

23-Feb-2018

Oceaneering International, Inc. (OII)

Q4 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Dan, and I will be your conference facilitator. At this time, I would like to welcome everyone to Oceaneering's Fourth Quarter and Full-Year 2017 Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer period.

With that, I will now turn the call over to Suzanne Spera, Oceaneering Director of Investor Relations.

Suzanne M. Spera

Director-Investor Relations, Oceaneering International, Inc.

Thank you, Dan. Good morning and welcome to the Oceaneering fourth quarter and full-year 2017 results conference call. Today's call is being webcast, and a replay will be available on Oceaneering's website.

Joining us on the call are Rod Larson, President and Chief Executive Officer, who will be providing our prepared comments; Alan Curtis, Chief Financial Officer; and Marvin Migura, Senior Vice President.

Before we begin, I would just like to remind participants that statements we make during the course of this call regarding our future financial performance, business strategy, plans for future operations, and industry conditions

are forward-looking statements made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995.

Our comments today also include non-GAAP financial measures. Additional details and reconciliations to the most directly comparable GAAP financial measures can be found in our fourth quarter press release. We welcome your questions after the prepared statements.

I will now turn the call over to Rod.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

Good morning, and thanks for joining the call. Today, I'll focus my comments on our performance for the fourth quarter and full year of 2017, our market outlook for 2018, outlook by business segment for the full year and first quarter of 2018, and what we're doing to reposition the company for 2018 and beyond.

In our press release for the fourth quarter, we reported net income of \$174 million or \$1.76 per share, reflecting the impact of \$182 million of adjustments, primarily a \$189 million non-cash tax benefit due to recent U.S. tax reform. Our adjusted net loss was \$0.08 per share. During the quarter, we generated \$44 million of adjusted EBITDA.

Overall, the anticipated impacts from seasonality and continued lower levels of activity and pricing in our oilfield segments were in line with our expectations. However, results for Advanced Technologies disappointed with the decline in profitability instead of the improvement we had anticipated. While our overall adjusted operating results and EBITDA were slightly less than our expectations, we are happy to report that each of our operating segments remained profitable.

On an adjusted basis, looking at our business operation for the fourth quarter compared to third quarter, our operating income was \$20 million lower than that of the immediately preceding quarter due to reduced profit contributions from each of our business segments. For ROVs, operating income was down, resulting from approximately a 12% reduction of revenue and 15% fewer days utilized.

The fourth quarter results included \$7.3 million of revenue associated with the sale of ROV accessory equipment that was integrated into a customer's rigs. This equipment sale increased our calculated ROV average revenue per day-on-hire and profitability.

During the fourth quarter, we added three new ROVs to our fleet and retired three, ending the year with an ROV fleet size of 279 vehicles. Our fleet utilization for the fourth quarter was 42%, down from 50% in the third quarter. The quarterly decline in the utilization percentage of our ROV fleet was primarily attributable to seasonality associated with the global vessel market.

Our fleet use mix during this period was 66% in drill support and 34% for vessel-based activity, compared to a 61% and 39% mix, respectively, last quarter.

At the end of December, we had ROVs on 82 or 56% of the 147 floating rigs under contract. This compares to our 55% drill support market share at the end of September. During the quarter, we were on 5 of the 10 rigs whose contracts ended or terminated early and in all of the 6 rigs that got contracted.

Now, turning to Subsea Products. Our fourth quarter operating income was slightly lower compared to the third quarter. As we anticipated, Subsea Products revenue was higher due to increased activity and profitability in our service and rental business unit, but the improvement was offset by decreased margins in manufactured products.

Our Subsea Products backlog at December 31, 2017 was \$276 million, compared to our September 30, 2017 backlog of \$284 million. Our book-to-bill ratio was 0.95 and 0.75 for the fourth quarter and full year of 2017, respectively.

Sequentially, Subsea Projects operating income was down during the fourth quarter. The decline was principally driven by the seasonal decrease in vessel and diving activities and the completion of the Island Pride contract offshore India during the fourth quarter.

Looking at Asset Integrity, operating income modestly decreased, as projected, on increased revenue at lower market pricing. For our non-energy segment, Advanced Technologies operating income declined on increased revenue due to execution issues and additional costs incurred for commercial programs. Unallocated expenses were higher than expected due to an unanticipated adverse judgment in an uninsured liability claim.

A \$189 million benefit related to recent United States tax reform is included in our tax provision. Excluding the impact of U.S. tax reform, our tax provision was a result of geographical mix of earnings and losses that resulted in taxes in certain jurisdictions that exceeded the tax benefit from the losses in other jurisdictions, which could not be realized in the quarter due to valuation allowances provided. During the fourth quarter, our capital expenditures totaled \$34 million and our cash position remained strong at \$430 million.

I'd now like to turn my focus to our results for the full-year 2017 compared to our 2016 results on an adjusted basis. We were very pleased that each of our operating segments remained profitable as we won significant new business and protected our market share, executed well for our customers, and maintained an impressive safety record.

For 2017, we reported an adjusted net loss of \$6.8 million or \$0.07 per share. These results reflected the impact of \$173 million of adjustments, primarily a \$189 million non-cash tax benefit due to recent U.S. tax reform. Operationally, we generated adjusted EBITDA of \$222 million.

We generated \$136 million of cash provided by operating activities, which resulted in \$43 million of free cash flow, after \$94 million of organic capital expenditures. We returned \$44 million to our shareholders in the form of cash dividends during the year, before we suspended the dividend starting with the fourth quarter of 2017.

