

Dril-Quip

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Dril-Quip Summary

HOLD

Recommendation Summary		
Company (DRQ) Current Trading Price	DRQ \$	59.65
Recommendation Target Price	H(old 54.65
Upside Potential	Ψ	-8.4%

Valuation Summary			
Method	Pric	e	Weight
Discounted Cash Flow			
Perpetuity Growth Method	\$	50.11	50%
Exit Multiple Method	\$	56.36	15%
Comparable Company Analysis			
P/E	\$	63.73	0%
EV/EBITDA	\$	55.67	35%
EV/Revenue	\$	38.63	0%
Target Price	\$	53.00	

Trend Overview

Oil's Impact on Market Cap

Dril-Quip's Margin Control

Strategic Expansion Summary





Introduction

■ The Offshore Energy Material Manufacturing industry is comprised of industrial manufacturers delivering materials and services to energy producers. There are three main types of of products produced by these companies such as such as semi-submersibles, jack-ups, and drill ships which primarily operate in the Gulf of Mexico. This industry exists to assist energy producers with offshore exploration by manufacturing custom rigs to match producer's wants and needs.



McDermott International

NYSE: MDR MC: \$1,070



Forum Energy Technologies

NYSE: FET MC: \$1,240



Oceaneering

NYSE : OII MC: \$3,570



NYSE : DRQ MC: \$2,270



Gulf Island Fabrication

NASDAQ: GIFI MC: \$120



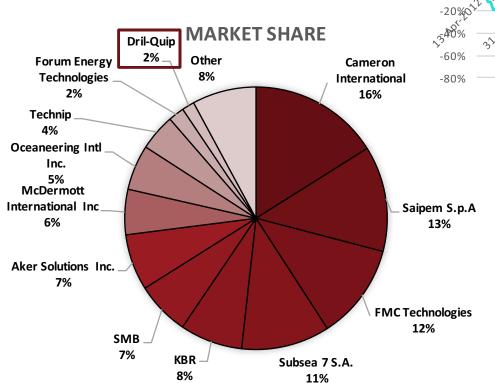
Keppel and Offshore Marine PRIVATE





Industry Snapshot

- Dril Quip owns 2.0% of the market for Offshore solutions.
- Among the top players in this industry are:
 - Cameron International (16%)
 - Saipem (13%)
 - FMC Technologies (12%)



Five Year: Industry/Oil/Russel



- Offshore manufacturing is highly correlated with the price of oil with an R^2 of .87 in respects to industry performance
- Although the industry has seen a declining trend, Dril-Quip has not declined in the same magnitude has the industry



Senior Leadership and Company Snapshot



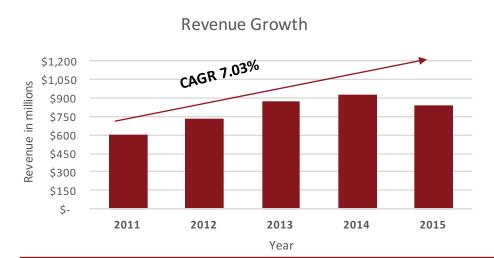
- CEO: Blake DeBerry
 - Employee since 1988,CEO since 2011
 - Held various management and engineering positions domestically and internationally



- COO: James Gariepy
 - COO since 2011
 - VP of Dril-Quip Europe from 2007-2011



- CFO: Jerry Brooks
 - CFO since 1999
 - From 1980-1999 held positions as CFO, Secretary, and Treasurer at Chiles Offshore Corporation



Dril Quip (DRQ)								
2015 Revenue	\$844.3 million							
CAGR	7.03%							
Headquarters	Houston, TX							
Operations	Western and Eastern Hemisphere. Asia- Pacific							



Dril – Quip's Superior Supply Chain

In House Operations In House Operations Finishing Operations (Huston) Design /Forge / Finishing Operations **Fabricate** (Aberdeen) Purchase Raw Materials Finishing Operations Heat Treat & Rough Machine (Singapore) Finishing Operations (Brazil) In house fabrication controls Regional facilities' Steel shapes, steel plate, construction meets for efficient inventory, steel pipe, welding gases, quality, and delivery to consumers specifications in a

