. They pulled back hard on capex budgets, particularly in U.S. unconventional plays, resulting in a peak-to-trough decline of 27% in the U.S. land rig count over the course of the year. While international and offshore projects with favorable return characteristics continued to receive FID greenlights, the industry as whole, particularly in the U.S., finally seemed to be resigning itself to the fact that a commodity price spike was not going to save the day, and the old way of business is not going to cut it. It will, unfortunately, be lower-for-longer and that is the new conventional wisdom that emerged at the beginning of 2019.

I wanted to step through this perspective with you this morning because I believe it has important implications for our company and our industry over the next few years, and this perspective has guided our strategic decisions through 2019.

First, with respect to the illusive recovery, through this year of capital austerity (some might say capital starvation), I have been struck by the number of conversations I have had with other oilpatch old-timers where we agree that this lack of capital is as bad as any time we saw during the 1980s or 1990s. Therein lie the seeds of a return to prosperity, because the new, grim view that has taken hold is now driving the industry to reduce its structural overcapacity, taking actions that will return this industry to health. Asset retirements, facility closures, regional withdrawals, exits from the businesses and consolidations got underway in earnest in 2019. While individually, none of these will heal the space, collectively, they inevitably lead the industry to better discipline, pricing, and shareholder returns.

NOV's share of the task began materially back in 2015, when we started reducing our overcapacity, facilities footprint and SG&A, but our efforts were accelerated sharply beginning in 2019, as the reality of the "new market normal" became apparent. Our team has undertaken many difficult decisions, including pulling back from unprofitable markets and closing numerous facilities around the world – some of which had been NOV mainstays for decades. Since 2015 we have closed 483 facilities to shrink our own internal capacity to better fit market demand. We've adopted a more efficient shared services model in many regions, and, through the hard work of our team through this past year, we have established a clear and tangible path to at least $230MM in annual cost savings, as compared to the first quarter of 2019. Thus far we have obtained approximately $170MM in annualized savings, up about $82MM sequentially in the fourth quarter. We continue to evaluate every opportunity to increase that number.

Second, every product line, no matter how well established, has fallen under the microscope of an in-depth returns analysis. Those that do not currently meet our internal threshold have either developed a tangible plan for near-term improvement or have been slotted for divesture or closure. Ultimately, 2019 was a year about building and solidifying our staying power. Operationally, we're leaner, more efficient, and more agile to react to the shifts in the market.

Third, from a balance sheet perspective, we continue to increase the strength of our capital structure in order to maintain the flexibility to act opportunistically. During the fourth quarter we called $1B in debt due in 2022, repaying a portion with cash and a portion with longer-tenor notes in a new issue that is due 2029.

Fourth, we've tailored our strategy to fit a world where our oilfield services customers have limited access to capital. Commercially, NOV won much of this race during the period from 2006 to 2014, when we won a significant portion of the largest buildout of oilfield service equipment the industry has seen in a generation. (We delivered 379 offshore new-build drilling packages since 2006, for instance). So today we benefit from having the largest installed base of oilfield equipment in the world. This enormous installed base gives rise to new, attractive business opportunities that are unique to NOV- aftermarket spares and services support, software system enhancements, the application of big data-driven predictive analytics products to drive efficiencies, the evolution of mechanization to automation of processes in the oilfield, for instance.

We are creating differentiated digital offerings built on over three decades of gathering big data in the oilfield through our MD Totco products and eHawk service offerings, among others. Due to our installed base of equipment that touches nearly every wellsite in the world, we're uniquely positioned as perhaps the only common thread between hundreds of unique equipment suppliers with thousands of non-standardized sensor tags.

On new product development, with capital scarce and equipment oversupplied, it makes less sense for oilfield service contractors to spend millions of dollars on new units; rather, we see the next attractive opportunities as being smaller-dollar investments that our customers can make in bigger-impact enhancements that will enable them to differentiate their equipment in a crowded marketplace. While there will be certain large new-build project opportunities that arise, even in this tough market, we will remain disciplined and will choose not to follow our competitors in doing the stupid stuff that desperate competitors inevitably do. A strong balance sheet and a large installed base of equipment requiring ongoing OEM support is the best way to ride out an industry downturn. The good news for NOV is that we have both.