To achieve this financial performance in a challenging market, we continued to leverage resources, people processes and technology across our worldwide organization to lower costs by gaining efficiencies through continuous improvements and standardized processes; and innovate and deliver value to our customers, as evidenced by our investments in our ROV remote piloting, resident ROVs and riserless light well intervention.

We're also pleased with these other achievements during 2017. We entered into a long-term contract with Mærsk Supply Service to provide eight world-class ROVs, including subsea tooling, survey and associated services, engineering, communication and data solutions to support their global operations.

We recently were awarded a contract from Statoil for the Johan Castberg Project in the Barents Sea to supply umbilicals. And our Advanced Technologies segment achieved record annual 2017 revenues of \$374 million,

which were up 21% from 2016. This was accomplished by a 16% increase in our government businesses and a 36% increase in our commercial businesses. These achievements were possible thanks to the dedication and support of our employees.

Turning to our 2018 market outlook. Looking at the oilfield market today, we see that the downturn has, of course, led to cost-cutting and weaker financial performance for oil and gas producers, as well as providers of services and products. It has also presented opportunities for reorganization, standardization and new ways of working. We are encouraged that projects have been reworked and costs reduced, driving break-even points lower, thereby enabling project sanctions to begin moving forward.

We were also encouraged by improvements in certain long-term industry drivers and fundamentals in the market we serve, indicating that the offshore energy industry appears to be turning the corner. These include 2018 appearing to be the third straight year with higher oil prices as we entered the year with the Brent price at \$67 per barrel.

OPEC appears to remain committed to production cuts, which should help sustain a strong oil market. The contracted floating rig count has been stable around 150 rigs during 2017 with reported [audio gap] (09:42) activity. Our top 20 customers in the oilfield sector, which comprise approximately 70% of the revenue in our oilfield-based segments, remain committed to the portfolio development of their reserves and have not decreased their long-term exposure mix away from the offshore sector.

Offshore represents a critical share of the oil supply. For 2017, data from Rystad Energy shows average offshore production of 27.7 million barrels per day or almost 30% of global production. Demand for offshore production is expected to remain stable or grow slightly for the foreseeable future.

Offshore project FIDs have begun to trend positively. Oil companies are once again sanctioning projects, which should lead to higher activity in the years ahead. According to Wood Mackenzie, sanctioned deepwater FIDs under development in water depths greater than or equal to 400 meters represented five projects in 2016 and 12 projects in 2017. There are 17 proposed deepwater projects projected to reach FID in 2018.

Turning to our outlook for 2018. As I mentioned earlier, for 2018 overall, we project our consolidated revenue to be down slightly, with decreases in three of our energy segments, offset by increases in Asset Integrity and Advanced Technologies. We continue to project our 2018 results to be lower than our 2017 results due to reduced pricing for our service and product offerings and lower absorption of our manufacturing fixed costs resulting from lower expected throughput.

For the year, we anticipate generating \$140 million to \$180 million of EBITDA, with positive EBITDA contributions from each of our operating segments. At the midpoint of this range, our EBITDA for 2018 would represent a decline of about 28% from our 2017 adjusted EBITDA. This decline can be primarily attributed to the lower level of beginning backlog and not a further deterioration of our markets. With the exception of seasonality, we view activity in the current market to be relatively stable.

For 2018, we expect our organic capital expenditures to total between \$80 million and \$120 million. This includes approximately \$40 million to \$50 million of maintenance capital expenditures and \$40 million to \$70 million of growth capital expenditures, including the final payments to complete the Jones Act vessel, Ocean Evolution and well intervention equipment. We expect to take delivery of the vessel and place it into service during the second quarter of 2018.

While 2018 is going to be challenging, we believe Oceaneering's financial profile provides us valuable optionality not only to manage our business through this cycle, but also positions the company for the eventual upturn in offshore activity.

Directionally, in 2018, for our operations by segment, we see ROVs, Subsea Products, and Subsea Projects results to be lower, with the largest declines in profitability occurring in Subsea Products and Subsea Projects. For ROVs, we expect increased days on hire, however, with lower operating results, due to a shift in geographic mix and continued competitive pricing that we expect to drive our average revenue per day on hire lower.

With the reported improvement in floating rig tendering and recent contracted awards, we expect to maintain or slightly shift our 2018 fleet mix more towards drill support utilization. Our overall ROV fleet utilization is expected to be in the low-50% range.

Considering the current and expected low ROV utilization, one might wonder why do we not simply retire more of our ROVs to improve our utilization. I'd like to address that possible concern. Let me start by saying it's not about percentage of fleet utilization. It's about market share and generating EBITDA by being available to provide excellent reliable service to our customers globally.

At any given time, only about 15% of our fleet is actually in our facilities around the world. The vast majority of our ROV systems have been deployed on rigs and vessels, and remain there even during idle periods, as we believe we are on assets that are most likely to return to work, even on a short-term or call-out contract.

To provide you some appreciation for the on-again/off-again contract activity in offshore markets in which we participate, about 80% of ROVs earned revenue at some point during 2017, and we expect similar conditions for 2018.

Based on our anticipated level of utilization, combined with our fleet mix expectations, worldwide locations where ROVs may work, and cost structure, we expect ROV EBITDA margin to be in the low-30% range for 2018 overall.

We expect to increase our ROV market share for drill support. At the end of 2017, there were approximately 43 floating drilling rigs that have contract terms expiring during the first six months of 2018, and we have 28 ROVs on 24 of them, or 56%.

Of the 43 floaters, 21 are rolling to new contracts. There are 23 additional floating rigs set to begin new contracts during the same period. So, of the 44 floaters receiving new contracts, we have 34 ROVs on 29 of them, or 66%.

