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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Forum Energy Technologies second-quarter 2018 earnings conference call. My name is Haley and I will be your coordinator for today's call. (Operator Instructions). As a reminder, this conference call is being recorded for replay purposes. After the speakers' remarks today I will instruct you on the procedures for asking questions. I will now turn the conference over to Mark Traylor, Vice President of Investor Relations. Please proceed, sir.

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

Thank you, Haley. Good morning and welcome to Forum Energy Technologies' second-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.



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Management 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 two weeks following the call. I am now pleased to turn the call over to Prady Iyyanki, our Chief Executive Officer.

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

Thanks, Mark. Good morning, everyone. I want to start my comments this morning with an overview of our second-quarter results and an assessment of current market conditions. I will also discuss our growth plan going forward. Pablo will provide details on our financial performance and strong liquidity position, and Lyle will discuss a few of our operating initiatives.

Our financial performance was solid in the second quarter. Our teams' execution and market share gains resulted in strong sequential growth in orders, revenue, EBITDA and margins. Orders increased 19%, revenue increased 10%, adjusted EBITDA increased 43% and margins improved 200 basis points to 10% of revenue.

North American activity, new product introductions and market share gains drove our growth in the first half of 2018. Some of the highlights for the second quarter are as follows: we received orders for over 325,000 horsepower of our J-Mac hydraulic fracturing power ends; we continue to receive strong bookings of our Multilift and Cannon products, which extend the life of electrical submersible pumps.

In addition, in July, we acquired certain assets of ESP Completions Technologies from C&J Energy Services to complement our rapidly growing artificial lift product offering.

Orders for valves in the second quarter set another record as customers prepare for midstream and downstream projects and we continue to take market share. We received an order for a submarine rescue vehicle plus a work class ROV and the associated launch and recovery systems. And finally, our drillings product line began to receive orders from the Middle East for land rig equipment, including our latest generation catalogs and our roughnecks, as well as handling tools and drilling consumable products.

Our balanced portfolio of consumable and capital equipment serving global markets across the well cycle positions us nicely to achieve continued growth. Looking ahead, our growth drivers are as follows: new product development; market share gains; the international recovery; the global midstream and downstream buildout; and finally, the completions service intensity. Now let me provide some color on each of these drivers.

Our investments in technology and innovation are yielding good results. We are seeing strong uptake of our differentiated products, such as our wire-line BOP hydraulic quick latch, greaseless wire-line cable, Multilift SandGuard ESP protectors and Duracoil coiled tubing. We continue to have a strong pipeline of new products which we'll be rolling out.

We also established a dedicated digital solutions team which has launched a new equipment monitoring and diagnostics service.

With respect to our market share gains in North America completions, we've added a significant number of new customers with the acceptance of our new products, cross-selling initiatives pulling for existing products and an increased commercial presence in the right regions. We expect market share gains to continue.

And a fourth growth driver, we are well positioned to take advantage of the international recovery. Our drilling and subsea portfolio includes highly engineered capital equipment that is critical to our international customers' operations. As the recovery unfolds, this segment has the potential to once again make up a substantial portion of Forum's total revenue.

The international orders received in the second quarter, and those we expect in the second half, are examples of the opportunities that lay ahead for the segment. In addition, our global infrastructure, including investments in the Middle East, will allow us to expand our completions and valve businesses to meet international customer needs.



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Next, our valves business is expanding to take advantage of the global midstream and downstream build out. This year our valves product line is on track to easily deliver its highest annual revenue performance. And finally, the level of completion service intensity and activity will support significant maintenance and replacement expenditures. This is evidenced by the fact that approximately 35% of our second-quarter powering orders were for maintenance of existing fleets.

Our favorable growth drivers are not without headwinds. We have not yet seen any slowdown in the Permian Basin. However, we are monitoring our customer activity closely. As the slowdown takes hold, we will expect to see our customers increase their activity in other basins, where we are well positioned.

In addition, our growth drivers are significant and will help offset any Permian slowdown. Our other headwinds are tariffs and cost inflation. Lyle will address these pressures in a response to mitigate their impact in his remarks. Despite these short-term headwinds, Forum is well positioned to benefit from the strong global energy macro environment.

As we look ahead to the third quarter of 2018, we expect continued orders growth, revenue to be between \$280 million and \$300 million, and EBITDA to be in the range of \$29 million to \$33 million. Let me ask Pablo to take you through our results and financial position.

Pablo Mercado - *Forum Energy Technologies, Inc. - SVP & CFO*

Thank you, Prady. Good morning. Strong market conditions in North America in the early stages of the international recovery drove a broad-based improvement in our second-quarter orders. Total orders for the Company were \$310 million, an increase of \$49 million or 19% from the first quarter. The second-quarter book to bill ratio was 113%, and once again each of our three segments delivered sequential bookings growth.

