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Q3 2018 Forum Energy Technologies Inc Earnings Call

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## PRESENTATION

### Operator

Good day, ladies and gentlemen, and welcome to the Q3 2018 Forum Energy Technologies Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded. I would now like to introduce your host for today's conference, Mark Traylor, Vice President of Investor Relations. Please go ahead.

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### Mark S. Traylor *Forum Energy Technologies, Inc. - VP of IR & Planning*

Thank you, Sarah. Good morning, and welcome to Forum Energy Technologies' Third Quarter 2018 Earnings Conference Call. With us today to present formal remarks are Prady Iyyanki, our Chief Executive Officer; Pablo Mercado, our Chief Financial Officer; and Lyle Williams, Senior Vice President of Operations.

We issued our earnings release last night and it is available on our website. The statements made during this conference call, including the answers to your questions, may include forward-looking statements. These statements involve risks and uncertainties that may cause actual results or events to differ materially from those expressed or implied in such statements. Those risks include, among other things, matters we have described in our earnings release and in our filings with the Securities and Exchange Commission. We do not undertake any ongoing obligation, other than that imposed by law, to publicly update or revise any forward-looking statements to reflect future events, information, or circumstances that arise after this call.

In addition, this conference call contains time-sensitive information that reflects management's best judgment only as of the date of the live call. Management's statements may include non-GAAP financial measures. For a reconciliation of these measures, refer to our earnings release.

This call is being recorded. A replay of the call will be available on our website for 2 weeks following the call.

I'm now pleased to turn the call over to Prady Iyyanki, our Chief Executive Officer.

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### Prady Iyyanki *Forum Energy Technologies, Inc. - President, CEO & Director*

Thanks, Mark. Good morning, everyone. I want to start my comments this morning with an overview of our third quarter results and provide our assessment of current and long-term market conditions. Pablo will then share details on our financial performance and liquidity position, and Lyle will discuss a few of our operating initiatives.

Forum was on a strong growth trajectory until the third quarter when we were negatively impacted by the slowdown in U.S. completions activity and tariffs. Despite these challenges, our revenue was down just slightly and adjusted EBITDA was up.

To summarize our third quarter financial result, orders were \$275 million dollars, approximately flat sequentially excluding the large submarine rescue package order received in the second quarter. Adjusted EBITDA was \$29 million dollars, up \$2 million sequentially despite a 3% decline in revenue. Our book-to-bill ratio was 103%.



Some of the highlights for the third quarter are as follows. We grew our artificiallift product orders and revenue in the quarter. We have created a full artificiallift protection solution including our Multilift SandGuard, Cannon cable protectors and ESPCT products, which are attracting new customers and generating several cross-selling opportunities. These products are also gaining momentum outside North America.

Orders in the Production Equipment product line were up 39% as operators began placing orders for 2019 deliveries, including a sizable order from a Marcellus operator. As the international recovery began to unfold, our Drilling product line bookings were up 11% as we continue to win orders from the Middle East for land rig equipment.

Consistent with our strategy to expand the Completion segment, we acquired Global Heat Transfer subsequent to the quarter. We are really excited about the strategic fit of this acquisition.

GHT's flagship product, the Jumbotron, is an innovative cube-style radiator that substantially reduces customer maintenance expense. GHT's radiator is a differentiated product solution due to its Smart monitoring, innovative heat exchange filter, and cube configuration which results in an expedited maintenance process. This product is complementary to our existing portfolio of hydraulic fracturing equipment and has a maintenance schedule that is similar to our power ends.

The ability to obtain simultaneous maintenance on these products at one facility should reduce downtime significantly for our customers, and expand our after-market revenue. Being part of Forum will also allow the GHT team to expand its sales beyond pressurepumping market, as we see significant opportunities with the drilling customers and in other industries.

Now with respect to a long-term outlook, Forum's balanced portfolio of consumables and capital equipment, serving global markets across the well cycle positions us nicely to benefit from the long-term industry recovery. Looking ahead, we are making progress with each of our growth drivers and will have impact in 2019. These growth drivers are the international and offshore recovery, Completions' service intensity, the global midstream and downstream build-out, new product development and market share gains.

Although our favorable growth drivers remain intact, we are experiencing near-term headwinds from the slowdown in U.S. completions activity and the impact of tariffs.