As we repeatedly said, although we endeavor to maintain and increase our drill support market share and place more ROVs on vessels, we need a sizable increase in our customers' offshore activity and spending levels for there to be a discernible increase in ROV fleet utilization and profitability.

For Subsea Products, our outlook is for results to decline due to anticipated lower pricing and manufacturing throughput, as we enter the year with less backlog compared to 2017 and the natural lag effect between our customers' financial investment decisions and order awards.

Until we see an increase in Subsea Products backlog and throughput, our outlook is that margins will weaken further into the low- or mid-single-digit range. Based on recent FIDs, current bid activity and anticipated award dates, we envision our book-to-bill for 2018 exceeding 1.0.

For Subsea Projects, we expect to have a more challenging year with reduced international vessel and diving activity, continued competitive pressures on vessel day rates in the spot call-out market in the U.S. Gulf of Mexico, and regulatory drydocking of the Ocean Intervention.

Unlike 2017, we are entering 2018 with no meaningful fixed-term vessel contracts with our customers. Once the current Ocean Alliance contract expires in March 2018, our fleet will include three owned Jones Act-compliant vessels available for term or spot hire, including our newbuild the Ocean Evolution.

For Asset Integrity, we project results to increase slightly year-over-year as we continue to respond to the needs of our customers for a more cost-effective method of ensuring the integrity and availability of their critical infrastructure.

For our non-energy segment, Advanced Technologies, we anticipate results to be higher due to increased activity within our entertainment group, supporting the theme park arena. We expect a stable level of activity for our government businesses.

On a year-over-year basis, we expect unallocated expenses to increase \$12 million to \$18 million in 2018 and be in the upper \$20 million range per quarter. For 2018, we anticipate our net interest expense to be notably higher and our effective tax benefit rate to be approximately 5% before discrete items and any potential adjustments to our provisional estimates related to the recently passed U.S. tax reform recorded in 2017.

For our first quarter 2018 outlook, we anticipate our operating results will be lower than our fourth quarter results due to a continuation of low levels of offshore activity. The decline will be led by operating losses in our Subsea Products, Subsea Projects and ROV segments. We expect near break-even operating levels in our Asset Integrity segment. For Advanced Technologies, we project our operating results to improve, and we expect our unallocated expenses and net interest to be higher.

And now, turning to how we are repositioning the company for 2018 and beyond. We recently issued \$300 million of 10-year senior notes through a public offering and used the net proceeds to pay up our outstanding \$300 million term loan due October 2019.

We also amended our credit agreement to extend the maturities of the \$500 million undrawn unsecured revolver, such that the total commitments for the revolving credit facility will be \$500 million until October 21 and, thereafter, \$450 million until January 2023. As a result, our next scheduled debt principal maturity is in November 2024.

While liquidity has not been a concern of ours, the extension of the revolving credit facility and the early repayment of the term loan increased Oceaneering's liquidity runway by improving our debt maturity profile. As mentioned earlier, we ended the year with \$430 million in cash and cash equivalents, \$500 million in an unsecured undrawn revolving credit facility, and no near-term loan maturities.

Our debt maturities are now \$500 million in November of 2024 and \$300 million in February 2028. We believe this provides us the financial flexibility to operate through the cycle as we reposition the company for enhanced growth, and we have no intention of simply marking time until our markets recover.

Our first and most important use of cash is to improve our portfolio and invest for growth, both organically and through bolt-on acquisitions. We believe the CapEx side of the offshore oil and gas business will be slow to recover. As the number of subsea wells continues to increase and age, we remain focused on looking for

opportunities to grow by identifying and providing better cost-effective solutions for our customers in the OpEx or production phase of the offshore oilfield lifecycle.

Recently, we expanded into the adjacent offshore renewables market to more comprehensively serve the offshore energy industry. This was accomplished organically by leveraging existing assets and personnel from within our core oil and gas businesses. We continue to explore growing the company in the offshore renewables market organically through niche acquisitions and by means of opportunities that align us with established players.

In addition to the offshore renewables, we are also targeting these four adjacent growth areas: riserless well intervention, robotics and automation, pipeline solutions, and asset integrity. While each of these areas are complementary to what we do today, most have applications beyond the traditional markets we serve.

Beyond 2018, with stable and improving long-term oil prices, continued efficiency gains, and break-even points falling for offshore projects, we foresee an increase in offshore expenditures and improving demand for our energy-related services and products.

In closing, our focus continues to be looking for opportunities to grow our company, defending or growing our market share in each of the markets we participate in, engaging more directly with our customers to develop value-added solutions that increase their cash flow, driving efficiencies throughout our organization, controlling our costs, and maintaining a strong balance sheet.

Finally, and perhaps most importantly, thank you to our dedicated employees and management teams for their continued hard work and focus during what has been a challenging last few years.

We appreciate everyone's continued interest in Oceaneering, and we'll now be happy to take any questions you may have.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Ian Macpherson with Simmons. Please go ahead.

Ian Macpherson
Analyst, Simmons & Company International

Q

Thanks. Good morning.

Roderick A. Larson
President & Chief Executive Officer, Oceaneering International, Inc.

A

Good morning, Ian.

Ian Macpherson
Analyst, Simmons & Company International

Q

Hey. Rod, I wanted to follow-up on the guidance a little bit. And let me know if this is incorrect, my adjustments, but if you take out the disposals in ROVs, then Q4 EBITDA around \$37 million. If you annualize that, you're at \$145 million. And then Q1 sounds weaker than Q4 sequentially.