New product development has zeroed in on bolt-on products that carry a price tag our customers can afford, with a value-added efficiency or useful life-improving profile they can justify to their shareholders. Think in terms of Trac-ID tags for drillpipe monitoring and autotallies on rigs; NOVOS™ operating system enhancements that our customers can charge their oil company customers for; new directional drilling tools like SelectShift™, which have no similar peer in the marketplace; PowerBlade™ energy management systems which reduce diesel consumption and carbon footprint for offshore drillers. Affordable products which can be used to retrofit existing capacity to improve its attractiveness in the marketplace.

Lastly, with respect to our outlook for the year, we're prepared to endure continued levels of reduced activity in North America with a meaningful market recovery unlikely to take hold before 2021. The kind of market that suits affordable, fit-for-market solutions.

International activity continues to be a bright spot as we enter 2020 for NOV as customers in the Middle East and other regions around the world look to harness the technologies that enabled the U.S. unconventional revolution. Where our Rig Technologies segment is experiencing limited demand for new equipment in North America, we're scheduled to deliver multiple new rigs and rig upgrade packages this year to the Middle East as several countries in the region seek to upgrade their fleets. We are pleased with our progress in our Saudi joint venture and expect to begin delivering the first of 50 modern, highly-efficient super-spec rigs to the Kingdom in 2021.

Offshore drilling and production continues to grow at a measured pace. Our Wellstream processing business, an industry-leader in production processing technologies, including monoethylene glycol regeneration units, is tendering at twice the pace it was at this time last year, indicative of greater activity in the offshore.

As the world continues to learn more about the Coronavirus outbreak, we're hopeful first that authorities around the globe are able to ease the suffering that it is causing so many. We also hope that its impact to the world's economy broadly, and the oil and gas industry specifically, is short-lived, but we're realistic in acknowledging that globalization leaves us exposed to market uncertainty, as it does for other industries. We expect our scale and global footprint will help us mitigate any direct supply chain repercussions, but the situation nevertheless remains fluid in early 2020.

Finally, before I hand it over to Jose, I'd like to finish where I began. If I've learned anything in business it's to be skeptical of conventional wisdom, because collectively, we're all, well, frequently wrong. I would be surprised to see a robust global recovery emerge in the oilfield in 2020 or even 2021, so we are managing the business accordingly. However, I do think a recovery will emerge when no one is predicting it. The only facts I know for certain is that the oil industry has seen global growth in demand for almost every single one of its 160 years, and that the industry has always been highly cyclical. The current time feels an awful lot like the 1990's when then, as now, capital providers to oil and gas were fatigued and frustrated. Another period of capital starvation. And then, as now, the industry responded by trimming overcapacity. History doesn't repeat itself, but it does rhyme, and I am encouraged that here in the sixth year of the downturn, the oil and gas industry is serious about reducing its structural oversupply.

There is a parallel narrative embedded in conventional wisdom about a looming energy transition. One that fully displaces fossil fuels, and therefore one that likely further diminishes the option value of oilfield assets, at least in the minds of some investors. While I'm confident mankind will transition to better forms of energy in the future, the shape and pace of that transition are probably going to surprise us all. In the near-term, oil and gas remain critical fuels that play a key role in, for instance, air travel and feeding the planet, so they will be a part of the energy mix for many years, perhaps generations, to come. Nevertheless, an energy transition is emerging as, potentially, the most valuable and interesting business opportunity of the twenty-first century. So there is one more, small but important element to our strategy, which is figuring out how NOV can capitalize on this and how we can make money by facilitating it. We quietly launched this initiative a few years ago to play offense rather than defense against this emerging backdrop. We are not spending much money in this area, but I have been very encouraged by what our teams are developing and I hope to be able to share more with you on future calls about the opportunities emerging for NOV in this space.

To our employees listening around the world – thank you for all that you do. Your resiliency, your dedication, and your hard work made a tough year a great year for NOV, and Jose and I couldn't be more thankful to have you on our 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 increased $155MM to $2.28B, or 7% sequentially as the continued momentum in international and offshore markets helped drive a 15% sequential improvement in international revenues, more than offsetting the impact of a rapid decline in North American activity levels during the fourth quarter.

EBITDA increased $26MM sequentially to $288MM, driven by strong operational performance and continued progress on cost savings initiatives, partially offset by favorable project closeout variances from Q3 not repeating and a less favorable product sales mix in our Completion and Production Solutions and Rig Technologies Segments.

