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EDITED TRANSCRIPT

NOV - Q2 2016 National Oilwell Varco Inc Earnings Call

EVENT DATE/TIME: JULY 28, 2016 / 1:00PM GMT

OVERVIEW:

Co. reported 2Q16 revenues of $1.7b and loss per fully diluted share (excluding certain items) of $0.30.

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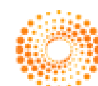

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the second-quarter 2016 National Oilwell Varco earnings conference call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session, and instructions will follow at that time. (Operator Instructions) As a reminder, today's conference may be recorded.

I would like to introduce your host for today's conference, Mr. Loren Singletary, Vice President of Investor and Industry Relations. Sir, please go ahead.

Loren Singletary - *National Oilwell Varco, Inc. - VP, IR*

Thank you, Michelle, and welcome, everyone, to the National Oilwell Varco second quarter 2016 earnings conference call. With me today is Clay Williams, President, CEO, and Chairman of National Oilwell Varco, and Jose Bayardo, Senior Vice President and Chief Financial Officer.

Before we begin this discussion of National Oilwell Varco's financial results for its second quarter ended June 30, 2016, please note that some of the statements we make during this call may contain forecasts, projections, and estimates, including, but not limited to, comments about our outlook for the Company's business. These are forward-looking statements within the meaning of the federal securities laws based on limited information as of today, which is subject to change. They are subject to risks and uncertainties, and actual results may differ materially. No one should assume that these forward-looking statements remain valid later in the quarter or later in the year. I refer you to the latest Forms 10-K and 10-Q National Oilwell Varco filed with the Securities and Exchange Commission for a more detailed discussion of the major risk factors affecting our business. Further information regarding these, as well as supplemental financial and operating information, may be found within our press release on our website at www.nov.com or in our filings with the SEC.

Please be aware that our use of the term EBITDA throughout the call this morning will correspond with the term adjusted EBITDA as defined in our press release. We also use other non-GAAP measures as described in our press release.

On a US GAAP basis for the second quarter of 2016, National Oilwell Varco reported revenues of $1.72 billion and a net loss of $217 million or $0.58 per share. Now, let me turn the call over to Clay.

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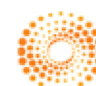

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Clay Williams - *National Oilwell Varco, Inc. - Chairman, President and CEO*

Thank you, Loren. In the second quarter of 2016, National Oilwell Varco posted revenues of $1.7 billion, down 21% from the first quarter and down 56% from the second quarter of 2015. Revenues declined more than expected, due mostly to offshore drilling contractors further delaying acceptance of new builds. The $26 crude oil prices we saw in February inflicted new agony on the oil field, sending second-quarter expenditures further downward and driving US rig counts to record lows going back seven decades.

NOV generated a loss of $0.30 per fully diluted share excluding severance, facility closure costs, and other items, totaling $0.28 per fully diluted share in the second quarter. EBITDA was $25 million for the quarter, and operating loss was $153 million, excluding $117 million in other items for both. Operating cash flow was $128 million for the quarter. Our managers continued to aggressively downsize our business to match the available market, enabling NOV to manage to decremental EBITDA leverage, ex other items, of only 22% sequentially. Our workforce was reduced 10%, and SG&A declined 16% during the quarter--solid cost reduction results in the face of continuing pricing and absorption pain. EBITDA leverage ex other items has been 30% on the 70% revenue decline since the present cyclical downturn began.

We continue to manage costs aggressively, but we're also maintaining our investment in promising new opportunities we see for our business when prosperity returns. New technology and lower costs will lead to higher incremental roles and margins for NOV in the eventual recovery, and I will speak to our efforts in both areas.

First, on cost. Our team is resolute in our commitment to improve efficiencies, reduce capacity, and generate higher profitability. During the second quarter, we detailed additional cost reduction steps that totaled over $400 million in annualized savings that will flow in over the next few quarters. Plans developed and actions taken during the second quarter are on top of considerable work performed already, having reduced our annual personnel costs well over $2 billion from peak levels. Since the downturn began, we have closed or are closing over 250 facilities to reduce capacity in view of lower demand. We've also insourced work being previously outsourced to retain as many of our employees as possible and to help with absorption. Importantly, we do not believe we have sacrificed our ability to ramp up and respond to the eventual recovery.

In a moment, Jose will take you through our detailed operating results by segment, but overall we expect these specific actions to lead to modestly higher EBITDA in the third quarter, on a modest decline in revenues, with more savings driving even higher EBITDA in the fourth quarter on roughly flattish sequential revenues. Like others in our space, we believe we are seeing some isolated green shoots of activity, and we are encouraged that the North American rig counts have begun to increase. We have seen demand rise in recent weeks for certain products and services for North America: rod guides for artificial lift, solids control jobs in West Texas, drilling motor rentals and other items. On the other hand, our rig equipment business, and many international markets, continued to decline. At or near the bottom of the cycle, we see considerable cross currents, price pressure, and shifting mix within our business. And, frankly, we're not ready to call bottom yet.

Our near-term outlook calls for modest revenue improvements in the Wellbore Technologies and Completion & Production Solutions Segments, offset by another quarter of declines in our Rig Systems Segment, which we expect to flatten thereafter. We expect Rig Aftermarket's third quarter to be down only slightly from the second quarter.

Laser focus on efficiency is part of our DNA, and cost savings measure evolve continuously with our market outlook. Jose, Loren, and I are grateful to serve with experienced, competent business leaders who roll up their sleeves and do the tough, grim work of downsizing when this industry demands it. Better days lie ahead for NOV, and this team will help us navigate the present storm. When it passes, we will emerge lean and tough.

The oil industry has been decimated by a generational downcycle, but record low levels of rig activity will inevitably lead to production declines, higher oil prices, and higher activity. In the meantime, we plan for this to be a slow grind, and we still have a lot of swamp to traverse until we get to full recovery.

