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National Oilwell Varco, Inc. (NOV) CEO Clay Williams on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-28-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $0.1832 beats by $0.06 | Revenue of $2.13B (-1.30% Y/Y) misses by $-45.71M

Earning Call Audio

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National Oilwell Varco, Inc. (NYSE:NOV) Q3 2019 Earnings Conference Call October 29, 2019 11:00 AM ET

Company Participants

Blake McCarthy - Vice President, Corporate Development & Investor Relations

Clay Williams - Chairman, President & Chief Executive Officer

Jose Bayardo - Senior Vice President & Chief Financial Officer

Conference Call Participants

Byron Pope - Tudor, Pickering, Holt

Bill Herbert - Simmons

Vebs Vaishnav - Howard Weil

Scott Gruber - Citigroup

Kurt Hallead - RBC

Cole Sullivan - Wells Fargo

Connor Lynagh - Morgan Stanley

Sean Meakim - JPMorgan

Operator

Good day ladies and gentlemen and welcome to the National Oilwell Varco Third Quarter 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. [Operator Instructions]. As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference Mr. Blake McCarthy, Vice President of Corporate Development and Investor Relations. Sir, you may begin.

Blake McCarthy

Thank you. Welcome everyone to National Oilwell Varco's third quarter 2019 earnings conference call. With me today are Clay Williams, our Chairman, President, and CEO and Jose Bayardo, our Senior Vice President and CFO.

Before we begin, I would like to remind you that some of today's comments are forward-looking statements within the meaning of the Federal Securities laws. They involve risks and uncertainty and actual results may differ materially. No one should assume these forward-looking statements remain valid later in the quarter or later in the year. For more detailed discussion of the major risk factors affecting our business, please refer to the latest Forms 10-K and 10-Q filed with the Securities and Exchange Commission.

Our comments also include non-GAAP measures, reconciliations to the nearest corresponding GAAP measures are in our earnings release available on our website. On a U.S. GAAP basis for the third quarter of 2019, NOV reported revenues of $2.13 billion and a net loss of $244 million or $0.64 per share.

Our use of the term EBITDA throughout this morning's call corresponds to the term, adjusted EBITDA, as defined in our earnings release. Later in the call we will host a question-and-answer session. Please limit yourself to one question and one follow-up to permit more participation.

Now, let me turn the call over to Clay.

Clay Williams

Thank you, Blake. In the third quarter of 2019, NOV generated EBITDA of $262 million, up $67 sequentially despite a modest revenue decline from our second quarter. Our third quarter benefited from credits related to the close out of the handful of projects in our Completion & Production Solutions and Rig Technologies segments, which contributed nearly $20 million to our improvement.

The more important driver behind our improving profitability was our cost savings which added over $20 million in EBITDA sequentially. The balance of the sequential improvement related to favorable product mix shifts for instance rising revenues in our Rig Technologies aftermarket. NOV made excellent progress on restructuring to drive efficiency and in a moment Jose will update you in more detail on our revised cost savings targets.

Additionally, we are pleased with the progress on improving cash flow. Cash flow from operations was $352 million in the third quarter, reflecting improving working capital intensity arising from the organization's heightened focus on receivables, inventory, and payables.

Despite the challenging market backdrop, NOV's team performed well and I am proud of everybody's hard work. Our third quarter international revenues grew 3% sequentially fully offset by 5% sequential declines in North America. The U.S. land rig count is now down more than 20% from its recent high in late 2018. And while this will eventually result in decelerating U.S. production growth, it is currently pressuring our domestic customer base and consequently our short-cycle U.S. business lines.

On the other hand, international and offshore activity continues to grow at a modest pace both the IOCs and NOCs have used the prolonged down-cycle to pull cost out of their planned projects and FID approvals appear to be increasing. International and offshore growth helped NOV post an overall book-to-bill ratio north of one in the third quarter.

As cross currents and deep cyclicality continue to affect the global oil and gas business, NOV continues to benefit from; one, its broad geographic and product diversity, a key strength of our business model. Two, its market leadership which provides numerous scale advantages; and three, it's enormous installed base of equipment.

These business model attributes lend NOV the necessary durability to navigate the extreme volatility experienced in oil and gas and are, in my opinion, important to understand with regards to the investment case for NOV at a time when oil and gas is deeply out of favor.

I believe there is no single greater determinant of long-term returns than a company's strategic positioning and NOV's is unique among oilfield ecosystem participants. Our diversity along several dimensions is a great example. We make a broad array of oilfield tools and equipment and consumables which we sell to more than 8,000 discrete customers.

Some energy services companies, some producers, and even some in unrelated industrial enterprises. We operate in exploration development and production phases in both land and offshore markets across 65 countries. Although almost all are affected by oil and gas commodity prices, which are cyclical rarely do all the subsectors move exactly in lockstep. So as North American cycles down, we can pivot and redeploy assets to areas like the offshore and international markets that are exhibiting growth. Q3 is a good example.

Our business has low capital intensity. NOV's manufacturing assets are generally not specialized even though they are used to make specialized equipment. Machine tools, assembly plants and rig up yards can be repurposed to areas of highest demand. They are also relatively small capital investments as compared to the revenues that they can generate.

Our ongoing maintenance capital investment needs are far lower than most oilfield participants as measured by CapEx as a percentage of revenue. Over the trailing 12 months for example, our CapEx is only been 2.8% of sales. Lower capital expenditure requirements equate to higher free cash flows and represent another attractive and differentiating attribute of NOV versus other in the oilfield.

We focus on market leadership. Our size and scale provide us clear advantages in procurement, manufacturing, logistics and distribution. We have built the largest installed base of equipment globally within most of the equipment categories we supply, something that would take many years for our competitors to replicate. This provides NOV the opportunity as OEM to sell spare parts and maintenance services to the owners of this equipment even during downturns.