As Clay mentioned, we continue to make progress on efforts to right-size our businesses and improve efficiencies across the organization and expect to realize another $24MM in annualized cost savings in the first quarter, or a $6MM improvement in Q1 over Q4.

We've also been reducing the working capital intensity of our business. We converted $246MM of working capital to cash in the fourth quarter and generated $473MM in cash flow from operations. After deducting $67MM of capital expenditures, free cash flow for the quarter was $406MM, bringing our second half 2019 free cash flow to $689MM, significantly exceeding our target.

Despite our expectation that capital expenditures for NOV will increase to around $325MM in 2020, as we ramp spending on our new rig manufacturing facility in Saudi Arabia, we believe we will increase free cash flow by at least $100MM year-over-year and that working capital will be a source of cash for NOV in 2020.

During the fourth quarter, we took measures to further strengthen our balance sheet by redeeming $1.0B of senior notes due December 2022 and issuing $500MM of new senior unsecured notes due 2029. These transactions extended the maturity of $500MM of existing debt by 7 years and reduced our debt by approximately $500MM, leaving us with $1.989 billion in gross debt as of December 31st. Cash flow generated in Q4 allowed us to reduce Net Debt to $818MM at year end.

Our actions demonstrate what we've long said, that defending the balance sheet is our top capital allocation priority. Our actions are designed to ensure NOV can successfully manage tumultuous market conditions and provide the flexibility to be opportunistic with compelling, high-return investments that we may identify.

As you know, NOV has a share buyback authorization that is contingent on the Company achieving gross debt to annualized EBITDA of less than two times. If 2020 continues to unfold as we expect, we will likely begin stock buybacks later in the year.

A few housekeeping items before we dive into our segment level results.

During the fourth quarter we took $537MM in mostly non-cash impairment and other charges due to the further deterioration in North American market conditions and our ongoing restructuring efforts.

Lower intercompany sales from cross-segment projects resulted in a $3MM sequential decrease in revenue eliminations. In the first quarter of 2020, we expect intercompany sales to remain in-line with the fourth quarter of 2019.

Other Expenses increased $44MM sequentially and included $26MM in expenses associated with the retirement of $1.0B of our 2022 notes, and a $14MM increase in foreign exchange losses.

And finally, while our effective tax rate may continue to be volatile over the near future, we expect our tax rate will average approximately 35% for 2020.

Moving to results from operations.

Wellbore Technologies

Our Wellbore Technologies segment generated $764MM in revenue in the fourth quarter, a decrease of $29MM, or 4%, sequentially. Revenues from North America declined 13%, slightly more than the fall-off in drilling activity, while revenues from the segment's international operations increased 7%. Despite the decline in revenue, EBITDA for the segment increased by $10MM sequentially, to $143MM, primarily due to the successful implementation of cost saving initiatives and structural improvements to operational efficiency across the business units in this segment.

Our ReedHycalog™ drill bit business posted a less than 1% decline in revenue due to continued weakness in the North American market that was mostly offset by growth in most international markets and continued market share gains in the U.S. Our high-performing bits are allowing us to gain share and preserve pricing in a competitive market.

Revenues in our Downhole business unit fell 12% as reduced demand and increased pricing pressure in North America were partially offset by higher revenues in most Eastern Hemisphere markets. Despite the challenges in the North American market, we continue to see healthy demand for our leading-edge motor, elastomer and other technologies, including our SelectShift™ adjustable motors, which are enabling customers to complete single run wells with greater consistency and reliability. During the fourth quarter we helped a customer in the Marcellus Basin drill a record-setting 19,132 foot single-run well.

Our MD Totco™ business unit realized a slight increase in revenue as the contribution from our growing number of drilling automation projects in the Norwegian North Sea more than offset a decline in revenue for MD Totco's business in North America.

Our Tuboscope™ business unit saw revenues fall 5% sequentially. Revenue from the business unit's coating operations were down slightly and inspection service revenues fell 6% as lower drilling activity levels in the U.S. and holidays reduced output from mills and outside processors.

Revenues in our Wellsite Services business unit declined 12% sequentially on fewer U.S. fluids jobs, but the unit's core solids control business only experienced a 5% sequential decrease in revenues. Its U.S. operations performed in-line with the 11% falloff in drilling activity but was partially offset by growing opportunities in international and offshore markets.

