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EDITED TRANSCRIPT

FTI.N - Q3 2018 TechnipFMC PLC Earnings Call

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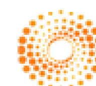

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PRESENTATION

Operator

Good afternoon, and welcome to the TechnipFMC's Third Quarter 2018 Earnings Conference Call. My name is Ashley, and I'll be your conference operator for today. (Operator Instructions)

At this time, I would like to turn the call over to your host, Mr. Matt Seinsheimer. Please go ahead Mr. Seinsheimer.

Matt Seinsheimer - *TechnipFMC plc - VP of IR*

Good afternoon, and welcome to TechnipFMC's Third Quarter 2018 Earnings Conference Call. Our news release and financial statements issued yesterday can be found on our website.

I'd like to caution you with respect to any forward-looking statements made during this call. Although these forward-looking statements are based on our current expectations, beliefs and assumptions regarding future developments and business conditions, they are subject to certain risks and uncertainties that could cause actual results to differ materially from those expressed in or implied by these statements.

Known material factors that could cause our actual results to differ from our projected results are described in our most recent 10-K, most recent 10-Q and other periodic filings with the U.S. Securities and Exchange Commission, the French AMF and the U.K. Financial Conduct Authority. We wish to caution you not to place undue reliance on any forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly update or revise any of our forward-looking statements after the date they are made, whether as a result of new information, future events or otherwise.

I will now turn the call over to Doug Pferdehirt, TechnipFMC's Chief Executive Officer.

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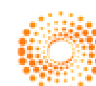

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Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

Thank you, Matt. Good morning, and good afternoon. Thank you for participating in our third quarter earnings call.

Total company revenue in the quarter was $3.1 billion. Adjusted EBITDA, up $431 million, benefited from further cost reduction as well as another quarter of strong operational execution, a theme I will discuss in more detail on today's call.

Looking at the business segments, Subsea revenue and EBITDA demonstrated solid performance as we continue to execute well on our backlog. Onshore/Offshore delivered exceptionally strong operating results, as evidenced by an improved EBITDA margin in the period. Revenue and margin for Surface Technologies were essentially flat when compared to the second quarter results, despite softer market activity in North America, a risk we discussed on the second quarter earnings call.

Total company inbound orders were $3.6 billion, with total company book-to-bill, again, above 1. Importantly, this has supported a return to year-over-year growth in total company backlog, up 9% when compared to the prior year quarter, with backlog growth occurring in all business segments.

For Onshore/Offshore, we previously communicated an inbound target of $5 billion for downstream opportunities, including refining, fertilizer and petrochemical projects. We have made notable progress towards meeting this goal, including, in the first quarter, an award for the Bapco Sitra Refinery Expansion in Bahrain; contracts for 2 fertilizer plants in India for the HURL joint venture in the second quarter; and in this quarter, an award at Vietnam's largest olefins project for Long Son Chemicals. This demonstrates our leadership in these important downstream markets, and we anticipate further award in the near term.

Turning to our operational performance. Strong execution continues to be a reoccurring theme across the project portfolio. In Onshore/Offshore, success is most evident in the performance of our largest individual project, Yamal LNG. Despite the inherent complexity of the project size, scope and location, execution has remained very strong.

We successfully delivered LNG Train 1 in the fourth quarter of 2017, and during the third quarter of this year, we completed Train 2. We delivered the second train some 6 months ahead of schedule. This was in part a key driver of the quarterly performance improvement in Onshore/Offshore.

Both trains have been operating within their nameplate design parameters. Train 2 reached this milestone in rapid fashion, just 17 days after first drop. As we approach the end of September, 68 cargoes have been offloaded from the project, bringing cumulative LNG shipped from Yamal to over 5 million metric tons. Our work on Yamal continues. Construction and commissioning of Train 3 is progressing well and is on track for another early delivery.

Our strong project execution extends beyond Onshore/Offshore. In Subsea, we have successfully delivered 3 integrated EPCI projects: Shell Kaikias in the U.S. Gulf of Mexico, which we discussed in detail last quarter; and now 2 additional iEPCI projects in the third quarter, Visund Nord and Trestakk, for our partner Equinor on the Norwegian Continental Shelf.

In September, Equinor announced that Visund Nord had come onstream below budget and 2 months ahead of schedule. Project completion took just 21 months from concept selection to first production, a new fast track record for Equinor. An important factor in the success of this project was the strong collaboration with our partner, Equinor, and the integrated capabilities of TechnipFMC.

For the Trestakk development, we successfully delivered a commission production system to the seabed in 22 months, requiring only a single season of marine operations. This project also benefited from new integrated connection technology that provided a lighter, more cost-effective solution. Achieving this optimized schedule was made possible through the completion of an integrated FEED, which was then directly converted into an integrated EPCI award.

The successful execution of Kaikias, Visund Nord and Trestakk clearly demonstrates the power of the integrated model. Through strong collaboration with our partners, beginning with integrated FEED studies, we have clearly demonstrated that we can significantly improve project economics

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with lower cost, reduce interface risk and accelerated time to first oil. And we remain confident that integrated developments, which we pioneered, will increasingly become the commercial model of choice for the subsea industry.

Let me now turn to the outlook for our key growth markets. The overarching trend for E&P CapEx has turned positive in 2018, following 3 years of declining investment. We expect the broader oil and gas market recovery to continue as we move into 2019. In Subsea, we are clearly in a period of recovery that began nearly 2 years ago. In 2017, we saw our Subsea order inbound increase 27% year-over-year and we continue to expect 2018 inbound to exceed that of 2017. Favorable book-to-bill trends also lend support to growth in backlog.

