

NATIONAL OILWELL VARCO INC  
Form 10-Q  
October 30, 2015

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

(Mark one)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2015**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**Commission File Number 1-12317**

**NATIONAL OILWELL VARCO, INC.**  
**(Exact name of registrant as specified in its charter)**

**Delaware** **76-0475815**  
**(State or other jurisdiction of** **(I.R.S. Employer**  
**incorporation or organization)** **Identification No.)**  
**7909 Parkwood Circle Drive**

**Houston, Texas**

**77036-6565**

**(Address of principal executive offices)**

**(713) 346-7500**

**(Registrant's telephone number, including area code)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of October 28, 2015 the registrant had 375,747,606 shares of common stock, par value \$.01 per share, outstanding.

**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****NATIONAL OILWELL VARCO, INC.****CONSOLIDATED BALANCE SHEETS****(In millions, except share data)**

|   | <b>September 30,<br/>2015<br/>(Unaudited)</b> | <b>December 31,<br/>2014</b> |
|---|---|------------------------------|
| <b>ASSETS</b>   |   |                              |
| Current assets:   |   |                              |
| Cash and cash equivalents                                   | \$ 1,846                                      | \$ 3,536                     |
| Receivables, net  | 3,325   | 4,416                        |
| Inventories, net  | 5,172   | 5,281                        |
| Costs in excess of billings                                 | 1,669   | 1,878                        |
| Deferred income taxes                                       | 391   | 447                          |
| Prepaid and other current assets                            | 530   | 604                          |
| <b>Total current assets</b>                                 | <b>12,933</b>                                 | <b>16,162</b>                |
| Property, plant and equipment, net                          | 3,122   | 3,362                        |
| Deferred income taxes                                       | 520   | 503                          |
| Goodwill  | 8,465   | 8,539                        |
| Intangibles, net  | 4,087   | 4,444                        |
| Investment in unconsolidated affiliates                     | 331   | 362                          |
| Other assets  | 170   | 190                          |
| <b>Total assets</b>   | <b>\$ 29,628</b>                              | <b>\$ 33,562</b>             |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>                  |   |                              |
| Current liabilities:  |   |                              |
| Accounts payable  | \$ 731  | \$ 1,189                     |
| Accrued liabilities   | 2,810   | 3,518                        |
| Billings in excess of costs                                 | 1,180   | 1,775                        |
| Current portion of long-term debt and short-term borrowings | 2   | 152                          |
| Accrued income taxes  | 112   | 431                          |
| Deferred income taxes                                       | 358   | 309                          |
| <b>Total current liabilities</b>                            | <b>5,193</b>                                  | <b>7,374</b>                 |
| Long-term debt  | 3,981   | 3,014                        |
| Deferred income taxes                                       | 1,826   | 1,972                        |
| Other liabilities   | 422   | 430                          |
| <b>Total liabilities</b>                                    | <b>11,422</b>                                 | <b>12,790</b>                |

## Commitments and contingencies

## Stockholders' equity:

Common stock - par value \$.01; 1 billion shares authorized; 375,735,085 and 418,977,608 shares issued and outstanding at September 30, 2015 and

|  |           |           |
|--|-----------|-----------|
| December 31, 2014                          | 4         | 4         |
| Additional paid-in capital                 | 6,201     | 8,341     |
| Accumulated other comprehensive loss       | (1,477)   | (834)     |
| Retained earnings                          | 13,398    | 13,181    |
| <br>                                       |           |           |
| Total Company stockholders' equity         | 18,126    | 20,692    |
| Noncontrolling interests                   | 80        | 80        |
| <br>                                       |           |           |
| Total stockholders' equity                 | 18,206    | 20,772    |
| <br>                                       |           |           |
| Total liabilities and stockholders' equity | \$ 29,628 | \$ 33,562 |

See notes to unaudited consolidated financial statements.

## NATIONAL OILWELL VARCO, INC.

## CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(In millions, except per share data)

|   | Three Months Ended    |          | Nine Months Ended     |           |
|---|-----------------------|----------|-----------------------|-----------|
|   | September 30,<br>2015 | 2014     | September 30,<br>2015 | 2014      |
| Revenue   | \$ 3,306              | \$ 5,587 | \$ 12,035             | \$ 15,731 |
| Cost of revenue                                       | 2,634                 | 4,059    | 9,360                 | 11,463    |
| Gross profit  | 672                   | 1,528    | 2,675                 | 4,268     |
| Selling, general and administrative                   | 383                   | 540      | 1,378                 | 1,568     |
| Intangible asset impairment                           | 55                    |          | 55                    |           |
| Operating profit                                      | 234                   | 988      | 1,242                 | 2,700     |
| Interest and financial costs                          | (24)                  | (26)     | (76)                  | (79)      |
| Interest income                                       | 2                     | 4        | 9                     | 13        |
| Equity income in unconsolidated affiliates            |                       | 9        | 16                    | 42        |
| Other income (expense), net                           | (20)                  | 9        | (106)                 | (12)      |
| Income from continuing operations before income taxes | 192                   | 984      | 1,085                 | 2,664     |
| Provision for income taxes                            | 36                    | 283      | 330                   | 806       |
| Income from continuing operations                     | 156                   | 701      | 755                   | 1,858     |
| Income from discontinued operations                   |                       |          |                       | 52        |
| Net income  | 156                   | 701      | 755                   | 1,910     |
| Net income attributable to noncontrolling interests   | 1                     | 2        | 1                     | 3         |
| Net income attributable to Company                    | \$ 155                | \$ 699   | \$ 754                | \$ 1,907  |
| Per share data:                                       |                       |          |                       |           |
| Basic:  |                       |          |                       |           |
| Income from continuing operations                     | \$ 0.41               | \$ 1.63  | \$ 1.92               | \$ 4.34   |
| Income from discontinued operations                   | \$                    | \$       | \$                    | \$ 0.12   |
| Net income attributable to Company                    | \$ 0.41               | \$ 1.63  | \$ 1.92               | \$ 4.46   |
| Diluted:  |                       |          |                       |           |
| Income from continuing operations                     | \$ 0.41               | \$ 1.62  | \$ 1.92               | \$ 4.31   |
| Income from discontinued operations                   | \$                    | \$       | \$                    | \$ 0.12   |

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|                                      |         |         |         |         |
|--------------------------------------|---------|---------|---------|---------|
| Net income attributable to Company   | \$ 0.41 | \$ 1.62 | \$ 1.92 | \$ 4.43 |
| Cash dividends per share             | \$ 0.46 | \$ 0.46 | \$ 1.38 | \$ 1.18 |
| Weighted average shares outstanding: |         |         |         |         |
| Basic                                | 380     | 429     | 392     | 428     |
| Diluted                              | 381     | 431     | 393     | 430     |

See notes to unaudited consolidated financial statements.

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**NATIONAL OILWELL VARCO, INC.**
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)****(In millions)**

|  | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|--|---------------------------|-------------|--------------------------|-------------|
|  | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|  | <b>2015</b>               | <b>2014</b> | <b>2015</b>              | <b>2014</b> |
| Net income   | \$ 156                    | \$ 701      | \$ 755                   | \$ 1,910    |
| Currency translation adjustments                             | (339)                     | (310)       | (650)                    | (248)       |
| Changes in derivative financial instruments, net of tax      | (19)                      | (99)        | 7                        | (110)       |
| Comprehensive income (loss)                                  | (202)                     | 292         | 112                      | 1,552       |
| Comprehensive income attributable to noncontrolling interest | 1                         | 2           | 1                        | 3           |
| Comprehensive income (loss) attributable to Company          | \$ (203)                  | \$ 290      | \$ 111                   | \$ 1,549    |

See notes to unaudited consolidated financial statements.

## NATIONAL OILWELL VARCO, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In millions)

|  | <b>Nine Months Ended<br/>September 30,</b> |              |
|--|--|--------------|
|  | <b>2015</b>                                | <b>2014</b>  |
| <b>Cash flows from operating activities:</b>   |  |              |
| Income from continuing operations  | \$ 755                                     | \$ 1,858     |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |  |              |
| Depreciation and amortization  | 564  | 579          |
| Deferred income taxes  | (122)                                      | (36)         |
| Equity income in unconsolidated affiliates   | (16)                                       | (42)         |
| Dividend from unconsolidated affiliate   | 34   | 73           |
| Intangible asset impairment  | 55   |              |
| Other, net   | 236  | 180          |
| <b>Change in operating assets and liabilities, net of acquisitions:</b>                  |  |              |
| Receivables  | 1,045                                      | (201)        |
| Inventories  | (6)  | (817)        |
| Costs in excess of billings  | 209  | (76)         |
| Prepaid and other current assets   | 73   | (73)         |
| Accounts payable   | (460)                                      | 186          |
| Billings in excess of costs  | (595)                                      | 38           |
| Income taxes payable   | (318)                                      | (289)        |
| Other assets/liabilities, net  | (736)                                      | 409          |
| <b>Net cash provided by continuing operating activities</b>                              | <b>718</b>                                 | <b>1,789</b> |
| Discontinued operations  |  | 89           |
| <b>Net cash provided by operating activities</b>   | <b>718</b>                                 | <b>1,878</b> |
| <b>Cash flows from investing activities:</b>   |  |              |
| Purchases of property, plant and equipment   | (332)                                      | (468)        |
| Business acquisitions, net of cash acquired  | (70)                                       | (181)        |
| Cash distributed in spin-off   |  | (253)        |
| Other  | 24   | 117          |
| <b>Net cash used in continuing investing activities</b>                                  | <b>(378)</b>                               | <b>(785)</b> |
| Discontinued operations  |  | (12)         |
| <b>Net cash used in investing activities</b>   | <b>(378)</b>                               | <b>(797)</b> |
| <b>Cash flows from financing activities:</b>   |  |              |
| Borrowings against lines of credit and other debt  | 9,184                                      | 153          |
| Repayments on debt   | (8,369)                                    | (155)        |



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|  |          |          |
|--|----------|----------|
| Cash dividends paid                              | (537)    | (507)    |
| Share repurchases                                | (2,221)  |          |
| Proceeds from stock options exercised            | 6        | 107      |
| Other  | (2)      | 9        |
| Net cash used in continuing financing activities | (1,939)  | (393)    |
| Discontinued operations                          |          |          |
| Net cash used in financing activities            | (1,939)  | (393)    |
| Effect of exchange rates on cash                 | (91)     | (33)     |
| Increase (decrease) in cash and cash equivalents | (1,690)  | 655      |
| Cash and cash equivalents, beginning of period   | 3,536    | 3,436    |
| Cash and cash equivalents, end of period         | \$ 1,846 | \$ 4,091 |

Supplemental disclosures of cash flow information:

Cash payments during the period for:

|              |        |          |
|--------------|--------|----------|
| Interest     | \$ 57  | \$ 57    |
| Income taxes | \$ 760 | \$ 1,097 |

See notes to unaudited consolidated financial statements.

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**NATIONAL OILWELL VARCO, INC.**

**Notes to Consolidated Financial Statements (Unaudited)**

**1. Basis of Presentation**

The preparation of financial statements in conformity with generally accepted accounting principles ( GAAP ) in the United States requires management to make estimates and assumptions that affect reported and contingent amounts of assets and liabilities as of the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The accompanying unaudited consolidated financial statements of National Oilwell Varco, Inc. ( NOV or the Company ) present information in accordance with GAAP in the United States for interim financial information and the instructions to Form 10-Q and applicable rules of Regulation S-X. They do not include all information or footnotes required by GAAP in the United States for complete consolidated financial statements and should be read in conjunction with our 2014 Annual Report on Form 10-K.

In our opinion, the consolidated financial statements include all adjustments, which are of a normal recurring nature, unless otherwise disclosed, necessary for a fair presentation of the results for the interim periods. The results of operations for the three and nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for the full year.

Effective April 1, 2014, the Company reorganized its reporting segments. All prior periods are presented on this basis. Results of operations related to the spin-off of the Company's distribution business ( spin-off ) have been classified as discontinued operations in all prior periods presented on Form 10-Q. See Note 7 for discussion on the Company's reporting segments and Note 2 for discussion on the spin-off of the Company's distribution business.

*Fair Value of Financial Instruments*

The carrying amounts of cash and cash equivalents, receivables, and payables approximated fair value because of the relatively short maturity of these instruments. Cash equivalents include only those investments having a maturity date of three months or less at the time of purchase. See Note 8 for the fair value of long-term debt and Note 11 for the fair value of derivative financial instruments.

**2. Spin-off of Distribution Business**

On May 30, 2014, the Company completed the previously announced spin-off of its distribution business into an independent public company named NOW Inc., which trades on the New York Stock Exchange under the symbol DNOW . After the close of the New York Stock Exchange on May 30, 2014, the stockholders of record as of May 22, 2014 (the Record Date ) received one share of NOW Inc. common stock for every four shares of NOV common stock held on the Record Date. No fractional shares of NOW Inc. common stock were distributed. Instead, the transfer agent aggregated any fractional shares into whole shares, sold those whole shares in the open market at prevailing rates and distributed the net cash proceeds, after deducting any taxes required to be withheld and any amount equal to all brokerage charges and commissions, pro rata to each holder who would otherwise have been entitled to receive fractional shares in the distribution.

The following table presents selected financial information regarding the results of operations of our distribution business, which is reported as discontinued operations (in millions):

|   | <b>Period<br/>Ended<br/>May 30, 2014</b> |
|---|--|
| Revenue from discontinued operations                    | \$ 1,701                                 |
| Income from discontinued operations before income taxes | 83                                       |
| Income tax expense                                      | 31                                       |
| Income from discontinued operations                     | \$ 52                                    |

Prior to the spin-off, sales to NOW were \$231 million for the period ended May 30, 2014 and purchases from NOW were \$82 million for the period ended May 30, 2014. Prior to May 30, 2014, the spin-off date, revenue and related cost of revenue were eliminated in consolidation between NOV and NOW. Beginning May 31, 2014, this revenue and cost of revenue represent third-party transactions with NOW.