We are encouraged to have begun working on several projects in the Gulf of Mexico recently, in addition to seeing rising demand overseas.

Our Grant Prideco™ drillpipe business realized a sharp increase in revenues in the fourth quarter as we shipped large volumes of high-spec drillpipe for international markets. Additionally, as was the case in the third quarter, more than 50% of the business unit's revenue was derived from offshore products. While orders for drillpipe in the U.S. have been sparse over the past few quarters, customer drillpipe inventories that we hold in the U.S. are at the lowest levels in recent history. We believe any material increase in drilling activity will require a healthy increase in orders. Meanwhile, as international customers re-stock diminished inventories, we continue to see rising demand for our Delta™ drillpipe connection technology.

Looking to Q1 for the Wellbore Technologies segment, the Coronavirus, oil prices, seasonality and evolving E&P budgeting practices all remain wildcards, but at this time, we expect revenues for our Wellbore Technologies segment will decline between 6% to 12% with decremental margins in the mid-30% range.

Completion & Production Solutions

Our Completion & Production Solutions segment generated $799MM in revenue in the fourth quarter, an increase of $71MM or 10% sequentially. Growing demand from offshore and international markets was partially offset by lower demand for completion equipment in U.S. Land markets.

EBITDA increased $14MM sequentially to $96MM, or 12% of sales. Incremental margins were limited to 20% as modestly higher sequential cost savings were offset by favorable credits related to the closeout of projects in Q3 that did not repeat in the fourth quarter.

The segment began realizing a considerable increase in orders during late 2018, largely driven by offshore and international projects. This trend continued through the fourth quarter resulting in orders of $502MM, and its fifth straight quarter with a book-to-bill in excess of 100%. While the project pipeline remains robust for 2020, at this point we expect lower orders in the first quarter due to the timing of specific projects.

Our Fiberglass Systems business unit posted an 8% sequential improvement in revenues, achieving the highest levels of revenue in its history. Increased deliveries of spoolable pipe from our new manufacturing plant in Dammam, Saudi Arabia and marine scrubber system components needed to retrofit vessels for IMO 2020 compliance drove the sequential growth, but was partially offset by rapidly contracting demand in North America, where orders decreased 15% sequentially. We expect the need for additional scrubber systems to remain robust, with experts estimating that owners of shipping vessels can achieve paybacks on their investments in less than a year, based on current price spreads between low sulphur and traditional bunker fuel.

Our Intervention and Stimulation Equipment business realized a 3% sequential increase in revenue on strong year-end shipments of coiled tubing and wireline units. However, margins decreased roughly 100 bps on a less favorable product mix, as revenues from pressure pumping aftermarket parts and services declined to a level that is less than half its recent highs.

Results from this business unit remain depressed due to the structural overcapacity of the North American completions market; however, the business continues to advance its technological leadership by assisting our customers in finding new, less-capital intensive ways to improve profitability for themselves and their end customers.

Our FracMaxx™, Big Bore QuickLatch™, and FracHose products are examples that are lower cost solutions for improving operational efficiencies and safety in a cash constrained environment.

The business is also focused on pursuing opportunities in other markets, such as the Middle East, Latin America and China, where the development of tight and unconventional natural gas formations is driving equipment needs that mirror what is used in North America.

In the fourth quarter we booked and delivered a large package of high-pressure equipment to an operator in Northwestern China, where there has been a rapid increase in the amount of hydraulic fracturing activities and is therefore experiencing a corresponding increase in demand for high-pressure flowline equipment in the Changqing and Xinjiang gas fields.

Our Process and Flow Technologies business unit realized revenue growth in each of the unit's major product lines. The unit's Production and Midstream product offerings saw a sequential decrease in demand in North America that was more than offset by large shipments of pump packages to India and an uptick in sales of production chokes including the first batch of chokes built in our new manufacturing facility in Dammam, Saudi Arabia.