When the market turns, NOV will have used the present downturn to improve its efficiency and importantly advanced promising new initiatives for the industry we serve. This Company has a diverse, robust portfolio of critical technologies the industry needs to drive better efficiencies in a low oil price world, a portfolio which we improve day by day as we continue to invest in our optionality to recovery.

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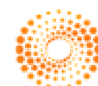

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We believe recovery will drive higher demand for completion tools and hydraulic fracture stimulation and pressure pumping equipment where NOV occupies market-leading positions. Our outlook for technology proven by the shale revolution is robust. Shale technologies will migrate to new basins on new continents, requiring new sophisticated Tier 1 land rigs, bits, downhole tools, and new drill pipe designs. Again, NOV occupies formidable positions in these markets.

Rising drilling efficiencies enabled by NOV's technologies will increase well counts, vis-a-vis rig counts, with fewer days of drilling required to create each new wellbore. This will spur incremental demand for well count driven products and services like the production chokes, sand separation, and oil separation equipment, markets where NOV also occupies leading positions. And high rates of drilling per day will equal high rates of consumption of bits, tools, drill pipe and rigs that we make, per day.

We acquired Trican's completion tools business into our Completion & Production Solutions Segment a couple of weeks ago, which brings promising new sliding sleeve and coil tubing frac technologies to our mix. The business plan here is simple: we can manufacture completion tools in our existing, under-absorbed facilities; we can expand sales through the 67 countries we already operate in with our existing infrastructure. We see opportunities to add other completions technologies to our mix through M&A and organic investment. We expect application of hydraulic fracture stimulation to continue to grow in an upturn, and the acquisition enhances NOV's exposure to this trend.

Drillers and service companies will bring more attention to efficient management of their assets in the upturn. So, within the Wellbore Technology Segment, we are advancing our new Trac-ID lifecycle management system, which utilizes RFID technology to provide customers with the complete life history, including hours in service, of drill pipe, BHA components, and drilling risers. Over 40,000 of these chips are in service globally, but the unpenetrated market is literally millions of components. The system tracks, manufacturing and inspection history of each drillstring component through our inventory management system. We can install Trac-ID RFID chips at our drill pipe and downhole tools factories, or in the field. And, once installed, the system can automatically tally strings on every trip when used with instruments mounted in the rotary table. This makes for more efficient drilling operations, in addition to more efficient lifecycle management of assets for our customers.

Operators will continue to push longer laterals and smooth profiles, tightly geosteered within the sweet spots of the shale's stratigraphy. In the first quarter, we acquired Tolteq, which brought us a mud pulse MWD system, which fits well with our BlackStar electromagnetic wave MWD system that we have offered for many years. We are now investing to add resistivity measurements and to combine mud pulse and electromagnetic wave propagation capabilities into the same tool, thereby positioning NOV to offer a unique, low-cost MWD tool that can be used together with our new low-cost rotary steerable system that we developed and introduced earlier this year. Together, this combination will enable our directional drilling service customers to provide cost effective geo-steering on longer horizontal wells.

We will be introducing a new rotating control device for managed pressure drilling in the second half of 2016, and we are investing in rental kits for the launch currently. We see more and more customers interested in rigs that are MPD=ready to drill more efficiently and safely, and NOV is developing the kit to fulfill this need.

In the first quarter, we acquired a unique remote unmanned gas analysis unit that provides high speed ratio measurements up to C5. The GEOgas Analyzer product transmits critical geologic data in real time, which enables operators to reduce wellsite personnel to lower costs. This fits well with the rig instrumentation business that we had been engaged in for decades.

Today we have three eVolve closed loop automated drilling jobs underway, and we expect to spud two more jobs soon, with dozens more operators interested in this emerging technology. Our eVolve closed loop drilling automation service has proven the ability to reduce spud to TD times by a third or more. Drilling programs in new basins experienced learning curve effects well by well, closed loop automated drilling accelerate this process. Recovery will see new, green drilling crews going back to work, and our new closed loop automated drilling service illuminates the drilling mechanics downhole and enables computers to control surface equipment on a microsecond basis to optimize drilling performance. The service works with our new NOVOS rig operating system, which we introduced this quarter and won our first upgrade order, and also works with our proprietary IntelliServ wired drill pipe to provide high-speed data link with downhole real-time drilling instrumentation.

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NOV is uniquely positioned to capitalize on this exciting technology, given that we have the world's largest installed base of drilling equipment, the most proven stable capable rig operating system, the wired drill pipe, and the experience of already having drilled hundreds of thousands of feet under our belt. Our rig of the future is here today and operating in the field with high efficiency.

Our installed base of drilling equipment also uniquely positions NOV to capitalize on Big Data in the oil field. We have monitored hundreds of rigs in real-time around the globe for over a decade through our eHawk system. This year we launched our enhanced RIGSENTRY system, and we saw a significant increase in revenues for our subsea RIGSENTRY BOP monitoring service in the second quarter.

You may recall that we announced last quarter our success in predictive analytics. We successfully forecasted certain component failures weeks in advance based on our analysis of years of operating data. Condition-based monitoring and Big Data will provide step change improvements and reliability and maintenance practices for sophisticated oilfield equipment, and NOV is positioned to lead the way. We are pursuing additional opportunities to host real-time remote monitoring centers in the Middle East, which will enable customers to reduce costs by permitting their experts to simultaneously monitor drilling progress across multiple rigs in real time.

Our second-quarter saw Rig System orders decline further, and we expect orders to remain depressed for the foreseeable future. With no new offshore rig builds on the horizon, we are investing in new products to enhance efficiency and safety of existing rigs, products that will enable drilling contractors to differentiate their rigs in a crowded marketplace. For instance, we expect to introduce a new ROV retrievable BOP pod this year for subsea stacks, which would enable drilling contractors to replace pods on the seafloor, avoiding an expensive and time-consuming round-trip of the stack. Drilling contractors can retrofit their stacks with this.

