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Frank's International N.V.'s (FI) CEO Mike Kearney on Q3 2019 Results - Earnings Call Transcript

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Q3: 11-05-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $-0.08237 misses by $-0.02 | Revenue of $140.42M (8.86% Y/Y) misses by $-17.45M

Earning Call Audio

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Frank's International N.V. (NYSE:FI) Q3 2019 Earnings Conference Call November 5, 2019 11:00 AM ET

Company Participants

Erin Fazio - Director, Finance & IR

Mike Kearney - Chairman, President & CEO

Melissa Cougle - SVP & CFO

Steve Russell - President, Tubular Running Services

Nigel Lakey - President, Tubulars

Scott McCurdy - President, Cementing Equipment

Conference Call Participants

Ian Macpherson - Simmons

David Anderson - Barclays

Operator

Welcome to the Third Quarter 2019 Frank's International N.V. Earnings Conference Call. My name is Sylvia and I'll be your operator for today. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. [Operator Instructions]. Please note that this conference is being recorded.

I will now like to turn the call over to Ms. Erin Fazio. Ms. Fazio, you may begin.

Erin Fazio

Good morning and welcome to the Frank's International conference call to discuss third quarter 2019 earnings. I'm Erin Fazio, Director of Finance and Investor Relations.

Our speakers on today's call as shown on Slide 2 of the earnings presentation, we have Mike Kearney, Chairman, President, and Chief Executive Officer; and Melissa Cougle, Senior Vice President and Chief Financial Officer.

Joining Mike and Melissa for the Q&A portion of today's call will be Steve Russell, President of Tubular Running Services; Nigel Lakey, President of Tubulars; and Scott McCurdy, President of Cementing Equipment.

A presentation has been posted on our website that we will refer to throughout this call. If you'd like to view this presentation, please go to the Investors section of our website at franksinternational.com.

On today's call, Mike will discuss our recently announced profitability improvement project as well as the segment technology highlights. Melissa will then review the financial performance of the quarter, discuss the details of the profitability improvement project, and give general guidance for the remainder of the year and 2020. We'll close with a question-and-answer session.

Before we begin commenting on our third quarter 2019 results, there are a few legal items that we'd like to cover beginning on Slide 3. First, remarks and answers to questions by company representatives on today's call may refer to or contain forward-looking statements. Such remarks or answers are subject to risks and uncertainties that could cause actual results to differ materially from those expressed or implied by such statements.

Such statements speak only as of today's date or if different as of the date specified. The company assumes no responsibility to update any forward-looking statements as of any future date.

The company has included in its SEC filings cautionary language identifying important factors that could cause actual results to be materially different from those set forth in any forward-looking statements. A more complete discussion of these risks is included in the company's SEC filings which may be accessed on the SEC's website or on our website at franksinternational.com.

Please note that any non-GAAP financial measures discussed during this call are defined and reconciled to the most directly comparable GAAP financial measure in the third quarter 2019 earnings release which was issued by the company earlier today.

I will now turn the call over to Mike.

Mike Kearney

Thank you, Erin. We appreciate everyone joining us today for the call.

I want to start my remarks by saying that for the last quarter, the management team has spent a tremendous amount of time looking at every area of the company in terms of how we deliver safe quality services and products to our customers, and do it in the most cost efficient manner. We call this effort our profitability improvement project. We examine the entire organization, and delve deeply into approximately 20 distinct areas of our operations, and cost structure to determine how we can operate more cost effectively.

Everything was on the table to be examined with a set of fresh eyes, and we went through our organization in a zero base clean sheet type approach. Every member of the executive team has been deeply involved. We established an internal working Steering Committee, which included eight direct reports to the executive team members. The project started with an eight week diagnostic analysis by a globally recognized management consulting firm with a long-standing successful history of projects. We set up an employee portal where employees at any level could submit opportunity areas and do it anonymously if they like.

Our employee engagement has been hard throughout the process, as most of our employee base realizes that a more profitable operation will be key to our future. Having their support has been amazing. And I'm personally immensely grateful for the professionalism everyone has shown in these past several months.

The reason for my sharing such significant detail is because our investors should know Frank's entire employee base appreciates the fact we must boost profitability to the maximum extent possible, while not only preserving, but enhancing our ability to safely serve our customers, and provide the great technological solutions that have made Frank’s successful. These changes we're making will positively and permanently impact our future financial results.

Later in the call, Melissa, will provide more color on some of the areas we touched and give some idea of the magnitude of the profit improvement we expect.