Our second-quarter revenue was \$274 million, an increase of \$24 million or 10% sequentially. Net loss for the quarter was \$15 million or \$0.14 per diluted share. Results for the quarter included restructuring and other charges totaling \$20 million on a pre-tax basis, offset by \$6 million of foreign exchange gains. We provided a reconciliation table of these special items in our earnings release for your reference.

Our adjusted EBITDA was \$27 million or 10% of revenue, a sequential improvement of 240 basis points. Incremental EBITDA margins were 35% driven by margin improvement in our completions and drilling and subsea segments. Adjusted net loss was \$0.01 per diluted share excluding special items.

For the first time since 2015, in our adjusted profit before tax was positive. However, we were unable to recognize certain tax benefits accounting for \$0.02 per diluted share, resulting in adjusted EPS falling below breakeven.

I will now summarize our segment results on a sequential basis. In our completions segment, orders increased 9% to \$121 million. Segment revenue was \$127 million, an increase of \$14 million or 13%. This was due to higher completions activity in North America and market share gains.

Included in our completions segment results was a \$900,000 gain from a property sale. Excluding this gain, adjusted EBITDA margins were 22%, an increase of 95 basis points, due to improved absorption of manufacturing costs and favorable sales mix of higher-margin new products. The margin improvement in the segment was partially offset by cost inflation, resulting primarily from steel tariffs affecting certain products.

Production and infrastructure segment orders were \$99 million, an increase of 2%. Orders in our valves product line set another record for the second quarter in a row. Segment revenue was \$89 million, a 3% increase, resulting from higher deliveries of well site production equipment in the United States. The increase was partially offset by lower sales of valves and downstream processing equipment. The higher mix of lower margin well site production equipment resulted in a compression of adjusted EBITDA margins for the segment of approximately 100 basis points to 7.2%.

In our drilling and subsea segment, orders were \$90 million, a 69% increase, resulting in a book to bill ratio of 150%. Orders included the previously announced rescue submarine award as well as the start of drilling equipment orders for the Middle East. Segment revenue was \$60 million, an increase of \$8 million or 15%. This growth resulted from higher revenue recognition on subsea capital equipment projects as well as from higher sales of drilling, consumable products and capital equipment.



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Adjusted EBITDA for the segment improved by approximately 780 basis points, or \$4.2 million, primarily driven by the subsea product line. The increase in subsea EBITDA was due to better absorption of manufacturing costs and a seasonal improvement in Ashtead, our subsea rentals joint venture. With the additional orders that we expect and the cost actions that we are executing, we anticipate that subsea will achieve breakeven EBITDA or better for the balance 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 second quarter was negative \$12 million, an improvement of \$8 million over the first quarter.

Despite the working capital build to support strong growth in orders, we are on track to be free cash flow positive in the second half of the year, and we expect another sequential improvement in the third quarter as we improve working capital efficiency. This remains a key focus area for us.

Our capital expenditures in the second quarter were \$9 million, partially offset by \$4 million of proceeds from sales of property and equipment. We expect our net capital expenditures for the year to be approximately \$25 million.

Our balance sheet and financial position remain strong. Our liquidity position at the end of the second quarter was approximately \$258 million. Net debt was \$428 million and our net debt to total capitalization ratio was 23%.

Our weighted average diluted share count for the second quarter was 108.7 million shares. Had we been EPS positive in the second quarter, the diluted share count would have been 110.8 million shares.

Interest, corporate expenses and depreciation and amortization were \$8 million, \$9 million and \$19 million, respectively, in the second quarter. We expect these to remain at similar levels in the third quarter. We estimate that our effective tax rate in the next couple of quarters 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.

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

Thank you, Pablo. Good morning, everyone. As Prady mentioned, the Forum team executed well in the second quarter, increasing our output and combating material cost inflationary pressures. Our operational objectives include improving EBITDA margins to pre-downturn levels and generating free cash flow. I will talk through some of the drivers impacting our profitability and end with our progress on working capital management.

We are seeing steel cost increases driven by tariffs and by industrial demand. Tariffs have been imposed on a variety of commercial steel products and more recently on finished and semi-finished equipment. We have been able to mitigate some of these cost increases through strategic sourcing initiatives and pricing.

In terms of pricing more generally, our gains continue to be limited to new products that are generating efficiencies for our customers and to passing on some of these inflationary increases.

As a result of the price and cost dynamics, we are seeing an impact on our profitability and our incremental margins. In response to these margin pressures, we have made considerable progress on further optimizing our cost structure. This progress includes leveraging our manufacturing capacity and further implementing our lean initiatives, with the impact of reducing both lead times and unit cost of production.

In the quarter, we have also initiated actions to consolidate or downsize a number of our non-US manufacturing and distribution locations in the drilling and subsea segment. In each of these cases, we retained core expertise and capability to support our customers while rightsizing our cost structure. Some of the savings for these initiatives will be realized in the second half of the year and a more significant amount in 2019. We anticipate completing these restructuring measures by the end of this year.