On land, we are set to introduce a new lower guide arm product, which will work in conjunction with our existing STV racking arm on land rigs to bring further mechanization, and potentially automation, of pipe tripping activities. We are developing ways to improve the efficiency of contractors' existing operations by, for example, exploring opportunities to reduce SPS costs and disruptions by using conditioned-based monitoring. We are working with the major classification agencies to develop a way to continuously certify drilling equipment in the field, using conditioned-based monitoring. It is early days, but this new model could significantly reduce drilling contractor costs and interruptions.

We were pleased to announce a few weeks ago a cooperation agreement with GE within our Completion & Production Solutions Segment to work jointly to improve costs and speed of execution on FPSO topside projects. We are in detailed development work around integrating GE's market-leading power generation and compression capabilities with our own offering of turret mooring systems, swivel stacks, seawater piping systems, pumps, fluid processing, treatment, cranes, and deck machinery. By reducing the number of complex interfaces between multiple vendors, NOV and GE are vastly simplifying the supply chain, jointly engineering and costing FPS topside modules across varying sizes and capabilities, which we will offer to the marketplace by early 2017. Final designs can be refined quickly to fit specific customer field needs, reducing time to first oil, reducing complexity, and reducing costs.

NOV is unique in our considerable experience and successful execution of complex vessel construction in dozens of projects with every major shipyard around the globe. While deepwater development projects remain challenged from a returns perspective, the opportunity to pioneer a new, efficient well construction model, together with initiatives being advanced by deepwater wellhead companies, together with subsea processing and boosting advancements, including our own Seabox technology, can materially improve the economics of developing the vast resources that have been discovered in the deep water. Our initial plans focus on smaller FPSO vessels, targeting marginal discoveries in mature basins.

In short, NOV continues to pivot into promising technologies that will disproportionately benefit in the upturn, even as we shrink our productive capacities and reduce costs. Hydraulic fracture stimulation, completion tools, remote operations, big data, deepwater advancements and horizontal drilling will all play key roles in supplying an energy-hungry world in the 21st century. NOV is investing both organically and through M&A in each of these areas. Brighter days lie ahead, and NOV will be there to lead the way.

To our team at NOV, let me tell you, I know these are difficult times, and I appreciate your resolve and your professionalism. We are laying the groundwork for future prosperity of the greatest company that you and I are blessed to be a part of. You have my heartfelt thanks.

Jose?

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Jose Bayardo - *National Oilwell Varco, Inc. - SVP, CFO*

Thanks, Clay. To quickly recap our consolidated results, revenues for the second quarter of 2016 were $1.7 billion, down 21% from the first quarter and in line with the 19% sequential decline in global rig counts. Revenues declined 23% in North America and 20% internationally as the North American and international rig counts fell 35% and 7%, respectively.

Adjusted EBITDA was $25 million, down $102 million from the first quarter of 2016. Sequential decremental EBITDA leverage was limited to 22% as efforts to resize the business and reduce our cost structure had their intended effect. Operating loss, excluding other items, was $153 million.

Looking at select other line items of the P&L, SG&A decreased by $56 million or 16% sequentially and by $125 million or 30% year over year. SG&A is now down $944 million on an annualized basis since the fourth quarter of 2014.

Interest and other financial costs expense increased $5 million sequentially, mostly driven by incremental interest costs of approximately $2.5 million, attributable to a large capital lease we booked in late Q1, as well as other charges we do not expect to repeat next quarter. Therefore, we anticipate interest expense to be between $27 million and $28 million for Q3.

Other expense for the quarter increased $13 million sequentially, driven primarily by a greater loss on disposals and fixed assets. Our GAAP effective tax rate was 35.8% for the quarter, and our rate, excluding other items, was 41.5%. As a reminder, in the current environment, relatively small changes in the split between domestic and international results can have a disproportionate impact on our tax rates. In the third quarter, we anticipate the tax rate to be approximately 38%.

Turning to the balance sheet and cash flow, working capital decreased $253 million from the first quarter of 2016. The decrease in working capital was primarily the result of a $247 million reduction in inventory levels, a $190 million reduction in customer financings (which is the decrease in cost in excess of billings, netted against the decrease in billings in excess of costs and customer prepayments), and a $168 million reduction in accounts receivable. The reductions in working capital were partially offset by decreases in accrued liabilities and accounts payable.

While working capital decreased by over $250 million, we continue to carry more working capital than required to support the business at today's activity levels as converting inventory and receivables to cash remains challenging in the current environment.

Cash flow from operations totaled $128 million. After deducting $77 million in capital expenditures, $19 million in dividend payments, $15 million for acquisitions, and $14 million in other items, we were essentially breakeven from a cash flow perspective for the quarter. Therefore, net debt remained mostly unchanged at approximately $1.6 billion.

During the quarter, we paid down our commercial paper by $100 million, leaving us with a balance of approximately $110 million. At June 30, 2016, we had a cash balance of $1.7 billion, $3.3 billion in total debt, and our debt to capitalization was 16.8%.

Our Rig Systems Segment generated revenues of $564 million during the second quarter of 2016, down 39% sequentially from $926 million and down 71% from the $1.9 billion posted in the second quarter of 2015. Sharp revenue declines were anticipated in the second quarter, due to reduced backlogs and more projects approaching completion; however, the falloff in revenue was stronger than expected as customers who lack contracts or face pressures from operators to delay projects do what they can to defer deliveries.

Second-quarter EBITDA for the Rig Systems Segment was $49 million. Efforts to resize the Rig Systems business and reduce the cost structure to mitigate the effects of the falloff in revenues had the intended result leading to decremental margins of only 24%. EBITDA margins fell 610 basis points to 8.7% of sales. Operating profit, excluding other items, was $30 million or 5.3% of sales.