We are taking actions to minimize the impact of the transitory slowdown in U.S. completions activity. [All the while] we are maintaining the operating capability to respond to the U.S. recovery as 2019 E&P budgets are established and completions activity rebounds. Lyle will address our response to reduce the impact of these near-term headwinds in his remarks.

Now let me ask Pablo to take you through our results and financial position. Pablo.

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**Pablo G. Mercado *Forum Energy Technologies, Inc. - Senior VP & CFO***

Thank you, Prady. Good morning. Total orders for the company were \$275 million, down \$36 million or 11% from the second quarter. The decrease was primarily due to the large subsea capital equipment order received last quarter and to a lesser extent a slowdown in U.S. completions activity. The book-to-bill ratio was 103%.

Our third quarter revenue was \$267 million, down only \$7 million or 3% sequentially, despite the slowdown in Completions activity.

Net loss for the quarter was \$3 million or \$0.03 per diluted share. Results for the quarter included restructuring and other charges totalling \$8 million, on a pretax basis, offset by \$1 million of foreign exchange gains. We provided a reconciliation table of these special items in our earnings release for your reference.

Adjusted EBITDA was \$29 million or 10.9% of revenue, a sequential improvement of 90 basis points. Our adjusted net income was \$0.03 per diluted share, excluding special items.

I will now summarize our segment results on a sequential basis.

In our Completions segment, orders decreased 5% to \$115 million. Segment revenue was \$119 million, a decrease of \$8 million or 6%. This was due to a slowdown in completions activity partially offset by higher market penetration of our artificial lift products.

Adjusted EBITDA margins were 23%, consistent with the prior quarter, as the impact of tariffs was offset by higher mix of high-margin downhole products.

Production and infrastructure segment orders were \$100 million, an increase of 1%, on strong orders of wellsite production equipment, as operators prepare for 2019 development plans. This was partially offset by decline in orders for valves after the product line delivered two consecutive quarters of record orders. Demand for valves in the quarter was somewhat negatively impacted by the recently imposed tariffs. Segment revenue was \$95 million, an 8% increase, resulting primarily from higher sales of valves as well as surface production equipment.

Adjusted EBITDA margins were 8% for the segment, an improvement of approximately 80 basis points.

In our Drilling & Subsea segment orders were \$60 million, a 33% decrease due to the large rescue submarine award received last quarter. Orders in our drilling product line increased by 11% as we continue to win international awards.

The book-to-bill ratio for the segment was 110%. Segment revenue was \$55 million, a decrease of \$5 million or 9%. This was due to the timing of drilling equipment deliveries and lower revenue recognition on subsea projects. Adjusted EBITDA for the segment improved to \$1.5 million with positive contribution from both product lines.

In October, subsequent to the quarter, we acquired GHT for \$52 million in cash and an earn-out, under which additional cash consideration will be paid if certain conditions are met in 2019 and 2020. We expect GHT to generate approximately \$12 million of EBITDA in 2018. Consistent with U.S. hydraulic fracturing activity, GHT's 2018 results will be weighted more towards the first half of the year.

I will now discuss some additional details about our results and financial position at the Forum level.

Our free cash flow after net capital expenditures in the third quarter was negative \$4 million, an improvement of \$8 million over the second quarter.

Despite the inventory investments made in anticipation of strong U.S. Completions activity in the second half of this year, we are on track to be free cash flow positive in the fourth quarter and for the second half of the year.

Our net capital expenditures in the third quarter were \$5 million. We expect our net capital expenditures for the year could be under \$25 million.

Our balance sheet and financial position remain strong. Our liquidity position at the end of the third quarter before the acquisition of GHT, was approximately \$246 million. Net debt was \$440 million and our net debt to total capitalization ratio was 24%.

Our reported diluted share count for the third quarter was 109 million shares. Since our adjusted net income was positive, our adjusted diluted share count, including the impact of options, was 111 million shares.

Interest and depreciation and amortization were \$8 million and \$19 million respectively, in the third quarter. We expect these to remain at similar levels in the fourth quarter.

Adjusted corporate expenses were \$7 million in the third quarter, a sequential decrease of \$2 million, due to a reduction of variable compensation expenses. We expect corporate expenses to return to the second quarter level of approximately \$9 million in the fourth quarter.



We estimate that our effective tax rate in the fourth quarter will be over 25%, since we continue to have unrecognized international tax benefits.

For more information about our financial results please review the earnings release on our website.