Year-to-date trends and Final Investment Decisions, or FIDs, for large offshore projects have been positive. Although FIDs have been tracking fairly in line when oil prices, it's encouraging that the number of FIDs related to larger projects has returned to levels last seen when oil was above $100 a barrel, as illustrated in this slide. This recovery from 2015 trough is supported by the considerable improvement in both deepwater project economics and operator's cash flow.

Our confidence is further underpinned by an approximate 90% increase in FEED studies year-to-date, with over 50% of these new studies focused on integrated projects. More importantly, many of these FEED studies now also incorporate our next-generation Subsea technology, Subsea 2.0.

Our second growth pillar, LNG, remains one of the fastest-growing markets in the oil and gas sector, stronger-than-expected near-term demand, driven by consumption in China and new geographies, continues to rebalance an oversupplied market. Industry forecast now suggests the next wave of LNG projects will need to be sanctioned in 2019 and beyond. Our experience and leadership leave us well positioned to capitalize on this growth.

Our early involvement in several potential projects includes greenfield projects, such as Novatek's Arctic LNG 2 and Sempra's Coastal Azul; as well as brownfield extensions, including the Nigeria LNG Train 7 expansion project.

Lastly, U.S. unconventionals are undergoing near-term turbulence, with pipeline takeaway capacity constraints negatively impacting activity levels after a period of rapid growth. However, these constraints should prove to be transitory and outside North America, we anticipate increasing demand for our specialized products and services.

As we turn to the broader market opportunity set for Subsea, we are encouraged by the increasing level of client engagement and project tender. In the most recent update to our Subsea opportunity slide, the market opportunity continues to broaden, with new projects dispersed across South America, West Africa and Asia Pacific. And while the slide only captures projects in excess of $250 million, the market for smaller brownfield and tieback projects remains quite large.

The increase in smaller project and service activity is also reflected in our business mix. Of the more than $9 billion of Subsea order intake received since January of 2017, less than 40% has been formally announced as a project award. And we continue to expect that over half of our inbound orders in 2018 will be direct awards associated with Subsea services, iEPCI and alliance partners.

Although we recognize the commercial environment and lower asset utilization remain headwinds near term, we remain focused on selecting projects where we can deliver a differentiated result, driven by our unique integrated offering and next-generation technology. Given the market outlook and our differentiated position, we remain confident that we are well positioned for success.

I will now turn the call over to Maryann to discuss the financial results in more detail.

Maryann T. Mannen - *TechnipFMC plc - Executive VP & CFO*

Thanks, Doug. Let me provide some further color on the financial performance in the quarter. Adjusted diluted earnings per share from continuing operations in the quarter were $0.31. After-tax charges and credits in the period totaled $3 million or $0.01 per diluted share. We have provided schedules that accompany our release, which detail these items.

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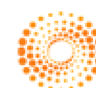

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Pretax items of significance impacting the quarter for which we do not provide guidance included the following: $34 million or $0.05 per diluted share of foreign exchange losses included in corporate expense, largely reflecting currency effects on cash and receivable balances in Angola, for which there was no ability to hedge; and $93 million or $0.20 per diluted share related to an increase in the liability payable to joint venture partners included in interest expense.

Adjusted EBITDA margin was 13.7%, up 74 basis points against the prior year quarter, largely the result of strong execution in the Onshore/Offshore business. The effective tax rate for the quarter was 32.2% when excluding the impact of discrete items.

I'll provide you a few more details at around the segment highlights. As our forecast indicated, Subsea revenue declined 18% from the prior year quarter. This is driven primarily by lower project activity in Africa, Europe and Asia Pacific, partially offset by increased activity in South America. In addition, foreign exchange translation acted as a headwind in the quarter and included a $48 million impact due to the Brazilian reals.

Adjusted EBITDA margin was 15.6%. EBITDA margin was negatively impacted by the anticipated revenue decline and more competitively priced backlog, offset in part by merger synergies and other cost-reduction initiatives achieved. The timing of completion of certain projects continue to benefit margins in the period, although the impact was less pronounced than in prior year quarter. Inbound orders were $1.6 billion in the quarter, resulting in a book-to-bill of 1.3 for our Subsea segment.

As we had anticipated, Onshore/Offshore revenue declined 34% from the prior year quarter as we moved closer to completion on major projects, primarily Yamal LNG. Project activity outside of Yamal was down modestly versus the prior year, but grew sequentially, led by increased activity on the Karish FPSO and strong growth in process technologies.

Adjusted EBITDA declined only 7% from the prior year quarter, despite the projected revenue decline. Adjusted EBITDA margin of 14.8% improvement over 400 basis points. Key drivers of the performance included: a bonus to the successful completion of Train 2 for Yamal LNG; continued strong execution across many projects, most notably in the Europe, Middle East and Asia Pacific regions; and continued strength in our process technologies group. Onshore/Offshore order inbound increased by 45% versus the prior year quarter to $1.7 billion, resulting in a book-to-bill of 1.1 for the quarter.