For the second quarter, the split between offshore and land-related revenue was roughly two-thirds onshore and one-third land. New construction of offshore rigs accounted for $213 million in revenues or 12% of NOV's consolidated revenue.

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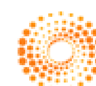

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New orders were down $31 million sequentially to $66 million in the second quarter, representing a ten-year low. Book to bill was 15% when new orders are compared to the $441 million shipped out of backlog during the quarter. Q2 bookings primarily consisted of pressure control systems and other replacement equipment. For the third straight quarter, we received no new rig orders.

Near-term demand for offshore remains almost nonexistent outside of replacement equipment. Discussions continue regarding midterm opportunities, which include one-off specialized 20K drill ships and speculative midwater semi-submersibles; however, we do not anticipate these orders materializing in 2016.

The land markets appear much more promising as conversations with customers in North America, the Middle East and certain other international markets are increasing regarding equipment upgrades and new build opportunities. More and more, operators are demanding modern, pad optimal, Tier 1 AC rigs for potential upcoming projects, and contractors are seeking to upgrade and expand their capabilities in order to position themselves to capture incremental market opportunities. While offshore opportunities will remain limited for the foreseeable future, we believe our land business will bottom in Q3 and begin to recover as we enter 2017.

We continue to work diligently on restructuring and resizing the business for anticipated future volumes. Our focus is on standardizing processes, optimizing structures, and eliminating all redundancies in our global operations. This focus is designed to ensure the flexibility and agility needed to respond to recovery the significantly reduced costs and lead times.

We anticipate revenue out of backlog will fall another $81 million in the third quarter to $360 million and anticipate an 18% to 20% falloff in total Segment revenue. As we continue to work off our backlog on existing projects, decremental margins should be in the low 20% range as we expect normal decrementals to be partially offset by $15 million in cost savings, resulting from our efforts to cut costs and improve efficiencies as we restructure the business.

Our Rig Aftermarket Segment generated $643 million in revenue during the second quarter of 2016, down 7% from $391 million in Q1 of 2016 and down 45% from $657 million in the second quarter of 2015. EBITDA for the Segment was $73 million or 20.1% of sales, down 11% sequentially and down 55% from the prior year. EBITDA decremental leverage was limited to 33% as cost controls were able to partially offset the decline in total revenue and an unfavorable mix shift as sales of spare parts continue to decline, while lower margin service and repair work began to improve. Operating profit, excluding other items, was $67 million or 18.4% of sales.

Spare parts sales continued to decline during the second quarter; however, bookings on spares began to solidify as we entered the third quarter. Customers have depleted existing inventories and are now getting to the point to where they must order new parts in order to support their existing operations.

Service and repair work rebounded during the second quarter as re-activations in the US began to take place and the number of special periodic survey projects increased by 30%. While the number of projects and associated revenue are increasing, strained customers continue to reduce the scope of projects and associated purchases as much as possible.

Our conditioned-based monitoring services continue to gain traction and deliver value for our customers. Our RIGSENTRY service, which was introduced last quarter, identified potential failures of subsea BOPs before they occurred on four separate occasions, potentially saving our customers millions of dollars in unplanned downtime. The operational success is driving commercial success as our monitoring service revenues increased by over 50% during the quarter.

We expect the pace of stacking offshore rigs will continue to accelerate, a difficult process which will ultimately help rebalance an oversupplied market.

In the current environment, Rig Aftermarket remains focused on providing industry-leading OEM parts, service and support that we have delivered over the years to take care of our customers' operating needs anywhere in the world. We also continue to partner with our customers to develop innovative solutions for their most pressing needs.

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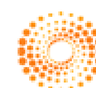

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Today, our customers cannot afford extra downtime and need to be optimally positioned to capitalize on any new opportunities. As previously noted, we are seeing strong demand for our conditioned-based monitoring solutions, which allow contractors to predict failures and address problems before they occur. We are also seeing growing demand for other recently introduced offerings designed to address the stress our customers are under in the current environment.

Some of these offerings include infield certification services for which we travel to rigs anywhere in the world to provide required certifications on active locations, resulting in substantially reduced downtime; rig performance services in which we assess and review a customer's equipment to identify opportunities for improving operational efficiencies and minimizing downtime; and storage, preservation, and reactivation services, which lower the cost of stacking equipment and enable faster reactivation of rigs, creating a competitive advantage for contractors in securing new contracts.

Notwithstanding the remaining challenges in the offshore space, conversations with our customers leave us cautiously optimistic that we are at or near a bottom for our Rig Aftermarket business. While we anticipate a tepid near-term recovery, driven by reactivation-related business in the US and pent-up demand for offshore parts, service, and repair work, we could still see revenue decline in the third quarter by a couple hundred basis points. We also anticipate realizing roughly $5 million in cost savings during the third quarter, which should more than offset decrementals associated with the revenue decline.

Our Wellbore Technologies Segment generated $511 million in revenue during the second quarter, down 19% sequentially from $631 million and down 47% sequentially from the $956 million in the second quarter of 2015. Revenue mix by destination was 43% in North America and 57% international. North America revenue declined 24% compared to the 35% decline in rig count, and international revenue fell 13%, exceeding the decline in the international rig count as drilling activity in the Middle East registered its sharpest decline since this down cycle began.

EBITDA was $1 million, down $42 million from the previous quarter and $156 million from the prior year. Sequential EBITDA decrementals were 35%. The Segment reported an operating loss excluding other items of $96 million for the quarter.

Throughout this cycle, we have been intensely focused on what we can control. We aggressively pursued the declining number of business opportunities that were available and continued to invest in and drive innovation with our customers' interests at heart, meaning our focus is on improving oilfield efficiencies by reducing time and costs while improving well productivity. We have also been relentlessly focused on resizing the organization, lowering our cost structure, and optimizing our processes. Additionally, we have repositioned our people and operations to focus on the customers and basins around the world, which we believe will be the most active throughout the next cycle.