As a result, our Rig Technology segment saw higher margin aftermarket revenue growth to 57% of its mix in the third quarter. Our installed base also provides proprietary opportunities to develop and sell digital enhancements to the owners of our equipment like Cerberus and NOVOS operating systems, software optimization tools, condition based maintenance programs and predictive analytics. These are all digital enhancements we've capitalized on through the downturn made possible by our enormous installed base.

Market leadership positions NOV best to help our customers achieve standardization, which helps them drive better service, training and procedural consistency across their own operations. All of this improves efficiency which in turn drives greater financial performance and capital returns for our customers.

Standardizing on technology from the market leader with global support capabilities and strong financial resources is the logical choice for an entrepreneur in the oilfield seeking to profitably grow his or her business. Many in our senior leadership team started our careers in the brutal 1980s and 1990s, another generational downturn in the oilfield.

We know that diversity and strategic positioning are critical to successfully navigating a tough downcycle, but so is executing well on cost savings initiatives and effectively managing working capital to maximize cash flow. In the third quarter NOV benefited from all of the above.

Pulling oil and gas out of the ground remains one of the most capital-intensive activities in the world, one that consumes equipment steadily and one that will continue to be required for decades to come as a key part of the mix of supplying rising global demand for energy. Eventually there will emerge an need for sustained reinvestment and retooling across oil and gas value chain. That said in the near-term, we are focused on the things that are directly within our control in this market costs and working capital.

Our capital allocation continues to focus on strategic positioning and returns. We are using the current period to review our portfolio of businesses to ensure that we are engaged in activities where we have a clear and demonstrable competitive advantage or where we see a low risk capital efficient opportunity to develop a new business that demonstrates competitive advantage and can be expected to generate solid financial returns within a reasonable timeframe.

Some of our products won't make the cut and will be divested to free up capital. With respect to capital deployment, we remain committed to maintaining a strong balance sheet to preserve our investment grade credit rating and ample liquidity.

After our CapEx needs we will continue to execute smaller M&A transactions, which enhance our business positioning and competitive mode and which can typically be further enhanced by organic investment in technology and product development and integrated into NOV's global network. Overall, despite a very tough five year downturn NOV has materially improved its positioning and its prospects and I remain optimistic about our long run success.

Finally to our employees listening your hard work, perseverance and professionalism during these rough times humbles me. You are truly what differentiates NOV and I consider myself fortunate to be a part of your team. Thank you.

With that I'll turn it over to Jose.

Jose Bayardo

Thank you, Clay. NOV's consolidated revenues were essentially flat sequentially as the continued momentum in our international and offshore operations was offset by deteriorating conditions in the North American market or revenue decreased 5%. Revenues from offshore markets improved 7% sequentially bringing the percentage of our consolidated revenue from offshore markets to more than 40% for the first time, since the first quarter of 2017.

Improving conditions in the offshore and international markets also helped us achieve our third quarter in a row, with a companywide book-to-bill of over 100%. EBITDA increased $67 million, sequentially to $262 million, reflecting great progress on our restructuring efforts a more favorable business mix and some favorable project completion variances.

As noted, we made great progress on realizing incremental cost savings, which totaled roughly $80 million on an annual basis. To date, we are realizing greater savings and initially anticipated on certain of our restructuring initiatives and we are continuing to find additional opportunities that will help make the organization more efficient. We now believe we will realize a total of approximately $200 million in annualized cost savings from our restructuring efforts by the end of 2020.

For the fourth quarter, we expect to realize an incremental $40 million of annualized cost savings. During the third quarter, we also made great strides in our efforts to reduce the capital intensity of our operations by reducing our working capital and improving our cash flow. We generated $352 million in cash flow from operations and after deducting $69 million in capital expenditures, we netted $283 million of free cash flow.

During the third quarter, we also collected a $65 million note receivable related to a divestiture we completed a few years ago. Even though the $65 million was on our balance sheet as a current asset, and therefore part of working capital it flowed through the cash flow from investing activities on our cash flow statement. If you included the $65 million in our free cash flow number, it would total $348 million.

No, matter how you look at it we're well on our way to achieving our target of between $300 million and $500 million of free cash flow in the second half of 2019. Couple of quick housekeeping items, before we jump into our segment results, SG&A declined $124 million during the quarter returning to a more normalized level relative to the second quarter. Additionally, during the third quarter our intercompany eliminations fell to a lower-than-normal level due to the timing of projects.

In the fourth quarter, we expect eliminations and corporate cost to return to levels in line with what we saw during the second quarter.

Turning to our results of operations, our Wellbore Technologies segment generated $793 million in revenue in the third quarter, a decrease of $57 million or 7% sequentially. Excluding results from our drill pipe manufacturing business, which tends to behave more like a capital equipment business, revenue in North America declined 7% in line with the fall off in drilling activity

EBITDA for the segment was down only $1 million sequentially as cost savings initiatives helps limit detrimental margins to approximately 2% a testament to the effort of our team to flex the size of our operations with the change in market conditions. Our ReedHycalog drill bit business posted a slight revenue decline due to weaker domestic activity, partially offset by growth in international markets

A contracting North American market is causing fierce pricing competition among our competitors, but our ability to deliver superior value to our customers through technology leadership has to date helped insulate more business from the pricing pressures without exceeding market share.

Our M/D Totco business unit experienced a mid-single digit drop in revenue due to the same North American headwinds affecting the rest of our business. While M/D Totco is certainly not immune to the headwinds of the current market environment, we expect our list of closed loop automated drilling and surface optimization projects in North America, the Middle East and offshore Europe will continue to grow as operators around the world look to our digital solutions to improve their ability to generate returns.

Revenues in our Downhole business unit also declined due to lower motor agitator and fishing tool sales in the U.S. International revenues were mostly flat and we are seeing rising demand for our agitators and other drilling tools in the Middle East in Europe. Part of this growing demand is coming from service companies seeking to drive additional efficiencies in their drilling operations as they execute on lump sum turnkey contracts.