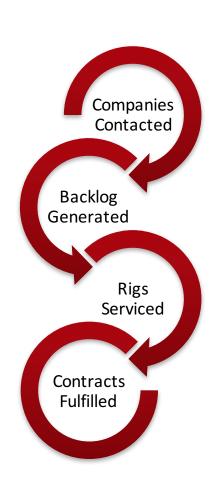
customers

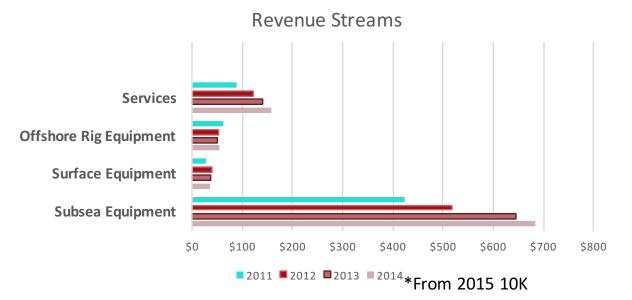


fuel, oil, gasoline and paint

timely manner

Revenue Generation and Margin Control





- Most revenue is generated through contracts and reported under "degree of completion"
- If contracts are canceled, companies are required to cancelation fee
- Dril-Quip's backlog at December 31, 2015 was \$685 million, compared to its December 31, 2014 backlog of approximately \$1.2 billion
- In the downturned economy, Dril-Quip has maintained their 5 year average margins, far superior to their competitors

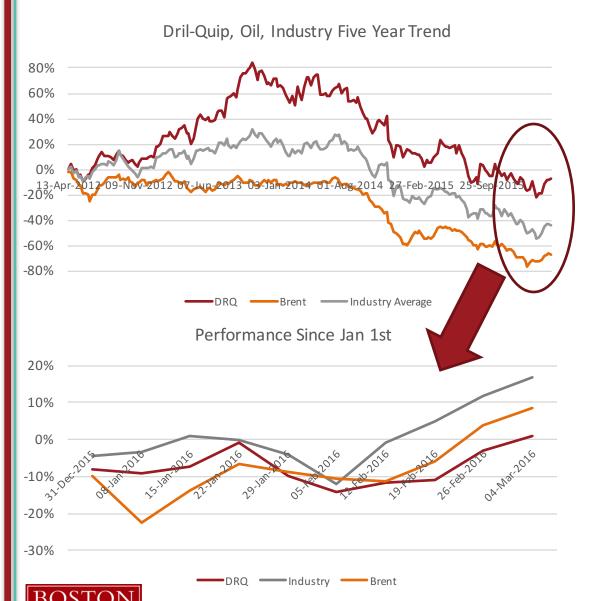


Trend Overview





Oil's Impact on Market Capitalization

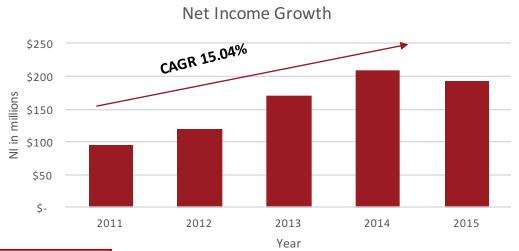


- Since our industry is tied so closely to oil, it's taken a big hit
- Dril-Quip has also taken a hit, but could generate a buying opportunity in the future
- Through the first quarter of 2016, oil and the industry has bounced backed
- Dril Quip has gained momentum and should continue to do so
- Despite the poor 2015 market, it has not significantly hurt their top and bottom lines



Oil's Impact on Top and Bottom Lines





- Dril Quip is able to manage their operations very efficiently in good and poor market conditions
- Revenue has grown at a 7% CAGR and net income has grown at a 15% CAGR
- This is part due to
 - Experienced leadership
 - In-house operations
 - Closely monitoring the market because of their small size
- Despite their slight decrease in 2015, 2016 could paint a different story since significant backlog has not be generated