Moving to Surface Technologies. Revenue increased 14% versus the prior year quarter, driven by higher North American activity. Adjusted EBITDA margins of 18% decreased more than 200 basis points versus the prior year quarter. Sequentially, Surface Technologies revenue was broadly flat with the second quarter, growth in international markets offset lower revenues in North America, where reduced completions activity negatively impacted flowline sales of the quarter. Backlog for Surface Technologies ended the quarter at $456 million, increasing 10% sequentially and by 16% over the prior year quarter.

Here, you can see we show the good progress made in backlog growth and improving 2019 revenue visibility for both Subsea and Onshore/Offshore. For Subsea, quarterly book-to-bill has trended consistently above 1.0 since the fourth quarter of 2017, driving backlog growth of 7% over this period. Inbound activity has been strongest in our Onshore/Offshore segment, generating 3 consecutive quarters of sequential backlog growth. Backlog at the end of the third quarter was $8.4 billion, an increase of over 30% from year-end.

Looking at the darker shaded areas of the 2 charts, we also highlight the much improved visibility we now have for 2019 revenues. In Subsea, $2.8 billion of the $6.3 billion in total backlog is scheduled for execution in 2019, up from $1.6 billion at the beginning of the year. Key project awards contributing to this improved visibility include the iEPCI for Energean's Karish development, SURF work for Chevron's Gorgon Stage 2 and a Subsea production system for ExxonMobil's Liza Phase 2 project, which we announced earlier this week.

Additionally, there will be inbound received in the fourth quarter that will deliver revenue in 2019. We remain confident that our total inbound for the current year will be above levels achieved in 2017, and we anticipate additional revenue from project inbound and Subsea service work awarded in 2019. Combining these factors with growth in backlog and an improving market outlook, we continue to believe 2018 should be the trough for Subsea revenues.

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Turning to Onshore/Offshore. As we have communicated before, revenue from Yamal LNG, our largest individual project under construction today, will take another step down in 2019 as the project moves closer to completion. And although it will continue to be a significant contributor to 2019 segment revenue, we have more than replenished the decline in Yamal backlog with other new projects scheduled for execution next year and beyond.

We continue to expect that we will benefit from disciplined project selectivity, strong risk management and solid project execution. These and other inbound awards have driven scheduled revenues for 2019 to $4.2 billion. I would also remind you that this backlog does not include activity related to the nearly $2 billion from nonconsolidated joint ventures, which are highlighted in the backlog scheduling slide provided in the appendix.

Turning to cash flow. We returned to positive operating cash flow in the period, generating $141 million in cash from operations. As we suggested on the second quarter earnings call, we benefited from good cash management and working capital improvement, including the receipt of advance payments in the period related to new project awards that were booked in both the second and third quarters. In an effort to continue improving our disclosures for you, we have expanded the detail on the cash flow statement to provide more clarity of working capital flow.

In the third quarter earnings release, we now show the current portion of changes in assets and liabilities so that you can see the change in working capital from quarter-to-quarter. For the third quarter, working capital was a use of $117 million; and for the 9 months ended, a use of $918 million. This does illustrate the improvement in working capital efficiency versus the first 6 months of the year where working capital was a use of $801 million. Beyond the operating line, I will focus on the key drivers of our capital allocation strategy.

First, capital expenditures were $122 million in the quarter. Looking at the other major discretionary spending items in the period, we distributed a total of $217 million to shareholders, including $158 million for share repurchase, our largest quarterly spend to date, and $59 million for the payment of quarterly dividends.

In total, these discretionary spending items, both capital expenditures and shareholder distributions, were $337 million in the period. The balance sheet remained very strong at quarter end, cash was essentially unchanged at $5.6 billion. We ended the period with a net cash balance of $1.5 billion.

Now a comment on our updated guidance for full year 2018. For Onshore/Offshore, we are once again increasing our expectations to include the strong operational results posted in the quarter. We now expect revenues in the range of $5.8 billion to $6.1 billion, with margins of at least 13%. This reflects the strength in the third quarter results for certain project milestones successes. EBITDA margin should trend lower in the period as we do not expect additional bonuses in the fourth quarter.

Given the reduced market activity in North America, we are also updating our guidance for Surface Technologies. We now anticipate full year margins of at least 16%. Additionally, we are revising our estimate for net interest expense. Excluding the impact of the revaluation of the Yamal financial liability, underlying net interest expense has totaled $30 million for the first 9 months of the year. This result is better than previously forecast and we have benefited from higher interest rate on cash balances. We now expect net interest expense in the fourth quarter to be in the range of $10 million to $12 million, excluding the impact of any further revaluation of the Yamal financial liability. All other guidance items remain unchanged.

In summary, our 2018 updated outlook is supported by our year-to-date performance. Our execution delivered higher adjusted EBITDA margins even as revenues declined. Inbound orders for the quarter, again, exceeded revenue in all segments, supporting a return to the year-over-year backlog growth and improved revenue visibility for 2019 and beyond.

Also in the quarter, we delivered much improved positive operating cash flow, benefiting from strong cash management and cash advances on certain inbound awards. We will provide our 2019 guidance on December 12, and will follow with a conference call on December 13.

Operator, you may now open the call for questions.

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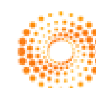

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from Michael Alsford with Citi.

Michael J Alsford - *Citigroup Inc, Research Division - Director*

Just a question firstly on the Subsea market. Wanted to get a sense, Doug, if you could, on the kind of pricing environment. Clearly, it's good to see the FIDs and their activities picking up, but you did talk a bit about that the fact that there's some sort of ill-discipline, I guess, around bidding and I was wondering whether that has normalized at all at the current market?

Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

Thank you, Michael, for the question. Clearly, we see less diversity in the results on the tenders in terms of the spread between the high point and the low point. Unfortunately, we still see, from time to time, some irrational pricing and some outliers on the low end. And that remains the challenge in the market that is, if you will, open for everyone to participate in. And again, on a positive side, we're seeing less degree of separation, but we are continuing to see some irrational pricing in that market. We believe some of those who have been active in that activity are to the point now that they will start to refrain from that going forward, so we do have a positive outlook for the trend over the near term. It's important when you think about TechnipFMC, just to reiterate what I said earlier in my script, to recognize that over 50% of our inbound opportunities are not exposed to that market conditions that I just described, and that's because of our ability to be able to convert our integrated FEED activity to direct awards for iEPCI projects as well as our Subsea services business, and our partner and alliance opportunities that we have. It's a real differentiator for our company.

Michael J Alsford - *Citigroup Inc, Research Division - Director*

And a follow-up if I could. Just on that, you talk a bit about saying that 2018 is going to be a trough on revenues in Subsea. So should we sort of expect, therefore, that margins are also troughing in '19?

Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

As you know, we're going to be sharing guidance here in December of this year. I think when we look at 2019 and going forward, as I indicated in my script, there continues to be some headwinds. We obviously have some activities that will offset that, but we look forward to sharing more detail with you in December.

Operator

Your next question comes from Jud Bailey with Wells Fargo.

Judson Edwin Bailey - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Research Analyst*

Doug, I was hoping to maybe get your thoughts on -- in looking at the order outlook maybe for the rest of this year, and maybe some early thoughts on 2019. I guess, number one, how do you handicap the odds of maybe booking another major award between now and year-end for this year? And then as you look into next year, how do you see the types of projects or mix of projects next year versus this year? Does it look materially different to you in terms of the number of large project opportunities or a mix for integrated? I'd be curious to get your thoughts on how you see the market evolving over the next 15 months or so.

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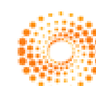

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Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

Thank you, Jud. And you can see where we updated our Subsea opportunity slide, gives a bit of that answer in the slide. But let me add some more color. So in the fourth quarter, we have to wait and see. It's one of the reasons we want to get -- have an opportunity to have a few more weeks under our belt as we move forward and looking at our 2019 guidance. You may recall, in 2017, there was a flurry of project awards, particularly from Equinor, at the very last days of the year. I cannot either -- I can't confirm or deny that, that's going to happen this year. That's really a function of our clients, and when they wish to sanction projects, be it at the end of one year or the beginning of the next year for certain budgetary conditions. What we do see is a number of projects that we think are increasing in the probability of them being awarded, could be in the end of 2018 or in the beginning of 2019. Of that mix of awards, there's clearly a trend towards integrated projects, and there's clearly a trend towards larger projects being sanctioned. At the same time, as indicated in my script, the smaller awards or tieback and brownfield opportunities continue to be very robust, and we continue to secure a significant portion of that work due to, as well, our accounts and our integrated approach to Subsea tieback.

Judson Edwin Bailey - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Research Analyst*

And my next -- my follow-up is maybe for Maryann. Maryann, could you give us any -- your thoughts on operating cash flow for the fourth quarter? And also maybe comment a little bit on working capital? You've made some progress this quarter on working capital. When do we start to see some tailwinds? As you book more awards, I would think working capital starts to turn more in your favor as you get more payments. Can you give us any insight as to how we think about that in the coming quarters and when working capital starts to maybe turn more positive?

Maryann T. Mannen - *TechnipFMC plc - Executive VP & CFO*

Yes. Sure, Jud. Thank you. So maybe just a bit of color on the quarter. As we shared with you on the second quarter, we're really trying to step away from giving specific working capital guidance and rather guide around operating cash flow. Operating cash flow in the quarter was favorable, as you saw -- positive, I should say, $140 million. In the quarter, we saw only a use of about $117 million in working capital. We think that is demonstrating, if you will, the benefit of the order inbound turning, our ability to receive those advance payments. And as you know, we always try to stay ahead of the cash flow curve. So again, in the fourth quarter, as I mentioned on the second quarter call, we are expecting operating cash flow to be positive in the fourth quarter. Inbound awards, and I think I mentioned on the second quarter call, Doug mentioned the possibility for another one in -- potentially in the fourth quarter, also carrying with them advance payments, certainly helped in further efficiency of working capital utilization. It's certainly beneficial as we are turning the corner with inbound. So that hopefully gives you a little bit of color in our performance in the third quarter, you can see the benefits of increased inbound and the effects of that on our performance.

Judson Edwin Bailey - *Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Research Analyst*

So would it be reasonable to expect for operating cash flow to grow off the third quarter in the fourth quarter?

Maryann T. Mannen - *TechnipFMC plc - Executive VP & CFO*

Jud, there's a few things that can happen, and timing of that is pretty critical. But we certainly think that operating cash flow in the fourth quarter will continue to be positive.

Operator

Your next question comes from James Evans with Exane BNP Paribas.