We're also seeing more customers leverage our agitator technologies to improve efficiencies and completion operations. Our TerraPULSE coiled tubing agitator system is enabling customers to meaningfully reduce the time and cost to complete the long lateral multi-stage drill out operations.

Our Tuboscope business posted results that were roughly flat for both revenue and EBITDA as the fall off in North American operations was offset by growth in international markets. The decline in Tuboscope U.S. coating revenue was compounded by downtime associated with planned equipment upgrades as well as lost days in our Houston area plant which resulted from Tropical Storm Imelda.

Strong demand for coating services and an increase in deliveries of our Thru-Kote sleeves to the Middle East more than offset the fall off in North America. Additionally, the decrease in drilling activity in the U.S. hurt demand from steel mills and pipe processors, resulting in a slight decline in revenue from our inspection service operations.

Our WellSite Services business unit experienced a high single-digit drop in revenue. Like the other business units in this segment, U.S. operations were impacted by slowing activity levels, which will continue to be a near-term challenge.

But we did begin start-up operations for projects in the Gulf of Mexico, which tend to drive higher revenue and profitability due to the sophisticated technology employed in offshore operations.

We're also excited about a series of additional offshore projects scheduled in 2020, for which the team is currently preparing. Our Grant Prideco drill pipe business recorded, a double-digit percent decrease in revenue, as demand from new pipe has fallen sharply in North America, as a result in the fall of rig count.

The decline in revenue from North America was only partially offset by increasing demand from international and offshore markets. While orders have been solid, international orders typically take more time to convert from bookings into revenue.

However, for the first time and quite a while, Grant Prideco's top line is more than 50% offshore. And while the business units revenue declined in Q3 bookings actually improved 30%, as international and offshore orders continue to flow in, at a welcome pace.

In the fourth quarter of 2019, we expect continued capital restraint across North American E&P complex, combined with the holiday season to result in further declines in U.S. activity, while our international and offshore markets are expected to continue their measured recovery.

We therefore expect revenue for our Wellbore Technologies segment to decline 5% to 7% with continued focus on cost savings, limiting our detrimental margins to approximately 25%.

Our Completion & Production Solutions segment generated $728 million in revenue in the third quarter, an increase of $65 million or 10% sequentially. Higher revenues, cost savings and favorable adjustments associated with the completion of certain projects, drove 46% incremental margins, resulting in a $30 million increase in EBITDA to $82 million or 11.3% of sales.

Order intake remained healthy, and we captured $535 million in bookings during the third quarter. Orders exceeded shipments by 24%, providing us with our fourth quarter row of a book-to-bill in excess of 100% for this segment.

Backlog at quarter end totaled $1.3 billion. Sharp improvement realized by this segment over the past two quarters, is a further testament to the diversity of our operations.

We've been able to more than offset the rapid deterioration in demand from completion service providers in the U.S. by capitalizing on improving fundamentals in the international and offshore markets, which allowed us to drive sequential revenue improvements in all, but one of our business units within the segment.

Our intervention and stimulation equipment business, experienced a 7% sequential decline in revenue, resulting from the sharp fall off in U.S. completions activities, that is once again causing customers to delay acceptance of equipment, ready for pickup and other customers to request deferrals on more recently placed orders.

Despite the sequential deterioration in performance, the business service is a great example of how our leadership, breadth and scale, enhance our ability to navigate through difficult market conditions. And give us the flexibility to pivot where opportunities exist.

While the need for new pressure pumping spreads has been virtually non-existent for the past year. And more recently we've experienced a sharp decline in orders for new coiled tubing equipment, in the U.S., demand from international markets remains robust.

In Q3, we booked orders for nine coiled tubing units, 24 nitrogen units, and a significant amount of other support equipment, from a wide range of customers that will deploy the assets in numerous international markets.

We also saw an increase in international orders for wireline and flow line, including a sizable order for our Anson 20,000, PSI-rated flow line, that's destined for China. And despite generally weak demand for pressure pumping equipment and aftermarket support, we were still able to book a few orders for blenders control systems and support pumps.

Our unparalleled global footprint, service infrastructure, technology, quality and customer base, can even create a safety valve for at least some optionality for our customers that can't be obtained from other vendors.

One of our loyal U.S. coiled tubing customers, we've seen rapidly deteriorating demand and it was able to sell their order slot. And associated deposit to an international service company that still sees unmet pent up need for more modern equipment in the markets they serve.

We believe no other vendor in the space has more customers that standardized on their equipment and has an install base as large as NOV. Our market position global footprint service infrastructure technology and quality make us uniquely positioned to help our customers in ways that others cannot.

While this type of transaction could temporarily cannibalize our near term opportunity set, it ultimately creates a healthier market over the long-term term and did not prevent us from realizing a respectable 92% book-to-bill order intake for our intervention and stimulation equipment business in the third quarter.

Revenue for our Process and Flow Technologies business unit was roughly flat, as growing contributions from the execution on projects to build offshore production equipment booked over the past several quarters were mostly offset by a deteriorating North American market that is dampening demand for production chokes and pumps. EBITDA margins improved on a better mix, cost savings and favorable adjustment on a legacy project closeout.

Near term, we expect growth from our Process and Flow Technologies international and offshore operations to more than offset the challenges associated with North American production and midstream markets that continue to contract in response to tightening E&P CapEx budget.

Tendering activity for APL and wellstream processing operations remained strong particularly for large-scale offshore gas development projects which supported the second sizable award for a submerged turret production system in as many quarters and allow the unit to post its third quarter in a row with a book to bill more than 100%.

Our Fiber Glass business unit posted another strong quarter of growth. Steady improvement in our core composite tubular offerings was supplemented by the first shipments from our new manufacturing plant in Dammam Saudi Arabia, an acquisition that was completed during the second week of July and rapid growth in demand from shipping companies for marine scrubber system components as they scramble to retrofit vessels to comply with IMO 2020 requirements.