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Working capital management continues to be a key focus area for the team. Although we are building inventory to support new products and increased activity levels, we are also drawing down legacy inventory. Planning improvements, collaboration with supply chain partners and employee incentive programs are helping us to move this inventory and improve terms. These efforts have modestly improved our working capital efficiency in the quarter and we expect further improvement this year.

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

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

Thanks, Lyle. In closing, the outlook for Forum is the best we've seen since the downturn. The long-term outlook for North America drilling, completions and infrastructure activity is robust.

In addition, the early signs of international recovery are underway. Our team remains focused on executing the following: revenue growth across each of the segments; EBITDA margin improvement; free cash flow generation; and maintaining the balance sheet discipline.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Dave Anderson, Barclays.

Dave Anderson - *Barclays Capital - Analyst*

So, I was interested in the tariff commentary you just made there. I was kind of curious how much of a -- how we can quantify what that headwind is. Which segment does that impact the most? And can you just help us understand maybe how the margin progression should work as we get through this restructuring?

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

Sure, Dave. This is Lyle. I'll talk to that one. The largest impact that we've seen on -- due to the tariffs were for commercial steel items, where we're both seeing tariff impact as well as opportunistic pricing increases by domestic steel suppliers. So we've seen those flow-through.

And as mentioned in the call, we've been able to offset some of that through our ongoing strategic sourcing initiatives and through better sourcing and best cost country sourcing programs. We've also been able to offset some of that by sharing -- by passing those prices along to our customers, especially in places where the overall market is seeing the impact of those tariffs.

So we've seen some impact come through. Our steel costs in total -- I think we mentioned this last quarter -- are about 20% to 30% of our total revenue. So, when you think about tariff impact on that, it's not overly substantial, but something that we are combating.

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

David, (multiple speakers) point, the 35% incrementals, which we talked about in the second quarter, had some of that impact in the second quarter. And the guidance we've given you for the third quarter, which are the 30% incrementals, are not including the -- including the -- not including, I'm sorry, the real estate gain also includes some of the impact of the tariffs. So -- which gives you a pretty good idea of what the impact is.

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Now, there is a price lag, a lag between when we get a very cost impact and when we can pass on the pricing to our customers, right? So we're going through that, and the future quarters we think we can offset some of that through the pricing -- for our customers.

Dave Anderson - *Barclays Capital - Analyst*

Okay, that's helpful. And on a separate subject, just curious if you could expand a little bit on your offshore portfolio. You talked about getting an order on the subsea part with one of those -- I think it was like a submarine type ROV.

But could you also just give us some overall data points of what you're seeing out there? I'm just wondering about any kind of green shoots you're seeing either in the Davis-Lynch product line or in the subsea. Can you just give us your outlook of what the second half of the year holds for you?

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

Yes. Absolutely, David. What I would say is that the offshore are -- our RFQ activity is up. And I will not be surprised if we announced another one or two sizable orders in the second half of 2018.

And I think there are two other for us, David. One is obviously the offshore oil and gas -- early signs of some activity there. And then we're also seeing pipeline building on the oil and gas side. When they will materialize I just don't know. But I will not be surprised at least if there's one order on the oil and gas front in the second half.

But the other lever that we also have on the offshore front, particular to subsea, our product line is a defense. The defense spend in North America and internationally is going up and we will benefit that because some of our products do apply. For example, the launch of recovery systems and some of the ROVs can also help the defense industry. For example, if we look at the Lockheed Martin and General Dynamics, the two biggest defense customers in North America, their activity is significantly up.

And then in general in offshore, we just secured another order for the coiled line pipe in the offshore in Middle East. And it's a good reference because that will drive that product line to go further in the offshore. And we're also seeing some activity on the offshore front on the drilling side, but more from some smaller rigs at this point of time.

Dave Anderson - *Barclays Capital - Analyst*

Great. Thanks, Prady.

Operator

George O'Leary, Tudor, Pickering, Holt.

George O'Leary - *Tudor, Pickering, Holt - Analyst*

About the international order commentary, especially on the drilling side, it was very encouraging given how large of a portion of revenue that was and earnings that was for you guys historically. Wondered if -- you mentioned the outlook is positive there and in the back half of the year as well.

I wondered if you could frame the opportunity in the back half versus the front half. Is momentum picking up in that business or did you get a really large slug already and maybe it slows a bit? Just curious how you'd frame that for us.



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

Now, good question, George. Listen, I mean if you go back to the 2014, 40% of our business was international, 40% of our business was capital equipment. So, it's good to see in this quarter both capital equipment orders materializing and also some of the big projects of international materializing.

So our view is I think we just scratched the surface in here. It's an early -- signs of international recovery in capital equipment; there's a lot more to come. And in the second half we expect a lot more orders to come. Specific to drilling, some of the orders we've been talking about from Kuwait have already materialized, but we are expecting significant more to come in the third and fourth quarter.