**3. Inventories, net**

Inventories consist of (in millions):

|                                       | September 30,<br>2015 | December 31,<br>2014 |
|---------------------------------------|-----------------------|----------------------|
| Raw materials and supplies            | \$ 1,143              | \$ 1,255             |
| Work in process                       | 892                   | 1,027                |
| Finished goods and purchased products | 3,137                 | 2,999                |
| Total                                 | \$ 5,172              | \$ 5,281             |

**4. Accrued Liabilities**

Accrued liabilities consist of (in millions):

|  | September 30,<br>2015 | December 31,<br>2014 |
|--|-----------------------|----------------------|
| Accrued vendor costs                           | \$ 773                | \$ 815               |
| Customer prepayments and billings              | 514                   | 703                  |
| Compensation                                   | 295                   | 662                  |
| Fair value of derivative financial instruments | 271                   | 297                  |
| Warranty                                       | 257                   | 272                  |
| Taxes (non-income)                             | 169                   | 211                  |
| Insurance                                      | 119                   | 126                  |
| Accrued commissions                            | 85                    | 97                   |
| Interest                                       | 29                    | 11                   |
| Other  | 298                   | 324                  |
| Total  | \$ 2,810              | \$ 3,518             |

*Service and Product Warranties*

The Company provides service and warranty policies on certain of its products. The Company accrues liabilities under service and warranty policies based upon specific claims and a review of historical warranty and service claim experience in accordance with Accounting Standards Codification ( ASC ) Topic 450 Contingencies . Adjustments are made to accruals as claim data and historical experience change. In addition, the Company incurs discretionary costs to service its products in connection with product performance issues and accrues for them when they are encountered.

The changes in the carrying amount of service and product warranties are as follows (in millions):

|  |        |
|--|--------|
| Balance at December 31, 2014                         | \$ 272 |
| Net provisions for warranties issued during the year | 58     |

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|  |        |
|--|--------|
| Amounts incurred                           | (71)   |
| Currency translation adjustments and other | (2)    |
| Balance at September 30, 2015              | \$ 257 |

**5. Costs and Estimated Earnings on Uncompleted Contracts**

Costs and estimated earnings on uncompleted contracts consist of (in millions):

|   | September 30,<br>2015 | December 31,<br>2014 |
|---|-----------------------|----------------------|
| Costs incurred on uncompleted contracts                                     | \$ 10,905             | \$ 10,442            |
| Estimated earnings  | 4,868                 | 4,699                |
|   | 15,773                | 15,141               |
| Less: Billings to date  | 15,284                | 15,038               |
|   | \$ 489                | \$ 103               |
| Costs and estimated earnings in excess of billings on uncompleted contracts | \$ 1,669              | \$ 1,878             |
| Billings in excess of costs and estimated earnings on uncompleted contracts | (1,180)               | (1,775)              |
|   | \$ 489                | \$ 103               |

**6. Accumulated Other Comprehensive Income (Loss)**

The components of accumulated other comprehensive income (loss) are as follows (in millions):

|   | Currency<br>Translation<br>Adjustments | Derivative<br>Financial<br>Instruments,<br>Net of<br>Tax | Defined<br>Benefit<br>Plans,<br>Net of Tax | Total      |
|---|--|--|--|------------|
| Balance at December 31, 2014  | \$ (515)                               | \$ (228)   | \$ (91)                                    | \$ (834)   |
| Accumulated other comprehensive income (loss) before reclassifications  | (650)                                  | (151)  |  | (801)      |
| Amounts reclassified from accumulated other comprehensive income (loss) |  | 158  |  | 158        |
| Balance at September 30, 2015   | \$ (1,165)                             | \$ (221)   | \$ (91)                                    | \$ (1,477) |

The components of amounts reclassified from accumulated other comprehensive income (loss) are as follows (in millions):

**Three Months Ended September 30,**  
**2015** **2014**

|                 | 2015                                  |  |                             | 2014    |                                       |  |                             |        |
|-----------------|---------------------------------------|--|-----------------------------|---------|---------------------------------------|--|-----------------------------|--------|
|                 | Currency<br>Translation<br>Adjustment | Derivative<br>Financial<br>Instruments | Defined<br>Benefit<br>Plans | Total   | Currency<br>Translation<br>Adjustment | Derivative<br>Financial<br>Instruments | Defined<br>Benefit<br>Plans | Total  |
| Revenue         | \$                                    | \$ (10)                                | \$                          | \$ (10) | \$                                    | \$ (4)                                 | \$                          | \$ (4) |
| Cost of revenue |                                       | 82                                     |                             | 82      |                                       | 6                                      |                             | 6      |
| Tax effect      |                                       | (21)                                   |                             | (21)    |                                       |  |                             |        |
|                 | \$                                    | \$ 51                                  | \$                          | \$ 51   | \$                                    | \$ 2                                   | \$                          | \$ 2   |

Nine Months Ended September 30,

2015

2014

|                 | 2015                                  |  |                             | 2014    |                                       |  |                             |         |
|-----------------|---------------------------------------|--|-----------------------------|---------|---------------------------------------|--|-----------------------------|---------|
|                 | Currency<br>Translation<br>Adjustment | Derivative<br>Financial<br>Instruments | Defined<br>Benefit<br>Plans | Total   | Currency<br>Translation<br>Adjustment | Derivative<br>Financial<br>Instruments | Defined<br>Benefit<br>Plans | Total   |
| Revenue         | \$                                    | \$ (11)                                | \$                          | \$ (11) | \$                                    | \$ (25)                                | \$                          | \$ (25) |
| Cost of revenue |                                       | 234                                    |                             | 234     |                                       | 5                                      |                             | 5       |
| Tax effect      |                                       | (65)                                   |                             | (65)    |                                       | 5                                      |                             | 5       |
|                 | \$                                    | \$ 158                                 | \$                          | \$ 158  | \$                                    | \$ 15                                  | \$                          | \$ 15   |

The Company's reporting currency is the U.S. dollar. A majority of the Company's international entities in which there is a substantial investment have the local currency as their functional currency. As a result, currency translation adjustments resulting from the process of translating the entities' financial statements into the reporting currency are reported in Other Comprehensive Income or Loss in accordance with ASC Topic 830 Foreign Currency Matters (ASC Topic 830). For the three and nine months ended September 30, 2015, a majority of these local currencies weakened against the U.S. dollar resulting in net Other Comprehensive Loss of \$339 million and \$650 million, respectively, upon the translation from local currencies to the U.S. dollar. For the three and nine months ended September 30, 2014, a majority of these local currencies weakened against the U.S. dollar resulting in net Other Comprehensive Loss of \$310 million and \$248 million, respectively, upon the translation from local currencies to the U.S. dollar.

The effect of changes in the fair values of derivatives designated as cash flow hedges are accumulated in Other Comprehensive Income or Loss, net of tax, until the underlying transactions to which they are designed to hedge are realized. The movement in Other Comprehensive Income or Loss from period to period will be the result of the combination of changes in fair value for open derivatives and the outflow of Other Comprehensive Income or Loss related to cumulative changes in the fair value of derivatives that have settled in the current or prior periods. The accumulated effect was Other Comprehensive Loss of \$19 million (net of tax of \$5 million) and Income of \$7 million (net of tax of \$8 million) for the three and nine months ended September 30, 2015, respectively. The accumulated effect was Other Comprehensive Loss of \$99 million (net of tax of \$38 million) and \$110 million (net of tax of \$42 million) for the three and nine months ended September 30, 2014, respectively.



**7. Business Segments**

Operating results by segment are as follows (in millions):

|                                       | Three Months Ended<br>September 30, |                 | Nine Months Ended<br>September 30, |                  |
|---------------------------------------|-------------------------------------|-----------------|------------------------------------|------------------|
|                                       | 2015                                | 2014            | 2015                               | 2014             |
| <b>Revenue:</b>                       |                                     |                 |                                    |                  |
| Rig Systems                           | \$ 1,496                            | \$ 2,659        | \$ 5,949                           | \$ 7,287         |
| Rig Aftermarket                       | 570                                 | 837             | 1,946                              | 2,372            |
| Wellbore Technologies                 | 834                                 | 1,469           | 2,961                              | 4,193            |
| Completion & Production Solutions     | 798                                 | 1,191           | 2,619                              | 3,320            |
| Eliminations                          | (392)                               | (569)           | (1,440)                            | (1,441)          |
| <b>Total Revenue</b>                  | <b>\$ 3,306</b>                     | <b>\$ 5,587</b> | <b>\$ 12,035</b>                   | <b>\$ 15,731</b> |
| <b>Operating Profit (Loss):</b>       |                                     |                 |                                    |                  |
| Rig Systems                           | \$ 253                              | \$ 533          | \$ 1,093                           | \$ 1,485         |
| Rig Aftermarket                       | 145                                 | 229             | 479                                | 637              |
| Wellbore Technologies                 | (7)                                 | 278             | 110                                | 762              |
| Completion & Production Solutions     | 3                                   | 185             | 160                                | 479              |
| Unallocated expenses and eliminations | (160)                               | (237)           | (600)                              | (663)            |
| <b>Total Operating Profit</b>         | <b>\$ 234</b>                       | <b>\$ 988</b>   | <b>\$ 1,242</b>                    | <b>\$ 2,700</b>  |
| <b>Operating Profit (Loss)%:</b>      |                                     |                 |                                    |                  |
| Rig Systems                           | 16.9%                               | 20.0%           | 18.4%                              | 20.4%            |
| Rig Aftermarket                       | 25.4%                               | 27.4%           | 24.6%                              | 26.9%            |
| Wellbore Technologies                 | (0.8%)                              | 18.9%           | 3.7%                               | 18.2%            |
| Completion & Production Solutions     | 0.4%                                | 15.5%           | 6.1%                               | 14.4%            |
| <b>Total Operating Profit %</b>       | <b>7.1%</b>                         | <b>17.7%</b>    | <b>10.3%</b>                       | <b>17.2%</b>     |

Sales from one segment to another generally are priced at estimated equivalent commercial selling prices; however, segments originating an external sale are credited with the full profit to the Company. Eliminations include intercompany transactions conducted between the four reporting segments that are eliminated in consolidation. Intercompany transactions within each reporting segment are eliminated within each reporting segment.

Included in operating profit are other items related to intangible asset impairments; costs associated with a Voluntary Early Retirement Plan established by the Company during the first quarter of 2015; costs related to severance and facility closures; items related to acquisitions, such as transaction costs, the amortization of backlog and inventory that was stepped up to fair value during purchase accounting; the costs of the spin-off of the Company's distribution business and certain legal costs. Other items by segment are as follows (in millions):

|                     | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |      |
|---------------------|-------------------------------------|------|------------------------------------|------|
|                     | 2015                                | 2014 | 2015                               | 2014 |
| <b>Other items:</b> |                                     |      |                                    |      |

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|                                       |               |             |               |              |
|---------------------------------------|---------------|-------------|---------------|--------------|
| Rig Systems                           | \$ 22         | \$          | \$ 65         | \$           |
| Rig Aftermarket                       | 1             |             | 11            |              |
| Wellbore Technologies                 | 29            |             | 83            | 9            |
| Completion & Production Solutions     | 60            | (1)         | 92            | 6            |
| Unallocated expenses and eliminations |               | 2           |               | 36           |
| <b>Total other items</b>              | <b>\$ 112</b> | <b>\$ 1</b> | <b>\$ 251</b> | <b>\$ 51</b> |

**8. Debt**

Debt consists of (in millions):

|   | September 30,<br>2015 | December 31,<br>2014 |
|---|-----------------------|----------------------|
| Senior Notes, interest at 6.125% payable semiannually, principal due on August 15, 2015 | \$                    | \$ 151               |
| Senior Notes, interest at 1.35% payable semiannually, principal due on December 1, 2017 | 500                   | 500                  |
| Senior Notes, interest at 2.6% payable semiannually, principal due on December 1, 2022  | 1,396                 | 1,396                |
| Senior Notes, interest at 3.95% payable semiannually, principal due on December 1, 2042 | 1,096                 | 1,096                |
| Commercial paper  | 946                   |                      |
| Other   | 45                    | 23                   |
| <b>Total debt</b>   | <b>3,983</b>          | <b>3,166</b>         |
| Less current portion  | 2                     | 152                  |
| <b>Long-term debt</b>   | <b>\$ 3,981</b>       | <b>\$ 3,014</b>      |

On August 15, 2015, the Company repaid \$151 million of its 6.125% unsecured Senior Notes using available cash balances.

During the second quarter of 2015, the Company exercised its accordion option to increase aggregate borrowing capacity under its five-year unsecured revolving credit facility by an additional \$1.0 billion, bringing the aggregate borrowing capacity to \$4.5 billion. The facility expires September 28, 2018. The Company also has a commercial paper program under which borrowings are classified as long-term since the program is supported by the \$4.5 billion, five-year revolving credit facility. At September 30, 2015, there were \$946 million in commercial paper borrowings, and there were \$84 million in outstanding letters of credit issued under the credit facility, resulting in \$3,470 million of funds available under this revolving credit facility. Interest under this multicurrency facility is based upon LIBOR, NIBOR or EURIBOR plus 0.875% subject to a ratings-based grid, or the U.S. prime rate. The credit facility contains a financial covenant regarding maximum debt to capitalization and the Company was in compliance at September 30, 2015.

The Company also had \$2,959 million of additional outstanding letters of credit at September 30, 2015 that are under various bilateral letter of credit facilities. Other letters of credit are issued as bid bonds, advanced payment bonds and performance bonds.

The fair value of the Company's debt is estimated using Level 2 inputs in the fair value hierarchy and is based on quoted prices for those or similar instruments. At September 30, 2015 and December 31, 2014, the fair value of the Company's unsecured Senior Notes approximated \$2,704 million and \$2,974 million, respectively. At September 30,

2015 and December 31, 2014, the carrying value of the Company's unsecured Senior Notes approximated \$2,992 million and \$3,143 million, respectively. The carrying value of the Company's variable rate borrowings approximates fair value.