Now let me turn the call over to Lyle to discuss some key operating initiatives.

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**David Lyle Williams *Forum Energy Technologies, Inc. - SVP of Operations***

Thank you, Pablo. Good morning, everyone.

As Prady mentioned, completions activity reductions and tariffs are headwinds impacting our near-term results. We are focused on executing our mitigation plans in these areas and improving on our overall operational execution.

First, regarding steel costs, we are seeing inflation generally including the impact of tariffs. We are reducing the impact by passing along a portion of the costs to our customers and through ongoing strategic sourcing initiatives.

Tariff expenses were approximately \$2.5 million in the third quarter, impacting both the Completions and P&I segments. Despite this fact strong execution by our team allowed us to maintain overall gross margins flat with the second quarter.

We expect tariff expense to increase by approximately \$2 million in the fourth quarter. As a result, we are expanding our mitigation efforts by working to source some of the impacted materials from non-tariffed countries.

Second, we are reacting prudently to the slowdown in well completion activity. Our supply chain partners are cooperating with us to reduce inbound material and to defer inventory receipts to next year.

We are managing our variable costs by reducing production hours at a few of our manufacturing facilities, while maintaining the capability to support our growth in 2019.

In addition, we are continuing to optimize our cost structure, which I discussed last quarter. For example, in the third quarter we completed the consolidation of facilities in the Aberdeen area and will complete other cost reductions this year. We remain committed to achieving our long-term goal of improving EBITDA margins to predownturn levels.

Finally, we continue to focus on working capital efficiency. Our team actively managed inventory and quickly throttled back incoming material as activity slowed in the third quarter. As a result, our inventory increased only modestly. We are confident that the continuation of these efforts will yield higher free cash flow this quarter and moving forward.

Let me turn the call back over to Prady for closing comments.

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**Prady Iyyanki *Forum Energy Technologies, Inc. - President, CEO & Director***

Thanks, Lyle.

Despite the short-term headwinds we are facing, Forum is well-positioned to benefit from the strong long-term energy macro environment, including the international and offshore recovery.

Looking past the U.S. Completions softness, we expect incremental contribution from the following: first, our completions segment rebounding and exceeding its previous levels; second, the GHT acquisition; third, the Drilling & Subsea segment's recovery; fourth, our tariff mitigation strategy, which Lyle has discussed; and finally, market preparation of new products.

For the fourth quarter we expect EBITDA to be in the range of \$21 million to \$25 million and to generate positive free cash flow in the

fourth quarter and also for the second half of 2018.

I am also confident that we will generate strong free cash flow in 2019.

Our team remain focused on the areas that we can control. Operational execution, including tariff mitigation, free cash flow generation, maintaining balance sheet discipline, and finally, driving our long-term growth.

We thank you for your interest. At this point we will open the line for questions. Operator, please take the first question.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from the line of George O'Leary with Tudor, Pickering, Holt & Company.

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### **George Michael O'Leary Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - Executive Director of Oil Service Research**

I thought the free cash flow commentary was interesting. I wonder if you guys could just dig in on that a little bit further. As we look out to the fourth quarter, any incremental color you could provide on what bridges the gap and gets us to free cash flow positive for overall back half of 2018 will be helpful. And maybe the magnitude of free cash flow you think you-all might be able to generate in the fourth quarter would be helpful.

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### **Prady Iyyanki Forum Energy Technologies, Inc. - President, CEO & Director**

Yes. Sure, George. First of all, if you look at all of 2018, George. We've been making sequential improvement quarter after quarter. And in the fourth quarter I think there was a sequential improvement of \$8 million. Again, just to remind, when we -- the Completions business grew 70% last year and 20% in the first half of this year, so we were building working capital not only to support that growth but also we were anticipating a strong second half of 2018. And despite all the challenges of managing the inventory and pushing out into the next year, in some case cancelling it, we have sequentially made improvement in the -- in the fourth -- in the third quarter. And more importantly, we will make sequential improvement going to the fourth quarter. And that's why we are pretty confident that we will generate free cash flow positive not only in the fourth quarter but also positive -- free cash flow positive for second half of 2018. And more importantly, we will generate strong free cash flow going to 2019. And George, I think at the first quarter call we can give some more guidance on the magnitude of that.