George O'Leary - *Tudor, Pickering, Holt - Analyst*

Great. That's very helpful color, Prady. Thanks. And then the production business for you guys, I think of that as a -- the order flow there is a good indicator of how activity is going to go.

So I guess thinking about the North American onshore production business in particular, what has the order cadence been and does that give you any insight into how well count may progress in the second half of the year? Is it positive or have we seen any slowing there?

Everyone's concerned about these Permian infrastructure issues that look like they may emerge, and I'm just curious if you're seeing resilience there or if you're seeing any ebb in the demand for production equipment at all.

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

Yes. No, that's the question, George. I would say we have not seen any slowdown yet, George. In fact, our third quarter for production equipment -- third and fourth quarter, the customers start planning for next year, for 2019.

And usually we see a big chunk of orders coming in the third and fourth quarter, and we don't see anything different happening in the second half on the production equipment. In fact, our orders will be up pretty high. And more importantly, I think our backlog on production equipment is very strong. It continues to build backlog going into 2019.

Pablo Mercado - *Forum Energy Technologies, Inc. - SVP & CFO*

I'd just add that, as Prady said, the orders have been strong there. They continue to be very strong. If anything, as we've talked about before, we're limiting our growth in the production equipment business to try to drive up the margins, really focused on working with customers that are paying for quality. So, that may drive a change in the pace of bookings but very, very strong expected still in the third quarter.

George O'Leary - *Tudor, Pickering, Holt - Analyst*

Great. Thanks, Prady and Pablo.

Operator

Joe Gibney, Capital One.



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Joe Gibney - *Capital One Securities - Analyst*

Just a question on the valve order side. I know we've been very second half weighted in terms of project releases and some things kicking in there. Just curious, the valve mix within P&I order flow in the first half, just trying to get a sense of how much of that order flow is valve oriented versus PEQ.

Prady, as you indicated on the second half is when PEQ orders kick in more for 2019 planning. But just trying to get a sense of what's coming on the revenue side for valves a little bit more tightly.

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

Yes, yes. I would say on the valves front, it's a second consecutive order record -- all time high. And the valves business, by design, we continue to grow significantly. It's all market share gains. And the contribution of Saudi has not kicked in yet. We expect that to kick in from an order standpoint in the second half with more revenue going into 2019. But if you look at sequentially, the valves guys from an order standpoint, they are breaking records and they will continue to do that on a move forward basis.

On the production equipment side, as Pablo mentioned, I think our strategy on production equipment is not necessarily to grow that business but pick and choose customers where we could expand our margins. And that has been a focus on the production equipment side. The only exception being in the case of production equipment just because of customers' behavior. In the second half of the year they start planning for 2019 and we usually get an uptick. But we're also managing our margins very closely there in the case of PE.

Pablo Mercado - *Forum Energy Technologies, Inc. - SVP & CFO*

Yes. That's right on. The big increase in -- I would say in the first half taken as a whole has been in valves, and it's really driven by that midstream build out -- infrastructure build out. And we think we are taking market share in the valves product line as well.

Joe Gibney - *Capital One Securities - Analyst*

Okay. On D&S margins, I know you guys were careful to indicate you didn't want us to get out over our skis after the subsea awards you guys booked. Breakeven EBITDA was the orientation. You did say breakeven or better this time, so is that predicated on some order flow in offshore oil and gas you talked about in the second half? Or is it just a function of better throughput, better absorption, just enabling a slightly better profit line there within D&S?

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

I'll start off and I'll give the lead to Pablo. I would say on the drilling and subsea side, Joe, I think that business has been depressed for quite a while, so we're coming from a very low level. As a result, any additional volume the incrementals are going to be very high, and that's what we saw in the second quarter. And our pipeline as we just go slowly is pretty strong on both sides, on the drilling front and also on the subsea front.

So, apart from the consumable activity, which has been pretty steady, in fact going up with the rig count going up, and the maintenance activity in subsea has been pretty stable. Just the capital equipment orders coming through both on the drilling and subsea, we expect the D&S to be much stronger in second half than first half.

Pablo Mercado - *Forum Energy Technologies, Inc. - SVP & CFO*

Yes, so just to add to that, to clarify the comment that we made on the call in the prepared remarks was regarding subsea specifically. So subsea was breakeven in 2017. It was right around breakeven in the second quarter. And we won't to make up the first quarter shortfall, but it will be



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breakeven for the balance of the year. Now, D&S as a whole will have some contribution in the second half of the year and, as Prady said, stronger in the second half of the year.

Joe Gibney - *Capital One Securities - Analyst*

Okay. I appreciate it, guys. I'll turn it back.

Operator

Sean Meakim, JPMorgan.

Sean Meakim - *JPMorgan - Analyst*

So Prady, I was curious if we could get a little more detail that -- you highlighted 325,000 horsepower were the power ends booked in the quarter. Could we maybe get a sense of how that compares to recent quarters from a magnitude perspective?