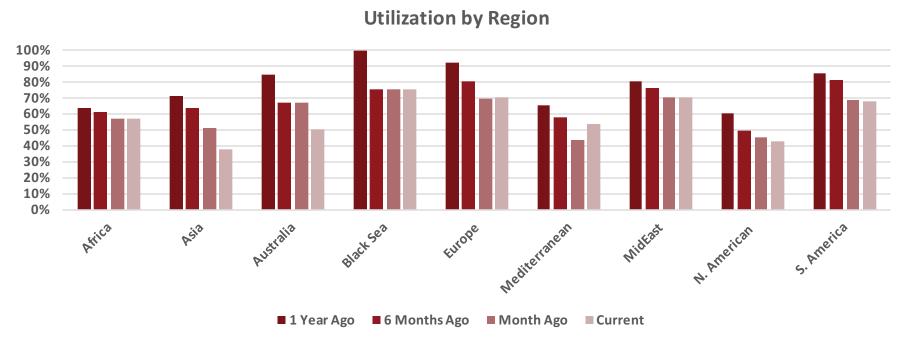


Trend Overview





Decreasing Rig Utilization



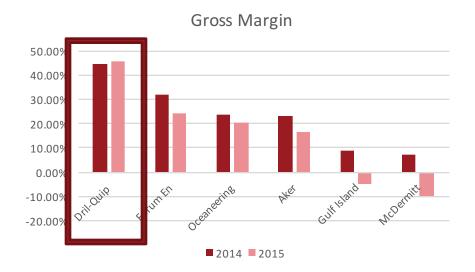
- Rig utilizations in some regions has steadily declined as of a year ago mainly due to decreasing oil prices
- Some regions have increased their total rig count while also decreasing total utilization
- Companies who cannot afford or do not wish to explore offshore solutions are not renewing contracts

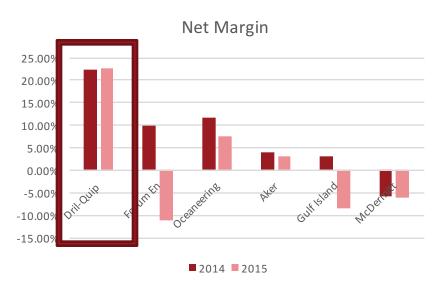
- This could be seen as a threat to the industry or lead to competition consolidation
- Analyst estimate rig utilization to increase in
 N. America over the next two years by 22%
- When oil prices drop, companies must be aware of break-even points in relation to onshore and offshore production. As low as \$20 onshore and \$25 offshore





Margin Control





- Despite the decreased utilization, this has not effected Dril-Quip's Margins
 - Gross Margin above 40% and grew marginally in 2015
 - Net Margin about 20% and also grew going into 2015
- Having all in-house operations makes it easy for them to add projects or make cut-backs
- They also have limited rig projects and have focused on more subsea equipment
- Services provided by the company also create a steady revenue stream

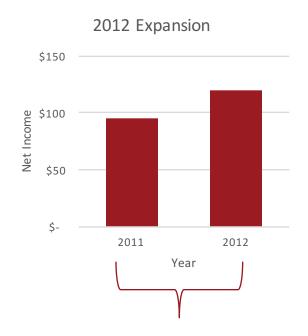


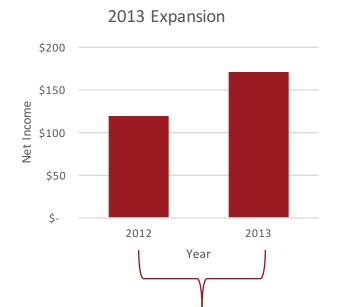
Trend Overview

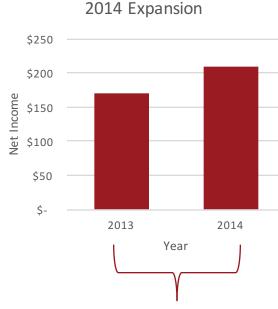




Impact of Strategic Expansions







\$24 million increase with their expansion in Brazil. Also awarded \$650MM, four year contact with Petrobras.