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### **George Michael O'Leary Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - Executive Director of Oil Service Research**

Great. That's helpful. And then maybe as a second question, very healthy level of power end orders during the quarter in your Completions business. Wonder if any color you could provide on whether that's going to replacement or new equipment and what the cycle times are there. So when might we expect the revenues to flow through from those power-end orders?

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### **Prady Iyyanki Forum Energy Technologies, Inc. - President, CEO & Director**

Yes. Which I think we continue to do very well on the power ends and continue to gain market share on the powers ends. And we think we have the absolute best power end in the market. In the third quarter specifically, George, I would say the split between maintenance and the new fleet was pretty much the same as the third quarter. Now we did see later part of the quarter more biased towards the maintenance, which is what we would expect in the fourth quarter. But we'll give you more guidance. There are some customers talking about some new fleets going into next year. We will see if that materializes or not. But I would expect the split to be more biased toward maintenance.

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### **Pablo G. Mercado Forum Energy Technologies, Inc. - Senior VP & CFO**

Yes, George, in terms -- just to add to that. In terms of when the revenue would come through, generally for the whole segment it's about one quarter. So most of these orders are relatively short in nature. Book-to-bill ratio for that segment anywhere from 90% to 110% is perfectly normal and healthy, as it's mostly book and ship.



**George Michael O'Leary Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - Executive Director of Oil Service Research**

Got it. And I'll sneak in one more if I could. On the Drilling side, the color on Middle East driving the booking up 11% quarter-over-quarter is helpful. What are you seeing on the U.S. side for Drilling, is it still just continued upgrades or any rig new builds U.S. onshore yet?

**Prady Iyyanki Forum Energy Technologies, Inc. - President, CEO & Director**

George, if you look at North America, George, also the activity is pretty stable on the North America, more biased towards the consumables in North America. However we are excited about the international recovery unfolding. If you look at the drilling orders, they were up 11% and a big part of that was some of the capital equipment orders materializing from Middle East. And also going to the fourth quarter and '19, we have a pretty robust pipeline of projects in the Middle East and Asia. Slow to materialize, and we've been talking with the Kuwait project for some time. But when they do materialize they come in big chunks. And I think that's what you should expect going to 2019, is there could be one quarter where we have some big bookings in Drilling and also in Subsea and another quarter we may not. So it'll be chunky of nature and I think as international and the offshore continues to recover, we will start seeing continuous flow of the big projects, but they will be chunky of nature.

**Pablo G. Mercado Forum Energy Technologies, Inc. - Senior VP & CFO**

Just to add to Prady's comments that in the U.S. market the rig count continues to be pretty healthy. And we would expect it to continue to pick up. There are a couple of drilling contractors that have opportunities to upgrade their drilling rigs and add them to the active rig count and those opportunities will be larger for us than they have been in the past. We haven't seen a lot of those quite yet but I think as the market continues to unfold we would see some of those.

**Prady Iyyanki Forum Energy Technologies, Inc. - President, CEO & Director**

Yes, I think last year, George, we saw a big slew of mud pump upgrades. And they have pretty much stabilized early part of this year. So what we are seeing now on the upgrade front in North America is the scope is larger, the content could be up to \$2 million or even more in some cases but the number of rigs being upgraded are smaller, right, compared to what we saw in '17. But the drilling activity is stable and even in the fourth quarter we expect it to be stable.

**Operator**

Thank you. Our next question comes from the line of John Watson with Simmons Energy.

**John H. Watson Simmons & Company International, Research Division - VP & Senior Research Analyst**

I wanted to ask another question on Completions. I agree that we should see a pickup in activity at some point next year. Do you have any view on the timing of that recovery? Are you seeing indications of potential orders for Q1? Are you expecting more of a revenue uptick in Q2 or Q3?

**Prady Iyyanki Forum Energy Technologies, Inc. - President, CEO & Director**

Now it's a great question, John. We would expect the recovery to happen probably in 2 phases. The first phase would be just the 2019 E&P budgets being replenished and the seasonal issues of the fourth quarter going away. So that will create activity levels going up. And then the second phase would be the transportation issue in Permian and also in Marcellus, the gas pipelines. And that would drive the second phase of activities going up in completions. The visibility, whether it's going to happen, which month in the year, I don't think we have that kind of visibility, but for sure once the E&P budgets are established we would expect to see activity increase in Completions.