**9. Tax**

The effective tax rate for the three and nine months ended September 30, 2015 was 18.8% and 30.4%, respectively, compared to 28.8% and 30.3% for the same periods in 2014. Compared to the U.S. statutory rate, the effective tax rate was positively impacted in the periods by the effect of lower tax rates on income earned in foreign jurisdictions, and foreign exchange losses for tax reporting in Norway. The effective tax rate was negatively impacted by foreign dividends net of foreign tax credits, nondeductible expenses and a foreign audit settlement during the nine months ended September 30, 2015. Excluding discrete items, the effective tax rate for the three and nine months ended September 30, 2015 was 20.3% and 27.8%, respectively.

The difference between the effective tax rate reflected in the provision for income taxes and the U.S. federal statutory rate of 35% was as follows (in millions):

|   | <b>Three Months Ended</b> |               | <b>Nine Months Ended</b> |               |
|---|---------------------------|---------------|--------------------------|---------------|
|   | <b>September 30,</b>      |               | <b>September 30,</b>     |               |
|   | <b>2015</b>               | <b>2014</b>   | <b>2015</b>              | <b>2014</b>   |
| Federal income tax at U.S. federal statutory rate | \$ 67                     | \$ 344        | \$ 380                   | \$ 932        |
| Foreign income tax rate differential              | (30)                      | (91)          | (117)                    | (189)         |
| State income tax, net of federal benefit          |                           | 8             | 3                        | 23            |
| Nondeductible expenses                            |                           | 1             | 17                       | 20            |
| Tax benefit of manufacturing deduction            | 7                         | (13)          | (3)                      | (31)          |
| Foreign dividends, net of foreign tax credits     | (1)                       | 113           | 14                       | 134           |
| Tax impact of foreign exchange                    | (4)                       | 16            | (22)                     | 14            |
| Change in valuation allowance                     |                           | (94)          |                          | (92)          |
| Change in tax reserves                            | (2)                       |               | 67                       |               |
| Other   | (1)                       | (1)           | (9)                      | (5)           |
| <b>Provision for income taxes</b>                 | <b>\$ 36</b>              | <b>\$ 283</b> | <b>\$ 330</b>            | <b>\$ 806</b> |

The balance of unrecognized tax benefits at September 30, 2015 was \$113 million, \$40 million of which if ultimately realized, would be recorded as an income tax benefit. Included in the change in the balance of unrecognized tax benefits is an uncertain tax position identified in a foreign jurisdiction totaling \$69 million, of which the Company has settled and paid \$69 million as of September 30, 2015. The Company does not anticipate that its total unrecognized tax benefits at September 30, 2015 will significantly change due to the settlement of audits or the expiration of statutes of limitation within 12 months of this reporting date.

The Company is subject to taxation in the U.S., various states and foreign jurisdictions. The Company has significant operations in the United States, Canada, the United Kingdom, the Netherlands and Norway. Tax years that remain subject to examination by major tax jurisdiction vary by legal entity, but are generally open in the U.S. for tax years after 2009 and outside the U.S. for tax years after 2007.

To the extent penalties and interest would be assessed on any underpayment of income tax, such accrued amounts have been classified as a component of income tax expense in the financial statements.

## 10. Stock-Based Compensation

The Company has a stock-based compensation plan known as the National Oilwell Varco, Inc. Long-Term Incentive Plan (the Plan). The Plan provides for the granting of stock options, performance-based share awards, restricted stock, phantom shares, stock payments and stock appreciation rights. The number of shares authorized under the Plan is 39.5 million. At September 30, 2015, 5,914,169 shares remain available for future grants under the Plan, all of which are available for grants of stock options, performance-based share awards, restricted stock awards, phantom shares, stock payments and stock appreciation rights.

On February 25, 2015, the Company granted 5,746,153 stock options with a fair value of \$15.41 per share and an exercise price of \$54.74 per share; 653,750 shares of restricted stock and restricted stock units with a fair value of \$54.74 per share; and performance share awards to senior management employees with potential payouts varying from zero to 396,666 shares. The stock options vest over a three-year period from the grant date while the restricted stock and restricted stock units vest on the third anniversary of the date of grant. The performance share awards can be earned based on performance against established goals over a three-year performance period. The performance share awards are divided into two equal, independent parts that are subject to two separate performance metrics: 50% with a TSR (total shareholder return) goal (the TSR Award) and 50% with an internal ROC (return on capital) goal (the ROC Award).

Performance against the TSR goal is determined by comparing the performance of the Company's TSR with the TSR performance of the members of the OSX index for the three year performance period. Performance against the ROC goal is determined by comparing the performance of the Company's actual ROC performance average for each of the three years of the performance period against the ROC goal set by the Company's Compensation Committee.

On May 13, 2015, the Company granted 26,992 restricted stock awards with a fair value of \$51.88 per share. The awards were granted to non-employee members of the board of directors and vest on the first anniversary of the grant date.

On August 28, 2015, the Company granted 75,000 restricted stock awards with a fair value of \$41.65 per share. The awards were granted to an officer of the Company and vest over a three-year period from the grant date.

Total stock-based compensation for all stock-based compensation arrangements under the Plan was \$21 million and \$83 million for the three and nine months ended September 30, 2015 and \$23 million and \$75 million for the three and nine months ended September 30, 2014, respectively. Included in stock-based compensation for the nine months ended September 30, 2015 is \$18 million related to the Voluntary Early Retirement Plan established by the Company in the first quarter of 2015. The total income tax benefit recognized in the Consolidated Statements of Income for all stock-based compensation arrangements under the Plan was \$7 million and \$20 million for the three and nine months ended September 30, 2015, respectively and \$7 million and \$23 million for the three and nine months ended September 30, 2014, respectively.

## 11. Derivative Financial Instruments

ASC Topic 815, *Derivatives and Hedging* requires a company to recognize all of its derivative instruments as either assets or liabilities in the Consolidated Balance Sheet at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation.

The Company is exposed to certain risks relating to its ongoing business operations. The primary risk managed by using derivative instruments is foreign currency exchange rate risk. Forward contracts against various foreign currencies are entered into to manage the foreign currency exchange rate risk on forecasted revenues and expenses denominated in currencies other than the functional currency of the operating unit (cash flow hedge). In addition, the Company will enter into non-designated forward contracts against various foreign currencies to manage the foreign currency exchange rate risk on recognized nonfunctional currency monetary accounts (non-designated hedge).

The Company records all derivative financial instruments at their fair value in its Consolidated Balance Sheet. Except for certain non-designated hedges discussed below, all derivative financial instruments that the Company holds are designated as cash flow hedges and are highly effective in offsetting movements in the underlying risks. Such arrangements typically have terms between 2 and 24 months, but may have longer terms depending on the underlying cash flows being hedged, typically related to the projects in our backlog. The Company may also use interest rate contracts to mitigate its exposure to changes in interest rates on anticipated long-term debt issuances.

At September 30, 2015, the Company has determined that the fair value of its derivative financial instruments representing assets of \$39 million and liabilities of \$335 million (primarily currency related derivatives) are determined using level 2 inputs (inputs other than quoted prices in active markets for identical assets and liabilities that are observable either directly or indirectly for substantially the full term of the asset or liability) in the fair value hierarchy as the fair value is based on publicly available foreign exchange and interest rates at each financial reporting date. At September 30, 2015, the net fair value of the Company's foreign currency forward contracts totaled a net liability of \$296 million.

At September 30, 2015, the Company did not have any interest rate swaps and its financial instruments do not contain any credit-risk-related or other contingent features that could cause accelerated payments when the Company's financial instruments are in net liability positions. We do not use derivative financial instruments for trading or speculative purposes.

### *Cash Flow Hedging Strategy*

To protect against the volatility of forecasted foreign currency cash flows resulting from forecasted revenues and expenses, the Company has instituted a cash flow hedging program. The Company hedges portions of its forecasted revenues and expenses denominated in nonfunctional currencies with forward contracts. When the U.S. dollar strengthens or weakens against the foreign currencies, the change in present value of future foreign currency revenues and expenses is offset by changes in the fair value of the forward contracts designated as hedges.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is subject to a particular currency risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of Other Comprehensive Income and reclassified into earnings in the same line item associated with the forecasted transaction and in the same period or periods during which the hedged transaction affects earnings (e.g., in revenues when the hedged transactions are cash flows associated with forecasted revenues). The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any (i.e., the ineffective portion), or

hedge components excluded from the assessment of effectiveness, is recognized in the Consolidated Statements of Income during the current period.

For the three and nine months ended September 30, 2015, the Company recognized losses of \$5 million and \$25 million, respectively, as a result of the discontinuance of certain cash flow hedges when it became probable that the original forecasted transactions would not occur by the end of the originally specified time period. At September 30, 2015, there were \$299 million in pre-tax losses recorded in accumulated other comprehensive income. Significant changes in forecasted operating levels or delays in large capital construction projects, whereby certain hedged transactions associated with these projects are no longer probable of occurring by the end of the originally specified time period, could result in additional losses due to the de-designation of existing hedge contracts.



The Company had the following outstanding foreign currency forward contracts that were entered into to hedge nonfunctional currency cash flows from forecasted revenues and expenses (in millions):

| Foreign Currency       | Currency Denomination |                      |
|------------------------|-----------------------|----------------------|
|                        | September 30,<br>2015 | December 31,<br>2014 |
| Norwegian Krone        | NOK 11,014            | NOK 10,781           |
| U.S. Dollar            | USD 331               | USD 231              |
| Euro                   | EUR 139               | EUR 462              |
| Danish Krone           | DKK 85                | DKK 227              |
| British Pound Sterling | GBP 22                | GBP 80               |
| Singapore Dollar       | SGD 15                | SGD 44               |
| Canadian Dollar        | CAD 5                 | CAD 14               |

*Non-designated Hedging Strategy*

The Company enters into forward exchange contracts to hedge certain nonfunctional currency monetary accounts. The purpose of the Company's foreign currency hedging activities is to protect the Company from risk that the eventual U.S. dollar equivalent cash flows from the nonfunctional currency monetary accounts will be adversely affected by changes in the exchange rates.

For derivative instruments that are non-designated, the gain or loss on the derivative instrument subject to the hedged risk (i.e., nonfunctional currency monetary accounts) is recognized in other income (expense), net in current earnings.

The Company had the following outstanding foreign currency forward contracts that hedge the fair value of nonfunctional currency monetary accounts (in millions):

| Foreign Currency       | Currency Denomination |                      |
|------------------------|-----------------------|----------------------|
|                        | September 30,<br>2015 | December 31,<br>2014 |
| Norwegian Krone        | NOK 2,077             | NOK 4,052            |
| Russian Ruble          | RUB 2,057             | RUB                  |
| U.S. Dollar            | USD 643               | USD 1,092            |
| Euro                   | EUR 404               | EUR 401              |
| Danish Krone           | DKK 307               | DKK 322              |
| British Pound Sterling | GBP 22                | GBP 19               |
| Canadian Dollar        | CAD 15                | CAD 4                |
| Singapore Dollar       | SGD 3                 | SGD 4                |
| Swedish Krone          | SEK 1                 | SEK 3                |
| Mexican Peso           | MXN                   | MXN 118              |
| Brazilian Real         | BRL                   | BRL 57               |

The Company has the following gross fair values of its derivative instruments and their balance sheet classifications:

|  | Asset Derivatives                |                    |                   | Liability Derivatives |                    |                   |
|--|----------------------------------|--------------------|-------------------|-----------------------|--------------------|-------------------|
|  | Fair Value                       |                    |                   | Fair Value            |                    |                   |
|  | Balance Sheet                    | September 30, 2015 | December 31, 2014 | Balance Sheet         | September 30, 2015 | December 31, 2014 |
|  | Location                         |                    |                   | Location              |                    |                   |
| <b>Derivatives designated as hedging instruments under ASC Topic 815</b>           |                                  |                    |                   |                       |                    |                   |
| Foreign exchange contracts   | Prepaid and other current assets | \$ 13              | \$ 18             | Accrued liabilities   | \$ 191             | \$ 204            |
| Foreign exchange contracts   | Other Assets                     | 1                  | 8                 | Other Liabilities     | 64                 | 102               |
| <b>Total derivatives designated as hedging instruments under ASC Topic 815</b>     |                                  | <b>\$ 14</b>       | <b>\$ 26</b>      |                       | <b>\$ 255</b>      | <b>\$ 306</b>     |
| <b>Derivatives not designated as hedging instruments under ASC Topic 815</b>       |                                  |                    |                   |                       |                    |                   |
| Foreign exchange contracts   | Prepaid and other current assets | \$ 25              | \$ 27             | Accrued liabilities   | \$ 80              | \$ 93             |
| <b>Total derivatives not designated as hedging instruments under ASC Topic 815</b> |                                  | <b>\$ 25</b>       | <b>\$ 27</b>      |                       | <b>\$ 80</b>       | <b>\$ 93</b>      |
| <b>Total derivatives</b>   |                                  | <b>\$ 39</b>       | <b>\$ 53</b>      |                       | <b>\$ 335</b>      | <b>\$ 399</b>     |

### The Effect of Derivative Instruments on the Consolidated Statements of Income

(\$ in millions)

| Derivatives in ASC Topic 815 Cash Flow Hedging Relationships | Amount of Gain (Loss) Recognized in OCI on | Location of Gain (Loss) Reclassified from | Amount of Gain (Loss) Reclassified | Location of Gain (Loss) Recognized in Income on | Amount of Gain (Loss) |
|--|--|---|------------------------------------|---|-----------------------|
|--|--|---|------------------------------------|---|-----------------------|

|                            | Derivative<br>(Effective<br>Portion) (a)           |       | Accumulated<br>OCI into<br>Income<br>(Effective<br>Portion) | from<br>Accumulated<br>OCI into<br>Income<br>(Effective<br>Portion) |     | Derivative<br>(Ineffective<br>Portion and<br>Amount<br>Excluded<br>from<br>Effectiveness<br>Testing) | Recognized<br>in<br>Income<br>on<br>Derivative<br>(Ineffective<br>Portion<br>and<br>Amount<br>Excluded<br>from<br>Effectiveness<br>Testing) (b) |    |
|----------------------------|--|-------|---|---|-----|--|---|----|
|                            | Nine Months<br>Ended<br>September 30,<br>2015 2014 |       |   | Nine<br>Months<br>Ended<br>September 30,<br>2015 2014               |     |  | Nine<br>Months<br>Ended<br>September 30,<br>2015 2014   |    |
|                            |  |       | Revenue   | 11  | 25  | Cost of<br>revenue   | (27)  | 1  |
| Foreign exchange contracts | (196)  | (132) | Cost of<br>revenue  | (207)   | (5) | Other income<br>(expense), net   | 1   | 25 |
| <b>Total</b>               | (196)  | (132) |   | (196)   | 20  |  | (26)  | 26 |

| Derivatives Not Designated as Hedging Instruments<br>under ASC Topic 815 | Location of Gain (Loss)               | Amount of Gain (Loss)   |      |
|--|---------------------------------------|---|------|
|  | Recognized in Income<br>on Derivative | Recognized<br>in Income<br>on<br>Derivative<br>Nine<br>Months<br>Ended<br>September 30,<br>2015 | 2014 |
| Foreign exchange contracts   | Other income (expense),<br>net        | (84)  | (25) |
| <b>Total</b>   |                                       | (84)  | (25) |

- (a) The Company expects that \$(235) million of the Accumulated Other Comprehensive Income (Loss) will be reclassified into earnings within the next twelve months with an offset by gains from the underlying transactions resulting in no impact to earnings or cash flow.
- (b) The amount of gain (loss) recognized in income represents \$(27) million and \$1 million related to the ineffective portion of the hedging relationships for each of the nine months ended September 30, 2015 and 2014, respectively, and \$1 million and \$25 million related to the amount excluded from the assessment of the hedge effectiveness for the nine months ended September 30, 2015 and 2014, respectively.