Excluding additions from the acquisition orders for our fiber glass business unit improved 34%. Lastly in our subsea flexible pipe business bookings were light, despite the continuation of a steadily growing opportunity set that allowed us to realize 3 straight quarters of improved bookings prior to Q3 and led to 22% sequential revenue growth.

Looking at the fourth quarter, we expect improved international and offshore directed activity to offset the impact from rapidly deteriorating market conditions in the U.S. completions market, resulting in fourth quarter revenues that are flat with Q3.

We also expect Q4 EBITDA to remain in line with third quarter results for our Completion & Production Solutions segment as cost savings realized should make up for the falloff in favorable project closeout settlements.

Our Rig Technologies segment generated $649 million in revenue in the third quarter, a decrease of $22 million or 3% sequentially. Aftermarket revenues which improved 5% were more than offset by an 11% decrease in revenues from capital equipment sales.

Growing contributions from our naval design jacking system and pipelay tensioner offerings from our marine construction operations were more than offset by a fall-off in drilling equipment project revenues associated with the completion of several projects in late Q2 and early Q3.

While revenue declined we realized a much more favorable shift in our product mix and when combined with project closeout variances and strong progress on our cost savings initiatives, we realized a $31 million improvement in EBITDA to $105 million or 16.2% of sales.

Rig Technologies' capital equipment orders totaled 221 million, a sequential decrease of $89 million or 29%.Shipments of $246 million outpaced bookings providing us with a book to bill of 90%. Total segment backlog at quarter end was $3.14 billion. We continue to see a growing opportunity set in the renewable sector where we are able to leverage our core expertise in lifting and handling and in naval architecture to serve this rapidly growing industry.

After booking a record size order for the jacking system of European offshore wind construction vessel in the second quarter, we received another large order associated with a 28,000 ton offshore wind turbine installation vessels that will be constructed at Japan Marine United shipyard or Shimizu Corporation.

NOV was awarded the design work, a telescopic leg crane and the jacking system for this 142 meter long 50-meter wide vessel, that is being purpose-built to efficiently construct the next generation of offshore windmills which will incorporate turbines with capacities of up to 12 megawatts and the rotor diameters of up to 220 meters.

NOV proprietary telescopic leg crane will provide a unique combination of high elevation hoisting capability for turbine installation and heavy load capability for foundation installation.

The crane will have a maximum lifting capacity of 2,500 tons and a maximum lifting height of 158 meters. The unique design of the telescopic boom also avoids per fusion outside the whole dimensions during transit, which increases the maneuverability of this vessel. Larger more economically efficient ultra large-scale wind turbines ranging from nine to 12 megawatts in size, will greatly improve the economics associated with the offshore wind industry.

We're excited about this opportunity, which has a dollar value roughly equivalent to a full equipment package associated with the high spec jack up rig and see the need for a healthy number of additional vessels over the coming years due to the limited fleet of installation vessels currently capable of installing wind turbines eight megawatts or larger.

As offshore rig activity continues to recover at a measured pace, we continue to see steady order intake associated with upgrading and differentiating the performance of offshore rigs with a heavy emphasis on automation and multi-machine control enabled by our NOVOS control platform.

While the number of rig contract tenders has increased, these processes remain very competitive and operators are increasingly insisting that these capabilities are included in bid packages. We booked four NOVOS orders associated with these automation upgrades during the third quarter, in addition two NOVOS systems for land rigs bringing our total number of orders to over 130.

While land rig capital equipment orders remained challenged in the Western Hemisphere as North American customers cannibalize equipment off their stacked assets and the short devaluation of the Argentine peso models the near-term outlook in that particular market.

We continue to see pent-up demand for cutting edge drilling technology and equipment in other international markets, including the Middle East where we were able to secure an order for two land rigs during the quarter.

In our Rig Aftermarket business, the positive booking momentum continued with another double-digit sequential increase in orders, yielding our highest order flow since Q1 of 2015.

While service and repair work was roughly flat, we continue to maintain a steady backlog of reactivation upgrade and recertification project volumes. In addition, we're continuing to realize greater adoption rates of our condition based monitoring solutions and total cost of ownership service model.

Looking at Rig Technologies fourth quarter, we expect revenues to improve between 4% to 6% on higher revenues from land rig sales and service and repair work. EBITDA margins are expected to decline between 200 and 400 basis points due to less favorable mix, a fall-off in favorable cost variances on project closeouts and limited incremental contribution from cost savings between now and the first quarter of 2020.

While we expect market conditions will remain challenging, we're pleased with the strides our people are making to improve our profitability, our working capital intensity and our already strong competitive positioning.

With that, we'll now open the call to questions.

Question-and-Answer Session

Operator

Thank you, sir. [Operator Instructions] Our first question comes from Byron Pope from Tudor, Pickering, Holt. Please go ahead.

Byron Pope

Good morning, guys.

Clay Williams

Good morning.

Jose Bayardo

Good morning, Byron.

Byron Pope

Is it really encouraging to hear that international recovery continues and steady fashion for you guys. And I was particularly struck by the growth in caps. Clay, I want to ask you to speak to specific countries and customers obviously. But could you just frame for us the maybe the regional international drivers for caps as you see it as we step through the next 12 or so months.

Clay Williams

Yeah. What's encouraging to us Byron is the pickup in activity in the offshore, in particular and I think that's been driving a lot of orders source in the Completion & Production Solutions group. So generally, the world seeing rising demand for LNG in Asian markets and that's contributing to, I think, some decisions by operators to move forward with development of gas discoveries in places like East Africa and elsewhere.

Our customers there, in many of the major basins, have had five years of reengineering and focusing on cost through this downturn and have been high grading their prospects have been taking advantage of deflation in the supply chain to reduce their cost of development. I think there are to a point where they're getting more confident about moving forward.