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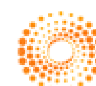

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James Matthew Evans - *Exane BNP Paribas, Research Division - Analyst of Oil and Gas*

A couple of questions from me on LNG. Firstly, a bit short term. On Yamal, is it fair to assume that you have additional bonus opportunities on Train 3? And can you just describe a little bit about what you're actually going to be doing in 2019 if we're almost there on the last train in terms of your revenue for next year? Is that the fourth smaller train coming through your revenue line? And then secondly, and a bit longer term, I mean, obviously very exciting market at the moment, LNG looks like it's not far from 100 million tons planned over a period of about 18 months for sanctioning. I'm sure not all of it will go ahead. But can the industry really deliver all of this? Or do you think you'll see any bottlenecks within the industry either in engineering or delivery?

Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

Thank you very much, James. So first of all, in Yamal LNG, we're extremely proud of the level of execution and of our team and the performance that we've had thus far on the project. There's still plenty of work left to be done around the delivery of Train 3. And based upon the success of that delivery, there could be an additional opportunity to be recognized for that delivery if it's done in an accelerated manner. Beyond the delivery of Train 3, there is ample activity for us to continue to perform. Keeping in mind that it's not only delivering the train, but it's been involved in the commissioning and start-up and successful testing and performance testing of the individual trains. So indeed, there is opportunity and additional work scope in 2019 on Yamal.

Looking at the longer-term opportunities, I think you summed it up well. I think the market is there. There is more projects being discussed and will likely be sanctioned. Our choice or our strategy has been to focus on those projects that we think have the highest strategic importance and the best economics in terms of delivered products.

So we look at each of those opportunities under that lens, and from that, we prioritize the projects that we're going to put our resources on. Clearly, there will be bottlenecks. In some geographies, the bottlenecks will be around construction and construction labor. More generally, it will be around the engineering, as you correctly point out. So therefore, as has been our approach to this business, we will continue to work closely with partners and diversify our projects, both in terms of the projects that we're operating. As you know, today, we're operating 3 LNG projects, not just Yamal, but also in the Prelude FLNG project as well as the Coral FLNG project. On those projects, some of the partners are similar; in other cases, there's different partners. So we'll continue to use that strategy of diversification, both in terms of the projects, the geographies and the way that we partner on those individual projects. But we think we're very well positioned to be awarded or to secure some of those projects that we think have high strategic importance and will have very good delivered economics.

Operator

Your next question comes from Sean Meakim with JPMorgan.

Sean Christopher Meakim - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

Doug, to start, since we can't talk about 2019 for another 6 weeks or so, how should we think about the underlying drivers of the solid margin performance we saw in 3Q for Subsea, thinking in the context of there are some seasonal services benefit maybe from Riserless Light Well Intervention and you have these Equinor project deliveries? So if you could talk about the underlying drivers there for 3Q. And then more importantly, how should investors interpret the decision to leave the 2018 margin guide unchanged?

Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

Thank you, Sean. I actually think you answered the question very well. The only thing I can really add to your answer is, we also mentioned in our press release, that we finished up the delivery around the North FPSO on Kaombo. This was the largest Subsea project award at that time, and we had a very successful completion of that campaign. So it really is -- it really does come down to the timing. These are -- we have many projects in the portfolio and reaching certain milestones or completing certain activities and/or closing certain projects does have an impact from a

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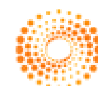

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quarter-to-quarter perspective. So when we look forward, we were looking at coming off of a Q2 and Q3, where we had several of those type of events that we don't necessarily see reoccurring in the fourth quarter. Again, timing is something that we don't necessarily control. It's our best outlook at this time. And coupled with that, as you pointed out, some seasonal impact on some of our other service lines.

Sean Christopher Meakim - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

Okay. I appreciate that. That all make sense. And maybe to circle back on the pricing discussion for Subsea, I'd be great if we could maybe dig a little deeper into how backlog pricing trends could be going across some of the different inbound streams. So just directionally, or in a relative basis, it'd be great to better understand iEPCI versus the legacy procurement type of bidding, SPS versus SURF. And even within Subsea 2.0, is there a margin premium that you're able to capture? There's a lot of pieces to unpack there, but I think there's also a lot of moving parts for investors to interpret as well.

Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

Well, thank you for the question, Sean, because it is somewhat what differentiates us as TechnipFMC versus not having those individual streams. So if we were to break those down, the competitive -- the open market where you're bidding against the lowest common denominator, you're not allowed to apply an integrated model, you're not allowed to apply your latest generation technology and you're going up on an agnostic FEED study that was done at the lowest common denominator, so that it could be tendered accordingly. Again, as I said, on the positive side, there was very large spreads between the top and the bottom and the various individuals in between, and you can see this in those standards that have been publicly disclosed. And what you now see is you see much less dispersion across the various entities that are bidding on the projects. Unfortunately, you still tend to see some outliers, and in some cases, outliers by a significant amount. That's not TechnipFMC. Our strategy is not to be an outlier. Our strategy is to demonstrate where we can create project success by the application of our integrated model, by the application of technology and based upon our leadership in the market and our demonstrated performance. You see that coming through in the projects, as we talked about, Kaikias last quarter, now 2 additional projects this quarter, being Visund Nord and Trestakk. These were not -- these were complicated projects that we were able to deliver in a very respectable manner and, in 2 cases, are being considered to be new records by our clients. So it's something we're very, very proud of, and we believe we're just beginning and we'll continue along that trend.