So I guess we're looking at an upward trending trajectory, and you said your segments have stabilized. So I see some improvement embedded in your ROV guidance, specifically with the low-50s utilization. That, to me, points to kind of 10% year-on-year total increase in activity in 2018. Maybe you can talk about how well contracted and how visible that is. As well as the below-30s EBITDA margin, I got to about 25% adjusted for Q4 after the asset sale, if that's correct or incorrect.

Roderick A. Larson
President & Chief Executive Officer, Oceaneering International, Inc.

A

Thanks. So I think, Ian, let me start by making a clarification on the asset sale. What that was, we actually charged for the equipment we permanently installed on a rig that we're being mobilized to. So you can't calculate that as, I mean, there's revenue and there's EBITDA there. So I think backing out the total revenue number is where you drove a little lower than what was actually true.

Ian Macpherson
Analyst, Simmons & Company International

Q

Okay. Okay.

Roderick A. Larson
President & Chief Executive Officer, Oceaneering International, Inc.

A

So, that's probably a big part of, I would say, the differential between the Q4, Q1 that you're having a hard time reconciling.

Alan R. Curtis
Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

A

Yeah. And I think that's why, in Rod's comments for 2018, we still see the low-30% EBITDA range and feel comfortable there.

Ian Macpherson

Analyst, Simmons & Company International

Q

Okay. Good. And then, am I right on the activity that you see some definitely positive, like, I got to about 10% positive activity growth for ROVs? Is that about right? Is that too much? And how well contracted do you think that is today?

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

Yeah. I mean, I won't jump on the activity level. But, yeah, you can kind of see that what we're seeing is we do have increased days on hire. We announced some of the contract awards that we're definitely winning more than our traditional market share on the rigs that are going back to work. So I think you're directionally correct, I'd put it that way.

Ian Macpherson

Analyst, Simmons & Company International

Q

Good. Thanks. I have another one, but I'll pass it over for now. Thanks.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

Thanks, Ian.

Operator: Your next question comes from the line of Kenneth Sill from SunTrust. Please go ahead

Ken Sill

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Hey. Good morning, guys. Wanted to get a little bit more into the technology segment. We've had a couple of projects there that have kind of hurt margins relative to expectations. I'm assuming this is related to entertainment projects. Is that just the nature of the beasts, or is there something that you guys are doing to maybe make results there a little bit more repeatable?

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

Well first of all, it's not just entertainment. It's both the entertainment and the AGV market. But a lot of this is growing pains. I would have to say is the best way to put it is we are pushing more through that machine. You saw the 36% increase.

So we've been continuing to reallocate actually some of the people from the oilfield sector to do more manufacturing on that side for the other groups, but it hasn't been completely pain-free. And I don't know if you understand, but the AGV, the automated guided vehicles that we sell, the guts of them or putting them together is a lot like putting together an ROV. So we continue to leverage the ROV group more and more to help them out.

Ken Sill

Analyst, SunTrust Robinson Humphrey, Inc.

Q

And just a follow-on on that. I mean, I'm assuming that the automated guidance vehicles, that's a big governmental market with the Navy. What about commercial, I mean, what's the kind of growth potential there for commercial [indiscernible] (25:52)?

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

Thank you for asking because we may be clearing up a misconception there. The automated guided vehicles are like – the best way I can think about is think about mobile robotics that are working on a factory floor. So these are moving car chassis around, things like that. So you're thinking of an AUV, which is the underwater vehicles...

Ken Sill

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Yeah.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

...and that's inside our other businesses. But it's a very commercial business and our main customer is the automotive industry.

Ken Sill

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thank you.

Operator: Your next question comes from the line of Haithum Nokta with Clarksons Platou Securities. Please go ahead.

Haithum Nokta

Analyst, Clarksons Platou Securities, Inc.

Q

Hi. Good morning.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

Good morning.

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

A

Good morning.

Haithum Nokta

Analyst, Clarksons Platou Securities, Inc.

Q

Talked about the negative mix shift geographically for ROV revenue per day. I guess, in terms of what you've been realizing the last couple of quarters, is there still some legacy strong pricing in there? Or are we relatively close to, call it, your spot pricing?

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

There is only a tiny bit of legacy left. And what you saw, actually fourth quarter was sort of the realization of I would say the last big move. So we don't have many of those hangovers left. We've been re-priced almost entirely.

A

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

Yeah. I think what you're seeing going into 2018 is more a reflection of where the rigs are working geographically.

A

Haithum Nokta

Analyst, Clarkson's Platou Securities, Inc.

Okay. Fair enough. Appreciate that. And can you just talk a little bit about the moving parts in the Subsea Projects segment this year? I know you're going to have the delivery of the Ocean Evolution, but you're also going to – you talked about how you don't have much backlog entering the year. Can you just help us kind of make heads or tails really how to model that for this year?

Q

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

Sure. So we had the India contract that dropped off last year. We had a larger component of our BP contract in Angola was last year. We do have some BP contract in 2018, but it's a shorter piece of work. But we don't have anything really offsetting the almost full year of the India contract that we had. So, that international contracted work, we'll be doing campaigns and spot work with the same vessels, but it's not as predictable, it's not as visible right now.

A

And as far as the Gulf of Mexico and talking about the Ocean Evolution, the Ocean Evolution has a pretty dedicated book of work supporting a large project in the Gulf of Mexico. But you think about that as the Gulf of Mexico is still not directly or not contracted to a customer. So, while it's been assigned to us, everything else is still spot market. So it is really difficult to model that spot market.

And the Ocean Evolution I wouldn't put out as being sort of incremental to our participation in the spot market. It's part and parcel of that.