**12. Asset Impairment**

During the third quarter of 2015, the Company incurred \$55 million in impairment charges on identified intangible assets with finite lives that were impaired and written off.

**13. Net Income Attributable to Company Per Share**

The following table sets forth the computation of weighted average basic and diluted shares outstanding (in millions, except per share data):

|   | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|---|-------------|--|-------------|
|   | <b>2015</b>                                 | <b>2014</b> | <b>2015</b>                                | <b>2014</b> |
| <b>Numerator:</b>   |   |             |  |             |
| Income from continuing operations   | \$ 155                                      | \$ 699      | \$ 754                                     | \$ 1,855    |
| Income from discontinued operations                                       | \$  | \$          | \$   | \$ 52       |
| Net income attributable to Company  | \$ 155                                      | \$ 699      | \$ 754                                     | \$ 1,907    |
| <b>Denominator:</b>   |   |             |  |             |
| Basic weighted average common shares outstanding                          | 380   | 429         | 392  | 428         |
| Dilutive effect of employee stock options and other unvested stock awards | 1   | 2           | 1  | 2           |
| Diluted outstanding shares  | 381   | 431         | 393  | 430         |
| <b>Per share data:</b>  |   |             |  |             |
| <b>Basic:</b>   |   |             |  |             |
| Income from continuing operations   | \$ 0.41                                     | \$ 1.63     | \$ 1.92                                    | \$ 4.34     |
| Income from discontinued operations                                       | \$  | \$          | \$   | \$ 0.12     |
| Net income attributable to Company  | \$ 0.41                                     | \$ 1.63     | \$ 1.92                                    | \$ 4.46     |
| <b>Diluted:</b>   |   |             |  |             |
| Income from continuing operations   | \$ 0.41                                     | \$ 1.62     | \$ 1.92                                    | \$ 4.31     |
| Income from discontinued operations                                       | \$  | \$          | \$   | \$ 0.12     |
| Net income attributable to Company  | \$ 0.41                                     | \$ 1.62     | \$ 1.92                                    | \$ 4.43     |
| Cash dividends per share  | \$ 0.46                                     | \$ 0.46     | \$ 1.38                                    | \$ 1.18     |

ASC Topic 260, Earnings Per Share requires companies with unvested participating securities to utilize a two-class method for the computation of Net income attributable to Company per share. The two-class method requires a portion of Net income attributable to Company to be allocated to participating securities, which are unvested awards

of share-based payments with non-forfeitable rights to receive dividends or dividend equivalents, if declared. Net income attributable to Company allocated to these participating securities was immaterial for three and nine months ended September 30, 2015 and therefore not excluded from Net income attributable to Company per share calculation.

The Company had stock options outstanding that were anti-dilutive totaling 15 million and 14 million shares for the three and nine months ended September 30, 2015, respectively, and 6 million and 8 million shares for the three and nine months ended September 30, 2014, respectively.

#### **14. Cash Dividends**

On August 13, 2015, the Company's Board of Directors approved a cash dividend of \$0.46 per share. The cash dividend was paid on September 25, 2015, to each stockholder of record on September 11, 2015. Cash dividends aggregated \$174 million and \$537 million for the three and nine months ended September 30, 2015, respectively, and \$198 million and \$507 million for the three and nine months ended September 30, 2014, respectively. The declaration and payment of future dividends is at the discretion of the Company's Board of Directors and will be dependent upon the Company's results of operations, financial condition, capital requirements and other factors deemed relevant by the Company's Board of Directors.

### **15. Share Repurchase Program**

During the third quarter of 2015 the Company completed its \$3 billion share repurchase program. As shares were repurchased, they were constructively retired and returned to an unissued state. During the three months ended September 30, 2015, the Company repurchased 10.9 million shares under the program for an average price of \$40.98 per share for an aggregate amount of \$444 million. During the nine months ended September 30, 2015, the Company repurchased 44.0 million shares under the program for an average price of \$50.53 per share for an aggregate amount of \$2,221 million.

### **16. Commitments and Contingencies**

We have received U.S. federal grand jury subpoenas and subsequent inquiries from U.S. governmental agencies requesting records related to our compliance with U.S. export trade laws and regulations. We have cooperated fully with agents from the U.S. Department of Justice, the Department of Commerce Bureau of Industry and Security, the United States Department of Treasury, Office of Foreign Assets Control, and U.S. Immigration and Customs Enforcement in responding to the inquiries. We have also cooperated with an informal inquiry from the Securities and Exchange Commission in connection with the inquiries previously made by the aforementioned federal agencies. We have conducted our own internal review of this matter. At the conclusion of our internal review in the fourth quarter of 2009, we identified possible areas of concern and discussed these areas of concern with the relevant agencies. We are currently negotiating a potential resolution with the agencies involved related to these matters. We currently anticipate that any administrative fine or penalty agreed to as part of a resolution would be within established accruals, and would not have a material effect on our financial position or results of operations. To the extent a resolution is not negotiated, we cannot predict the timing or effect that any resulting government actions may have on our financial position or results of operations.

In addition, we are involved in various other claims, internal investigations, regulatory agency audits and pending or threatened legal actions involving a variety of matters. As of September 30, 2015, the Company recorded an immaterial amount for contingent liabilities representing all contingencies believed to be probable. The Company has also assessed the potential for additional losses above the amounts accrued as well as potential losses for matters that are not probable but are reasonably possible. The total potential loss on these matters cannot be determined; however, in our opinion, any ultimate liability, to the extent not otherwise provided for and except for the specific cases referred to above, will not materially affect our financial position, cash flow or results of operations. As it relates to the specific cases referred to above we currently anticipate that any administrative fine or penalty agreed to as part of a resolution would be within established accruals, and would not have a material effect on our financial position or results of operations. To the extent a resolution is not negotiated as anticipated, we cannot predict the timing or effect that any resulting government actions may have on our financial position, cash flow or results of operations. These estimated liabilities are based on the Company's assessment of the nature of these matters, their progress toward resolution, the advice of legal counsel and outside experts as well as management's intention and experience.

Our business is affected both directly and indirectly by governmental laws and regulations relating to the oilfield service industry in general, as well as by environmental and safety regulations that specifically apply to our business. Although we have not incurred material costs in connection with our compliance with such laws, there can be no assurance that other developments, such as new environmental laws, regulations and enforcement policies hereunder may not result in additional, presently unquantifiable, costs or liabilities to us.

Further, in some instances, direct or indirect consumers of our products and services, entities providing financing for purchases of our products and services or members of the supply chain for our products and services may become involved in governmental investigations, internal investigations, political or other enforcement matters. In such circumstances, such investigations may adversely impact the ability of consumers of our products, entities providing financial support to such consumers or entities in the supply chain to timely perform their business plans or to timely

perform under agreements with us. For example, the on-going, publicly disclosed investigations in Brazil may adversely impact our shipyard customers, their customers, entities providing financing for our shipyard customers and/or entities in the supply chain. The investigations in Brazil have led to, and are expected to continue to lead to, delays in deliveries to our shipyard customers in Brazil, along with temporary suspension of performance under our supply contracts, and could result in attempted cancellation or other breaches of our contracts by our shipyard customers.

In other jurisdictions, our shipyard customers' customers in some instances have, and may in the future, sought suspension, delay or cancellation of the contracts or payment due between our shipyard customers and their customers. Further, customers in other markets may seek delay or suspension of deliveries, extending delivery into future periods, or may attempt cancellations. While we manage deliveries and collection of payment to achieve percentage of completion payments that mitigate our financial risk, such delays, suspensions, attempted cancellations, breaches of contract or other similar circumstances, could adversely affect our operating results, collections of accounts receivable and financial condition and could reduce our backlog.

#### **17. Recently Issued Accounting Standards**

In May 2014, the FASB issued Accounting Standard Update No. 2014-09 Revenue from Contracts with Customers (ASU No. 2014-09), which supersedes the revenue recognition requirements in Accounting Standard Codification Topic No. 605 Revenue Recognition and most industry-specific guidance. This update requires that entities recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. ASU No. 2014-09 is effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of ASU No. 2014-09 on its consolidated financial position and results of operations.



## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### *Introduction*

National Oilwell Varco, Inc. (the Company) is a worldwide leader in the design, manufacture and sale of equipment and components used in oil and gas drilling, completion and production operations, and the provision of oilfield services to the upstream oil and gas industry.

Unless indicated otherwise, results of operations data are presented in accordance with accounting principles generally accepted in the United States (GAAP). In an effort to provide investors with additional information regarding our results of operations, certain non-GAAP financial measures, including operating profit excluding other items, operating profit percentage excluding other items and operating (non-GAAP) earnings per share, are provided. See Non-GAAP Financial Measures and Reconciliations in Results of Operations for an explanation of our use of non-GAAP financial measures and reconciliations to their corresponding measures calculated in accordance with GAAP.

### *Rig Systems*

The Company's Rig Systems segment makes and supports the capital equipment and integrated systems needed to drill oil and gas wells on land and offshore. The segment designs, manufactures and sells land rigs, offshore drilling equipment packages, including installation and commissioning services, and drilling rig components that mechanize and automate the drilling process and rig functionality.

Equipment and technologies in Rig Systems include: substructures, derricks, and masts; cranes; pipe lifting, racking, rotating, and assembly systems; fluid transfer technologies, such as mud pumps; pressure control equipment, including blowout preventers; power transmission systems, including drives and generators; and rig instrumentation and control systems.

Rig Systems supports land and offshore drillers. Demand for the segment's products depends on drilling contractors and oil and gas companies' capital spending plans, specifically capital expenditures on rig construction and refurbishment.

### *Rig Aftermarket*

The Company's Rig Aftermarket segment provides comprehensive aftermarket products and services to support land and offshore rigs, and drilling rig components manufactured by the Company's Rig Systems segment.

The segment provides spare parts, repair, and rentals as well as technical support, field service and first well support, field engineering, and customer training through a network of aftermarket service and repair facilities strategically located in major areas of drilling operations.

Rig Aftermarket supports land and offshore drillers. Demand for the segment's products and services depends on overall levels of oilfield drilling activity, which drives demand for spare parts, service, and repair for Rig Systems' large installed base of equipment; and secondarily on drilling contractors' and oil and gas companies' capital spending plans, specifically capital expenditures on rig refurbishment and re-certification.

### *Wellbore Technologies*

The Company's Wellbore Technologies segment designs, manufactures, rents, and sells a variety of equipment and technologies used to perform drilling operations, and offers services that optimize their performance, including: solids control and waste management equipment and services, drilling fluids, premium drill pipe, wired pipe, tubular

inspection and coating services, instrumentation, downhole tools, and drill bits.

Wellbore Technologies focuses on oil and gas companies and supports drilling contractors, oilfield service companies, and oilfield equipment rental companies. Demand for the segment's products and services depends on the level of oilfield drilling activity by oil and gas companies, drilling contractors, and oilfield service companies.

### *Completion & Production Solutions*

The Company's Completion & Production Solutions segment integrates technologies for well completions and oil and gas production. The segment designs, manufactures, and sells equipment and technologies needed for hydraulic fracture stimulation, including pressure pumping trucks and pumps, blenders, sanders, hydration units, injection units, flowline, manifolds and wellheads; well intervention, including coiled tubing units, coiled tubing, and wireline units and tools; onshore production, including composite pipe, surface transfer and progressive cavity pumps, and artificial lift systems; and, offshore production, including floating production systems and subsea production technologies.

Completion & Production Solutions supports service companies and oil and gas companies. Demand for the segment's products depends on the level of oilfield completions and workover activity by oilfield service companies and drilling contractors, and capital spending plans by oil and gas companies and oilfield service companies.

### *Discontinued Operations*

On May 30, 2014, the Company completed the spin-off of its distribution business into an independent public company named NOW Inc. and the results of operations for the distribution business have been classified as discontinued operations for all prior periods presented. Unless indicated otherwise, the information in the Management's Discussion and Analysis of Financial Condition and Results of Operations relates to our continuing operations.

### **Critical Accounting Policies and Estimates**

In our annual report on Form 10-K for the year ended December 31, 2014, we identified our most critical accounting policies. In preparing the financial statements, we make assumptions, estimates and judgments that affect the amounts reported. We periodically evaluate our estimates and judgments that are most critical in nature which are related to revenue recognition under long-term construction contracts; allowance for doubtful accounts; inventory reserves; impairment of long-lived assets (excluding goodwill and other indefinite-lived intangible assets); goodwill and other indefinite-lived intangible assets; purchase price allocation of acquisitions; service and product warranties; and income taxes. Our estimates are based on historical experience and on our future expectations that we believe are reasonable. The combination of these factors forms the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results are likely to differ from our current estimates and those differences may be material.