**John H. Watson Simmons & Company International, Research Division - VP & Senior Research Analyst**

Understood. Thanks for that, Prady. Speaking to Q4 specifically, the orders in 3Q were solid. Should we expect, could revenues be flat in 4Q or will the holiday slowdown preclude revenues from staying flattish?

**Prady Iyyanki Forum Energy Technologies, Inc. - President, CEO & Director**

That's a good question, John. As -- we held back in revenue guidance this quarter primarily due to lack of visibility into the Completions slowdown, right. I mean we just don't know after the Thanksgiving break how is it going to play out. The anecdotes we're hearing from our customers which is consistent with what you may have heard from the big service companies is some are talking about extended breaks during the Thanksgiving, and the December and the budget exhaustion and all that. So the visibility on the Completions side for

us is not clear once we start going into the mid-November period. We do have visibility on the Drilling & Subsea and the P&I segment. And what we would expect is the drilling activity remains stable and we expect our P&I segment in fact to be higher, sequentially in Q4 than Q3. But the revenue guidance on Completions is difficult to -- what could help you guys is probably we do expect some margin degradation. Not sure of the extent I think there are probably some transitional issue, one is the high-margin Completions slowdown and the mix which comes with it. And also the tariffs, which Lyle talked you about, which are also transitional of nature because we had a mitigation strategy on that which Lyle talked you about. And then the last piece being the corporate cost which Pablo talked about which comes back to normal in 4Q. I hope that helps, John.

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**John H. Watson *Simmons & Company International, Research Division - VP & Senior Research Analyst***

No, that's super helpful. Thank you. One last one on Global Heat Transfer. Can you help us think about what revenues were in 2018 just for modeling purposes or what revenues could be in the realm of?

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**Prady Iyyanki *Forum Energy Technologies, Inc. - President, CEO & Director***

I'll let Pablo answer that. Yes, Pablo?

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**Pablo G. Mercado *Forum Energy Technologies, Inc. - Senior VP & CFO***

Yes. Hey John, just -- so more color on the acquisition on. At this point we just gave the EBITDA piece which is \$12 million. They are significant EBITDA margins. So I would say accretive to Forum's overall margins today. With a \$52 million purchase price at least the upfront consideration, that's obviously a pretty attractive multiple. And we are very excited about the prospects for this acquisition on a go-forward basis.

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**Prady Iyyanki *Forum Energy Technologies, Inc. - President, CEO & Director***

And just to give you some more color on GHT, what our excitement here is, there were 85,000 radiators which is a legacy product, the horizontal radiators and they will go through an upgrade program where the cubical radiators will take its place. So the opportunity to retrofit this large install fleet is ahead of us. And that's one big opportunity for the GHT. The second is, I think going into the next year the new frac fleets, that will also contribute and they have pretty good maintenance cycle of 3 years and 6 years and 9 years which will also drive revenue. And that's all on the frack side. And the second area, region of focus as they being part of Forum is with our Drilling customers there's another segment where we're going to penetrate and also on the midstream side and primo industry. So really excited about this acquisition. And the team is dynamic and realistic and did a nice job of building the business and we're going to scale it up.

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**Operator**

Our next question comes from the line of Jacob Lundberg with Credit Suisse.

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**Jacob Alexander Lundberg *Crédit Suisse AG, Research Division - Research Analyst***

I guess first -- first question just on the valves factory and -- or facility in Saudi. What was the contribution in 3Q? And then if we could get just an update on sort of timing, magnitude of ramp there. And can you remind of the revenue target?

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**Prady Iyyanki *Forum Energy Technologies, Inc. - President, CEO & Director***

Yes. Jacob, as you know, the operation was active only part of this year. The shop was built and we were open to do business. So starting third quarter orders are trickling in, so we had a pretty good order intake mostly on the practical side and the transactional side. But we did get orders in the third quarter. The approvals are coming through slow but they are coming through, which we anticipated. So we did get one big approval from one of the petrochemical companies in the third quarter. The Saudi Aramco approval we have not received yet but we do expect to get that in the next few months, so the -- we going to next year, we're also expecting orders in the fourth quarter. So our outlook has not changed. I think what we've told the investment community is \$50 million of bookings in the third quarter -- in the third year and this is the first year. So we -- our outlook is intact and we are making good progress with the approvals and also orders coming through. And we're pretty confident we're going to hit the outlook.