I think you have a lot of operators around the globe that are -- have seen our normal depletion and declines of the base loads around some offshore infrastructure, gathering hubs and pipelines and things like that who recognize the need to replace some of that production. And so, I think that's kind of giving a little impetus to operators to move forward on some of these developments.

So it's really -- it's been a slow, but steady recovery and very pleased to see it continue on through the third quarter. But really a global phenomenon. We're seeing, I think Jose in his prepared comments referenced some of the equipment that we expect to go to work in the

Gulf of Mexico and the U.S., lot of interest in the Mexican side of the Gulf of Mexico, Brazil offshore, North Sea. So, again very, very steady and slow and encouraging for the outlook and lots of markets around the globe.

Onshore, the Middle East has remained fairly active through the downturn and just continues to be a lot of things going on there. And so we've got a number of tenders that we're looking at. With respect to providing equipment into that market, we've opened a number of facilities in the Kingdom of Saudi Arabia that came online specifically, for instance, our Fiber Glass pipe manufacturing plant in Dammam that Jose also referenced. We opened that in April and it's ramping up production, now we're making both real pipe and jointed pipe there, and so just a lot of -- as opposed to North America, we're facing a lot of headwinds, international offshore seems to be much brighter.

Byron Pope

That's really helpful. Clay I appreciate it. And then Jose just one quick question, I mean the strong free cash flow generation in Q3, but I think I heard you say that the back half free cash flow target is still intact the where you guys had previously characterized it. Is that fair?

Clay Williams

It is fair. So yeah, obviously, we made some really good progress during the course of the third quarter. Made more progress than we had anticipated related to collection of receivables, we're continuing to tighten up and improve our processes. So even as business mix becomes a little bit more challenging as it relates to collections, organization is doing a great job, getting their arms around the process and it's squeezing down the days receivable.

So as we look at the fourth quarter, we are holding our prior guidance intact, the $300 million to $500 million in free cash flow for the second half of the year, but obviously we've made great strides in getting there, and so you could be pretty confident that we would look at the upper end of that range.

Byron Pope

Great. Thanks guys. I appreciate it.

Clay Williams

Thanks Byron.

Operator

Thank you. Our next question comes from Bill Herbert from Simmons. Please go ahead.

Bill Herbert

Good morning. So sticking with the free cash flow theme, so if you could hit the upper end or your guidance for free cash flow for the year that implies yet another significant working capital harvest in Q4 that's not necessarily dissimilar to what was witnessed in our Q3. Is that correct?

Jose Bayardo

It certainly involves some additional contribution from working capital and we're confident in our ability to realize that. But later today once you -- once we are sure of our Q, you'll be able to see a little bit more granularity from the cash flow statement. As I mentioned, we made great progress as it pertains to harvesting cash flow from receivables and other elements of the -- of our working capital.

We started to get cash from our inventory. However, the contribution in Q3 was pretty light and so I think you'll see a little bit of shift in terms of where the source of cash is coming from. You'll have continued source just from operational performance, but you'll see a shift from more contribution from inventory versus receivables as we move into the future.

Clay Williams

Yeah, we're really going to focus our attentions I think on getting better at inventory. We did as Jose mentioned was a source of cash but that's where the -- I think remaining opportunity is for us.

Bill Herbert

Okay. So we have a shift from receivables to inventories in Q4, but nonetheless the working capital harvest in Q4 is still fairly considerable?

Jose Bayardo

Our expectation is to see continued contribution from working capital.

Bill Herbert

Got it. And with working capital spending, I'm not sure if you touched on this in your commentary Jose, but what should we expect with regard to Q4? And also if you can just take a look into 2020 and what your expectations would be for capital spending intensity. It's been fairly low as Clay pointed out year-to-date. And I'm just curious is as to whether it can stay that low?

Jose Bayardo

Yeah, sure. I think there are a couple of questions mixed in there. One additional question related to working capital. So, yeah, as we move forward into the fourth quarter as we've touched on, we expect to continue -- continued improvement on the working capital intensity of the business. And we're certainly not going to sit still as it pertains to 2020. Still think there are more opportunities for improvement through the course of 2020 to bring down that ratio of working capital to our revenue run rate.

Yeah, as it pertains to the capital intensity of our business associated with capital expenditures, yeah I think its most folks are well aware, we have a very capital-light business that's operating in a pretty capital-intensive business which is prone to generation of cash flow and we continue to view our business in that way and manage it that way.

As you've highlighted, our capital expenditures for this year is certainly below the plan, which we laid out at the beginning of the yea, at $69 million in CapEx in Q3. Q4 is normally our highest CapEx quarter of the year. But I think we'll probably finish up the year at about $260 million of CapEx full year. One of the several reasons why our CapEx for 2019 is a little bit below or is a bit below our original plan is no surprise that things are going -- we've factored the budget around sort of best case scenario in terms of progress going -- we've factored the budget around sort of best case scenario in terms of progress associated with the new rig manufacturing plant in Saudi Arabia. Things take a little bit more time and so we're not surprised that's taking a little bit longer when you're building a facility in completely undeveloped territory within Saudi. So, some of that CapEx will shift into 2020 and so we can see a little bit of an increase for 2020. But then after that expect our capital expenditures to get back in line with history which should be plus or minus 3% of our revenue run rate.

Bill Herbert

Okay, fine. So it's basically a little bit of an increase for 2020, is that splitting the difference between Q3 and Q4.

Jose Bayardo

We have -- we're in the middle of our planning process right now. But I think -- I think that's a safe assumption.

Bill Herbert

Okay. Thanks very much.

Clay Williams

Thanks you, Bill.

Operator

Thank you. Our next question comes from Vebs Vaishnav from Howard Weil. Please go ahead.

Vebs Vaishnav

Hey good morning and congratulations on the very good quarter.

Clay Williams

Thank you, Vebs.

Vebs Vaishnav

Vebs Vaishnav

I guess just following up on the last questions, if I think about the CapEx for next year, my sense from what we were talking is, it could be flattish. Is that fair way of thinking?