### *Impairment of Long-Lived Assets (Excluding Goodwill and Other Indefinite-Lived Intangible Assets)*

Long-lived assets, which include property, plant and equipment and identified intangible assets, comprise a significant amount of the Company's total assets. The Company makes judgments and estimates in conjunction with the carrying value of these assets, including amounts to be capitalized, depreciation and amortization methods and estimated useful lives.

The carrying values of these assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. An impairment loss is recorded in the period in which it is determined that the carrying amount is not recoverable based on estimated future undiscounted cash flows. We estimate the fair value of these intangible and fixed assets using an income approach. This requires the Company to make long-term forecasts of its future revenues and costs related to the assets subject to review. These forecasts require assumptions about demand for the Company's products and services, future market conditions and technological developments. The forecasts are dependent upon assumptions regarding oil and gas prices, the general outlook for economic growth worldwide, available financing for the Company's customers, political stability in major oil and gas producing areas, and the potential obsolescence of various types of equipment we sell, among other

factors. The financial and credit market volatility directly impacts our fair value measurement through our income forecast as well as our weighted-average cost of capital, both key assumptions used in our calculation. Changes to these assumptions, including, but not limited to: sustained declines in worldwide rig counts below current analysts forecasts, collapse of spot and futures prices for oil and gas, significant deterioration of external financing for our customers, higher risk premiums or higher cost of equity, or any other significant adverse economic news could require a provision for impairment in a future period.

In the first nine months of 2015, commodity prices have remained at low levels and the active rig count has continued to decline. As such the Company continues to evaluate its near term and longer term strategies which include evaluating capital allocations, facilities and machinery and headcount. During the third quarter of 2015, the Company incurred \$55 million in impairment charges on intangible assets with finite lives. Additional changes in strategy or sustained low commodity prices and rig counts could result in further impairment charges to long-lived assets.

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*Goodwill and Other Indefinite-Lived Intangible Assets*

The Company has approximately \$8.5 billion of goodwill and \$0.5 billion of other intangible assets with indefinite lives as of September 30, 2015. Generally accepted accounting principles require the Company to test goodwill and other indefinite-lived intangible assets for impairment at least annually or more frequently whenever events or circumstances occur indicating that goodwill or other indefinite-lived intangible assets might be impaired. Events or circumstances which, over a sustained period, could indicate a potential impairment include (but are not limited to) a significant reduction in worldwide oil and gas prices or drilling; a significant reduction in profitability or cash flow of oil and gas companies or drilling contractors; a significant reduction in worldwide well remediation activity; a significant reduction in capital investment by other oilfield service companies; or a significant increase in worldwide inventories of oil or gas.

The implied fair value of goodwill is determined by deducting the fair value of a reporting unit's identifiable assets and liabilities from the fair value of that reporting unit as a whole. Fair value of the reporting units is determined in accordance with ASC Topic 820 Fair Value Measurements and Disclosures using significant unobservable inputs, or level 3 in the fair value hierarchy. These inputs are based on internal management estimates, forecasts and judgments, using a combination of three methods: discounted cash flow, comparable companies, and representative transactions. While the Company primarily uses the discounted cash flow method to assess fair value, the Company uses the comparable companies and representative transaction methods to validate the discounted cash flow analysis and further support management's expectations, where possible.

The discounted cash flow is based on management's short-term and long-term forecast of operating performance for each reporting unit. The two main assumptions used in measuring goodwill impairment, which bear the risk of change and could impact the Company's goodwill impairment analysis, include the cash flow from operations from each of the Company's individual business units and the weighted average cost of capital. The starting point for each of the reporting unit's cash flow from operations is the detailed annual plan or updated forecast. The detailed planning and forecasting process takes into consideration a multitude of factors including worldwide rig activity, inflationary forces, pricing strategies, customer analysis, operational issues, competitor analysis, capital spending requirements, working capital needs, customer needs to replace aging equipment, increased complexity of drilling, new technology, and existing backlog among other items which impact the individual reporting unit projections. Cash flows beyond the specific operating plans were estimated using a terminal value calculation, which incorporated historical and forecasted financial cyclical trends for each reporting unit and considered long-term earnings growth rates. The financial and credit market volatility directly impacts our fair value measurement through our weighted average cost of capital that we use to determine our discount rate. During times of volatility, significant judgment must be applied to determine whether credit changes are a short-term or long-term trend.

The annual impairment test is performed during the fourth quarter of each year. The valuation techniques used in the annual test were consistent with those used during previous testing. The inputs used in the annual test were updated for current market conditions and forecasts. The fair value for all of the Company's intangible assets with indefinite lives were in excess of the respective asset carrying values, with two exceptions. These intangible assets, which represent indefinite-lived trade names within the Company's Wellbore Technologies segment, had a calculated fair value approximately \$104 million below carrying value. The fourth-quarter 2014 impairment charge was primarily the result of the substantial decline in oil prices during the fourth quarter of 2014, declines in forecasts in rig activity for 2015, and a decline in the revenue forecast for the segment for 2015 and future periods. During the review of its 2014 annual goodwill impairment test, the calculated fair values for all of the Company's reporting units significantly exceeded the respective reporting unit's carrying value. Twelve of the Company's 15 reporting units had fair values in excess of 50% of the respective reporting unit's carrying value. The Company's Drilling and Intervention, Grant Prideco and Fiberglass reporting units each had calculated fair values that were between 25% and 50% in excess of the respective carrying values. We continue to monitor the cash flows for these reporting units as they each contain material goodwill.

Based on its analysis, the Company did not report any impairment of goodwill and other indefinite-lived intangible assets, other than those mentioned above, for the years ended December 31, 2014, 2013 and 2012.

In the first nine months of 2015, commodity prices have remained at low levels and the active rig count has continued to decline resulting in a significant decline in the Company's market capitalization. While the Company incorporated a downturn into its forecasts in our previous annual test, should current conditions worsen, or continue for an extended period of time, we may identify and record an impairment charge related to the reporting units previously identified or other intangible assets as a result of our annual test or as a result of a trigger and interim impairment test.

## EXECUTIVE SUMMARY

For its third quarter ended September 30, 2015, the Company generated \$155 million in net income, or \$0.41 per fully diluted share, on \$3.3 billion in revenue. Compared to the second quarter of 2015, revenue decreased \$603 million or 15% and net income decreased \$134 million or 46%. Compared to the third quarter of 2014, revenue decreased \$2.3 billion or 41%, and net income decreased \$544 million or 78%.

Operating profit excluding other items was \$346 million or 10.5% of sales in the third quarter of 2015, compared to \$455 million or 11.6% of sales in the second quarter of 2015, and \$989 million or 17.7% of sales in the third quarter of 2014.

During the third quarter of 2015, second quarter of 2015, and third quarter of 2014, pre-tax other items included in operating profit were \$112 million, \$17 million and \$1 million, respectively. Excluding other items charges from all periods, third quarter 2015 operating (non-GAAP) earnings were \$0.61 per fully diluted share, compared to \$0.77 per fully diluted share in the second quarter of 2015 and \$1.62 per fully diluted share in the third quarter of 2014.

### Oil & Gas Equipment and Services Market

Rising oil and gas prices seen between 2003 and 2008 led to high levels of exploration and development drilling in many oil and gas basins around the globe. By late 2008 and into 2009, the availability of credit tightened as major financial institutions wrote down significant housing-related assets, leading to a credit-driven worldwide economic recession. Developed economies struggled to recover throughout 2010 and 2011, facing additional economic hardships related to potential sovereign debt defaults in Europe. As a result, commodity prices, including oil and gas prices, were volatile.

As the global economy began to improve, oil prices strengthened enabling a steady increase in worldwide drilling activity into late 2014. While natural gas prices initially recovered as well, prices fell in 2012 as supply increased due in part to higher production of unconventional shale reservoir developments in North America. Drillers then redirected their efforts towards unconventional shale plays targeting oil, rather than gas, further contributing to the rise in oil-drilling activity.

For the majority of 2014, oil prices and the number of rigs actively drilling worldwide continued their upward trend. Increased global demand had helped sustain relatively high oil prices and worldwide drilling activity. Within the same time frame, technological improvements in drilling and extraction had unlocked formations that were previously unproduceable, especially in North America. Global supply started to catch up to demand, creating a relatively balanced market. In the second half of 2014, demand in areas such as Asia, Europe and the U.S. weakened, while drilling and production activity held steady. As opposed to limiting supply to stabilize prices, OPEC responded by increasing production levels. As a result, oil prices fell significantly to levels not seen since 2009. As prices fell in the first quarter of 2015 and remained depressed since, so did active drilling rigs, especially in North America. Operators adjusted accordingly, acutely reducing both operating and capital expenditures, thus slowing orders for our equipment and services.

### Segment Performance

The Rig Systems segment generated \$1.5 billion in revenues and \$253 million in operating profit or 16.9% of sales in the third quarter of 2015. Compared to the prior quarter, revenues decreased \$434 million or 23%, and operating profit decreased \$139 million or 35%. Compared to the third quarter of 2014, segment revenues decreased \$1.2 billion or 44%, and operating profit decreased \$280 million or 53%. Operating margins were 16.9% in the third quarter of 2015, a decrease of 340 basis points from operating margins of 20.3% posted in the second quarter of 2015 on lower activity levels. Third quarter 2015 revenue out of backlog for the Rig Systems segment decreased 24% sequentially and 45%

year-over-year on fewer shipments of land rigs and postponed delivery dates of some offshore projects.

The Rig Aftermarket segment generated \$570 million in revenues and \$145 million in operating profit or 25.4% of sales in the third quarter of 2015. Compared to the prior quarter, revenues decreased \$87 million or 13%, and operating profit increased \$2 million or 1%. Compared to the third quarter of 2014, segment revenues decreased \$267 million or 32%, and operating profit decreased \$84 million or 37%. Both sequentially and year-over-year, revenues were negatively impacted by decreased drilling activity as drilling contractors cut spending and opted to pull spare parts and replacements from idle and stacked rigs within their fleets. Margins declined year-over-year on lower volumes, a lower mix of spare part sales and inventory charges related to older equipment. Compared to the second quarter margins increased as a result of a second-quarter inventory charge related to older equipment that did not recur in the third quarter.



The Wellbore Technologies segment generated \$834 million in revenue and a \$(7) million operating profit loss, or (0.8)% of sales, for the third quarter of 2015. Compared to the prior quarter, revenue decreased \$122 million or 13%, and operating profit decreased \$45 million or 118%. Compared to the third quarter of 2014, revenues decreased \$635 million or 43%, and operating profit decreased \$285 million or 103%. Revenues and operating profit were down on lower levels of global drilling activity. As rigs sit idle, operators are able to reposition and utilize existing inventory, decreasing demand for new products and services offered by the segment. Third quarter operating profit was negatively impacted by a write down of definite lived intangible assets.

The Completion & Production Solutions segment generated \$798 million in revenue and \$3 million in operating profit or 0.4% of sales during the third quarter of 2015. Compared to the prior quarter, revenue decreased \$75 million or 9%, and operating profit decreased \$75 million or 96%. Compared to the third quarter of 2014, revenues decreased \$393 million or 33%, and operating profit decreased \$182 million or 98%. Fewer rigs actively drilling over the past few quarters has inevitably led to fewer wells being completed and produced. Revenues within the segment have been negatively impacted both year-over-year and sequentially as a result. Third quarter operating profit was negatively impacted by a write down of definite lived intangible assets.

## Outlook

Beginning in the latter half of 2014, lower commodity prices and lower rig counts presented increasingly challenging prospects to our business as declining dayrates stressed drilling contractors' and well service firms' ability to deliver a strong return on invested capital. Consequently, we are cautious in our outlook for the rest of 2015. We expect to see revenues out of backlog exceed orders for new rigs and components in our Rig Systems segment, resulting in a book-to-bill ratio well below one. In addition, delays in delivery dates, temporary suspensions of delivery or attempted or actual order cancellations may adversely affect our backlog and our operating results. Thinking longer-term, in a low oil price environment, contractors become more hesitant to invest in older rigs which are far less productive and competitive. As a result, the industry expects to see a large number of rigs retired during this cyclical downturn, which could result in a newbuild order recovery when commodity prices recover and drilling activity responds. Sales of parts, repair work and service in the Rig Aftermarket segment depend upon the level to which our customers defer expenditures in favor of cannibalizing idle rigs. However, the growing installed base of NOV equipped rigs may allow the group to partially mitigate this effect.

As of September 30, 2015, the Company has orders for twenty-two drilling equipment packages for floating rigs for Brazil. The contracts for these drilling equipment packages are with Brazilian shipyards. These shipyards have contracts with Sete Brasil to construct the drillships and semi-submersible rigs which are contracted by Sete to Petrobras. The on-going, publicly disclosed investigations in Brazil have led to, and is expected to continue to lead to, delays in deliveries to our shipyard customers in Brazil, along with temporary suspension of performance under our supply contracts, and could result in attempted cancellation or other breaches of our contracts by our shipyard customers. Furthermore, the investigations in Brazil may adversely impact our shipyard customers, or Sete's ability to obtain financing. It has been reported that the Brazilian shipyards, the Company's customers, have come under financial stress due to a lack of payments from Sete. The Company is engaged with its shipyard customers in Brazil to adjust manufacturing schedules for the now delayed programs. Some reports in the Brazilian press have suggested that one or more of the contracts between our shipyard customers and Sete may be or have been cancelled. The reports reflect the evolving and uncertain circumstances arising out of the continuing investigations and the current market environment for oil. To date, our shipyard customers have not attempted to cancel their agreements with the Company. We continue to monitor the situation and confer with our shipyard customers.

Our outlook for the Company's Wellbore Technologies and Completion and Production Solutions segments remains cautious as drilling activity is not expected to improve substantially in the rest of 2015. In order to keep contracted rigs running, our customers could reposition components and consumables, including drill pipe, bits, jars and shakers off of idle rigs within their fleets, as opposed to placing new orders for these items with NOV. Drilling consumes rigs,

and the rate of capital equipment and consumables consumption will decline with lower drilling activity, while customers will live off of current inventory and postpone maintenance and upgrades when possible. However, this behavior is not sustainable over the long term. When customers exhaust current on-hand inventory, demand could recover for the equipment and services NOV provides once drilling activity recovers.