While our third quarter results did reflect North American market headwinds facing our entire industry, I'm very proud of the steps Frank’s has taken in the quarter. And we are definitely encouraged by the momentum that we're continuing to see in the international markets. Our long-standing reputation for industry-leading technology and exceptional customer service continues to be our guidepost as we implement changes to drive improved long-term profitability and generate free cash flow.

At Frank's, we’re determined to do everything possible to create value for our shareholders.

One of the focus areas for the management team and the board is the commitment we make to our customers to bring them technologically advanced equipment and well trained personnel. Our mantra is to be the high-value low risk provider of services and products that enable our customers wells to be drilled and completed faster, safer, and with better well integrity than any other service company.

We're increasing our focus even further on inventing and commercializing solutions that drive safety remove personnel from the red zone and reduce the number of personnel required at the well site. This is what our customers expect, and we're delivering it.

We want to decrease the timeline of inventing, prototyping and commercializing technologies.

Companies that offer high technology solutions compared to commoditized providers have a higher multiple because they offer premium products, they can achieve higher margins over a cycle. This is the space in which we operate. And it is a space in which we have excelled in the past and must excel in the future.

Before turning the call over to Melissa to review the financials and the profitability improvement program in more detail, I want to tell you about some of our more recent technological achievements and awards.

Our engineering team is totally focused on partnering with our customer base to produce industry-leading technologies. Recently Frank's International was recognized as the 2019 World Oil Award Winner for our JET STRING ELEVATOR in the category of Best Health, Safety, Environmental Sustainable Development - Offshore. The JET STRING ELEVATOR is a hands free innovative lifting device that is designed to lift large diameter pipe and install the pipe into the wells, eliminating the need for cumbersome and time consuming lift dyes and lift clamps. Furthermore, it eliminates the need for dangerous manipulation of the pipe high above the rig floor. The JET STRING ELEVATOR has been and continues to be deployed on numerous jobs around the world, creating substantial savings to customers, while improving the safety of their operations.

In addition, Frank's Rack Back Console technology was also honored as an Award finalist. Building stands of pipe requires a number of carefully coordinated and controlled steps and this console's mechanical programming and pneumatic control allows this rig floor process to take place, while eliminating the need for hazardous area certification associated with electronic devices. The Rack Back Console has been successfully deployed in Brazil, and the Gulf of Mexico with more deployments scheduled.

As noted last quarter, the International certification process for our cementing equipment portfolio was completed, opening several new markets for our technologies. We're now seeing increased traction internationally in the adoption of our cement heads, SKYHOOK and other Cementing Equipment products and services. In the third quarter jobs were executed in 12 different countries.

We recently hosted a customer event at our training rig in Scotland, where we demonstrated our SKYHOOK technology, with over 35 customers in attendance. We generated a great deal of interest and have already been awarded our first job to these tools in the North Sea. We expect greater international revenue contribution for our Cementing Equipment product and service lines in the fourth quarter of 2019 as well as full-year 2020.

We also continue to be very excited about the adoption of our drilling technology solutions by our customers. We completed our 100 VERSAFLO job this quarter and we are now seeing long-term deployments as customers are specifying this tool into their drilling protocol.

We have several new drilling technology solutions in development, all with the same intent of optimizing drilling performance and reducing operational risk.

I will now hand it over to Melissa to discuss our financial results and outlook in further detail. Melissa?

Melissa Cougle

Thank you, Mike.

During the third quarter, Frank's faced some headwinds in the North American market which was somewhat expected. As we have heard through this earnings season, the North American land erosion story is not new news. And so we will not spend much time dwelling on it. We've also seen demonstrated and discussed in prior quarters that our Tubular business can show large swings when our customer drilling schedules change. And this was one of those quarters creating some unexpected headwinds.

On the positive side, our international businesses continue to show steady improvement and positive momentum, and our margins are showing strong leverage as well.

In reviewing our results on Slide 4, in the third quarter we generated $140 million of revenue, which was up 9% from the third quarter of 2018, although down 10% sequentially, largely as a consequence of the Tubular product sales delays.

Adjusted EBITDA was $16 million in Q3, and $43 million for the first nine months of the year, demonstrating year-over-year incremental margins of 35%.

We are most pleased to report that we generated $16 million of free cash flow this quarter, highlighting our focus on capital discipline and working capital management.

Turning to Slide 5, our TRS segment produced third quarter revenue of $102 million, a slight sequential decrease driven by the substantial headwinds in the North American markets this quarter. While we were able to maintain growth through the second quarter of 2019, despite the declining rig counts, as expected, our third quarter results were affected and we expect those headwinds to continue for at least the next couple of quarters. These challenges have been partially offset in certain international markets that continue to see increasing activity. Europe and the Middle East have both been notable bright spots this quarter. Asia-Pacific is also anticipated to be a good contributor in the fourth quarter of this year and into 2020 as well, due to some recent contract wins and market share gains.