Jose Bayardo

No Vebs. So when we came into this year, our initial expectation was CapEx plan just a little south of $350 million. So, as we move into 2020, we will see that step-up associated with the increased spend related to that rig manufacturing plant. So as Bill was kind of indicating, I think you'll see somewhere between through the $260 million that we're calling for now this year and that $350 million number for next year, but subject to revision next quarters as I mentioned we're in the middle of our planning process right now.

Clay Williams

Yeah. The plant that Jose referenced in Saudi Arabia is the big piece this year. I think, if you recall when we came into 2019, we basically said, we're taking 2018s level of CapEx at about $250 million and another $100 million for that plant in Saudi Arabia. The reason we're a little bit hesitant is, it depends on how constructions progressing there and as Jose mentioned, some minor delays there. But on the whole, we're developing kind of our and fine-tuning I think our outlook for CapEx as we move into 2020.

Jose Bayardo

Yeah. And there is spend that is occurring on that plant. So therefore, we certainly wouldn't expect 2020s CapEx to be in line with what our original plan was for this year which had assumed everything went as quickly as possible.

Vebs Vaishnav

Yeah, got it and I'm sorry, if I missed it, but did you guys call out how much was severance cost in your free cash flow number in 3Q?

Jose Bayardo

We did not specifically called that out but I think in Q2, you saw the non-cash charges associated with some of our severance expense. The majority of that would have flowed through as a real cash expense in the third quarter.

Vebs Vaishnav

And that should decline in 4Q.

Jose Bayardo

Yes it should.

Vebs Vaishnav

Okay. And I guess last question for me, just if I think about those cost savings, can you just help me think about you went from $160 million to $200 million. Like what are the incremental steps that you guys are taking you have been very proactive at that?

Clay Williams

Yeah. We spent all time on that on the last couple of calls Vebs. And we've continued to evolve our plans, but as we've mentioned before, we're kind of more fundamentally reorganizing how we execute our businesses. And as you're well aware, we operate through fairly autonomous business units, but as we enter 2019 and market outlook was diminished a little bit, we said you know, now is the time really to go into in particular the administrative support functions and support those business units and see where we can capture more savings.

And so a lot of the effort that's going on through the summer and now into the fourth quarter has been around that reorganization along with other cost savings measures that we're undertaking kind of business unit by business unit across all three of our segments.

And so the difference between 160 million target that we talked about in the second quarter and now the revised $200 million target that we're talking about in the third quarter is just kind of the -- getting deeper into it and refining of the steps that we can and are taking and so the savings have continued to now.

Jose Bayardo

But also I want to add. Very, very proud of the organization for stepping up for this to this challenge and for our employees and our managers looking for ways to run our business more efficiently. They're doing a great job on this.

Vebs Vaishnav

That's all for me. Thank you for taking the question. And great job.

Clay Williams

Thank you, Vebs.

Operator

Thank you. Our next question comes from Scott Gruber from Citigroup. Please go

Scott Gruber

Yes, good morning.

Clay Williams

Hi, Scott.

Scott Gruber

Just staying on the same line of questioning, the cost-out program now up to $200 million. Is there more to go here? Do you think it could keep moving beyond that $200 million mark in 2020 in the absence of any divestitures. And then as you start to think about that portfolio mix, it sounds like there could be some divestitures on the horizon. Could the cost-out program continue to grow as some businesses come out or should we think about those two separate?

Clay Williams

Yeah that's a great question. I'm -- to compete effectively in oilfield services, you always have to be paying attention to cost inefficiencies and I think it's kind of in our DNA to continue to look for cost savings efforts. And so I think that really is -- the part of the reason we have overachieved on cost savings around our plans.

But as I mentioned in my prepared remarks, we are reviewing parts of our portfolio, products and services around the globe to see kind of where there may be opportunities to further improve our returns on capital, in fact, I'm going to ask Blake to comment on that process.

But one of the things we got to think about is, how -- what -- if you take some product or revenue stream out of a business then how do you adjust the fixed cost to support that business, so you don't run into an absorption.

Blake McCarthy

Right and Scott, I think we're looking at this more from a returns basis than just a pure cost standpoint and we're being pretty methodical about it. It's more than just a math exercise. We're looking at it from a qualitative basis as well, right. Well, we don't want to sell businesses that we feel we have a real competitive advantage on it and we're just looking at a trailing 12 months return, where it's been bouncing along the bottom of the downcycle.

So we're looking at both from the numbers standpoint and where we stand in the business and we're looking at it across all of our different product lines and taking our time on this. As we look to either exit through whether it's through divestiture or whether we just have to close the product line, we will obviously take a long hard look at the RemainCo fixed cost structure.

Jose Bayardo

Yeah. And yeah, I think there may be some opportunities come out of that but too early to say.

Scott Gruber

Got it. And then just a follow-up on the portfolio review, great to hear the returns focused. Are you guys starting to think about the mix of businesses within the portfolio that mix of kind of upstream, downstream, other industrial you've taken on some contracts to access the renewables mark in a bigger way with those vessels. Is that part of the review?

Clay Williams

I would say -- I think we're more of a bottoms up sort of analysis than a top-down. We don't sort of think of what's an optimal mix of exposures for NOV and as much as we think about. Hey, here's a really interesting business that has demonstrable competitive advantage.

To me, I think and I think I said in my opening remarks, I think the strategic positioning of businesses is critically important to returns and so kind of understanding how businesses can outperform competition in this space and can carve out long-term returns that are very attractive.

It's more of a granular sort of thinking through what's -- what sort of competitive advantage or what sort of moat does this particular business have? And that tends to guide our decisions more than hey, I would like to optimal mix to be you know 20% midstream and something like that if that makes sense.

So it's less of a view on -- on kind of sector exposure, more of a view of hey, how do you get, sort of, classic competitive advantage and I think over the years that's probably been much more of an important guide in terms of our strategic capital allocation decisions here at NOV.