And then thinking about if the outlook gets worse for you are frac customers, do you have much concern that you'll need to -- that they'll -- that there could end up being pricing concessions on your end? Or given the fact that so much of what -- of the work that you doing is maintenance based, would you think that perhaps you are a bit more insulated?

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

Sean, great question, no. So, if we look at quarter to quarter trend over the last several quarters what we see is the amount of volumes we're getting just on our power ends across the portfolio on the frac side. On the maintenance side is sequentially increasing quarter after quarter, which makes sense because the active horsepower in North America over the last several quarters have gone up.

So if we take 15 million to 17 million horsepower, in that kind of range which is active today, that means a lot equipment in consumable for maintenance. And I think it's a data point, not necessarily a trend. In the case of second quarter what we saw is 75% of the power ends we'll see were for maintenance and not for capital equipment.

That doesn't necessarily mean it's going to be 80% in third quarter or it could be 50-50 depending on how much capital equipment orders we get. But the trend is clearly more towards maintenance just because of the amount of horsepower needed. And that's why we account for -- that even if there is a modest slowdown in Permian, I think the amount of activity will be still significant on the horsepower side.

Sean Meakim - *JPMorgan - Analyst*

Got it, okay. Thank you for that.

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

And then the other one -- the other two points I could also make is the operators will move to other basins if there's any potential slowdown in Permian. And our customers will either move the fleets or add new fleets since it's transitionally of nature. And either way it's good for us.



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Sean Meakim - *JPMorgan - Analyst*

Okay, understood. And then on the valves, it was interesting -- I didn't hear much in the way of Permian takeaway constraints and to what extent that creates more urgency to get capacity online among your midstream customers. Just curious, to what extent does that create incremental opportunities or even incremental pricing power? And it would be great to hear a sense of lead time for you to deliver into those types of products in the US.

Pablo Mercado - *Forum Energy Technologies, Inc. - SVP & CFO*

So Sean, the valves business is benefiting from the midstream build out in North America, including the build out on the Permian side. Some of the orders that we've received in the recent quarters are indicative of that and will go for those midstream projects in the US. The long deliveries are really driven by the timing of the projects.

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

At a very high level, Sean, if you look at the valves business, it's a third, a third and a third; third upstream, third midstream, third downstream. So very limited exposure to Permian, but significant growth coming from -- also on the international front. And the other big point is the Saudi will start kicking in on order strength for you in the second half and we'll start seeing revenue in 2019, which will be significant.

Sean Meakim - *JPMorgan - Analyst*

Got it, yes. Well understood on the Saudi piece. Okay, great, thank you.

Operator

Jacob Lundberg, Credit Suisse.

Jacob Lundberg - *Credit Suisse - Analyst*

A quick question, and I may have missed this earlier, but I was just wondering if there's any change to the previous guidance for year-on-year incremental margins of -- I think as of the last call it was 35% plus. Is that still the thinking today?

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

Yes, again, our guidance, Jacob, has been -- is 35% to 40% if we get market pricing across the segments, else 30% without the market pricing. And we are very confident that for the year for sure we'll be 30% without any market pricing, including any potential impact of tariffs and inflation. So that's already baked into the 30% incrementals. Now, if we do get market pricing in the next few quarters, in the next two quarters, we will see incrementals higher.

Jacob Lundberg - *Credit Suisse - Analyst*

Okay. And do you expect that pricing, if it materializes, to be concentrated more in completions, or how should we think about where that's going to flow through?

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

Yes, that's another good question. Also we are seeing the impact first in completions, just because most of the products are consumable related. So the impact is a little immediate and impact -- some of that was already baked in into the incrementals, which Pablo talked about in the completion segment. But some of the longer cycle products, the capital equipment and production equipment, we will feel the impact but we also have the time to pass on the pricing to our customers.

Pablo Mercado - *Forum Energy Technologies, Inc. - SVP & CFO*

Yes, regarding pricing, we're also seeing good momentum on the new product side. And the biggest impact new products, they are across the Company, but the biggest impact are in the completions segment, so that's where we could see a continued uptick.

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

And a few more things we're doing to rationalize the supply chain and cost out, which, Lyle, you may want to add some color there.

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

Yes, thanks. So as we mentioned -- as I mentioned in remarks, we've been focusing on working to get our EBITDA margins back to pre-downturn levels. That's one of our big operational levers. And that's coming through the cost reduction activities that we've had going on that we launched in the second quarter and will wrap up towards the end of this year. Some of that benefit is flowing through in the second half and the full value will be next year.

But probably more importantly, as Pablo mentioned in his remarks, seeing better absorption in our manufacturing costs and therefore some better incrementals on incremental volumes as they flow through. So definitely feeling the benefits out of some of the cost out that we have baked in for the second half of the year offsetting some of the inflation and tariffs.