Haithum Nokta

Analyst, Clarkson's Platou Securities, Inc.

Okay. Appreciate that. And just one quick clarification on the Subsea Products margin guidance, low- to mid-single-digit, is that on the EBIT or EBITDA line?

Q

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

That's on the EBIT line.

A

Haithum Nokta

Analyst, Clarkson's Platou Securities, Inc.

EBIT. Okay. Great. Thanks so much.

Q

Operator: Your next question comes from the line of Sean Meakim with JPMorgan. Please go ahead.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

Morning, Sean.

Sean C. Meakim

Analyst, JPMorgan Securities LLC

Thank you. Morning. So, to continue with the discussion on ROVs, you talked about the market being fairly stable and highlighted some positives on activity. Maybe could you give us an indication on where spot dayrates are trending across drill support versus vessels or some of the different geographic markets?

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

Yeah. Spot dayrates within regions appear to be pretty flat. I mean, we're looking for places where we may have some opportunity to start raising prices, but I think that's still going to be very exceptional for a while.

Sean C. Meakim

Analyst, JPMorgan Securities LLC

Okay. Fair enough. And then I guess not too dissimilar of a question with respect to the Products side, how has manufactured product pricing tracked? Just looking for also maybe some color on kind of the mix of services and the rentals business, how that was in the fourth quarter and how that could frame the outlook you have for 1Q or all of 2018?

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

I think it impacts us primarily in the first quarter and a lot of it is when you look at our backlog numbers, going into the year, they're substantially reduced from this time last year. And a lot of the production associated with some of that is going to come in the back half the year. So we do expect more of a move to service and rental as a percentage of revenue early on. And then we need, obviously, some contract awards towards the back end of the year within manufactured products.

Sean C. Meakim

Analyst, JPMorgan Securities LLC

And so should we think of that just in terms of is there – we need to see some of that traction in the first half in terms of orders to get that in the back half? Is that how we should think about the cadence of it?

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

I think, for manufactured products, yes, we need to see some in the first half of the year. But I think what you'll see is service and rental becoming a larger component of overall Subsea Products in the year.

Sean C. Meakim

Analyst, JPMorgan Securities LLC

Got it. Okay. Thank you very much.

Operator: Your next question comes from the line of Vebs Vaishnav with Cowen. Please go ahead.

Vaibhav Vaishnav

Analyst, Cowen & Company, LLC

Hey. Good morning and thank you for taking my questions.

Q

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

Morning.

A

Vaibhav Vaishnav

Analyst, Cowen & Company, LLC

So I guess if I start with the first quarter and just following the guidance, probably like we end up at, call it, \$20 million, \$25 million of EBITDA in the first quarter. If that is correct, if I'm in the ballpark? That would be helpful. And then thinking about from that to getting to \$160 million of annualized number implies a very steep increase. Just what gives the confidence in that?

Q

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

I think directionally, you're in the ballpark, Vebs, on the first quarter at least. Yeah. I can't argue with your math and I think we do see the increased work coming in the probably second, third quarters. And then we do see increased production even holding on into the fourth quarter, which gives us some line of sight to our confidence level and then our guidance.

A

Vaibhav Vaishnav

Analyst, Cowen & Company, LLC

Because I guess if I look at last four years, and not that last four years will repeat itself, but from third quarter to fourth quarter, the EBITDA declines like \$25 million, \$30 million each year. So...

Q

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

Vebs, we can't – I'm going to caution you, don't try to make it look like every other year. I mean, just like everybody else, we do expect some improved activity in the back half of the year. Just like some of the other years when you started the first quarter or the fourth quarter on a downward slope, it doesn't look like sort of an average year. So, that's where it's probably causing you a little bit of stress.

A

Vaibhav Vaishnav

Analyst, Cowen & Company, LLC

Got it. That's helpful. And if I may ask one question on Subsea Products. So the way at least I understood was Products margins are going to be negative in first quarter, which is like a huge decline from 7% in fourth quarter. And then I guess the guidance is going up to low- to mid-single digits. I just wanted to make sure I understood it correctly.

Q

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

A

Yes. What we're seeing, Vebs, is we could be slightly negative on the EBIT line for products in the first quarter. Some of it's going to be related to the new revenue recognition standards and the margin progression throughout the year. So we do see that having a little bit of an impact potentially in the first quarter and then increasing as we produce throughout the year.

Vaibhav Vaishnav

Analyst, Cowen & Company, LLC

Q

Okay.

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

A

And volume is expected to pick up too, Vebs. So we've talked quite a bit in the past about absorption and the impact on primarily the three large facilities that we have. So we do need throughput.

Vaibhav Vaishnav

Analyst, Cowen & Company, LLC

Q

Okay. And fair to think Subsea Projects is down year-over-year in terms of EBIT if you don't have much of a backlog, or is there something that can surprise us there?

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

A

No, that's exactly what Rod was describing earlier with the reduction of – we had the long-term vessel contract in India that we finished the work on in November of 17, as well as we had quite a bit of contracted work for BP and Angola last year. So, both of those were in our backlog going into 2017 and we had none of that flowing into this year.

Vaibhav Vaishnav

Analyst, Cowen & Company, LLC

Q

Okay.

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

A

So it's still a very competitive Gulf market operating in the spot market.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

And if I were to tie that back to the other question, Vebs, one of the things is we can – there are things that we can model in there with orders and backlog, and rig contracts and everything else, where I can say I've got confidence of a better second, third, fourth quarter than first quarter. That's not in Projects. I will just say that Projects is hard to model and we aren't planning on that dramatic improvement year-over-year that would cause a big part of that ramp.