The Company expects to manage through this uncertain period, and should benefit from its strong balance sheet and capitalization, access to credit, and a high level of contracted orders which are expected to continue to generate good earnings well into this cyclical downturn. The Company has a long history of cost-control and downsizing in response to depressed market conditions, and of executing strategic acquisitions during difficult periods. As in prior cyclical downturns, we expect to manage our business efficiently through insourcing certain manufacturing processes and developing new products and technologies, while continuing to pursue acquisition opportunities to support our strategic objectives.

## Operating Environment Overview

The Company's results are dependent on, among other things, the level of worldwide oil and gas drilling, well remediation activity, the prices of crude oil and natural gas, capital spending by other oilfield service companies and drilling contractors, and worldwide oil and gas inventory levels. Key industry indicators for the third quarter of 2015 and 2014, and the second quarter of 2015 include the following:

|  | 3Q15*    | 3Q14*    | 2Q15*    | %<br>3Q15<br>3Q14 | %<br>3Q15<br>2Q15 |
|--|----------|----------|----------|-------------------|-------------------|
| <b>Active Drilling Rigs:</b>                             |          |          |          |                   |                   |
| U.S.   | 865      | 1,903    | 909      | (54.5%)           | (4.8%)            |
| Canada   | 191      | 385      | 100      | (50.4%)           | 91.0%             |
| International  | 1,132    | 1,347    | 1,169    | (16.0%)           | (3.2%)            |
| Worldwide  | 2,188    | 3,635    | 2,178    | (39.8%)           | 0.5%              |
| <b>West Texas Intermediate Crude Prices (per barrel)</b> | \$ 46.50 | \$ 97.78 | \$ 57.85 | (52.4%)           | (19.6%)           |
| <b>Natural Gas Prices (\$/mmbtu)</b>                     | \$ 2.74  | \$ 3.94  | \$ 2.73  | (30.5%)           | 0.4%              |

\* Averages for the quarters indicated. See sources below.

The following table details the U.S., Canadian, and international rig activity and West Texas Intermediate Crude Oil prices for the past nine quarters ended September 30, 2015, on a quarterly basis:

Source: Rig count: Baker Hughes, Inc. ([www.bakerhughes.com](http://www.bakerhughes.com)); West Texas Intermediate Crude Oil and Natural Gas Prices: Department of Energy, Energy Information Administration ([www.eia.doe.gov](http://www.eia.doe.gov)).

The worldwide quarterly average rig count increased slightly (from 2,178 to 2,188) however, the U.S. decreased 4.8% (from 909 to 865), in the third quarter of 2015 compared to the second of 2015. The average per barrel price of West Texas Intermediate Crude Oil decreased 19.6% (from \$57.85 per barrel to \$46.50 per barrel) and natural gas prices remained flat (from \$2.73 per mmbtu to \$2.74 per mmbtu) in the third quarter of 2015 compared to the second quarter of 2015.

U.S. rig activity at October 23, 2015 was 787 rigs, decreasing 9% compared to the third quarter average of 865 rigs. The price for West Texas Intermediate Crude Oil was at \$44.60 per barrel at October 23, 2015, decreasing 4 % from the third quarter average. The price for natural gas was at \$2.27 per mmbtu at October 23, 2015, decreasing 17% from the third quarter average.

## Results of Operations

Operating results by segment are as follows (in millions):

|                                       | Three Months Ended<br>September 30, |                 | Nine Months Ended<br>September 30, |                  |
|---------------------------------------|-------------------------------------|-----------------|------------------------------------|------------------|
|                                       | 2015                                | 2014            | 2015                               | 2014             |
| <b>Revenue:</b>                       |                                     |                 |                                    |                  |
| Rig Systems                           | \$ 1,496                            | \$ 2,659        | \$ 5,949                           | \$ 7,287         |
| Rig Aftermarket                       | 570                                 | 837             | 1,946                              | 2,372            |
| Wellbore Technologies                 | 834                                 | 1,469           | 2,961                              | 4,193            |
| Completion & Production Solutions     | 798                                 | 1,191           | 2,619                              | 3,320            |
| Eliminations                          | (392)                               | (569)           | (1,440)                            | (1,441)          |
| <b>Total Revenue</b>                  | <b>\$ 3,306</b>                     | <b>\$ 5,587</b> | <b>\$ 12,035</b>                   | <b>\$ 15,731</b> |
| <b>Operating Profit (Loss):</b>       |                                     |                 |                                    |                  |
| Rig Systems                           | \$ 253                              | \$ 533          | \$ 1,093                           | \$ 1,485         |
| Rig Aftermarket                       | 145                                 | 229             | 479                                | 637              |
| Wellbore Technologies                 | (7)                                 | 278             | 110                                | 762              |
| Completion & Production Solutions     | 3                                   | 185             | 160                                | 479              |
| Unallocated expenses and eliminations | (160)                               | (237)           | (600)                              | (663)            |
| <b>Total Operating Profit</b>         | <b>\$ 234</b>                       | <b>\$ 988</b>   | <b>\$ 1,242</b>                    | <b>\$ 2,700</b>  |
| <b>Operating Profit (Loss)%:</b>      |                                     |                 |                                    |                  |
| Rig Systems                           | 16.9%                               | 20.0%           | 18.4%                              | 20.4%            |
| Rig Aftermarket                       | 25.4%                               | 27.4%           | 24.6%                              | 26.9%            |
| Wellbore Technologies                 | (0.8%)                              | 18.9%           | 3.7%                               | 18.2%            |
| Completion & Production Solutions     | 0.4%                                | 15.5%           | 6.1%                               | 14.4%            |
| <b>Total Operating Profit %</b>       | <b>7.1%</b>                         | <b>17.7%</b>    | <b>10.3%</b>                       | <b>17.2%</b>     |

### Rig Systems

Three and nine months ended September 30, 2015 and 2014. Revenue from Rig Systems was \$1,496 million for the three months ended September 30, 2015, compared to \$2,659 million for the three months ended September 30, 2014, a decrease of \$1,163 million or 44%. For the nine months ended September 30, 2015, revenue from Rig Systems was \$5,949 million compared to \$7,287 million for the nine months ending September 30, 2014, a decrease of \$1,338 million or 18%.

Operating profit from Rig Systems was \$253 million for the three months ended September 30, 2015 compared to \$533 million for the three months ended September 30, 2014, a decrease of \$280 million or 53%. Operating profit percentage decreased to 16.9% for the three months ended September 30, 2015, from 20.0% in the three months ended September 30, 2014. For the nine months ended September 30, 2015, operating profit from Rig Systems was \$1,093 million compared to \$1,485 million for the nine months ending September 30, 2014, a decrease of \$392 million or 26%. Operating profit percentage decreased to 18.4% for the nine months ended September 30, 2015, from 20.4% in the nine months ended September 30, 2014. Operating profit percentage decreased as the segment continued to work through lower priced backlog and faces more pricing pressures.

The Rig Systems segment monitors its capital equipment backlog to plan its business. New orders are added to backlog only when the Company receives a firm written order for major drilling rig components or a signed contract related to a construction project. The capital equipment backlog was \$8.0 billion at September 30, 2015, a decrease of \$6.3 billion, or 44%, from backlog of \$14.3 billion at September 30, 2014. Numerous factors may affect the timing of revenue out of backlog. Considering these factors, the Company reasonably expects approximately \$1.1 billion of revenue out of backlog in the last three months of 2015 and approximately \$6.9 billion of revenue out of backlog in 2016 and thereafter. At September 30, 2015, approximately 90% of the capital equipment backlog was for offshore products and approximately 93% of the capital equipment backlog was destined for international markets.

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### *Rig Aftermarket*

*Three and nine months ended September 30, 2015 and 2014.* Revenue from Rig Aftermarket was \$570 million for the three months ended September 30, 2015, compared to \$837 million for the three months ended September 30, 2014, a decrease of \$267 million or 32%. For the nine months ended September 30, 2015, revenue from Rig Aftermarket was \$1,946 million compared to \$2,372 million for the nine months ending September 30, 2014, a decrease of \$426 million or 18%. This decrease was due to the overall decrease in drilling rigs and drilling activity with customers using existing inventories and components from idle and unused rigs rather than purchasing new.

Operating profit from Rig Aftermarket was \$145 million for the three months ended September 30, 2015 compared to \$229 million for the three months ended September 30, 2014, a decrease of \$84 million or 37%. Operating profit percentage decreased to 25.4% for the three months ended September 30, 2015, from 27.4% in the three months ended September 30, 2014. For the nine months ended September 30, 2015, operating profit from Rig Aftermarket was \$479 million compared to \$637 million for the nine months ending September 30, 2014, a decrease of \$158 million or 25%. Operating profit percentage decreased to 24.6% for the nine months ended September 30, 2015, from 26.9% in the nine months ended September 30, 2014. Operating profit percentage decreased due to lower volumes, unfavorable product mix and inventory charges on older items.

### *Wellbore Technologies*

*Three and nine months ended September 30, 2015 and 2014.* Revenue from Wellbore Technologies was \$834 million for the three months ended September 30, 2015, compared to \$1,469 million for the three months ended September 30, 2014, a decrease of \$635 million or 43%. For the nine months ended September 30, 2015, revenue from Wellbore Technologies was \$2,961 million compared to \$4,193 million for the nine months ending September 30, 2014, a decrease of \$1,232 million or 29%. This decrease was due to the overall decrease in drilling activity.

Operating profit (loss) from Wellbore Technologies was \$(7) million for the three months ended September 30, 2015 compared to \$278 million for the three months ended September 30, 2014, a change of \$285 million or 103%. Operating profit (loss) percentage decreased to (0.8)% for the three months ended September 30, 2015, from 18.9% in the three months ended September 30, 2014. For the nine months ended September 30, 2015, operating profit from Wellbore Technologies was \$110 million compared to \$762 million for the nine months ending September 30, 2014, a decrease of \$652 million or 86%. Operating profit percentage decreased to 3.7% for the nine months ended September 30, 2015, from 18.2% in the nine months ended September 30, 2014. This decrease was due to impairment charges incurred in the third quarter of 2015 as well as pricing pressures resulting from an overall decrease in drilling activity.

### *Completion & Production Solutions*

*Three and nine months ended September 30, 2015 and 2014.* Revenue from Completion & Production Solutions was \$798 million for the three months ended September 30, 2015, compared to \$1,191 million for the three months ended September 30, 2014, a decrease of \$393 million or 33%. For the nine months ended September 30, 2015, revenue from Completion & Production Solutions was \$2,619 million compared to \$3,320 million for the nine months ending September 30, 2014, a decrease of \$701 million or 21%. This decrease was due to the overall decrease in market activity.

Operating profit from Completion & Production Solutions was \$3 million for the three months ended September 30, 2015 compared to \$185 million for the three months ended September 30, 2014, a change of \$182 million or 98%. Operating profit percentage decreased to 0.4% for the three months ended September 30, 2015, from 15.5% in the three months ended September 30, 2014. For the nine months ended September 30, 2015, operating profit from

Completion & Production Solutions was \$160 million compared to \$479 million for the nine months ending September 30, 2014, a decrease of \$319 million or 67%. Operating profit percentage decreased to 6.1% for the nine months ended September 30, 2015, from 14.4% in the nine months ended September 30, 2014. This decrease was due to impairment charges incurred in the third quarter of 2015, an overall decrease in market activity, and a shift in product mix as revenue decreased more in higher operating profit businesses such as pressure pumping and fiberglass pipe.

The Completion & Productions Solutions segment monitors its capital equipment backlog to plan its business. New orders are added to backlog only when the Company receives a firm written order for major completion and production components or a signed contract related to a construction project. The capital equipment backlog was \$1,171 million at September 30, 2015, a decrease of \$916 million, or 44% from backlog of \$2,087 million at September 30, 2014. Numerous factors may affect the timing of revenue out of backlog. Considering these factors, the Company reasonably expects approximately \$470 million of revenue out of backlog in the last three months of 2015 and approximately \$701 million of revenue out of backlog in 2016 and thereafter. At September 30, 2015, approximately 76% of the capital equipment backlog was for offshore products and approximately 86% of the capital equipment backlog was destined for international markets.



*Unallocated expenses and eliminations*

Eliminations were \$160 million and \$600 million for the three and nine months ended September 30, 2015, respectively, compared to \$237 million and \$663 million for the three and nine months ended September 30, 2014, respectively. This change is primarily due to the change in intersegment eliminations. Sales from one segment to another generally are priced at estimated equivalent commercial selling prices; however, segments originating an external sale are credited with the full profit to the company. Eliminations include intercompany transactions conducted between the four reporting segments that are eliminated in consolidation. Intercompany transactions within each reporting segment are eliminated within each reporting segment.

*Other income (expense), net*

Other income (expense), net were expenses of \$20 million and \$106 million for the three and nine months ended September 30, 2015, respectively, compared to income of \$9 million and expenses of \$12 million for the three and nine months ended September 30, 2014, respectively. The increase in expense was primarily due to the fluctuations in foreign currencies as well as the write down of assets related to the Company's Venezuelan businesses in the first quarter of 2015.

*Provision for income taxes*

The effective tax rate for the three and nine months ended September 30, 2015 was 18.8% and 30.4%, respectively, compared to 28.8% and 30.3% for the same periods in 2014. Compared to the U.S. statutory rate, the effective tax rate was positively impacted in the periods by the effect of lower tax rates on income earned in foreign jurisdictions, and foreign exchange losses for tax reporting in Norway. The effective tax rate was negatively impacted by foreign dividends net of foreign tax credits, nondeductible expenses and a foreign audit settlement during the nine months ended September 30, 2015. Excluding discrete items, the effective tax rate for the three and nine months ended September 30, 2015 was 20.3% and 27.8%, respectively.