In the Tubular segment, as presented on Slide 6, third quarter revenue was $12.5 million, a decline of 18% year-over-year and 44% sequentially. The decline in revenues sequentially was driven largely by the timing of customer drilling schedules and changes to deliveries and programs that had been forecasted to occur during the second half of this year. To remind there are two businesses in the segment, Tubular product sales and drilling technologies. The Tubular product sales business can be characterized as mostly large discrete customer orders that can introduce large swings in our results at times.

We have had several changes to plan deliveries in this quarter that we expect may continue into Q4, as some of our customers update and shift their drilling schedules. That said, we are confident in the long-term growth trajectory of our Tubular product sales business, as we currently have line of sight to a much improved backdrop during 2020.

Our customers schedules indicate significantly stronger demand, and we anticipate more robust sales in this business than we have seen in the past several years. Additionally, our reputation for quality and reliability has recently opened several international market opportunities for us including in Mexico, the Caribbean, and South America.

Looking to 2020 within our drilling technologies business line and as mentioned by Mike, we have recently completed development of some next-generation technologies that will give us improved market access to more drilling programs. We remain focused upon increasing our drilling technology asset base and expanding our customer accounts for Tubular product sales in order to drive more consistent performance quarter-to-quarter.

Turning to Slide 7, our Cementing Equipment segment's third quarter revenue declined 4% sequentially, although it increased 7% over the prior-year. The slight reduction in sequential revenue was primarily driven by reduced customer activity in our U.S. land market. This was partially offset by increased revenue in international markets and the U.S. Gulf of Mexico. We continue to increase our presence in the Gulf of Mexico with over 60% market share on floating rigs maintained throughout the quarter.

Turning to Slide 8, as Mike mentioned in his comments, the Frank's management team conducted a series of strategic business reviews with the goal of streamlining the organization for margin improvement. It has become apparent that the trajectory of the onshore and offshore markets will not be a quick rise back to historic levels. And even if the markets were to fully recover the industry itself will be changed. We recognize that in order to be a viable player in this space, we also will have to adapt.

Since going public in 2013, the company has had to build out a lot of infrastructure that comes with being a publicly listed company, and has simultaneously tried to maintain its relationships and customer oriented culture. Unfortunately, our infrastructure was built for a much larger company and a more significant market recovery scenarios than what is our current reality.

The combination of our business review has been the initiation of a project to be implemented over the next five quarters. We took a soup to nuts approach and the team has identified some of the following categories where we feel meaningful change can be affected.

The first is rationalization of locations and reducing our overseas cost footprint. Global reach and serving the basins in which our customers operate is imperative to our success. We are pursuing models where we can move more nimbly into and out of jurisdictions where the returns make the most sense in addition to reducing some of our heavier regional structures. Also, we are going through the process of evaluating our engineering projects.

We are committed to ensuring that every dollar we spend on an engineering development project goes through a rigorous Stage Gate process that validates our customer need, time to market, and put the expected returns through a rigorous challenge. There will be some projects that we decide to shelve in favor of more focused development efforts and shortening time commercialization.

We're also evaluating our stands and layers of management. As I mentioned earlier, the Frank's today was built for a different market scenario. And some of our support organizations we simply have too many layers of management that creates inefficiency and can affect the quick decision making that smaller organizations need.

Finally, we're also looking to speak at length with our vendors during negotiations, and create general cost savings to cultural change. It is imperative for Frank's to be more cost conscious given our new industry backdrop of a slow and prolonged recovery. We need to set the tone at the top to empower our employees to drive change, ask for discounts, and explore alternatives to the way we operate.

I am very encouraged that our messaging has been taken to heart and we have started to see the results of that in Q3.

To-date, we have already taken actions in our U.S. onshore operations to right size staff and facilities considering recent market shifts. We anticipate making significant changes in the fourth quarter, with incremental reductions also occurring during 2020. The changes we are making are systemic and will affect how we conduct our day-to-day business processes for the better.

Our objective is to maintain our global reach and our unparalleled service to our customers, while doing so in an efficient manner that vastly improves return to our shareholders. We have currently identified approximately $30 million of savings that can be implemented between now and the end of 2020.

We will be actioning our plans beginning in the fourth quarter and be focused on enabling as much as these savings programs as possible before year-end. Associated with that, we're currently anticipating $4.5 million to $6 million of restructuring expense.