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

A

Yeah. And you'll note in Rod's commentary that we do have the drydocking in the first quarter for the OI, or the Ocean Intervention.

Vaibhav Vaishnav

Analyst, Cowen & Company, LLC

Q

All right. Well, very helpful. Thank you for taking my questions.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

No. Thank you.

Operator: Your next question comes from the line of James Wicklund with Credit Suisse. Please go ahead.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

Good morning, Jim.

James Wicklund

Analyst, Credit Suisse Securities (USA) LLC

Q

Good morning, guys.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

Morning.

James Wicklund

Analyst, Credit Suisse Securities (USA) LLC

Q

I love the comments about you're looking for opportunities to grow the company. You've obviously got no maturities due till several of us are retired and you've got it sitting on a ton of cash. And the question I've been asked before that the likelihood that you go negative free cash flow to this is low.

So you actually have a loaded shotgun. You're looking to reposition the company. You're looking for opportunities to grow. You guys mentioned robotics and some other things. Could you repeat those four things you rattled off? And I'm especially interested in where do you think robotics will first have an impact in Oceaneering's business?

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

So the ones we mentioned were riserless well intervention and we talked about robotics, you wrap it up in automation, pipeline solutions and asset integrity, were the ones who we mentioned. It's pretty easy to see the adjacent ones, right, the riserless well intervention, pipeline and asset integrity.

Automation is closer than you might think. I mean you think about our entertainment business, that was subsea robotics which looks like an ROV when we started, it was the Jaws ride. And then we formed a relationship with

the theme parks and started to develop more and more complex to where we built some of the best trackless rides around the world and that's helped us break into China.

So, just the part in the entertainment systems is part of our robotics and automation that's grown. But then the partner that we work with to build the entertainment rides also was doing software and building control systems for that industrial site, which is the robotic platforms that move auto chassis around a non-production line type automotive plant. So you've got that automated guided vehicle part is one of those things that we think could grow quickly as we start to introduce that to new industries. So, that's where I think the first sort of automation bit happens.

Now, there's also some other things that we'll continue to work on building the next-generation ROVs that have greater autonomy. And we have ability, like the resident ROV, to leave them behind. So we think there's going to be some breakthroughs within our industry that's going to lower costs and create a greater low-cost availability of being able to do work subsea. I think that's very important when you think about what's going to happen if we start to do more and more subsea processing. So, that ties in really well with what you're hearing from some of our other peers.

Finally, when we think – what we're doing with that, the next thing I would say is going to be really near-term for us for investments is renewables. We've made a couple of announcements. Stay tuned for more. But we're continuing to participate more and more in the offshore wind business, particularly in Europe. And then we're trying to prepare for when that eventually comes to the United States as well. So, that's kind of where I'd say the leading edge of that is.

James Wicklund

Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. You can tell the enthusiasm in your voice. That's good. And if I could, well, first of all – and I'm assuming all this isn't like pie in the sky. This is actually starting to happen and be implemented now, right?

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

Absolutely. I mean we've got...

James Wicklund

Analyst, Credit Suisse Securities (USA) LLC

Q

[ph] I believe in first quarter. (39:03)

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

Yeah. Yeah. They're working.

James Wicklund

Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. And could you do a little drill down for me? What is it that you're doing for the offshore renewable industry in places like Europe?

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

So a lot of it is just things you'd expect us to do, ROV support. We've done some product work. We've done some survey work with the AUVs. We're doing asset integrity where we're doing inspection on newbuild equipment or a third-party vendor inspection. So, just kind of across the board of Oceaneering, almost all of our groups have a chance to participate.

James Wicklund

Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Perfect. Gentlemen, thank you very much. Appreciate it. Best of luck.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

Thanks, Jim.

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

A

Yeah. Thanks, Jim.

Operator: Your next question comes from the line of Stephen Gengaro with Loop Capital. Please go ahead.

Stephen D. Gengaro

Analyst, Loop Capital Markets LLC

Q

Thanks. Good morning.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

Good morning.

Stephen D. Gengaro

Analyst, Loop Capital Markets LLC

Q

I guess, two things. One, just quickly, when you look at ROVs, I mean, we generally kind of look at implied dayrates. And is it fair to just back out that \$7.3 million extra revenue in the quarter to get a reasonable dayrate? Or is there other kind of noise that we normally see in these quarters that you don't call out because it's not that big a number?

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

A

Stephen, you did exactly what we were hoping from an average revenue per day-on-hire. We put the number in there, so people could get to a more normalized average revenue per day-on-hire.

Stephen D. Gengaro

Analyst, Loop Capital Markets LLC

Q

Okay. Very good.

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

I'll caution, just like Rod did, that's the revenue. That's not necessarily the profit.

A

Stephen D. Gengaro

Analyst, Loop Capital Markets LLC

Yes. I understand that. Thank you.

Q

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

Okay.

A

Stephen D. Gengaro

Analyst, Loop Capital Markets LLC

And then just to follow up on some of the guidance parameters that you've provided already, when you look at the three – well, taking Asset Integrity out and looking at the other three businesses which you kind of guided to be in an op inc loss in the first quarter, do they rebound? I mean, outside of, I would guess, Projects, and correct me if I'm wrong, but the others rebound do you think to profitability in the second quarter?

Q

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

Yeah. Of course, to get the average out, we got to come back up, especially when you consider two and three are strong quarters for us with seasonality.

A

Projects, I would say – remember, Projects not necessarily from beyond seasonality, we do have the drydocking of the Ocean Intervention in Q1. So it's going to get a rebound, too, with that being exceptional event in the first quarter.