*Non-GAAP Financial Measures and Reconciliations*

In an effort to provide investors with additional information regarding our results as determined by GAAP, we disclose various non-GAAP financial measures in our quarterly earnings press releases and other public disclosures. The primary non-GAAP financial measures we focus on are: (i) operating profit excluding other items, (ii) operating profit percentage excluding other items and (iii) operating (non-GAAP) earnings per share. Each of these financial measures excludes the impact of certain amounts as further identified below and has not been calculated in accordance with GAAP. A reconciliation of each of these non-GAAP financial measures to its most comparable GAAP financial measure is included below.

We use these non-GAAP financial measures internally to evaluate and manage the Company's operations because we believe it provides useful supplemental information regarding the Company's on-going economic performance. We have chosen to provide this information to investors to enable them to perform more meaningful comparisons of operating results and as a means to emphasize the results of on-going operations.

The following tables set forth the reconciliations of these non-GAAP financial measures to their most comparable GAAP financial measures (in millions, except per share data):

|   | Three Months Ended    |                  | Nine Months Ended     |                       |                 |
|---|-----------------------|------------------|-----------------------|-----------------------|-----------------|
|   | September 30,<br>2015 | June 30,<br>2014 | September 30,<br>2015 | September 30,<br>2014 |                 |
| <b>Reconciliation of operating profit:</b>    |                       |                  |                       |                       |                 |
| GAAP operating profit                         | \$ 234                | \$ 988           | \$ 438                | \$ 1,242              | \$ 2,700        |
| <b>Other items (1):</b>                       |                       |                  |                       |                       |                 |
| Rig Systems                                   | 22                    |                  | 3                     | 65                    |                 |
| Rig Aftermarket                               | 1                     |                  | 2                     | 11                    |                 |
| Wellbore Technologies                         | 29                    |                  | 9                     | 83                    | 9               |
| Completion & Production Solutions             | 60                    | (1)              | 3                     | 92                    | 6               |
| Eliminations                                  |                       | 2                |                       |                       | 36              |
| <b>Operating profit excluding other items</b> | <b>\$ 346</b>         | <b>\$ 989</b>    | <b>\$ 455</b>         | <b>\$ 1,493</b>       | <b>\$ 2,751</b> |

|   | Three Months Ended    |                       | Nine Months Ended |                       |                       |
|---|-----------------------|-----------------------|-------------------|-----------------------|-----------------------|
|   | September 30,<br>2015 | September 30,<br>2014 | June 30,<br>2015  | September 30,<br>2015 | September 30,<br>2014 |
| <b>Reconciliation of operating profit %:</b>    |                       |                       |                   |                       |                       |
| GAAP operating profit %                         | 7.1%                  | 17.7%                 | 11.2%             | 10.3%                 | 17.2%                 |
| Other items %                                   | 3.4%                  | 0.0%                  | 0.4%              | 2.1%                  | 0.3%                  |
| <b>Operating profit % excluding other items</b> | <b>10.5%</b>          | <b>17.7%</b>          | <b>11.6%</b>      | <b>12.4%</b>          | <b>17.5%</b>          |

|  | Three Months Ended    |                       | Nine Months Ended |                       |
|--|-----------------------|-----------------------|-------------------|-----------------------|
|  | September 30,<br>2015 | September 30,<br>2014 | June 30,<br>2015  | September 30,<br>2015 |
| <b>Reconciliation of diluted earnings per share:</b> |                       |                       |                   |                       |

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|  |         |         |         |         |         |
|--|---------|---------|---------|---------|---------|
| GAAP earnings per share (continuing operations)          | \$ 0.41 | \$ 1.62 | \$ 0.74 | \$ 1.92 | \$ 4.31 |
| Other items (1)  | 0.20    |         | 0.03    | 0.42    | 0.07    |
| Venezuela asset write-down (Other income (expense), net) |         |         |         | 0.02    |         |
| Tax exposure (Provision for income taxes)                |         |         |         | 0.17    |         |
| Operating (non-GAAP) earnings per share                  | \$ 0.61 | \$ 1.62 | \$ 0.77 | \$ 2.53 | \$ 4.38 |

- (1) Included in operating profit are other items related to intangible asset impairments; costs associated with a Voluntary Early Retirement Plan established by the Company during the first quarter of 2015; costs related to severance and facility closures; items related to acquisitions, such as transaction costs, the amortization of backlog and inventory that was stepped up to fair value during purchase accounting; the costs of the spin-off of the Company's distribution business and certain legal costs. See Note 7. For the three and nine months ended September 30, 2015, other items included in operating profit were \$112 million and \$251 million, respectively. For the three and nine months ended September 30, 2014, other items included in operating profit were \$1 million and \$51 million, respectively. Other items included in operating profit for the three months ended June 30, 2015 totaled \$17 million.

## Liquidity and Capital Resources

### Overview

The Company assesses liquidity in terms of its ability to generate cash to fund operating, investing and financing activities. The Company remains in a strong financial position, with resources available to reinvest in existing businesses, strategic acquisitions and capital expenditures to meet short- and long-term objectives. The Company believes that cash on hand, cash generated from expected results of operations, amounts available under its revolving credit facility and its commercial paper program will be sufficient to fund operations, anticipated working capital needs and other cash requirements such as capital expenditures, debt and interest payments and dividend payments for the foreseeable future.

At September 30, 2015, the Company had cash and cash equivalents of \$1,846 million, and total debt of \$3,983 million. At December 31, 2014, cash and cash equivalents were \$3,536 million and total debt was \$3,166 million. A significant portion of the consolidated cash balances are maintained in accounts in various foreign subsidiaries and, if such amounts were transferred among countries or repatriated to the U.S., such amounts may be subject to additional tax obligations. Of the \$1,846 million of cash and cash equivalents at September 30, 2015, approximately \$1,777 million is held outside the U.S. If opportunities to invest in the U.S. are greater than available cash balances, rather than repatriating this cash, the Company may choose to borrow against its revolving credit facility or its commercial paper program.

On August 15, 2015, the Company repaid \$151 million of its 6.125% unsecured Senior Notes using available cash balances.

The Company's outstanding debt at September 30, 2015 was \$3,983 million and consisted of \$500 million in 1.35% Senior Notes, \$1,396 million in 2.60% Senior Notes, \$1,096 million in 3.95% Senior Notes, \$946 million in commercial paper borrowings and other debt of \$45 million. The Company was in compliance with all covenants at September 30, 2015.

During the second quarter of 2015, the Company exercised its accordion option to increase aggregate borrowing capacity under its five-year unsecured revolving credit facility by an additional \$1.0 billion, bringing the aggregate borrowing capacity to \$4.5 billion. In addition to the \$946 million in commercial paper borrowings supported by the credit facility, there were \$84 million in outstanding letters of credit issued under the credit facility, resulting in \$3,470 million of funds available under this revolving credit facility.

The Company also had \$2,959 million of additional outstanding letters of credit at September 30, 2015 that are under various bilateral letter of credit facilities. Other letters of credit are issued as bid bonds, advanced payment bonds and performance bonds.

The following table summarizes our net cash provided by (used in) continuing operating activities, continuing investing activities and continuing financing activities for the periods presented (in millions):

|  | <b>Nine Months Ended</b> |             |
|--|--------------------------|-------------|
|  | <b>September 30,</b>     |             |
|  | <b>2015</b>              | <b>2014</b> |
| Net cash provided by continuing operating activities | \$ 718                   | \$ 1,789    |
| Net cash used in continuing investing activities     | (378)                    | (785)       |

|  |         |       |
|--|---------|-------|
| Net cash used in continuing financing activities | (1,939) | (393) |
|--|---------|-------|

*Operating Activities*

For the first nine months of 2015, cash provided by continuing operating activities was \$718 million compared to \$1,789 million in the same period of 2014. Before changes in operating assets and liabilities, net of acquisitions, cash was provided by continuing operations primarily through income from continuing operations of \$755 million plus non-cash charges of \$442 million, plus \$34 million in a dividend received from Voest-Alpine Tubulars, an unconsolidated affiliate, less \$16 million in equity income.

Net changes in operating assets and liabilities, net of acquisitions, used \$788 million of cash for the first nine months of 2015 compared to \$823 million used in the same period in 2014. The decrease in cash used in the first nine months of 2015 compared to the same period in 2014 was the result of a decline in accounts receivable and inventory; partially offset by a decline in accounts payable and decreased orders in the Rig Systems segment which is reflected in customer financing, where revenue recognized outpaced prepayments and milestone invoicing on major projects.

### *Investing Activities*

For the first nine months of 2015, net cash used in continuing investing activities was \$378 million compared to \$785 million for the same period of 2014. Net cash used in continuing investing activities was primarily the result of capital expenditures and acquisition activity both of which decreased in the first nine months of 2015 compared to the same period of 2014. The Company used \$332 million during the first nine months of 2015 for capital expenditures compared to \$468 million for the same period of 2014 and \$70 million for acquisitions in the first nine months of 2015, compared to \$181 million for the same period of 2014.

### *Financing Activities*

For the first nine months of 2015, net cash used in continuing financing activities was \$1,939 million compared to \$393 million for the same period of 2014. This increase was primarily the result of \$2,221 million used to repurchase and retire 44.0 million of the Company's common shares outstanding during the first nine months of 2015. In order to fund a large portion of the share repurchases, the Company entered into net commercial paper borrowings of \$946 million during the first nine months of 2015. The Company repaid \$151 million of Senior Notes in the third quarter of 2015. In addition, the Company increased its dividend to \$537 million during the first nine months of 2015 compared to \$507 million for the same period in 2014.

### *Other*

The effect of the change in exchange rates on cash flows was a decrease of \$91 million and \$33 million for the first nine months of 2015 and 2014, respectively.

We believe that cash on hand, cash generated from operations, amounts available under our credit facility and through our commercial paper program, as well as from other sources of debt will be sufficient to fund operations, working capital needs, capital expenditure requirements, dividends and financing obligations.

During the third quarter of 2015 the Company completed its \$3 billion share repurchase program. As shares were repurchased, they were constructively retired and returned to an unissued state. During the three months ended September 30, 2015, the Company repurchased 10.9 million shares under the program for an average price of \$40.98 per share for an aggregate amount of \$444 million. During the nine months ended September 30, 2015, the Company repurchased 44.0 million shares under the program for an average price of \$50.53 per share for an aggregate amount of \$2,221 million.

We intend to pursue additional acquisition candidates, but the timing, size or success of any acquisition effort and the related potential capital commitments cannot be predicted. We continue to expect to fund future acquisitions primarily with cash flow from operations and borrowings, including the unborrowed portion of the credit facility, our commercial paper program or new debt issuances, but may also issue additional equity either directly or in connection with acquisitions. There can be no assurance that additional financing for acquisitions will be available at terms acceptable to us.

### **Recently Issued Accounting Standards**

In May 2014, the FASB issued Accounting Standard Update No. 2014-09 Revenue from Contracts with Customers (ASU No. 2014-09), which supersedes the revenue recognition requirements in Accounting Standard Codification Topic No. 605 Revenue Recognition and most industry-specific guidance. This update requires that entities recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. ASU No. 2014-09 is effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of ASU No. 2014-09 on its consolidated financial position and results of operations.

### **Forward-Looking Statements**

Some of the information in this document contains, or has incorporated by reference, forward-looking statements. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements typically are identified by use of terms such as may, expect, anticipate, estimate, and similar words, although some forward-looking statements are expressed differently. All statements herein regarding expected merger synergies are forward-looking statements. You should be aware that our actual results could differ materially from results anticipated in the forward-looking statements due to a number of factors, including but not limited to changes in oil and gas prices, customer demand for our products, difficulties encountered in integrating mergers and acquisitions, and worldwide economic activity. You should also consider carefully the statements under Risk Factors, as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014, which address additional factors that could cause our actual results to differ from those set forth in the forward-looking statements. Given these uncertainties, current or prospective investors are cautioned not to place undue reliance on any such forward-looking statements. We undertake no obligation to update any such factors or forward-looking statements to reflect future events or developments.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to changes in foreign currency exchange rates and interest rates. Additional information concerning each of these matters follows:

*Foreign Currency Exchange Rates*

We have extensive operations in foreign countries. The net assets and liabilities of these operations are exposed to changes in foreign currency exchange rates, although such fluctuations generally do not affect income since their functional currency is typically the local currency. These operations also have net assets and liabilities not denominated in the functional currency, which exposes us to changes in foreign currency exchange rates that impact income. We recorded a foreign exchange loss in our income statement of approximately \$41 million in the first nine months of 2015, compared to approximately \$1 million in foreign exchange gains in the same period of the prior year. The gains and losses are primarily due to exchange rate fluctuations related to monetary asset balances denominated in currencies other than the functional currency and adjustments to our hedged positions as a result of changes in foreign currency exchange rates. Strengthening of currencies against the U.S. dollar may create losses in future periods to the extent we maintain net assets and liabilities not denominated in the functional currency of the countries using the local currency as their functional currency.

Some of our revenues in foreign countries are denominated in U.S. dollars, and therefore, changes in foreign currency exchange rates impact our earnings to the extent that costs associated with those U.S. dollar revenues are denominated in the local currency. Similarly some of our revenues are denominated in foreign currencies, but have associated U.S. dollar costs, which also give rise to foreign currency exchange rate exposure. In order to mitigate that risk, we may utilize foreign currency forward contracts to better match the currency of our revenues and associated costs. We do not use foreign currency forward contracts for trading or speculative purposes.