Scott Gruber

Got it. Great color. Thank you, Clay.

Clay Williams

You bet. Thank you, Scott.

Operator

Thank you. Our next question comes from Kurt Hallead from RBC. Please go ahead.

Kurt Hallead

Hey, good morning.

Clay Williams

Hey, Kurt.

Kurt Hallead

Hey, congrats. Great job, guys. The question follow-up was given the cost saving dynamics you guys have put in place. Just curious as to whether they give us an update as to the incremental margin profile for the respective segments as we kind of going to move forward from here. In the past I think you've going to give us some indications on what they were maybe on a pre-cost savings dynamic. So just curious as to how these cost savings may change that incrementals on a go-forward basis?

Jose Bayardo

Sure. Kurt. Yeah, so the prior guidance that we have provided related to what we believe normalized incrementals are for each of the segments still stands. But as you've touched on you've got to adjust for the nuances that take place from quarter-to-quarter. And right now as we're undergoing our cost savings initiatives you could expect incrementals to be bigger than that prior guidance. And you can expect decrementals to be smaller right.

And then you also have those individual nuances quarter-to-quarter such as pricing dynamics et cetera that come into play. But so if you look at the guidance that we provided for Q4 in our prepared remarks those factor in the impacts of cost savings that we anticipate will materialize during the fourth quarter.

Kurt Hallead

Okay, great. I appreciate that color. And then Clay just kind of curious, you know, as you've had a variety discussions with a number of different customers and things are pretty uncertain as it relates to the North American market going into next year. But what I want to get your sense as to how you might see this thing evolving and given your experience of prior cycles. And kind of what's similar, what's different and what we from the outside looking in potentially drawn to determine what kind of growth rate we could see from this business over the next three to five years potentially.

Clay Williams

Yeah, I think, it's a great question, Kurt. I think that the challenge through the first five years in this downturn is that every time we start to see the signs of recovery there is a another big production report coming out of West Texas. And you've had unconventional shale surprise to the upside on production through this five-year period, which I would characterize as a lot of entrepreneurial aggressive smaller E&P companies in kind of a land rush phase still of securing acreage and drilling it up.

And as the Permian Basin and other unconventionals across North America evolve into to move to a handful of larger players who I think are going to be steadier in kind of their drilling and production then maybe the possibility of big production surprises to the upside diminishes a bit. It's kind of a steadier more workman like undertaking and developing that acreage.

I think that could basically provide maybe a little more confidence in other EMPs around the globe. More confidence to their price decks and lead to the return to normalcy over the next few years in terms of development that's more balanced in international markets and offshore markets. I think we're starting to see the early signs of that perhaps in 2019 and -- but certainly 2020 the near-term looks -- in North America looks pretty challenging in Q4.

2020 is -- remains opaque, but what's been missing through the five years of the downturn really is the offshore and international markets. And so we're pleased to see progress over the last several quarters. Slow and steady in those marketplaces. But kind of a more levelized level of production out of -- out of the Permian and North American unconventionals. I think could help maybe accelerate that just a tad and we could get back to a greater level of prosperity globally, which is really what we've all been -- have been seeking.

The other big factor too which is really come to bear here in 2019 is the fact a lot of the North American producers responsible for those production out-performances were finding a much more challenging to get capital. And the level of capital austerity and discipline that's going into their drilling programs and living with cash flows and so forth. I got to think that's going to -- that's going to affect U.S. production growth going forward. And I think be one of the building blocks for a healthier industry.

Kurt Hallead

Great. Thanks, Clay. I appreciate that color.

Clay Williams

You bet. Thanks, Kurt.

Operator

Thank you. Our next question comes from Cole Sullivan from Wells Fargo. Please go ahead.

Cole Sullivan

Congrats on a good quarter guys. Within Wellbore the North American declines kind of hit in 3Q and obviously fell out a lot more and – over the September time. And you guys held in pretty well on the margin side actually kind of beat guidance. Obviously on cost savings and the fourth quarter guidance it looks like it's holding in as well pretty – pretty strongly. Is that cost savings that's really driving that stronger performance expected in 4Q there in Wellbore?

Jose Bayardo

Yeah. There is certainly an element of cost savings, but I think the – really the contributions we provided from a consolidated standpoint is consistent with what we're seeing across each of the segments, where the contribution from cost savings in the fourth quarter will be a little bit less than what we experienced in Q3. So, we're also seeing mix shifts across all of our businesses, which contribute to the performance and I'm not entirely clear. I got your question precisely right, I think to recall is that Wellbore Technologies is still 46% of its revenues is coming from the international markets.

Clay Williams

Yes. That will help, but you know – so in the third quarter coming from the second quarter top line were down 7% and the Group there did a fantastic job managing detrimental leverage to only 2% sequentially. Really basically holding EBITDA flat despite a 7% top line decline, going from the third quarter to fourth quarter we're guiding down I think Jose said you said 5%, 6%, 7% top line decrementals more like 25%. So which is lower than you would otherwise expect normal operating leverage or normal variable margins to be in that space, which are probably 35% something like that. So that's where kind of the cost savings show up, but to be clear we are guiding down again in Q4 around on the topline of Wellbore Technologies.

Cole Sullivan

All right. That's helpful. Thanks. On CMP revenues were guided to kind of flattish for revenues. Can you help us think about the backlog conversion there with the higher orders that have been flowing through this year that are I guess implied in the fourth quarter number? And then how to think about the non-backlog revenue side for the shorter cycle items in 4Q guidance?

Jose Bayardo

Yeah. So, Cole that's a good question. So with the shift in the mix that we're seeing you're right we are guiding to effectively flat quarter in the fourth quarter, but an increasing proportion of that revenue will be from our backlog oriented businesses. So we expect that revenue from backlog to pick up just a little bit from Q3 to Q4.

Cole Sullivan

All right. That's all I had. Thanks.

Clay Williams

Clay Williams

Great. Thanks, Cole.