So breaking it down further, that's the competitive market. When you -- when we're able to secure a project, an iEPCI award is a direct of the integrated FEED activity that we're performing, and we're able to secure that as a direct award. We're focused on the project economics. We're not focused on the individual line items or lowest common denominator. So we sit down with the client early. We understand that client's economics, the project economics and our own economics. And we're able to find a solution that allows us to achieve an outcome, and in many cases, achieve outcomes that become records for the industry as we have demonstrated thus far. Those margins, quite frankly, tend to be at a higher level because we're being recognized and rewarded for that performance. And again, we're working with the client with a common goal, which is unlocking the potential of the Subsea project economics and delivering it both in terms of lower cost, but more importantly, accelerated first oil. Same applies for Subsea 2.0, but slightly different. We're able to apply our Subsea 2.0 technology. It may give us an advantage in time to first oil, in other words, we can use that as a differentiator and a tender; or it may just give us a benefit in terms of our cost associated with that product or with that set of products. As opposed to the competitors who are bidding at a Subsea 1.0, if you will, we have that advantage or that greater pricing elasticity as a result of our Subsea 2.0 family. I will point out, although it represents 50% of our current activity, there is 50% that is still being competitively tendered. Our goal is to continue to drive that percentage up. That's in our favor. And we think the recent successes that we have will demonstrate to the market the benefit of going with the integrated commercial model and/or Subsea 2.0 technology.

Operator

Your next question comes from James West with Evercore ISI.

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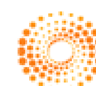

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James Carlyle West - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Doug, curious about, I guess, one statement you made, 90% increase in FEED studies year-to-date, I'd call that not just a continuation of recovery, but certainly an acceleration here of the recovery. And I'm curious, in that 90%, and then you just touched on a bit of that with Sean, 50% I think of the business right now was competitively bid, but of the increase we've seen this year, is that moving more towards 50% relative to, say, this time last year? What's the trend in that mix?

Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

So the trend in the FEED studies is -- if you just look at our activity, as you know, we started doing integrated FEED studies back at the time of Forsys Subsea. So we have built up a set of opportunities that in many cases are proprietary to our company that were never competitively studied by others and are -- now, we're in a position to convert those into a direct award. We have to deliver on the integrated FEED study and we have to deliver on reaching the agreed-upon project economics. When we do so, then it's obviously in the client's hand to decide when to sanction or FID that project. But we watch that opportunity set very closely because that helps us understand how we want to prioritize our own resources, which we would obviously prefer to dedicate to those types of projects based upon my earlier response that I gave to Sean, because on those projects we can realize a higher margin. The -- so the overall mix is clearly moving in that direction as well as you say the overall level of activity. But I would caution, just the 90% increase in FEED activity doesn't necessarily -- is meaningful in the number and the acceleration, as you point out, but I would just caution that it's really the quality of those projects that you're working on. Doing a FEED study for the sake of engineering hours is not where our focus is. We clearly see our clients shifting to, let's say, a much more intimate conversation around production levels, a much more intimate conversation around the timing of projects to be able to achieve first oil in a certain accelerated manner. And I'm -- so it's a more serious discussion along that line. So therefore, I would say the quality, more important than the quantity, has improved quite a bit.

James Carlyle West - *Evercore ISI Institutional Equities, Research Division - Senior MD*

That's a good point, Doug. And then one follow-up from me. Is there any way that you could quantify -- I guess when we originally put forth this together, and then of course with the transaction with Technip and FMC, part of the driver here was to create market? Now we obviously went through a downturn and all these types of things, but do you have any sense of kind of -- is that happening? And do you have any idea or can you quantify in any way kind of how much market you think you may have created that wouldn't normally be there if you didn't -- if you weren't able to provide these fully integrated projects?

Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

Thanks, James. A very interesting question. Let me point to 2 very real examples, because I like to give real tangible evidence. Equinor has said that the Trestakk project was an economically challenged project, it was a project they had looked to move forward in the past, but there wasn't necessarily the right execution model and commercial model to move that project forward. As indicated, we have now delivered the Trestakk project, and it was delivered on budget and ahead of schedule, and is considered to be a significant success by Equinor. Likewise, Shell has said that Kaikias was a project that needed a new commercial model in order to unlock its potential. So I would simply point to those 2 projects, which are now full cycle and have been successfully delivered, as clear evidence of the ability of being able to unlock the potential of Subsea projects. Beyond that, I would rather not talk about the number that we think are possible because, if you will, that's our proprietary set of projects that we're working on, that we've been doing studies for over 3 years in some cases, that would be -- that we have the opportunity to convert those into integrated projects. And if you will, I would see that as the accelerator to our growth relative to our competition.

Operator

Your next question comes from Mick Pickup with Barclays.

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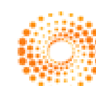

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Michael Brennan Pickup - *Barclays Bank PLC, Research Division - MD & Senior European Oilfield Services Analyst*

Two questions if I may. Firstly, just on On/Off, you've got $4.2 billion in hand for next year. That's the same you had at the end of 2017 for this year. So why aren't you saying that you've seen the trough in revenues in On/Off?

Maryann T. Mannen - *TechnipFMC plc - Executive VP & CFO*

So Mick, I think when we look at the composition of backlog, hopefully you can see that from the slide as well, but when you look at the composition of the backlog, one of the things we're trying to indicate is year-over-year, the composition of the backlog coming from Yamal has declined. We'll provide much more color as we get to the earnings -- excuse me, the guidance call on the 12th and tell you about the top line for Onshore/Offshore. But the point there was really just trying to say, year-over-year, that backlog is now made up of other non-Yamal projects and giving the indication that as Yamal continues to reach to completion, there is a very solid backlog of other projects work.