The efficiency plans have been done in parallel to beginning our 2020 budget process. We will be able to share more details around our 2020 expectations and our progress toward our profitability improvement project on our year-end call.

There are also multiple longer-term projects such as an ERP implementation, and procurement savings opportunities involving more cost effective maintenance programs. The savings will be realized principally over the course of 2021 and are additive to the $30 million mentioned earlier. We believe we can exit 2021 with cumulative profit improvement opportunities implemented to bring about at least $45 million of savings beginning in 2022. And we hope to achieve this run rate well before the end of 2021.

Turning to Slide 9, for the fourth quarter of 2019, we anticipate a similar trend on the top-line compared to the third quarter. We are optimistic that with early adoption of our efficiency plans and our high-end estimated incrementals over last year that we will improve EBITDA quarter-over-quarter.

Looking to 2020, on Slide 10, we're expecting full-year top-line growth with contribution from all segments. Our TRS segment has seen some recent contract wins in activities in certain international basins that bring strong margin contribution.

During this call, we've also discussed strong line of sight in our Tubular business that would bring about double-digit top-line growth next year.

The international side of Cementing Equipment segment is getting traction with SKYHOOK projects starting in at least three new countries this quarter. And we anticipate stronger ramp up and adoption next year.

What we have struggled to predict is the U.S. land implications to our 2020 financial profile. That said we are confident in our ability to exceed $100 million of adjusted EBITDA in 2020 and as we push our savings plans through our budget details and update our U.S. land use, we will provide updated guidance.

We appreciate everyone's participation in today's call. Mike and I welcome your feedback and questions.

Question-and-Answer Session

Operator

Thank you. We will now begin the question-and-answer session. [Operator Instructions].

We have a question from Ian Macpherson from Simmons.

Ian Macpherson

Good morning. Due to the background noise, I'll ask quickly unmuted. So Melissa for the 2020 top-line Tubulars is the most feasible with double-digit and then surely international and I would expect total offshore, at least high-single-digit top-line for next year. Is that credible that just leaves the U.S. land piece at the black box?

Melissa Cougle

Ian, appreciate the question. I think we're still looking through it. Next year, we are going through the process right now presently of quantifying essentially the contracts that are rolling over. We are optimistic, as you mentioned about the offshore space Tubulars does have really strong line of sight. I think we didn't need to hold on giving you any more than that probably for a couple more months as we get through everything else clustered.

Ian Macpherson

That's fair enough. The drilling contractors are getting pricing now as they historically been in correlation there that we should think about in terms of recovery for your pricing, or is that not in your thinking yet for 2020?

Melissa Cougle

It's not in our thinking yet for 2020. I'll let Steve expand upon it as well. Certainly, we would expect there would be a correlation. I would say it's fair, Steve chime in that we have not factored that into our 2020 budget at present.

Steve Russell

Yes, Ian, I think Melissa is correct on that. I mean, we are seeing a mixed story on pricing this, I think we reached bottom when we're in the early stages of a recovery internationally. As Melissa alluded to, there's some market headwinds specifically in U.S. land that will no doubt give us some challenges on pricing next year.

Ian Macpherson

Got it. Thank you. Then last one for me. Can you offer anything on CapEx for next year yet?

Melissa Cougle

Give us a little bit of time there, Ian. We're still working through some projects as part of linking back to the profitability improvement program. We have some early days, but I think we'd rather come back to you with firmer guidance there in future.

Operator

[Operator Instructions].

We have a question from David Anderson from Barclays.

David Anderson

Hi, good morning. I was wondering if you could just kind of dig into your International TRS business a little bit for me. You had said in your remarks that the Middle East and Europe were positive for you in the quarter. Can you just kind of talk about it’s kind of within your projections how you think about next year and you talked about overall revenue growth. Can you remind us how much the international business is offshore? And I think what you're referring to is more the onshore business and can you just kind of talk about where that business is in terms of kind of your strategic vision, a few years ago that was a business you guys got into? I'm just kind of curious how you feel the business is running today. Is that a business that you think you can continue to expand? I'm thinking you just kind of talk about the different nuances of international please?

Mike Kearney

Yes, thank you. So I think first of all, if we look forward to next year, we're generally seeing an increasing market trend internationally. For us this geographical -- it's a hot spot for us, we see pretty decent growth coming out of Asia-Pacific, Africa and Europe next year. To the specific comments on the Middle East that for us is a mix land in offshore market. It's approximately half and half, the offshore being a shelf market. And in general, I would say that gives us some opportunities for next year, we don't see that as one of the major growth opportunities for next year internationally.