Stephen D. Gengaro

Analyst, Loop Capital Markets LLC

And then just as a quick follow-up to that. Outside of seasonality, which we obviously see in the first quarter all the time, is there anything else that's dragging those three segment down in the first quarter that is sort of non-repeating in the second, or is it just the seasonality and then just activity?

Q

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

No. I think the only other thing would be just, as I discussed a little bit earlier, about the revenue recognition and the progression of margins on some of our Subsea Products components.

A

Stephen D. Gengaro

Analyst, Loop Capital Markets LLC

Okay. Great. Thank you for the color.

Q

Operator: [Operator Instructions] Your next question comes from the line of George O'Leary with TPH & Company. Please go ahead.

George O'Leary

Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Morning, guys.

Q

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

Morning, George.

A

George O'Leary

Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

As you look at the EBITDA guidance range for 2018, maybe we've hit on some of this, but I just wondered if you could provide a little more color on maybe what puts and takes would put you at the upper end of that range and what would keep you at the lower end of that range? It sounds like Subsea Projects, you're not baking in much love there, but might there be downside risk to those numbers? And then, conversely, what other segments could drive you to the top end of that range?

Q

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

Let me start with Subsea Projects. Subsea Projects can get some thoughts. It's hard to model. But if there is any sort of events offshore, if there's any issues, if a customer has production, for example, that goes offline and they need a choke change-out or jumper changes and things like that, they can be a big boon to Projects in a quarter or in a year. So, while I can't model it, there is a chance that those – they are almost the most likely ones to appreciate something like that.

A

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

Which also has good pull-through for ROVs and for Subsea Products in our service and rental business as well.

A

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

Yeah.

A

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

So those are the events that really help.

A

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

On the high side, I would say you've also got in the Products business, if we got some orders early, some tiebacks, things like that, that we could get in the system and get more throughput on that side, that could also help us, especially in the back half of the year, in the manufactured products group.

A

Upside-down, I mean, there's -

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

A

I mean, we saw more activity levels. I mean, earlier in the year, that would certainly benefit us. I think we guided to where we think the midpoint is, and I think we gave a fairly narrow range of plus or minus \$20 million the way we see the markets right now.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

Yeah. And I think if you want to know on the low side, the low side means it's going to be something that we're all going to feel. And if we see another hickey to the market and people lose confidence and we see the operators pull back on spending, then I think that's going to – but that's not going to be unique to us. We're just going to feel the market pressure at that point.

George O'Leary

Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

All right. That's super helpful color. And then just curious in – you talked about some of the stats from the third parties that you rely on, Rystad and Wood Mac, and that's all helpful and interesting to hear.

But also just curious, as you guys have direct discussions with customers, we're hearing and seeing as we progress through this earnings season offshore drillers by and large pick up a decent absolute number of contracts, but the nature of those contracts are fairly short-term.

I guess, just how would you describe customer moods? And might we see some of these bigger and larger projects actually push forward this year and then really translate into either late 2018 activity increases or 2019 activity increases? Just kind of customer mood and what it seems like they are thinking as you enter into discussions with them.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

A

Really, I think where we use the customer mood, there are some specific things. For us, that generally where I would say it's differentiated from anything you're hearing from either the Rystad or the Wood Macs or even some of our peer group.

It's more along the lines of what's their interest in sort of that production enhancement phase. How are they looking at – is the oil price at a point where they're looking to go back in and improve their existing assets? That does appear very strong. I mean, that would be something that you're not necessarily hearing everywhere. And we do see a significant change in the level of interest over the last couple of years, particularly this year. So, that's good.

The rest of it, I would just say our customers are telling us things that make us feel confident that when we start talking about 17 FIDs and things like that, that we really believe they are trying to pull those things through. Now, some of them are international and they can't control the speed entirely themselves without help of local government and things like that. But their tone says they want to get them done, and they're confident that those are things that they want to push through if they can.

George O'Leary

Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Great. Thanks very much for the color, guys.

Q

Operator: Your next question comes from the line of Ian Macpherson with Simmons. Please go ahead.

Ian Macpherson

Analyst, Simmons & Company International

Hi. Thanks for the follow-up. I wanted to ask about the Castberg umbilicals. I know in prior days an umbilicals booking would be dilutive to Products margin. I assume that's really not true anymore. Maybe you can speak to that.

Q

And also, a three-year lead time for 39 kilometers, does it take you three years to produce this award, or is this an example of Statoil sort of ordering something with a bit of cushion, with more cushion than they would have in [ph] other cycles (47:20) just based on the slack in the market?

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

So, first of all, I mean, one of the things that we like about this is Statoil is looking for the most appropriate technology to lower their costs, to be more effective, and they're opening up their vendor category a little bit here because it's been hard for us to win work with Statoil. And they're a very important customer because we see them as being beyond Norway, and they're a big international deepwater player. So, on the umbilical front, it's a good win for us.

A

And the reason we won is because it is a little outside the norm, which means that we will be building a prototype, and we're going to be doing some additional work. So it does kind of buy into – it's their schedule. They want to give us time to do all that and prove it out before it gets built and installed. So I think you're on the right track there. And Alan will kind of talk about margins.

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

Yeah. I think that when you looked at it as far as being dilutive, I think, yes, it still tends to be the lower margin business in our Subsea Products segment. That has not changed.

A

Ian Macpherson

Analyst, Simmons & Company International

Okay. All right. Well, thank you very much. Good color on the call today.

Q

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

Yeah. Thank you.

A

Operator: And your next question comes from the line of Cole Sullivan with Wells Fargo. Please go ahead.