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**Pablo G. Mercado *Forum Energy Technologies, Inc. - Senior VP & CFO***

So just to add to Prady, more specifically in the quarter I think he gave you enough color to conclude there was not a significant contribution yet from Saudi, so that is still ahead of us.

**Jacob Alexander Lundberg *Crédit Suisse AG, Research Division - Research Analyst***

Got it. Thank you. And then if we could go back to the acquisition. I was just wondering if we could get a little more color on what sort of the product service mix looks like there. If there's anything you can tell us about kind of unit economics. Where is current market share? And then, I know it's a lot of questions altogether, but then what sort of revenue or cost synergies do you think you can squeeze out there?

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**Prady Iyyanki *Forum Energy Technologies, Inc. - President, CEO & Director***

Yes, I -- listen, the synergies in this case, in this particular acquisition would be to penetrate markets with Forum's customer base, right, which is the drilling customer base and the midstream customers. And I think for top line synergies are pretty significant for the acquisition. The second is the aftermarket, right? If you look at the maintenance cycle of a radiator and the maintenance cycle of a power end, they're pretty much the same. So the opportunity of doing both in the same location at the same time is a significant downtime and maintenance savings for our customers. And then from an economic standpoint, listen, I mean we don't give price level for radiators, but what I could say is the -- when we do an upgrade of replacing even a horizontal radiator with a GHT radiator, we're replacing with a brand new radiator, and that's the upgrade process. And the savings for our customers are pretty significant. The price range is little greater than a fluid end, and the maintenance cycle is close to a power end. Hopefully that's helpful. Pablo, can you add any color here?

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**Pablo G. Mercado *Forum Energy Technologies, Inc. - Senior VP & CFO***

Yes, so just to add on what -- to what Prady said, I think this business has had great success on the new equipment side. So in terms of market share, very high market share, kind of new radiator sales these days. But as he mentioned, it is a great opportunity to retrofit the installed base of 85,000 radiators that are out there. So the revenue today is more product weighted but GHT and Forum overall we have a great opportunity to expand the aftermarket service revenue. And then as Prady mentioned, the cost, somewhat similar to a fluid end. I think that's a key thing to think about because it is a relatively low-cost product but it is a critical component to protect your engine which is a very large investment. And in addition to that, if you've got one of these radiators that are cube styled, that are easier to clean and easier to service, you're going to be reducing your maintenance cost. So the value proposition is just fabulous for our customers.

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**Prady Iyyanki *Forum Energy Technologies, Inc. - President, CEO & Director***

And probably Lyle can add some color on the aftermarket too.

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**David Lyle Williams *Forum Energy Technologies, Inc. - SVP of Operations***

Yes, thanks, Prady. Jacob, when we think about our frac products and space, we've got really great products in terms of power ends, in terms of our -- in terms of manifold product. We've great success in the market with those. We are building our aftermarket capability there. We have some obviously and we're able to service our products. The fit of GHT in with our team really magnifies our ability to service our customers and will give us some strong legs from an aftermarket perspective going forward. Finally, when you pair up -- Prady mentioned the smart radiator and smart diagnostic technology there, that's another fit with what we've been doing on the digital technology side in order to link ourselves in with our customers, help them understand the nature and maintenance requirements of their products and to drive incremental aftermarket revenues for Forum.

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**Jacob Alexander Lundberg *Crédit Suisse AG, Research Division - Research Analyst***

Yes, that's helpful. And if I could sneak one more in. You talked about incremental \$2 million cost impact from the tariffs in 4Q. How would that be kind of allocated between P&I and Completions?

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**David Lyle Williams *Forum Energy Technologies, Inc. - SVP of Operations***

Yes, Jacob, this is Lyle again. So I think the key point in thinking about tariffs for us is that we're not really -- we're not disproportionately disadvantaged versus any of our competitors, feel like we're right in the mix there. And we've got good strategies with a dedicated team working to mitigate those over time. What we're seeing now is we're seeing the full effect of the tariff flowing through the balance sheet into the P&L and probably -- and even waiting between those two segments of what we see in terms of that incremental impact in the fourth quarter. So seeing that longer term, how that's exactly going to play out is going to depend on how our mitigation strategies work and how much we're able to push back and share with our customers and supply chain partners. So far we've been able to share about half of the tariff impact between our customers and our vendors, so looking to mitigate that other half of the tariff impact is what we're working on.