 \$51 million increase after expanding their Aftermarket businesses for subsea solutions \$39 million increase with their Aberdeen expansion. Attributed to \$110MM subsea development contract.

Announced: 2015 R&D Facility in Singapore

- \$15 million expansion announced to be completed by 2017
- The High Pressure High Treatment facility will will enhance product development
- Engineering capabilities make them a attractive supplier to leading oil and gas providers



Valuation Summary



Recommendation Summary		
Company (DRQ) Current Trading Price	DRO \$	Q 59.65
Recommendation	I	Hold
Target Price	\$	54.65
Upside Potential		-8.4%

Valuation Summary			
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EV/Revenue	\$	38.63	0%
Target Price	\$	53.00	

- Despite the strong operations of Dril-Quip, we decided rate this as a hold
- Main points for the rating
 - Low backlog
 - Unfavorable market conditions
 - Length of time to realize revenue
- Key Assumptions made in output
 - Terminal Growth Rate 2%
 - Cost of Debt 0%
 - Cost of Equity 8.24%
 - Size Premium 1.74%

Valuation Summary

Comparable Company Analysis

LTM data (04-02-2016)

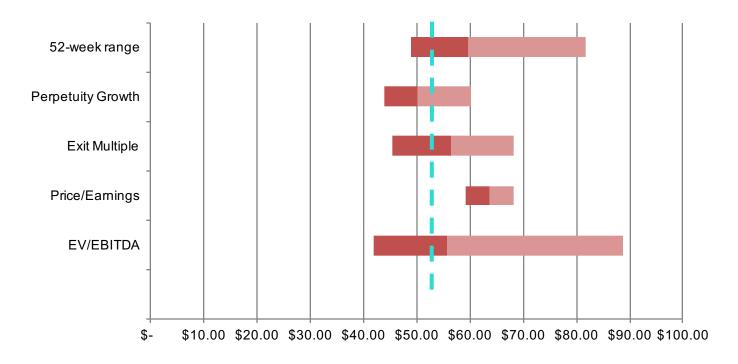
<i>LTM data (04-02-201</i> 6 Company	/ Ticker	EV	Market Cap	Revenue	EBITDA	Net Income	P/E ¹ I	EV/EBITDA EV/	Revenue
, ,			•						
Dril-Quip	DRQ-US	1,969.1	2,315.1	844.3	274.31	192.0	11.9x	6.9x	2.3x
McDermott	MDR-US	1,068.0	949.0	3,070.3	204.0	(18.0)		4.5x	0.3x
Gulf Island Frabrication	GIFI-US	78.0	113.5	306.1	(5.2)	(25.4)		4.5x	0.4x
Forum Energy Techno	FET-US	1,446.3	1,169.5	1,073.7	127.2	(119.4)		11.1x	1.3x
Oceaneering	OII-US	3,574.4	3,133.2	3,062.8	640.4	231.0	13.7x	6.4x	1.3x
High		3,574.4	3,133.2	3,070.3	640.4	231.0	13.7x	11.1x	2.3x
Mean		1,627.2	1,536.1	1,671.4	248.1	52.0	12.8x	6.7x	1.1x
Median		1,446.3	1,169.5	1,073.7	204.0	(18.0)	12.8x	6.4x	1.3x
Low		78.0	113.5	306.1	(5.2) (119.4)	11.9x	4.5x	0.3x

P/E	
LTM EPS	\$ 4.98
Implied Price Target	\$63.73
Upside (Downside) %	6.8%

EV/EBITDA	
LTM EBITDA	\$ 274.31
Implied Price Target	\$55.67
Upside (Downside) %	-6.7%



Valuation Summary



Weighting Summary

- DCF: 50% due to variance in projecting out backlog and realizing revenue
- EV/EBITDA: 35% due to strong operational efficiency compared to competitors
- Exit Multiple: 15% to pull up DCF's low valuation