These actions have taken place across all four of our operating segments and all 15 business units. But, today, I will highlight a few representative examples from within our Wellbore Technologies Segment.

In our Dynamic Drilling Solutions Business Unit, we have streamlined our operations, enhanced relationships with old and new customers, and we continue to execute well with our legacy offerings. We recently displaced a primary competitor across the fleet of one of the largest private rig contractors in North America with our data acquisition and information management systems.

Additionally, we have continued investing in delivering innovative solutions to better serve the current needs of our customers, including: one, building out capabilities and executing revenue generating contracts associated with real-time drilling data acquisition, visualization, and optimization technologies; two, delivering substantial drilling improvements for customers with our eVolve optimization and closed loop drilling automation services; three, introducing a new MWD tool; and, four, introducing our GEOgas Analyzer, the first patented Fourier Transform Infrared Spectrometer, specifically designed to provide real-time gas ratio analysis for formation hydrocarbon identification.

In our Drilling and Intervention business, in addition to launching a number of literally groundbreaking technologies such as our rotary steerable tool, and multiple innovative new drill bits and motors, we have substantially improved our product development and manufacturing capabilities. Investments made in streamlining processes, leading-edge manufacturing equipment, and repositioning operations have us well positioned for the future.

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Changes implemented in our drillbit business have reduced the time it takes to take a new drill bit design from concept to finished product down to six weeks from over 16 weeks as recently as a year ago. These changes will also allow us to reach prior peak volumes with a 25% lower headcount and will allow us to maintain substantially lower inventory levels reducing working capital and the potential for obsolescence.

In our field service related operations, we have numerous examples of how we have repositioned our assets and our personnel to become much more intimate with our customers focused on regions that will be the most active in the future. Our Well Site Services Business Unit has added to its capabilities in Argentina, which positions us well for the anticipated long-term ramp in activity within the Vaca Muerta field. Here recently, an operator utilized our Well Site Service Business Unit's PETROS fluid system and solids control services, in addition to a myriad of other NOV products and equipment, to drill the deepest horizontal well yet in the Loma Campana block of the Vaca Muerta field.

Circling back to our Drilling and Intervention Business Unit, we have reduced the average turnaround time for repairing bits and redressing motors in certain key basins around the world, including the Permian, from three weeks to one week by expanding our field service and repair facilities. This type of improvement significantly enhances our ability to take care of our customers and reduces inventory requirements.

As you can tell, we haven't simply reacted to a sharply deteriorating market over the past six quarters, we have and will continue to play offense.

In May, the US land rig count was down 80% from the prior peak, and the past two quarters have had successive declines declines of approximately 20%, but it appears things have begun to stabilize, at least within the North American marketplace. While there is cautious optimism about rigs getting back to work, the extent of declines have induced a level of trauma that likely delays a meaningful recovery until next year.

For the third quarter, we expect our Wellbore Technologies Segment's top line to increase 200 basis points with mid-30% incremental EBITDA margins. We also expect to realize an additional $15 million benefit in Q3 due to our ongoing cost-cutting and operational efficiency initiatives.

Our Completion & Production Solutions Segment generated $538 million in revenue during the second quarter, down 4% sequentially from $558 million, and down 38% from $873 million recognized in the second quarter of 2015. EBITDA was $57 million or 10.6% of sales, an increase of $9 million from the previous quarter, but down $91 million from the prior year. The Segment reported operating profit excluding other items of $5 million for the quarter. EBITDA improved on lower revenue, due to cost-cutting initiatives, operational efficiencies, and strong improvements in our subsea business as the operation benefited from high absorption in both of its manufacturing facilities and an executed well on existing orders.

We took in $269 million of new orders, down $59 million sequentially and shipped $333 million in revenue from backlog, resulting in an 81% book to bill. The segment ended the quarter with a backlog balance of $947 million, $47 million lower than the prior period.

While our Subsea business had strong levels of activity this quarter and our plants should remain busy through at least year-end, the outlook for offshore related projects remains challenging and pricing pressures persist. These challenges extend into other offshore-oriented businesses, including our Floating Production operations where there is limited visibility into additional projects outside of our existing backlog for the remainder of the year. We do, however, remain optimistic regarding midterm prospects as we continue to have strong dialogue regarding FPSO opportunities with customers, and our new relationship with GE is contributing towards rapidly advancing our efforts to engineer and offer integrated topside solutions with standardized interfaces, which should materially improve the economics of deepwater production development.

With the average price for WTI still hovering below $50 a barrel during the quarter, new order intake remains soft. While certain operators have slightly increased activity related to working down the inventory of drilled but uncompleted wells in the US, it has not yet translated into an increase in activity for our Well Intervention and Stimulation business and other completion-related offerings. But conversations regarding the plans to step up activity have increased.

Additionally, we are seeing slight increases in production and infrastructure related offerings, something we see as a good indication operators are preparing to get back to work as they cannot complete wells without having the production infrastructure in place.

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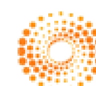

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For the third quarter, we expect revenue to increase around 10% as we execute on certain large projects booked earlier in the year and see continued improvement in our production-related businesses. We should see 30% decrementals on the increase in revenue, and we expect to realize an additional $10 million benefit from the ongoing cost savings and efficiency enhancing initiatives which are occurring across the segment.

While market conditions have proved challenging through the first half of 2016, we have been able to generate cash flow from operations of approximately $750 million, more than twice the amount produced during the first half of 2015. With a current cash balance of $1.7 billion and an undrawn capacity on our credit facility of $4.4 billion, we have total liquidity in excess of $6 billion. So from us a financial standpoint, NOV is very well positioned.