Coleman W. Sullivan
Analyst, Wells Fargo Securities LLC

Q

Hi.

Roderick A. Larson
President & Chief Executive Officer, Oceaneering International, Inc.

A

Morning, Cole.

Coleman W. Sullivan
Analyst, Wells Fargo Securities LLC

Q

Morning. On the ROV utilization guidance you guys gave, I think you said around 50% for 2018. It compares with 42% in the fourth quarter. Can you help us kind of bridge the gap on how you see that will trend over the year with rig start-ups and vessel seasonality, especially as we look at the first quarter and how that kind of paces throughout the year?

Roderick A. Larson
President & Chief Executive Officer, Oceaneering International, Inc.

A

Well, I think the best way to say it is we are ramping from that low 40s to 50s, and hovering up and down in the 50s to account for seasonality. So, yeah, it's got to ramp up through to mid-year and then we'll see some of that utilization get softer towards the end of the year with seasonality. So I think you got it figured out. It's sort of up to the mid and then tailing off a little bit towards the back.

Now, if we see this continue – I think we've all heard a lot of the rig contracts tend to be shorter duration. So we have to see some of this enthusiasm either hold or continue to build to say that that will determine what the tail off at the end of the year really ends up being.

Alan R. Curtis
Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

A

Yeah. I think when we look at the ROVs, I mean, we're certainly running as fast on that hamster wheel. I mean, the team is really working hard. And as Rod in his comments talked about, last year, while our utilization was in the mid-30% range, 80% of our assets had a revenue day. So it took a lot of hard work to generate that level of utilization.

Roderick A. Larson
President & Chief Executive Officer, Oceaneering International, Inc.

A

And I think that helps people understand when we talk about how can you maintain margins, how do you keep that thing going. It's because we've got these assets placed at lot of different places and some of them only work a little bit, some of them work a lot. But having them out there and working and not sitting in our yard and having a broad reach with a large fleet is what really keeps this going for us. And it also means that we look forward to on a recovery, because if more of those go back to work, we've got a lot of great placements.

Coleman W. Sullivan
Analyst, Wells Fargo Securities LLC

Q

Okay. Thanks for that. On the products piece of the business, specifically services and rentals, it sounds like there may be a bit of a shift towards services and rentals over the first half of the year due to lower throughput on the

production side. Does that imply a bit of a run rate increase out of the fourth quarter? Is that the right way to think about that over the first half?

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

How did you describe that, a run rate freeze...

A

Coleman W. Sullivan

Analyst, Wells Fargo Securities LLC

A run rate increase out of the fourth quarter on services and rentals.

Q

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

No. I think it's more the decrease in the throughput at our manufacturing facilities.

A

Coleman W. Sullivan

Analyst, Wells Fargo Securities LLC

Okay. Thanks. I appreciate it.

Q

Operator: And your next question comes from the line of Vebs Vaishnav with Cowen & Company. Please go ahead.

Vaibhav Vaishnav

Analyst, Cowen & Company, LLC

Hey. Thank you for letting me back in. I wanted to focus just on the Projects this time because, obviously, it's one of the more difficult segments to model. If you can just walk through the four or maybe now three vessels?

Q

So it seems like Island Pride has been returned now to the client. So, that's gone. Ocean Intervention III, right now, I'm not sure if you said how many days would it be drydocking but in first quarter, then it will go to work through end of June. And Ocean Alliance...

Alan R. Curtis

Chief Financial Officer & Senior Vice President, Oceaneering International, Inc.

Vebs, let me stop real quick. The Ocean Intervention III is not going to drydock, the Ocean Intervention which we own. The Ocean Intervention III is a vessel that we have in charter on occasion and is currently working in Angola with Oceaneering at this time.

A

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

And right now, we don't know, it's more of a – there's work that we're doing and when we're done with that work, that'll go away. So we can't give you an exact number on that. But I'll walk you through. Ocean Intervention will go to drydock and then it'll go back to work. So it'll be working in the second, third, fourth quarter out there chasing work. The Intervention II, no drydock, out there chasing spot work.

A

The Intervention III you mentioned, I'll just say that if and when it finishes with BP, it's going to – we've been working with the vessel owner to stay on the rig and, no, we don't pay each other, we just go chase work. So

we're trying to pick up spot work, particularly in West Africa. So, that's an opportunity. Same thing with the Island Pride, we are working with the vessel owners to find more work for that on the spot market. So we're out there.

The other thing I'd add is, in addition to the Ocean Evolution that's coming out, we have great relationships with other boat owners in the Gulf of Mexico. So we are able to spot-hire a boat if we get called out on spot work. And so we've got a tremendous amount of capacity to go out and catch work by using a vessel of availability at any time in the Gulf of Mexico. So we're pretty excited about being able to put that out.

The Ocean Alliance we had under contract and so that was one that we pay for every day, whether we're busy or not. That actually rolls off in March. So what I would tell you is I think we are very well-positioned with capacity and our vessel costs to go out and work jobs for Projects. So, as it goes up and down this year more than ever, we don't have as much fixed cost as we have in that business in the past.

Vaibhav Vaishnav

Analyst, Cowen & Company, LLC

Q

Okay, that's very helpful. Thank you so much.

Operator: And we have no further questions in the queue at this time. I'll turn the call back over to the presenters.

Roderick A. Larson

President & Chief Executive Officer, Oceaneering International, Inc.

Great. Well, since there are no more questions, I'd like to wrap up by thanking everyone for joining the call. And this concludes our fourth quarter and full-year 2017 conference call. Have a great day.

Operator: Thank you to everyone for attending today. This will conclude today's call. And you may now disconnect.

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