Michael Brennan Pickup - *Barclays Bank PLC, Research Division - MD & Senior European Oilfield Services Analyst*

So it's just the ramp-up on that $4.2 billion is different than the execution of the $4.2 billion previously?

Maryann T. Mannen - *TechnipFMC plc - Executive VP & CFO*

That's right, Mick. You got it.

Michael Brennan Pickup - *Barclays Bank PLC, Research Division - MD & Senior European Oilfield Services Analyst*

Okay. And...

Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

Mick, if I could add to Maryann's comment, because I appreciate your question. As I indicated, we've had a large award in each of the first 3 quarters for Onshore/Offshore, starting with the Bapco refinery, then the 2 fertilizer projects for HURL in India, and then most recently in this quarter, the award of the Long Son Petrochemical project. That really shows clear evidence that we are delivering against the $5 billion target that we put for our downstream opportunity, keeping in mind that we indicated that there'd be another award in the near term. In addition to that would be any opportunity for LNG. So we are very pleased with the progression of inbound in our Onshore/Offshore GBU, as we call it, our segment.

Michael Brennan Pickup - *Barclays Bank PLC, Research Division - MD & Senior European Oilfield Services Analyst*

Okay. And then just a follow-up on the 4Q margin in Subsea. Your guidance hasn't changed all year for greater than 14%. And if I look at your revenue guidance, it means 4Q is going to be, by far, your strongest quarter. And given where your guidance is, it means it's going to be, by far, your lowest margin. Now I understand part of that is projects not completing, but is there anything else in there driving it down, like flat spots or the start of new contracts, seasonal impacts? Or is it just the backlog that's been executed and the state of the business?

Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

Yes, Mick, as you know, it's a combination of many things, and I think you touched actually on all those, and it includes seasonality and includes the timing of certain projects, certain milestones. And as we sit today and we look at what we can see, again, we don't control the timing of each and individual project and the completion and milestones that are achieved. But as we look at it today, that was the reason we maintained the margin guidance that we have in Subsea.

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Operator

Your next question comes from Kurt Hallead with RBC.

Kurt Kevin Hallead - *RBC Capital Markets, LLC, Research Division - Co-Head of Global Energy Research and Analyst*

Doug, I wanted to ask a similar question that came out a little bit earlier, this one on the Subsea side of the business in the context of you talked about the increase in FIDs. So I'm just kind of curious, given the kind of recovery phase that we're in right now in the marketplace, given some of the downsizing that occurred at the major oil companies, what do you think the market could handle reasonably with current resources and staffing with respect to Subsea project awards in any given year, FIDs or however you may want to answer the question? I'm just trying to gauge what can the industry reasonably handle at current kind of resource and staffing levels from a subsea standpoint?

Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

Thank you. Thank you, Kurt. I think if you look at it both from the operator side as well as from the service industry side, although there have been, obviously, an impact of this downturn, I think given new commercial models, like our integrated model, given the opportunity to have much earlier engagement, like we do with the integrated FEED studies, or if you will, vendor-based solutions as some people refer to it, I think what we have been able to demonstrate is we can deliver significant projects very successfully with the resources that in the industry. In terms of the physical assets, be it manufacturing capacity or be it fleet capacity, I think there is quite a bit of growth that the industry can continue to support. So I would -- in responding to your question, if you look at it through a very traditional lens and say we're going to continue to do projects the way we always have as an industry. Meaning, every award is bespoke, requirements change on every single award, we are always building a first article item, we are using a Subsea architecture that has never been used before, we have heavy engineering hours associated post-project with each and every project, then I would be concerned about the constraints. We have inverted that. We have changed the way that we're approaching the Subsea market. And we believe that with that change, we'll be able to have much more elasticity in terms of the ability to be able to grow the market with a reasonable number of resources versus what we have done in the past. And the lot of that means going from bespoke engineering to the approach that we have done with our Subsea 2.0 technology and the ability to be able to do projects like Trestakk, where we delivered it in a single-season for marine operations. When a project like that was historically been done over 2 seasons, we, because of the ability to be able to look at it as a single project and working in a collaborative way with our client, we were able to change the scheduling, to change and synchronize the manufacturing versus the fleet capacity and to be able to do it in a single season. Those are profound changes when you think about what we can do with the same amount of resources going forward. We believe that's the right way, and we believe that's the way that projects will be done in the future.

Kurt Kevin Hallead - *RBC Capital Markets, LLC, Research Division - Co-Head of Global Energy Research and Analyst*

And then a follow-up I had for you, just kind of staying on the Subsea dynamic and this time maybe focusing on the economics through the lens of, say, the major oil companies or national oil companies, whatever it may be. What do you sense the oil companies -- what kind of oil price level do you think the oil companies are comfortable with in kind of gauging their economic profile? Think about it maybe on the terms of a Brent complex. Has it moved up over the course of the past 12 months? Are they more confident in a $50 or $60 oil price environment than they were? Are they still being very conservative in kind of assessing projects more in kind of $40 kind of Brent environment? Any color on that will be very helpful, Doug.

Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

I certainly don't want to speak on behalf of our clients, I'll kind of let them answer what the oil price environment that they're comfortable with. What I can say is, in the discussions that I'm having with them, they recognize that what we have done is enable Subsea projects to move forward in that sub-$50 barrel range. And if you look at the projects that we've delivered and look at the comments that our clients have made around those projects, many of which they're saying we're valid at -- economic at sub-$40 and even sub-$30. So I don't think it's an issue of oil price unlocking the potential. We needed to change our behaviors in industry. We needed to get away from this take advantage in an upturn in terms of inflation

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and radical deflation in the downturn. We had to move away from bespoke engineering and think about doing things differently. And we needed to find a way to be able to utilize our resources in a much more efficient manner as we indicated -- as we were able to do on the Trestakk development. And by the way, I think that applies to IOCs, NOCs and independents, who are an increasing portion of our customer base as well.

Operator

Your next question comes from Bertrand Hodee with Kepler.

Bertrand Hodee - *Kepler Cheuvreux, Research Division - Head of Oil and Gas Sector Research*

The first one is looking at big oils and the adoption of the integrated concept. Shell and Equinor have tested successfully as a model. What are the pushback you are getting from others, like Exxon, like Total? And do you believe that you could get us, in the short term, some integrated project from those names?

Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

Yes, I am confident we will.

Bertrand Hodee - *Kepler Cheuvreux, Research Division - Head of Oil and Gas Sector Research*

Okay. And then a follow-up on Yamal. Novatek had been talking for some time now of an additional small 1-million-ton train at Yamal. Is this already in your backlog? Or is something else that you, as a near-term opportunity, you are still pursuing?

Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

Thank you for the question, because I think it is important that we clarify. I'll leave the client to discuss what their plans are. But our scope on a project like that would be simply to provide the interconnects from the third train to the fourth train, but the fourth train itself would have very little impact on us. I -- what the client has discussed before was using a much more local content on a fourth train. And as you indicated, it would be a smaller train. So the larger opportunity for us with Novatek would be on Arctic LNG 2, a project they're working very closely in the final stages of delivering the FEED study to Novatek. And we continue to work very closely with them to improve the overall project economics and hopefully build on the success of Yamal LNG.

Operator

Your last question comes from Bill Herbert with Simmons.

William Andrew Herbert - *Simmons & Company International, Research Division - MD & Senior Research Analyst*

Doug, quick question on Surface. I was surprised by how robust the orders were in the third quarter given the dislocations unfolding with regards to Lower 48 frac, which albeit are transient, nonetheless are real. I'm just curious with regard to -- I mean, you lowered margin for the year, which I'm sure is in the response to what's happening at ground level on Lower 48. But what are the discussions that you're having with customers? Are orders being deferred or canceled or both? And what would you expect to happen with regard to surface inbound, which has been very strong and surprisingly strong in Q3, over the next few quarters as we wrestle with these Permian constraints?

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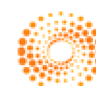

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Douglas J. Pferdehirt - *TechnipFMC plc - CEO & Director*

Thank you, Bill. We, too, were pleased with the robustness in our Q3. But again, let's be very frank, we are being impacted as everyone else is by the lower level of activities both in the Permian Basin and beyond. We do have an advantage other than -- our business model is one that is not very asset-intensive, our Surface Technologies business. We have the ability to be able to move resources and to remove -- and to move our assets around from basin to basin, which does allow us to dampen some of that impact. But clearly, there, we will see, we saw some and we'll continue to see the impact of the slowdown in the activity in North America. Keep in mind, a large portion of that segment is not exposed to the North American market, our international business. And in our international business, we indicated that we were seeing the recovery in that market last quarter, and that has certainly continued in the trend that we would expect to continue into 2019. We look forward to securing additional awards very soon, very large awards, frame agreement type awards. And we also look forward to demonstrating the value of our new integrated offering by receiving awards with our integrated offering as well.

William Andrew Herbert - *Simmons & Company International, Research Division - MD & Senior Research Analyst*

And Maryann, 2 quick ones from me. I think you maintained the capital spending guidance of $300 million for the year, which implies, I think, once again, a pretty significant step-down in CapEx in Q4. Is that correct? Which would imply a nice free cash flow improvement in the fourth quarter. And then -- that's a lot, I know for one.

And then secondly, ETR. I know when we redomiciled to the U.K., the objective, if memory serves, was to bend that tax rate down to the low to mid-20s. Is that still where you think it lands over the next few years?

Maryann T. Mannen - *TechnipFMC plc - Executive VP & CFO*

You're welcome, Bill. So first question, CapEx. Yes, you're right, we have not adjusted CapEx on a full year basis, so we still feel $300 million is an appropriate level of spend of 2018. So you're right, we have not changed CapEx consciously.

Your second question on tax rate. We -- I'll call this a high-class problem in a way, but you're absolutely right, our domicile does give us benefit as we reach out in the next coming years. We're fortunate to have good success in key areas, and those key areas right now happen to be tax jurisdictions that have higher rates than our domicile. So we're driving a lot of profitability through some higher rate jurisdictions. But ultimately, as we continue to contract in the future, our ability to benefit in a more favorable way from that domicile should be seen in the coming years.

Operator

We have reached the end of the Q&A session. I will turn the call back over to Matthew Seinsheimer for closing remarks.

Matt Seinsheimer - *TechnipFMC plc - VP of IR*

This concludes our third quarter conference call. A replay of the call will be available on our website beginning at approximately 8:00 p.m. British summer time today. If you have any further questions, please feel free to contact the Investor Relations team. Thanks very much for joining us. Operator, you may end the call.

Operator

That concludes today's conference. Thank you for your participation. You may now disconnect.

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