Recommendation Summary		
Company (DRQ) Current Trading Price	DRO \$	Q 59.65
	•	_
Recommendation		Hold
Target Price	\$	54.65
Upside Potential		-8.4%



Risks

Continued downturn or continued low oil prices

- Large oil extracting companies will not invest capital in offshore exploration if sizeable profits cannot be realized
- Our Dril-Quip depends on higher oil prices to turn a profit on capital intensive projects

Failure to generate significant backlog

- Dril Quip relies on a small number of customers and relies on fewer than 10 for larger contracts
- Failure to meet customers needs and generate large contracts will cease revenue

Continuing to make strategic expansions

- Dril Quip must continue to make expansions to find new customers
- Expansions are very capital intensive and global demand fluctuates with utilization and oil prices



Thank you!

Questions?



Margin vs Competitors

Company	Gross Margin	Op Margin	Net Margin		
Dril-Quip	45.6	28.9	22.7		
Forum En.	24.5	5.7	(11.1)		
Oceaneering	20.6	13.1	7.5		
Aker	16.3	5.64	3.2		
Gulf Island	(4.9)	(10.3)	(8.3)		
McDermott	9.8	2.8	(0.6)		



Income Statement 1

Income Statement										
		_	Historical				E.	oro cocto d		
	2011	2012	2013	2014	2015	2016	2017	orecasted 2018	2019	2020
D					-					
Revenue	601.3	733.0	872.4	931.0	844.3	739.0	665.0	757.0	860.0	877.0
% growth		21.9%	19.0%	6.7%	-9.3%	-12.5%	-10.0%	13.8%	13.6%	2.0%
COGS (excl. D&A)	(338.8)	(425.4)	(484.6)	(482.4)	(428.8)	(403.4)	(363.2)	(413.2)	(469.3)	(478.6)
% of Revenue	56.35%	58.04%	55.55%	51.81%	50.79%	54.59%	54.61%	54.59%	54.57%	54.57%
Gross Profit	262.5	307.6	387.8	448.6	415.5	335.6	301.8	343.8	390.7	398.4
% Margin	43.7%	42.0%	44.5%	48.2%	49.2%	45.4%	45.4%	45.4%	45.4%	45.4%
SG&A	(70.5)	(82.2)	(94.8)	(92.8)	(88.0)	(80.1)	(72.1)	(82.1)	(93.2)	(95.1)
% of Revenue	11.73%	11.22%	10.87%	9.96%	10.43%	10.84%	10.84%	10.84%	10.84%	10.84%
EBITDA	192.0	225.4	293.0	355.8	327.5	255.5	229.7	261.7	297.5	303.3
% Margin	31.9%	30.7%	33.6%	38.2%	38.8%	34.6%	34.5%	34.6%	34.6%	34.6%
					:					
Depreciation	(23.0)	(26.2)	(29.3)	(31.2)	(30.5)	(28.0)	(23.8)	(27.1)	(30.8)	(31.4)
Amort. of Intangibles	-	-	-	-	- !	-	-	-	-	-
Total D&A	(23.0)	(26.2)	(29.3)	(31.2)	(30.5)	(28.0)	(23.8)	(27.1)	(30.8)	(31.4)
Other Operating Expenses	(39.3)	(37.5)	(40.2)	(45.9)	(48.1)	(42.2)	(42.2)	(42.2)	(42.2)	(42.2)
Total Operating Expenses	(132.9)	(145.9)	(164.3)	(169.8)	(166.7)	(150.3)	(138.1)	(151.3)	(166.2)	(168.6)
Operating Income (EBIT)	129.6	161.7	223.5	278.7	248.8	185.3	163.8	192.4	224.5	229.8
% Margin	21.6%	22.1%	25.6%	29.9%	29.5%	25.1%	24.6%	25.4%	26.1%	26.2%