Operator

Thank you. Our next question comes from Connor Lynagh from Morgan Stanley. Please go ahead.

Connor Lynagh

Yeah. Thanks. I was wondering, if you could just characterize we've spent a fair bit of time on it already I know but just what drove the cost out to surprise to the upside. What specifically were the – the things that move to on faster than you expected?

Clay Williams

It’s hard to generalize honestly other than just really, I mean, I've said it before and it's probably worth repeating, it's a pretty volatile business and you got to be able to downsize when called upon. And I think our teams are really good at sort of moving quickly and acting decisively in taking costs out. And so we entered this latest round in the first quarter of 2019 and begin to get traction in the second quarter and then in the third quarter. I think you're seeing a lot of the results of steps that have been taken. And I can't say this enough we have a great team, who really understands we have to constantly size our business to market requirements. And in a down market, you're downsizing, but it up market we're also pretty good at flexing upwards to meet market demand, which can rise pretty sharply in this place – in this space as well. So just really good execution all the way around, and again difficult to generalize other than to say I think it's embedded in our DNA here and the good news is we're continuing to take the steps necessary to position the Company and we're making good progress on that.

Connor Lynagh

Got it. That's helpful. Maybe to pivot a little bit since we are talking about the portfolio. I would assume that you will still be active on the building portfolio as well, where you see opportunities. I'm wondering if you could just characterize how you see the M&A market right now. And just any portions of your portfolio that you find interested to add on to in the current market environment.

Clay Williams

I'm going to hand that off to Blake to speak to.

Blake McCarthy

Yeah I mean there's definitely -- as we've mentioned in the past like the buyer universe with running parallel with the limited access to capital in the space is definitely getting smaller, and so we find that we think we're in a pretty opportunistic situation.

There are some business lines that we definitely think we can augment through M&A over the next year. But also like -- I think we're in a pretty good spot when I look at the overall portfolio. There is no huge gaps that I think that we need to fill. So we're definitely can be very disciplined and take our time. I think patients is the name of the game right now.

Clay Williams

Yeah we're -- I'd add too. In contrast with prior eras, we are more -- we're using M&A in conjunction with organic investments in technology and kind of these are smaller more rifle shot sort of acquisitions were mostly doing. And then investing internally to enhance our technology to take their products through the NOV infrastructure to really -- we think that's the most efficient use of capital now. But it is to Blake's point it's a becoming more of a buyer's market. So we're watching that intently.

Connor Lynagh

Got it. Thanks a lot.

Clay Williams

Thank you.

Operator

Thank you. Our next question comes from Sean Meakim from JPMorgan. Please go ahead.

Sean Meakim

Thank you. Hey good morning.

Clay Williams

Good morning Sean.

Sean Meakim

So Clay or Jose, just one point of clarification, I was curious how much did -- or to what extent did the write-down's of inventory in the second quarter aid the margins in 3Q across any of your segments. Can you maybe give us a sense of magnitude if there is one? And two to extend is that a tailwind for you going forward?

Clay Williams

Yeah, there really is not a contribution or any sort of tailwind that comes from us writing down our inventory. So we have been very consistent in terms of our approach related to how we've dealt with items that go through our P&L or come out of our P&L via other items.

And well first of all, the vast majority of inventory that we write down is heading for the scrap heap and really over the last three years, we scrapped over $700 million of the inventory. There are times where we are writing things down to a lower cost of market.

And occasionally, those do sell and usually they were at zero margin to the extent they were at any sort of material margin. We will actually reverse the write down through or other items.

And so, if you go back and you look at some of our prior quarterly press releases and 10-Qs and you study those other items, you can actually see that there are places where we are reversing those charges because there have been a couple of areas. I think Q1 of 2018, Q2 of 2017 specifically you can go back and look and see that there are reversals of some of those charges and that's why, that's happening is because we were pleasantly surprised with the outcome on a couple of those write downs. But we do not take that back to the P&L to inflate our margin.

Jose Bayardo

Yeah that's really rare for us to write something down and then be able to sell it for margin. But when it does happen we're pretty -- it's pretty consistent in taking it to other item.

Sean Meakim

Thank you for that clarification. That's really helpful. The other point on working capital, you're targeting free cash in the back half of the year obviously a very good shape there. Could you maybe just give us your latest thoughts on working capital to sales maybe -- actually 2020 because again you've made significant progress there? How is that change and maybe just Jose, how you think about DSOs, DSIs, DPOs what's kind of the normalized run rate that you're trying to accomplish from that angle?

Jose Bayardo

Yeah Sean, I think of course we're going through our planning process and trying to determine what all the right metrics are for 2020. It’s probably a little bit premature for us to give you a precise guidance. But pleased with the progress that we have made so far in the back half of -- in 2019 getting extremely close to the targets that we set at the beginning of this year and we look for continued improvement moving into 2020.

And so, as I mentioned earlier, it is about focus on all of the blocking and tackling details associated with improving our processes. We have made considerable strides. But there is still meaningful room for improvement.

So, with our DSOs, I think at about 77 days. I think we can get a little bit better than that. Our turns, as I mentioned earlier, we've made some progress but not nearly enough progress in terms of inventory turns, so we can do better with that in 2020.

And so, we'll be working on setting that guidance. But needless to say, we're going to continue to squeeze it down and get as efficient as we possibly can, as it pertains to working capital intensity in our business.

Sean Meakim

Got it, fair enough, thanks a lot.

Jose Bayardo

Thanks, Sean.

Clay Williams

Thanks, Sean.

Operator

Thank you. This concludes our Q&A session. At this time, I'd like to turn the call over to Clay Williams, CEO for closing remarks. Please go ahead, sir.

Clay Williams

Thank you, Duanne. And thank you all for joining us this morning. Also thanks to our employees that are listening. We look forward to updating you on our fourth quarter and full year results, in early 2020.

Goodbye.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may all disconnect. Good day.