We hope our commentary this morning also provided you with insights into how well NOV is positioned from an operational and strategic standpoint. We are working hard to continue our long history of pioneering the critical technologies which drive the oil and gas industry, and the entire team at NOV remains laser focused on reducing our cost structure and fine-tuning our ability to execute more efficiently, regardless of the market environment.

With that, Michelle, we will open it up to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Kurt Hallead, RBC Capital Markets.

Kurt Hallead - *RBC Capital Markets - Analyst*

So I wanted to focus a little bit more on Rig Aftermarket. You mentioned that you are starting to see some pickup in inquiries, and I just wanted to make sure I heard you correctly. Was most of the inquiries coming from the land business, or is there some mix of land in offshore?

Jose Bayardo - *National Oilwell Varco, Inc. - SVP, CFO*

I think we are really seeing a mix of both, Kurt. Certainly, active dialogue and action related to reactivations, re-mobilizations in the US land market, as well as more dialogue and more action related to service and repair-related activities offshore, as well as some reactivations that have been taken place in the Gulf.

Kurt Hallead - *RBC Capital Markets - Analyst*

Okay. Great. And then, I was also wondering, as you guys are always very active in central M&A, do you feel like we are at an inflection point where deals could start to get done and bid-ask spreads have kind of narrowed?

Clay Williams - *National Oilwell Varco, Inc. - Chairman, President and CEO*

Yes, we do, Kurt. In 2015, we had a lot of conversations underway, but not many closings as valuations continued to move downward. I think, as we entered 2016, we are starting to see, I think, counterparties that are really coming to grips with the very, very tough market we all find ourselves in. And so that has helped in driving bids and asks together. And so I am actually very encouraged with the number of conversations that we have underway.

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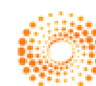

We had about -- I don't know -- seven or eight closings, I think, so far this year, and lots of other conversations that are underway. And, as you have seen, many that we have referred to in our comments on this call and the preceding call, a lot of really interesting technologies that I think will have a lot of leverage in an up cycle.

Kurt Hallead - *RBC Capital Markets - Analyst*

Great. And then one more follow-up, maybe for you, Clay, is a lot of discussion in the marketplace, given the -- it looks like the dearth of offshore drilling orders that are going to take place over potentially a multi-year period, that there is some viewpoint out in the marketplace that NOV is going to feel pressured to do a deal to kind of offset that business segment and potentially get into something a little bit different than just the manufacturing element. I was wondering if you might be able to provide some insights on how you are thinking about the longer-term review and whether or not NOV needs to get involved in something else other than manufacturing?

Clay Williams - *National Oilwell Varco, Inc. - Chairman, President and CEO*

Well, first, I would say that we don't disagree. I mean, you go back to our comments and we are kind of hunkering down for a much lower level of building in the offshore, and certainly that has been a big business for NOV over the preceding 12-plus years. But that is also nothing new. That narrative has been out there for a year and a half, and frankly we, since the downturn began, have been kind of preparing for a near-term future that looks that way. And, in view of that, we haven't jumped out there and done a great big deal.

What I would tell you is, I think we can get more impact from our capital by continuing to knock out these sort of bolt on transactions that are little bit smaller. When we examined the portfolio of acquisitions that we have made over the preceding 20 years, we find consistently that the smaller transactions carry higher returns and lower risk. The specific examples that we have done here in the last six months have been really interesting technologies, have brought on really, really good people. The Trican team, for instance, who came in with the completion tools business is very experienced in that space and can help us grow and build the business.

If you look back at our history, over the preceding 20 years, we have done a couple of large deals, but the business units that we have today that are mostly market leaders around the globe, were really built kind of transaction by transaction, smaller acquisitions bringing in really high quality businesses and products and technology and management teams and kind of brick by brick. And, to me, that is a more efficient, more workmanlike and more effective way to kind of build out global leading franchises.

And so if we see a terrific opportunity that is much larger, certainly we will act on it. But realistically, I think we can do, and will do, a lot of good by continuing to deploy capital through the downcycle and a lot of smaller, interesting, high-value acquisition targets.

Kurt Hallead - *RBC Capital Markets - Analyst*

That's great color. Thanks.

Operator

Sean Meakim, JPMorgan.

Sean Meakim - *JPMorgan - Analyst*

So, Clay, I was hoping maybe we could talk a little bit more about the GE partnership, and it seems like a lot of potential there. Is there any way you can help us size some of that potential, maybe just a couple of different ways to think about it, could be you are starting with brownfield opportunities, which makes sense, but what the cost savings could look like for the customer or either time savings to first oil, things that could really drive the value on greenfield projects. (multiple speakers) potential for you all.

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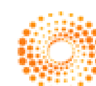

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Clay Williams - *National Oilwell Varco, Inc. - Chairman, President and CEO*

Yes. Sean, we -- a few years ago, we sort of began to invest in the FPSO opportunity. We did a little study or actually had an industry expert do a study around the FPSO construction results for the industry and looked at, I want to say, a dozen or more vessels. And, on average, they are 35% or more over budget and more than a year late. And when you talk about delaying production that much, when you talk about those sorts of costs overrun, that is a huge inefficiency in the space.

And so in terms of the savings that this may carry, I think, realistically, bringing a more industrialized sort of supply chain, standardization in the design, kind of the partnership that we are forging with GE. I think it is going to materially move the needle. The size of each individual project for the two of us is going to vary a lot, given the size and capabilities of the FPSO, but it can easily range well over $200 million per vessel for the larger FPSOs and beyond.

And so that is exciting.

But, more specifically, in terms of the near-term opportunities, the brownfield focuses -- the idea here is that we can develop families of small FPSOs that really target one, two, four, five wells and make those smaller accumulations more economic.

What is interesting is, if you look statistically across deepwater basins, there are a lot more smaller fields than there are giant fields. And so it is a larger opportunity set, a way that a new technology, new sort of industrialized system that enables many, many, many more smaller fields to be produced will enable GE and NOV and our shipyard partners to get up the learning curve on making these vessels. And so it seems that it will sort of grow on itself, and so we are pretty excited about that.