David Anderson

Okay. And then when you've talked about your Tubular business and kind of the optimism you have there for some of those big diameter pipes, does that give you kind of confidence on the offshore market for next year? Just kind of curious what you're hearing from your customers. The offshore rig count has kind of plateaued here a little bit. What's your confidence that that offshore rig count picks up next year and does that Tubular business; can you give me some of that confidence?

Nigel Lakey

Yes, thanks, David. It’s Nigel Lakey here. The market for us is localized, if you will from our perspective, our customers are going to increase their level of activity that gives us strong line of sight and good confidence for Q4 recovering from Q3 and certainly into 2020 also.

David Anderson

And I guess a final question from me would be on some of your cost-out program, you talked about the additional $15 million that you could take out on supply chain. I was wondering if you could just talk about that a little bit. I know it's been something we've talked about with Frank's in past years in terms of kind of fixing up some of the supply chain; I know you've got different businesses that aren't necessarily talking to each other internally. Can you just talk about some of the plans there of kind of what you're looking out on the supply chain? And maybe also just help us understand it's kind of what's the ultimate goal here? You had a nice quarter in free cash flow this quarter. But as you look out going forward and as you think about maybe that EBITDA of $100 million plus next year, and do you have a goal in mind in terms of the free cash flow conversion on that, and how does that supply chain, I guess overall fit into that?

Mike Kearney

So I'll take the supply chain first, this is Mike. In terms of our business, we have discrete business units. So we actually procure things in a number of locations and our objective there and of course, it's longer-term is to get better visibility in terms of all of these functions that are somewhat disparate, and bring them together more closely and try to get that volume purchasing power by being more coordinated.

So that's clearly a longer-term project. In that you've got to go your vendors, you've got to seek to get reductions. If you can't get the reductions you want, then you need to look harder for other vendors. So it's definitely a longer-term initiative. But we're just in the early stages of that, but I think we can do a better job and we'll be working on that. But we didn't want to -- we view that as longer-term, not something you've kind of flip the switch and get those savings.

In terms of the free cash flow, I'll let Melissa speak to that one in terms of 2020.

Melissa Cougle

Yes, I think I would also add to what Mike just said, and what you also heard from us is that the supply chain optimization was coinciding with an ERP implementation. So that $15 million, we would tap into on the backside of having what we view as far more clarity and real time data to be able to react to.

So proper category spend to facilitate vendor discussions, better working capital management because we can get a firm handle on invoices getting out of the door quicker and can pull our outstanding receivable reports more efficiently. So the general efficiency that comes along with an ERP implementation is also rolled into that. Everything Mike said plus some more is what I would say.

From a free cash flow next year perspective, what I would tell you is we're still going through the process right now of really recasting our view as relates to U.S. Land as well as pushing through our profitability improvement project.

So we are -- it would be fair to say we’re highly focused on free cash flow. We understand its priority in the space and it is a primary metric for us to track. So we will be looking to optimize and make it as efficient as possible. That being said, we feel like there's still more work to do in quantifying and pushing out the work that we know we can do into the financials to see how it flows through to the free cash flow line.

David Anderson

Okay. So to be continued, so actually that was my question on your supply chain and whether or not your infrastructure kind of improvements were required and I guess the answer to that is yes. So you think that will take kind of -- how long do you think it takes to implement the new ERP system?

Melissa Cougle

Well, we're largely looking at next year as our timeline to get to -- when we start 2021, now we -- there are things as Mike mentioned, there are things we can do now and we will be doing what we can do now. But a lot of this longer-term stuff starts to tap into when you have good clear clarity to your spend categories and you can go back to your vendors with full spends and global agreements.

Mike Kearney

As you probably know, these ERP projects are long and complicated. And we're choosing to implement in phases. So one approach is the Big Bang where you try to convert everything at the same time. And so our first phase is going to be kind of our financial and back office piece, which would include a lot of supply chain components. And we're targeting to have that pretty much done by the end of next year.

And then there'll be other things beyond that in terms of our inventory management and other modules, HR would be added on at a later date, but it'll be a sequential process. We're not going to stop and take a break. We'll do it one module at a time, but it will take place over more than one year.

Operator

[Operator Instructions].

We show no further questions. I would like to turn the call back to Mr. Kearney for final remarks.

Mike Kearney

Okay, thank you, Sylvia. Well, we appreciate everyone joining us on today's call. And the management team is very excited about the steps we're taking to improve our profitability and serve our customers in the safest, most cost effective manner. We look forward to updating everyone on our fourth quarter call. Thanks for joining.

Operator

Thank you. And ladies and gentlemen, this concludes today's conference. We thank you for participating. You may now disconnect.