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

Depending on the medium term, Jacob, I would say if we know for sure that the tariffs are going to stick, then we also have the opportunity to rationalize our supply chain and go to non-tariff countries and whatnot. But we will make that decision once we know it's going to stick. And a little bit of watch it, monitor and take actions selectively to mitigate it at this point.

Jacob Lundberg - *Credit Suisse - Analyst*

Got it, understood. That's it for me. I'll turn it back. Thanks, guys.

Operator

Martin Malloy, Johnson Rice.

Martin Malloy - *Johnson Rice - Analyst*

Could you provide us with an update on discussions you're having with domestic rig companies regarding upgrades?



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

Yes, sure, Marty. On the rig we have been getting rig upgrades in North America, Marty, for the last several quarters and we continue to get that. I think the difference now versus probably I would say maybe 15 months ago is the scope of the upgrades is a little larger than just the mud pump package upgrades.

Also we are seeing activity on the offshore front and also internationally, but a very early start. It's more the RFQ activity coming through at this point, which probably start materializing in early part of 2019. But the upgrade activity in North America has not stopped, it continues to grow at a pretty good pace.

Martin Malloy - *Johnson Rice - Analyst*

Okay, great. And then could you provide us with an update? You mentioned gaining market share, and I heard you mention midstream valves. Any other product line that you would highlight as where you think you are gaining some market share?

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

Yes. I would say completions overall in every segment -- stimulation intervention and Global Tubing where the coil line pipe is a new product where we are gaining our market share. And also in the case of downhole, especially in the artificial lift front with the Multilift acquisition, the Cannon protectors, and now we also the ESP PCP from C&J which has got good products, we will gain good market share.

But I would say the new products, Marty, has given us a very good lever for market share gain. We're taking the advantage of that and pulling through the new products and we've also invested in several areas where we are not present. So a combination of new products, pulling through new products and through the commercial presence we're gaining market share.

One thing we have told our investment community, Marty, is that there are three product lines we expect to go past the historic high. Valves is already there; the run rate has already passed the historic high. And from here there's significant growth at of us. If we look at the stimulation intervention, in third-quarter they will go past the historic high. There's significant opportunity from here.

And the third one is the Global Tubing. I think second half they'll get back to the historic high, primarily driven by the growth not only in the Duracoil product downhole but also the coil line pipe momentum we've got.

And then the valves business we've already talked about. And production equipment by design, our strategy there is to grow the margins, not necessarily the top line. And drilling and subsea with international activity coming through, we'll give an update in future quarters. But I think they are well positioned there to gain market share through the new products.

Martin Malloy - *Johnson Rice - Analyst*

Great, thank you.

Operator

John Watson, Simmons & Company.



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John Watson - *Simmons & Company - Analyst*

Prady, talking about the guidance for Q3, it looks like \$16 million of sequential revenue growth at the midpoint. Can you talk to us about the puts and takes to get to that number? Will the bulk of the growth come from completions?

Pablo Mercado - *Forum Energy Technologies, Inc. - SVP & CFO*

So look, this is Pablo. I expect growth across the portfolio in the third quarter, both in bookings and in revenue. What we won't see is such a big jump in subsea EBITDA like we had in the second quarter. But it should be across-the-board growth.

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

Also to add to Pablo's comment, we expect growth in all segments: completions, D&S and P&I. And again, going back to the growth levers, the new product development will increase the growth in our completions. The market share gains is another strong lever we talked about.

The international recovery in capital equipment, that's a very good combination for us. And we have not seen that in the last several quarters. And with the orders we've announced, and more importantly the orders we're going to announce in the second half, gives us very good momentum on the capital equipment and the international recovery.

And the valves business continues to take market share and investments being made on the midstream and downstream front. And the completion service intensity, right? So, those are all the growth levers and we expect growth in all three segments.

John Watson - *Simmons & Company - Analyst*

Okay. Thanks for that. And you mentioned product innovation. Can you talk to us about recent innovation on the fluid end and power end front? Do you have any insight into how much longer your pumps are lasting today versus, say, a year or two ago?

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

Yes. Listen, we think we have the best power end in the marketplace, and as a result there we continue to add customers and we continue to penetrate our existing customers. We just commercialized in a fluid end, which is gaining pretty good traction in the marketplace. We also have the best tractor manifold in the marketplace and we are gaining pretty good traction there.

Also not connected to just the service intensity, but we also commercialized a hydraulic latch product which helps the zipper fracs and it saves them 15 to 20 minutes per stage. And the comparative landscape there it's a differentiated product. We're gaining very good traction there. Gaining significant market share in the case of the hydraulic latch.

So, in general I think the team on the frac side have done a great job of differentiating the products. As a result, we're gaining market share. And as I said, we are past the historic high in third quarter and there's significant growth ahead of us on revenue front.