The other element to the strategy, I would also point out, is that a lot of these larger fields, some of the inefficiencies around FPSO construction stem from the fact that the view of the field changes over time. And so the forecast on production profiles and the like changes over time.

So part of our idea is, if we can take one of our smaller FPSOs and put it in a large field, put that field under production for a year or two, the owner of that field gets a lot smarter and enables all parties to sort of optimize the design of the larger FPSO that might come in later and produce the field through many more wells.

So on the whole, very excited about the partnership. I think GE is going to be a great partner and bring a lot to the mix.

Sean Meakim - *JPMorgan - Analyst*

Got it. Thank you for all that detail. And I guess I wanted to touch on Rig Systems also. Throughput has been coming in generally below expectations. Of course, that just pushes (inaudible) to the right, but can you give us some more detail on what is driving that confidence stabilization exiting 2016?

Jose Bayardo - *National Oilwell Varco, Inc. - SVP, CFO*

Sean, so yes. We are seeing -- you know, it is obviously a very challenging environment today. There is a lot of stress and strain on the systems. We are continuing to progress all of the contracts forward and are maintaining really good relationships with both the shipyards and the drilling contractors as well. But there is certainly a tremendous amount of tension between the drilling contractors and the shipyards, and to some degree we are helping facilitate those discussions.

And so while those pressures are in place, things tend to -- customers tend to want to put off acceptance of rigs, particularly for the rigs that don't have contracts in place. We still feel really good about the overall position, but, as you know, we are very cautious about making sure that we don't get over the tips of our skis in terms of the balance of where we are in terms of progress payments and the amount that we have at risk. So try to keep the overall portfolio in a positive position, and that is how we are managing the business.

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Clay Williams - *National Oilwell Varco, Inc. - Chairman, President and CEO*

Yes. We also see, I think, as you move into 2017, I think -- and Jose had this in his prepared remarks -- our outlook for the land side of the business is improving. And so the number of conversations we have underway -- part of what we saw in the second quarter, reactivations, the land rigs in North America, we have got others -- drilling contractors interested in not pulling the trigger yet on purchase orders, but interested in talking about new rigs. And then, in many international markets around the globe also. So I think you're going to see our mix shift in the coming quarters a little more towards land.

Sean Meakim - *JPMorgan - Analyst*

Okay. Got it.

Operator

Marshall Adkins, Raymond James.

Marshall Adkins - *Raymond James & Associates, Inc. - Analyst*

Morning, guys. A lot of great detail there. Appreciate that. A couple of conflicting things, and you probably reconciled them but I just missed it. Clay, you started out saying you are not really willing to call a bottom yet, but it sounds like in a lot of your businesses, you are at a bottom, probably saw in Q2. So I just want to get a little more color. We all know the offshore Rig Systems is going to be challenged for a while, but outside of that, you said you were at or near bottom of rig aftermarket. Wellbore tech completions seem like they are there, too. Am I missing something?

Clay Williams - *National Oilwell Varco, Inc. - Chairman, President and CEO*

Well, Marshall, I will stress what was also in my opening remarks, which is, we are seeing businesses within those Segments continuing to decline, and we are seeing pricing pressures continuing to mount, particularly overseas, generally. And so, again, kind of at or near bottom, a lot of crosscurrents, a lot of moving pieces. What I can tell you with a great deal of certainty, though, is that we are definitely taking costs out of these businesses, continuing to do that.

And so, yes, I hope you're right. I hope we are at bottom and maybe even have bottom in the rearview mirror on the Company's business units, but not ready to jump out there and say that emphatically.

Marshall Adkins - *Raymond James & Associates, Inc. - Analyst*

Okay. Unrelated follow-up. Clearly, you have capacity to expand in upturn, which we are looking for. What are going to be the bottlenecks on the way up? Is labor going to be an issue, or is there something else? I know you guys have spent a lot of time thinking about this. Is there something else we should be watching in terms of bottlenecks on the way back up?

Clay Williams - *National Oilwell Varco, Inc. - Chairman, President and CEO*

Yes, I would say our external supply chain, which we have talked a lot about insourcing over the last year and a half and have done a lot of that, when I think back to the ramp-up from 2006 onward, a lot of time and effort went into qualifying our vendors and kind of developing a supply chain that supports our operations. And, honestly, in terms of cost cutting, in 2015 that was kind of the first actions that we took, was to insource more and try to keep our factories loaded.

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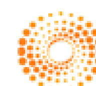

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So building out our supply chain once again will be challenging.

Labor will be a challenge, certainly. Obviously, a very painful time for this industry and for this Company to lose so many talented people, and attracting those folks back are folks that can come in and kind of grow with us is going to be challenged. But, look, this is nothing new in the oil field. This is a cyclical business, and I think we have said in prior calls, one of the critical skill sets you have got to have is the ability to both reduce quickly in markets like this, but also the ability to grow quickly when it goes the other way. And so, frankly, we're looking forward to solving the challenges that the upturn are going to bring to us.

Marshall Adkins - *Raymond James & Associates, Inc. - Analyst*

Pretty sure we are all looking forward to that. Thanks.

Clay Williams - *National Oilwell Varco, Inc. - Chairman, President and CEO*

Amen.

Operator

Tom Curran, FBR Capital Markets.

Tom Curran - *FBR Capital Markets - Analyst*

When it comes to the continued uptrend -- the secular uptrend in completion demand in intensity, the focus, understandably, tends to be on the implications for hydraulic fracturing, horsepower, and proppant consumption, primarily sand. And, yet, on Dover's Q2 call, they rightly reminded us that it has implications for other offerings, such as rod lift and the amount of rod consumption you will see as average lateral lengths continue to increase. Could you give us an update on all those different offerings for you or maybe just highlight a few where you are seeing the greatest impact of the continued uptrend in demand intensity?