**Prady Iyyanki Forum Energy Technologies, Inc. - President, CEO & Director**

And I think the mitigation strategy job includes nonstrategic sourcing which will also help us even if the tariff goes away because we're going to create some competition for our (inaudible).

**Pablo G. Mercado Forum Energy Technologies, Inc. - Senior VP & CFO**

Just to address your question more specifically in terms of what segment is being impacted, both segments are impacted as Lyle mentioned, probably a little more weighted towards the completion side at this time.

**Operator**

(Operator Instructions) Our next question comes from the line of Martin Malloy with Johnson Rice.

**Martin Whittier Malloy Johnson Rice & Company, L.L.C., Research Division - Director of Research**

Could you maybe talk about the tone of the customer conversations that you're having regarding offshore and in Subsea, maybe the outlook for the non-oil and gas component of that?

**Prady Iyyanki Forum Energy Technologies, Inc. - President, CEO & Director**

Yes, great question, Martin. As you know, if you look at the last 6 quarters of Forum is a 3-cylinder engine, Completions, P&I and Drilling & Subsea. And the contribution from Drilling & Subsea segment have not been meaningful. And as the international recovery unfolds, including the offshore, the Drilling & Subsea segment has significant earnings potential ahead of us. And to answer your question now, Marty, I would say we are tendering significant projects in Middle East and in Asia, capital projects on the Drilling side. And the pipeline for offshore projects, including the jack-up rigs on the drilling side, which will be the first one to recover on the drilling front. And on the nonoil and gas it's pretty robust. So as mentioned in the last call, we will announce some orders also in the offshore front in the next 3 to 4 months, and some of them are at a matured stage. But we're very confident that the contribution from drilling and subsea segment will be meaningful going into 2019. But if I can give you a broader picture than that, Marty, what I would say is a path to Completions' softness in North America we have 5 big levers, right, the first one is what you just talked about, is the international and offshore recovery will be meaningful for the drilling and subsea contribution but will also contribute on the completion side because our Global Tubing product lines were 30% international. It will help that product line. And also to go back to our Downhole product line, it was about 40% international in 2014, right. So the international and offshore recovery is important not only for the Drilling & Subsea segment but also Completions. That's the first one. The second one is the GHT acquisition which we just talked about and the incremental contribution from that. And we expect GHT to be much longer in the second half than the first half of 2019. And we expect the Completions segment to rebound and exceed its previous levels, which would be the third lever. And the fourth one is the tariff mitigation strategy. I mean, the best thing to happen is the tariffs move away. But even if they don't, we have a pretty solid strategy to mitigate a big part of the 50% which would be not able to pass on to our customers. And then finally, the market penetration of our new products, right. We have several new products in the pipeline and they will contribute meaningfully for us going into '19.

**Martin Whittier Malloy Johnson Rice & Company, L.L.C., Research Division - Director of Research**

Okay, great. And then on the Subsea side, the non-oil and gas opportunities that are out there.

**Prady Iyyanki Forum Energy Technologies, Inc. - President, CEO & Director**

Yes, Marty, let me give you some color there, is while our teams have done a nice job during the downturn to penetrate the non-oil and gas part of the market, I mean just to give you some color, if you look at 2018, I would say more than 60% of activity is coming from non-oil and gas and will not be any different going into 2019. And I can safely say that the subsea business will grow. To what extent, we'll give you more color in the first quarter going into 2019. But more than 60% of revenue will come from non-oil and gas. And what's driving that is -- is primarily if you look at the defense budgets are going up in North America with some of the defense customers. And also the defense spend in for the far East with this China highway being built is creating some opportunity. And one of the big submarine order was an opportunity coming out of that which we announced in second quarter. So going into '19, we will have a pretty good baseline for the nonoil and gas, which will not go away. And that will be oil and gas comes on the top of it, which we do expect to get some orders, that will be in top of it. So we really feel good about the Subsea business and the offshore recovery which is going to be slow but the nonoil and gas and the slow trickling of oil and gas will help the subsea business to contribute meaningfully for us.

**Operator**

We have no further questions at this time. I would now like to turn the call back to Mark Traylor for any further remarks.

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**Mark S. Traylor *Forum Energy Technologies, Inc. - VP of IR & Planning***

Thank you for joining us this morning. We look forward to speaking with you guys again in the new year. Sarah, you may end the call. Thank you.

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**Operator**

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

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