And the margins are -- we'll get back to the historic high but it will take us a few quarters just because the pricing is still not yet at the historic high. And most of the margin expansion we've got with some pricing in third quarter of last quarter it all has been through the operating leverage and some of the things we've done to reduce our cost structure.

John Watson - *Simmons & Company - Analyst*

Great. Thanks, guys. I'll turn it back.

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Operator

Marc Bianchi, Cowen.

Marc Bianchi - Cowen and Company - Analyst

Prady, you mentioned the new orders for pumps that -- about 75% of it was replacement. Can you talk to the completions segment overall? Thinking about the revenue run rate that you have right now, how much of that might be something to think about as recurring maintenance type work versus delivery of capital equipment that might be for growth for your customers? I know it might be hard to parse, but just any estimate you can give would be helpful.

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

Yes. I mean if we look at on the frac side, let's start on the frac front, which is probably an easier question, is if we use power end as a data point and then once you go below power end it becomes more maintenance than capital equipment by design, because you need a lot more fluid ends, you need a lot more iron you need a lot more kits, you need a lot more consumables.

But just then the case of power end, 75% of the power ends we received in the second quarter were for maintenance activity and 25% for the capital book. Then if you go below that, it's more maintenance than capital build. And listen, at this point of time we're still talking to the customers in the second half of some capital builds.

But the maintenance activity for 15 million to 17 million of horsepower, that's a lot of consumables, a lot of activity driven, combine that with our new products and with the market share gains, I think there's significant growth ahead of us here.

And then if we look at the downhole, it's all consumables, activity driven product. If we look at Multilift, the competitive landscape is pretty much in our favor. When we got the acquisition there were a handful of customers and now we've got 30, 40 customers and maybe even more. We continue to add more customers and we just added some international customers the last quarter, so we just got the surface on the international front for the Multilift.

And then when we look at Global Tubing, it's all predominantly activity driven business. And last quarter -- or in the second quarter, we had a record quarter internationally, the largest revenue we ever received internationally on Global Tubing, and we will continue to gain momentum there.

Marc Bianchi - Cowen and Company - Analyst

Okay. So, just trying to convert that into some numbers. If I took -- your flow equipment revenue this quarter was \$60 million. If I just said conservatively half of that, which it sounds like it's probably even more than half, but half of that is a recurring kind of number, and then everything else in downhole is recurring in terms of activity base, would that be a right approach? That kind of works out to like 75% of revenue for completions.

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

Well, so 75%, 80% maybe, but I think we could give you more details (multiple speakers).

Marc Bianchi - Cowen and Company - Analyst

Sure, offline. Okay. Okay, that's --.



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Pablo Mercado - *Forum Energy Technologies, Inc. - SVP & CFO*

Marc, that's probably a little higher in your math just because on the S&I side 75% in the quarter of the power ends, which is the most capital equipment piece that we have, was for maintenance. So --.

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

Yes, it would be lower than that just because that's the -- everything below that is consumable activities.

Pablo Mercado - *Forum Energy Technologies, Inc. - SVP & CFO*

Correct.

Marc Bianchi - *Cowen and Company - Analyst*

Okay. And then on the international outlook, it sounds like you guys are positive on the opportunity there. And certainly we're hearing that from a lot of other companies that participate in international. If we were to think that the international market grows at some sort of low double-digit number over the next couple years, could you walk us from what proportion of your revenue is international today and where that could be in a couple years?

Pablo Mercado - *Forum Energy Technologies, Inc. - SVP & CFO*

Yes. So, about 75% of our year-to-date revenue was in the US, okay, in the first half of the year. Only 25% was outside of the US. Historically that number has been more in the 40% range. And then of the -- if you look at the US activity and you remove subsea and valves, then you're looking at about 50% US land as a remainder. So I think we've got good opportunity, with the diversified portfolio, to continue to increase the international exposure and you should see that mix changing in the next few quarters.

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

And I will add -- the thing I would add to that, Marc, is we have gained market share in North America with the levers we talked to you about, and I think the same phenomenon will happen on the international front.

Marc Bianchi - *Cowen and Company - Analyst*

Okay. Very good. Thanks for the comments.

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

Yes. But 60-40 is a good place for us to land in a couple of years.

Marc Bianchi - *Cowen and Company - Analyst*

Got it.



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Operator

Edward Muztafago, Societe.

Edward Muztafago - Societe Generale - Analyst

I'm wondering if you can maybe help us just think through a little bit about the flow through of the international. Some of the other equipment companies of course that have reported are a little bit longer lead time in general when you think about their portfolios.

So, could we see a similar pace of revenue growth out of your international business as we could for discrete services over the next one or two years? Or do you think it takes a little bit longer for that to flow through for your business?

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

Listen, I think our longest lead-time product on the subsea or on the drilling front is about six to nine months. Now, the submarine rescue order which talked about, that's a two-year project, but that's not a typical project we normally get. Most of the projects we get on the drilling and subsea is about six to nine months, so that's the kind of lead time we would get.