The business unit also realized its third straight quarter of improved results from its offshore market-focused Wellstream processing and APL turret mooring product offerings, primarily driven by growing LNG-related activity. Headlining the order book was a monoethylene glycol regeneration and reclamation unit for an LNG project in Mozambique and an order for our newly-developed ePack™ electrostatic coalescer technology that will be installed at the Equinor Johan Sverdrup. Tendering activity for the offshore market remains the strongest in recent memory, which is reflected in the business' ability to post a book-to-bill in excess of 150% and which should begin to allow for incremental pricing improvements during the year.

Our Subsea flexible pipe business posted a 15% sequential increase in revenues, but at low flow-through as the market for flexible pipe remains very price competitive. Bookings improved from the third quarter, generating a book-to-bill of 134% and included more than 56 miles of flexible pipeline systems for a project in the North Sea. Our team continues to use its technology advantages to focus on higher-value-add projects.

For the first quarter of 2020, we expect revenues from our Completion and Production Solutions segment to decline 10% to 15% sequentially with decremental EBITDA margins in the upper 20 to lower 30 percent range.

Rig Technologies

Our Rig Technologies segment generated $759MM in revenue in the fourth quarter, an increase of $110MM. A sharp increase in land rig equipment sales, including sales of older inventory at low margins, and improved progress on offshore projects drove the 17% sequential improvement in revenue.

However, an unfavorable shift in product mix, together with old inventory we've moved at a discount, were only partially offset by cost savings, which limited incremental margins and resulted in a $7MM increase in EBITDA to $112MM, or 14.8% of sales.

Orders declined $10MM, or 5%, to $211MM in the fourth quarter. Total segment backlog at year end was $2.99B.

The sharp improvement in land revenues resulted from a significant increase in year-end equipment deliveries and better progress on land rig projects. During the fourth quarter we booked orders for six land rigs destined for multiple customers in the Middle East, with three of the rig orders specifying our NOVOS control system.

We are seeing NOCs more frequently pushing their contractors to provide high-spec land drilling rigs that can meaningfully improve performance and operator returns. The growing number of international operators pursuing development of tight gas formations is accelerating the demand for this equipment and, similar to what we are seeing in our Intervention and Stimulation Equipment business unit, the equipment these customers are seeking is beginning to look like the high-spec equipment found in West Texas. We've seen this in Argentina for several years and are now seeing customers across the Middle East and Asia pursue 1,500 horse power rig packages with three gen sets that are almost identical to what we are selling into the U.S.

During the fourth quarter, we also realized a substantial increase in revenues from deliveries of offshore capital equipment and from improved progress on our offshore wind construction vessel projects. We continue to see gradual improvement in offshore markets with steady demand for rig equipment and technology upgrades as well as a growing opportunity set for our Marine Construction business, including replacement cranes for FPSOs, equipment for pipelay vessels and additional offshore wind construction vessels.

NOV continues to leverage our core competencies to assist in the development of solutions that help our customers reduce their environmental footprint while also improving operational efficiencies. In the fourth quarter we introduced our PowerBlade™ Hybrid system that is currently being installed on a rig on the Norwegian Continental Shelf. PowerBlade allows drilling contractors to reduce their carbon footprint, and fuel costs, by recycling the captured energy back into the rig. We estimate that the PowerBlade system will allow the drilling contractor to reduce diesel consumption by 771,000 gallons per year, saving them $1.75MM in cash, reducing 110 tons of NOx emissions per year, and reducing their carbon footprint, or CO_2 emissions, by 6,200 tons per year.

Revenues from our Rig Aftermarket operations were flat sequentially due to a decrease in spare part sales that resulted from budget exhaustion that set in with our customers near the end of the year. Additionally, the significant increase in the number of rigs enrolled in our total cost of ownership programs moderates the Q4 uplift we've historically seen in our service and repair operations. We've increased the number of offshore rigs in our programs to 83 at year end, an increase of over 2.4 times since the end of 2018.

In the first quarter of 2020, we expect lower deliveries of capital equipment to be partially offset by a slight increase in aftermarket sales, resulting in a 10 to 15 percent sequential decrease in revenues and a 100 to 300 basis point reduction in EBITDA margins.

While we know there is much more work to be done in 2020, we were pleased with the strong finish to 2019 and the progress the organization made on key initiatives throughout the year. The actions taken by the talented, hardworking employees of NOV allowed us to balance our efforts to reduce costs and improve operational efficiencies with advancing our technologies and supporting our customers with cost-effective solutions. Those actions have NOV well-positioned for the future.

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