Jose Bayardo - *National Oilwell Varco, Inc. - SVP, CFO*

Sure, Tom. I will start off on this, and then Clay can take it back. But, it is a good question. And I think people have -- sometimes have some misperceptions about our portfolio and product offering. But, really, as we see the trend that is moving forward across not just North America but all markets, and that trend is due to -- is related to more product consumptive wells, more service intensive and product consumptive wells. It is not just impacting specifically completion, what you think of as traditionally completion related items. It really impacts the entire well construction process.

So even though we are drilling much more efficiently and the rate of penetration is much, much higher, on a per footage basis, the amount of tubing, bits, motors, et cetera, that you consume is remaining essentially the same on a per foot basis.

Additionally, when you are putting in the volumes of sand and proppant and all these other items, you think about the flow back type operations, you think about production chokes, and things of that nature, that is an area where we are seeing seeing a lot of demand for our products. And I think earlier, Clay touched on rod lift and the rods to where we are seeing a lot of demand and attention put on that product offering.

So, across our Wellbore Technologies Segment, as well as some large components for Completion & Production Solutions Segment, we are seeing -- we're going to see a good impact from the trends that are taking place.

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Clay Williams - *National Oilwell Varco, Inc. - Chairman, President and CEO*

Yes. Specific on our artificial lift, we did see a pickup in the second quarter on rod guide application, and we did a little bit of that. Robbins & Myers brought a lot more to our Tuboscope Business Unit within Wellbore Technologies, and we saw pickup in the second quarter. A lot of these shale wells were going on rod lift pretty quickly. And those products are, in addition to, downhole progressing cavity pumps, rotating heads, other artificial lift products that we have, and those are in addition to, as I just mentioned, production chokes, our dynamic oil recovery system for produced water. We have a lot of compeletion and a growing portfolio of production equipment and processing and treatment equipment, centrifugal pumps, LACT units, those sorts of things.

So NOV -- we have been quietly investing more in that area and kind of growing out that portfolio, and we would absolutely echo Dover's comments that it is not just the horsepower, it is everything else that goes with that that will benefit.

Tom Curran - *FBR Capital Markets - Analyst*

Right. Thank you for that, guys. Returning to the M&A line of questioning, if you were to consider a more sizable transaction, given your current expectations with regard to the timing and the strength of the recovery, what is the highest you would be willing to take your leverage exiting that transaction?

Clay Williams - *National Oilwell Varco, Inc. - Chairman, President and CEO*

I am actually going to beg off answering that specifically. We have looked at larger transactions. I think my earlier answer kind of gave you a feel that it would have to be very, very compelling, and I think we would have to look at the actual opportunity and the proximity to the upturn to make the call on kind of what we would think would be an appropriate balance sheet profile going into that.

So that is all very, very speculative. But, just to state it more bluntly, I think we are mostly interested today, as we look out across a big and growing portfolio of potential M&A opportunities, in pursuing a lot of smaller critical technologies, bolt-on sort of ads, that we really think are going to create the most shareholder value for our shareholders in the upturn.

And, again, I can't stress this enough. This is sort of how we really did build the business over the last 20-plus years, and having now moved into much more of a buyer's market, that sort of roll up your sleeves and get out there in a lot of conversations and look for opportunities to add on smaller acquisitions, I think, is the best application of capital.

Conversely, to go out there into and to make one larger bet on one larger transaction and sort of say, well, that is it, it is just far less appealing.

Tom Curran - *FBR Capital Markets - Analyst*

All right. I appreciate the thoughts.

Operator

Byron Pope, Tudor, Pickering, Holt.

Byron Pope - *Tudor, Pickering, Holt & Co. Securities - Analyst*

I had a question about Completion & Production Solutions with regard to the Q3 guidance and top line being up sequentially. I would think that that would be elements of Well Intervention and Stimulation Equipment that would lead the way, but I was just wondering, maybe, Jose, if you can provide some color around what is driving that? And if you spoke to it earlier, I apologize.

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Jose Bayardo - *National Oilwell Varco, Inc. - SVP, CFO*

No problem, Byron. It is a combination of factors. One of the items driving it is a large anticipated shipment from -- related to an order in our Well Intervention and Stimulation business. But, as we also talked a little bit about, we are seeing some pretty good orders coming in and discussions related to more production-oriented equipment. So that is the primary factor associated with the pickup in revenue.

Clay Williams - *National Oilwell Varco, Inc. - Chairman, President and CEO*

Yes. We have also seen pretty good demand on flexible pipe for Brazil as well.

Byron Pope - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Okay. And then, Clay, one question for you, just sticking with Completion & Production Solutions, it seems as though -- when you all had your analyst day, it seems as though one of the long-term goals for that segment was this notion of integration. And it seemed as though E&P operators weren't necessarily standardizing on surface production and processing equipment. Is it your sense that during this downturn and maybe coming out of this downturn more appropriately E&P reception to that more standardized integrated model on the surface production side might be gaining some traction?

Clay Williams - *National Oilwell Varco, Inc. - Chairman, President and CEO*

Yes. If you are talking about FPSO, certainly. And I think our customers recognize their model is broken, and so there is a lot of receptivity to doing things differently there.

With regards to onshore, it remains fairly fragmented. Volumes are down, and so our customers, I think, are more open to buying -- assembling their own packages. However, there are benefits to our customers through acquiring a little broader package of equipment when it comes to putting in processing equipment for land wells as well.

Byron Pope - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Okay. Thanks, guys. I appreciate it.

Operator

Thank you and this does conclude today's Q&A session. And I would like to turn the conference back over to Mr. Clay Williams for any closing remarks.

Clay Williams - *National Oilwell Varco, Inc. - Chairman, President and CEO*

Thank you, Michelle, and thank you all for joining us. We look forward to speaking to you next quarter.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a great day.

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