Income Statement 2

Net Income	95.3	119.2	169.8	208.7	192.0	139.2	123.0	144.5	168.5	172.4
Minority Int. in Earnings	-	-	-	-	- !	0	0	0	0	(
Net Income to Company	95.3	119.2	169.8	208.7	192.0	139.2	123.0	144.5	168.5	172.4
Extraord Item & Acct. Change	-	-	-	-	-	-	-	-	-	-
Earnings from Discounted Ops.	_	-	-	-	-	-	-	-	-	-
Earnings from Cont. Ops	95.3	119.2	169.8	208.7	192.0	139.2	123.0	144.5	168.5	172.4
Income Tax Expense	(34.7)	(42.9)	(54.3)	(70.7)	(57.8)	(46.8)	(41.4)	(48.6)	(56.7)	(58.0)
EBT Incl. Unusual Items	130.0	162.1	224.1	279.4	249.8	186.0	164.4	193.0	225.1	230.4
Unusual Items	-	-	-	-	-	-	_	-	-	-
% Margin	21.6%	22.1%	25.7%	30.0%	29.6%	25.2%	24.7%	25.5%	26.2%	26.3%
EBT Excl. Unusual Items	130.0	162.1	224.1	279.4	249.8	186.0	164.4	193.0	225.1	230.4
Other Non-Operating Income	_	_	_	_	- !	_	_	_	_	_
Net Interest Inc. (Exp)	0.4	0.4	0.6	0.6	0.9	0.6	0.6	0.6	0.6	0.6
Interest Income	0.4	0.5	0.6	0.7	0.9	0.6	0.6	0.6	0.6	0.6
Interest Expense	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)	-	-	-	-	-



Sensitivity – FCF - CAPM

DCF - Perpetuity Growth Sensitivity													
		WACC											
	_	0.08479	ç	9.0%		9.5%		10.0%		10.5%	11.0%	11.5%	12.0%
Φ	3.0%	\$ 71.52	\$	66.37	\$	62.04	\$	58.35	\$	55.17	\$ 52.42	\$ 50.00	\$ 47.87
Rat	2.5%	\$ 67.18	\$	62.76	\$	59.00	\$	55.77	\$	52.96	\$ 50.50	\$ 48.33	\$ 46.40
ا بة د	2.0%	\$ 63.50	\$	59.67	\$	56.37	\$	53.51	\$	51.00	\$ 48.79	\$ 46.83	\$ 45.07
ermi wth	1.50%	\$ 60.35	\$	56.99	\$	54.07	\$	51.52	\$	49.26	\$ 47.26	\$ 45.48	\$ 43.88
<u>⊬</u> g	1.00%	\$ 57.63	\$	54.65	\$	52.05	\$	49.75	\$	47.71	\$ 45.89	\$ 44.26	\$ 42.79
U	0.50%	\$ 55.24	\$	52.59	\$	50.24	\$	48.16	\$	46.31	\$ 44.65	\$ 43.15	\$ 41.79

			Fo	orecasted		
	2016	2017		2018	2019	2020
EBIT	\$ 154.37	\$ 163.76	\$	192.42	\$ 224.50	\$ 229.78
- Taxes	(38.85)	(41.21)		(48.42)	(56.50)	(57.83)
	 115.52	122.55		143.99	168.00	171.95
+ D&A	24.17	23.78		27.07	30.76	31.37
- CAPEX	14.48	(19.66)		(61.87)	(69.71)	(37.80)
- Δ in NWC	 52.28	(80.39)		(16.40)	(6.81)	(13.64)
Unlevered FCF Net Present Value	\$ 206.45 \$473.70	\$ 46.28	\$	92.80	\$ 122.24	\$ 151.88

Capital Asset Pricing Model						
Beta		0.87				
Risk-free Rate		2.41%				
Base Risk Premium		6.70%				
Market Cap	\$	2,249.44				
Size Premium		1.74%				
САРМ		9.98%				

Key Statistics:	
Current Trading Price	\$ 59.65
Market Cap	\$ 2,298.37
Net Debt	\$ (381.30)
Beta	0.87
Shares Outstanding	38.53
Marginal Tax Rate	35.00%