So for example, some of these Kuwaiti orders which are materializing, we expect them to be delivered fourth quarter and also going into 2019. So the lead times, again, almost six to nine months.

So, and the other front is if we look at it on the international front, if we look at our drilling and subsea business, we have a significant exposure on the international front. If we look at our downhole business going back to 2014, 40% of that business was international. Today it's pretty much more biased towards the North America.

And then some of the other products we have commercialized across our product lines, like the Multilift is a good example, the Cannon protectors on the artificial lift front, they are all international products, right?

And valves business we have focused by design, it was a North American business and we are gaining pretty good traction on the international front. And we would like to gain significant market share on the international front in the valves business. So there are all the opportunity for us on the international front.

Edward Muztafago - Societe Generale - Analyst

Okay. That's helpful, but I guess generally speaking, it sounds like you shouldn't be more than about six months behind the major service providers in terms of where your -- at least your current revenue drivers are?

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

I think that's a good assessment, yes.

Edward Muztafago - Societe Generale - Analyst

Okay, okay. That's the only question I had. Thanks, guys.



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Operator

Brad Handler, Jefferies.

Brad Handler - Jefferies LLC - Analyst

Just a couple questions from me or categories of questions, and it's probably more helping me understand the market -- giving a little more market context as you see it from your vantage point.

So, I was curious about -- with J-Mac, is there anything to read into power end rebuilds or useful lives or anything that you see related to that versus new orders of capital equipment that you're seeing in trends? Are useful lives -- is there a slug of useful life that we're reaching end of and you see signs of the because of new orders?

Or is there something not -- do you see some lower demand than you might have expected for power end rebuilds, for example? Or anything that you might not participate in but just some sign of it that you're seeing in the order trend?

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

Yes, no, I think it's a great point. Well, the first point I'll make is the service intensity, right? If you go back to the last several quarters, just the amount of sand being used, the amount of water being used, how hard the pumps are being run, more stages, longer laterals, all that is service intensity, so the pumps are running a little harder.

On the equipment side from a product standpoint what we've done, and some of our competitors have done the same, but we do have the best pump in the marketplace, is we're adding to the life of the pump. And one of the reasons why we are gaining market share in the case of pumps is because of the life of our power end.

But the service intensity is what is driving the maintenance activity on the frac side. And it is just not just power ends. They need a lot more fluid ends, they need a lot more iron ends, they need a lot more consumable items, kits, bearings, which all go with it. But we are not seeing any particular trend in the case of our power ends but the service intensity is going up.

Now, on the capital build program, it's not every month, we don't see it every month. It comes in chunks. We saw that last quarter. We expect to see that this quarter, but it happens in chunks. It doesn't happen every month like the way it happens in the consumable front.

Brad Handler - Jefferies LLC - Analyst

Sure, sure. Okay, I certainly understand the point about service intensity. I just didn't know whether -- obviously you have a choice between trying to rebuild a power end, but I suppose that you can only do that so many times. And you're obviously seeing the growth and need for replacement.

Let me try a slightly different one, then. Relative to artificial lift exposure, you've obviously just added that with the new acquisition, but can you give us some context as to what -- I guess it's a proportion of revenue or what you expect it to be soon or something that's specifically related to artificial lift. And maybe you can give us your sense of what kind of market outlook you have for growth in that category.

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

Yes, yes. No, listen, that's a good question. Well, the first response to that is the -- it's a very -- it's a sub product line within downhole and it's the fastest -- one of the fastest-growing sub product line in Forum's portfolio, primarily driven by the Cannon protectors and Multilift acquisition.



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And the Multilift acquisition, as mentioned, we did that about 15 to 18 months ago, a handful of customers. And the revenue has gone up significantly, the margin has improved and we still have significant growth ahead of us.

We have also added a few more products with the ESPCT acquisition and it -- for example, our phase regulator is a good product. Early stages, as Pablo mentioned, at this point of time. There's revenue, there's cost, but there's no EBITDA, so we will make that profitable going into 2019.

But there are also cast protectors which are complement our Cannon protectors. So we have a good four or five products in the artificial lift space and we can grow that sub product line significantly from here going into 2019, 2020.

And on the quantification piece, I mean that's a sub product line that -- we normally don't do that. What I can tell you is it's the fastest-growing sub product line in Forum's segment.

Brad Handler - *Jefferies LLC - Analyst*

Fair enough. Okay, that's fine. I appreciate the color on that line. I'll turn it back. I can always follow up later. Thank you.

Operator

Thank you. Ladies and gentlemen, this concludes today's question-and-answer session. I would like to turn the call back to Mark Traylor, Vice President of Investor Relations, for any closing remarks.

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

Thank you for your attendance to Forum Energy Technologies' second-quarter earnings conference call. Thank you once again and have a great day.

Operator

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

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