The following table details the Company's foreign currency forward contracts grouped by functional currency and their expected maturity periods at September 30, 2015 (in millions, except contract rates):

| Functional Currency                              | As of September 30, 2015 |        |        |        | December 31,<br>2014 |
|--|--------------------------|--------|--------|--------|----------------------|
|  | 2015                     | 2016   | 2017   | Total  |                      |
| <b>CAD Buy USD/Sell CAD:</b>                     |                          |        |        |        |                      |
| Notional amount to buy (in Canadian dollars)     | 12                       |        |        | 12     | 66                   |
| Average USD to CAD contract rate                 | 1.3297                   |        |        | 1.3297 | 1.1632               |
| Fair Value at September 30, 2015 in U.S. dollars |                          |        |        |        |                      |
| <b>Sell USD/Buy CAD:</b>                         |                          |        |        |        |                      |
| Notional amount to sell (in Canadian dollars)    | 182                      | 26     |        | 208    | 285                  |
| Average USD to CAD contract rate                 | 1.3120                   | 1.2779 |        | 1.3077 | 1.1511               |
| Fair Value at September 30, 2015 in U.S. dollars | (3)                      |        |        | (3)    | (3)                  |
| <b>EUR Buy USD/Sell EUR:</b>                     |                          |        |        |        |                      |
| Notional amount to buy (in Euros)                | 2                        | 2      |        | 4      | 4                    |
| Average USD to EUR contract rate                 | 0.8467                   | 0.9047 |        | 0.8740 | 0.7933               |
| Fair Value at September 30, 2015 in U.S. dollars |                          |        |        |        |                      |
| <b>Sell USD/Buy EUR:</b>                         |                          |        |        |        |                      |
| Notional amount to buy (in Euros)                | 226                      | 50     | 1      | 277    | 430                  |
| Average USD to EUR contract rate                 | 0.8764                   | 0.8623 | 0.8771 | 0.8738 | 0.7832               |
| Fair Value at September 30, 2015 in U.S. dollars | (3)                      | (1)    |        | (4)    | (25)                 |
| <b>KRW Sell USD/Buy KRW:</b>                     |                          |        |        |        |                      |



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|   |        |        |        |         |
|---|--------|--------|--------|---------|
| Notional amount to buy (in South Korean won)        | 71,185 |        | 71,185 | 143,488 |
| Average USD to KRW contract rate                    | 1,186  |        | 1,186  | 1,104   |
| Fair Value at September 30, 2015 in U.S. dollars    | (1)    |        | (1)    |         |
| <b>GBP Sell USD/Buy GBP:</b>                        |        |        |        |         |
| Notional amount to buy (in British Pounds Sterling) | 128    | 6      | 134    | 205     |
| Average USD to GBP contract rate                    | 0.6482 | 0.6621 | 0.6488 | 0.6201  |
| Fair Value at September 30, 2015 in U.S. dollars    | (3)    |        | (3)    | (6)     |

| Functional Currency                              | As of September 30, 2015 |        |        | Total  | December 31,<br>2014 |
|--|--------------------------|--------|--------|--------|----------------------|
|  | 2015                     | 2016   | 2017   |        |                      |
| <b>USD Buy CAD/Sell USD:</b>                     |                          |        |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 13                       |        |        | 13     | 16                   |
| Average CAD to USD contract rate                 | 0.8257                   |        |        | 0.8257 | 0.9431               |
| Fair Value at September 30, 2015 in U.S. dollars | (1)                      |        |        | (1)    | (1)                  |
| <b>Buy DKK/Sell USD:</b>                         |                          |        |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 24                       | 18     |        | 42     | 75                   |
| Average DKK to USD contract rate                 | 0.1596                   | 0.1566 |        | 0.1583 | 0.1813               |
| Fair Value at September 30, 2015 in U.S. dollars | (1)                      | (1)    |        | (2)    | (6)                  |
| <b>Buy EUR/Sell USD:</b>                         |                          |        |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 185                      | 215    |        | 400    | 884                  |
| Average EUR to USD contract rate                 | 1.2335                   | 1.2215 |        | 1.2270 | 1.3411               |
| Fair Value at September 30, 2015 in U.S. dollars | (17)                     | (16)   |        | (33)   | (77)                 |
| <b>Buy GBP/Sell USD:</b>                         |                          |        |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 41                       | 11     |        | 52     | 147                  |
| Average GBP to USD contract rate                 | 1.5511                   | 1.5852 |        | 1.5583 | 1.5779               |
| Fair Value at September 30, 2015 in U.S. dollars | (1)                      |        |        | (1)    | (3)                  |
| <b>Buy NOK/Sell USD:</b>                         |                          |        |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 324                      | 1,099  | 249    | 1,672  | 1,961                |
| Average NOK to USD contract rate                 | 0.1508                   | 0.1410 | 0.1268 | 0.1404 | 0.1642               |
| Fair Value at September 30, 2015 in U.S. dollars | (71)                     | (183)  | (18)   | (272)  | (276)                |
| <b>Buy SGD/Sell USD:</b>                         |                          |        |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 3                        | 6      |        | 9      | 36                   |
| Average SGD to USD contract rate                 | 0.7743                   | 0.7925 |        | 0.7676 | 0.7966               |
| Fair Value at September 30, 2015 in U.S. dollars |                          |        |        |        | (1)                  |
| <b>Sell DKK/Buy USD:</b>                         |                          |        |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 19                       |        |        | 19     | 22                   |
| Average DKK to USD contract rate                 | 0.1483                   |        |        | 0.1483 | 1.3625               |
| Fair Value at September 30, 2015 in U.S. dollars |                          |        |        |        | 1                    |
| <b>Sell EUR/Buy USD:</b>                         |                          |        |        |        |                      |
| Notional amount to sell (in U.S. dollars)        | 139                      | 6      |        | 145    | 251                  |
| Average EUR to USD contract rate                 | 1.1476                   | 1.3772 |        | 1.1550 | 1.3109               |
| Fair Value at September 30, 2015 in U.S. dollars | 3                        |        |        | 3      | 7                    |
| <b>Sell GBP/Buy USD:</b>                         |                          |        |        |        |                      |
| Notional amount to sell (in U.S. dollars)        | 17                       |        |        | 17     |                      |
| Average GBP to USD contract rate                 | 1.5449                   |        |        | 1.5449 |                      |
| Fair Value at September 30, 2015 in U.S. dollars |                          |        |        |        |                      |
| <b>Sell NOK/Buy USD:</b>                         |                          |        |        |        |                      |
| Notional amount to sell (in U.S. dollars)        | 111                      | 57     | 1      | 169    | 348                  |
| Average NOK to USD contract rate                 | 0.1381                   | 0.1515 | 0.1335 | 0.1423 | 0.1634               |
| Fair Value at September 30, 2015 in U.S. dollars | 16                       | 13     |        | 29     | 44                   |
| <b>Sell RUB/Buy USD:</b>                         |                          |        |        |        |                      |
| Notional amount to sell (in U.S. dollars)        | 30                       |        |        | 30     |                      |
| Average RUB to USD contract rate                 | 0.0146                   |        |        | 0.0146 |                      |
| Fair Value at September 30, 2015 in U.S. dollars |                          |        |        |        |                      |
| <b>Sell SGD/Buy USD:</b>                         |                          |        |        |        |                      |
| Notional amount to sell (in U.S. dollars)        | 1                        |        |        | 1      | 2                    |
| Average SGD to USD contract rate                 | 0.7041                   |        |        | 0.7041 | 0.7678               |
| Fair Value at September 30, 2015 in U.S. dollars |                          |        |        |        |                      |

**BRL Buy EUR/Sell BRL:**

|  |        |        |
|--|--------|--------|
| Notional amount to sell (in U.S. dollars)        | 427    | 427    |
| Average EUR to BRL contract rate                 | 4.6985 | 4.6985 |
| Fair Value at September 30, 2015 in U.S. dollars | 21     | 21     |

**BRL Sell EUR/Buy BRL:**

|  |        |        |
|--|--------|--------|
| Notional amount to sell (in U.S. dollars)        | 853    | 853    |
| Average EUR to BRL contract rate                 | 4.6985 | 4.6985 |
| Fair Value at September 30, 2015 in U.S. dollars | (26)   | (26)   |

| Functional Currency   | As of September 30, 2015 |              |             | Total        | December 31,<br>2014 |
|---|--------------------------|--------------|-------------|--------------|----------------------|
|   | 2015                     | 2016         | 2017        |              |                      |
| <b>DKK Sell DKK/Buy USD:</b>                                  |                          |              |             |              |                      |
| Notional amount to buy (in U.S. dollars)                      | 46                       | 1,349        |             | 1,395        | 59                   |
| Average DKK to USD contract rate                              | 6.6789                   | 6.5536       |             | 6.5577       | 5.9300               |
| Fair Value at September 30, 2015 in U.S. dollars              |                          | (2)          |             | (2)          |                      |
| <b>Other Currencies</b>                                       |                          |              |             |              |                      |
| Fair Value at September 30, 2015 in U.S. dollars              | (1)                      |              |             | (1)          |                      |
| <b>Total Fair Value at September 30, 2015 in U.S. dollars</b> | <b>(83)</b>              | <b>(195)</b> | <b>(18)</b> | <b>(296)</b> | <b>(346)</b>         |

The Company had other financial market risk sensitive instruments denominated in foreign currencies for transactional exposures totaling \$124 million and translation exposures totaling \$360 million as of September 30, 2015 excluding trade receivables and payables, which approximate fair value. These market risk sensitive instruments consisted of cash balances and overdraft facilities. The Company estimates that a hypothetical 10% movement of all applicable foreign currency exchange rates on the transactional exposures financial market risk sensitive instruments could affect net income by \$8 million and the translational exposures financial market risk sensitive instruments could affect the future fair value by \$36 million.

The counterparties to forward contracts are major financial institutions. The credit ratings and concentration of risk of these financial institutions are monitored on a continuing basis. In the event that the counterparties fail to meet the terms of a foreign currency contract, our exposure is limited to the foreign currency rate differential.

#### *Interest Rate Risk*

At September 30, 2015, long term borrowings consisted of \$500 million in 1.35% Senior Notes, \$1,396 million in 2.60% Senior Notes and \$1,096 million in 3.95% Senior Notes. At September 30, 2015, there were \$946 million in commercial paper borrowings, and there were \$84 million in outstanding letters of credit issued under the credit facility, resulting in \$3,470 million of funds available under this revolving credit facility. Occasionally a portion of borrowings under our credit facility could be denominated in multiple currencies which could expose us to market risk with exchange rate movements. These instruments carry interest at a pre-agreed upon percentage point spread from either LIBOR, NIBOR or EURIBOR, or at the U.S. prime rate. Under our credit facility, we may, at our option, fix the interest rate for certain borrowings based on a spread over LIBOR, NIBOR or EURIBOR for 30 days to nine months. Our objective is to maintain a portion of our debt in variable rate borrowings for the flexibility obtained regarding early repayment without penalties and lower overall cost as compared with fixed-rate borrowings.

**Item 4. Controls and Procedures**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. The Company's disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed by the Company in the reports it files under the Exchange Act is accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures and is recorded, processed, summarized and reported within the time period specified in the rules and forms of the Securities and Exchange Commission. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this report at a reasonable assurance level.

There has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## **PART II - OTHER INFORMATION**

### **Item 1A. Risk Factors**

As of the date of this filing, the Company and its operations continue to be subject to the risk factors previously disclosed in Part I, Item 1A Risk Factors in our 2014 Annual Report on Form 10-K. The following risk factor has been updated from our 2014 Annual Report on Form 10-K:

*There are risks associated with our presence in international markets, including political or economic instability, currency restrictions, and trade and economic sanctions.*

Approximately 75% of our revenues in the third quarter of 2015 were derived from operations outside the United States (based on revenue destination). Our foreign operations include significant operations in Argentina, Canada, Brazil, Europe, the Middle East, China, Africa, Nigeria, Southeast Asia, Russia, Latin America, Libya and other international markets. Our revenues and operations are subject to the risks normally associated with conducting business in foreign countries, including uncertain political and economic environments, which may limit or disrupt markets, restrict the movement of funds or result in the deprivation of contract rights or the taking of property without fair compensation. Government-owned petroleum companies located in some of the countries in which we operate have adopted policies, or are subject to governmental policies, giving preference to the purchase of goods and services from companies that are majority-owned by local nationals. As a result of these policies, we may rely on joint ventures, license arrangements and other business combinations with local nationals in these countries. In addition, political considerations may disrupt the commercial relationships between us and government-owned petroleum companies or oilfield service companies.

Our operations outside the United States could also expose us to trade and economic sanctions or other restrictions imposed by the United States as well as non-U.S. Governmental Regulatory Authorities. The U.S. Department of Justice ( DOJ ), the U.S. Securities and Exchange Commission, other U.S. federal agencies and foreign governmental authorities have a broad range of civil and criminal penalties they may seek to impose against corporations and individuals for violations of trading sanctions laws, the Foreign Corrupt Practices Act ( FCPA ), other federal statutes, and foreign anti-bribery, anti-corruption and trade laws. Under U.S. trading sanctions laws, the government authorities may seek to impose modifications to business practices, including cessation of business activities in sanctioned countries, and modifications to compliance programs, which may increase compliance costs. If any of the risks described above materialize, it could adversely impact our operating results and financial condition.

Our ability to comply with the FCPA and foreign anti-bribery laws is dependent on the success of our ongoing compliance program, including our ability to continue to supervise, train and retain competent employees. Our compliance program also depends on the efforts of our employees to comply with applicable law. We could be subject to sanctions and civil and criminal prosecution as well as fines and penalties in the event of a finding of a violation of the FCPA or other anti-corruption laws by us or any of our employees. Compliance with, and changes in, laws could be costly and could affect operating results. In addition, government disruptions could negatively impact our ability to conduct our business.

We have operations in the U.S. and in approximately 70 countries that can be impacted by changes in the legal and business environments in which we operate, including new legislation, new regulations, new policies, investigations and legal proceedings and new interpretations of existing legal rules and regulations, export control laws or exchange control laws, additional restrictions on doing business in countries subject to sanctions, and changes in laws in countries where we operate or intend to operate all could adversely impact our business .

Further, in some instances, direct or indirect consumers of our products and services, entities providing financing for purchases of our products and services or members of the supply chain for our products and services may become

involved in governmental investigations, internal investigations, political or other enforcement matters. In such circumstances, such investigations may adversely impact the ability of consumers of our products, entities providing financial support to such consumers or entities in the supply chain to timely perform their business plans or to timely perform under agreements with us. For example, the on-going, publicly disclosed investigations in Brazil may adversely impact our shipyard customers, their customers, entities providing financing for our shipyard customers and/or entities in the supply chain. The investigations in Brazil have led to, and are expected to continue to lead to, delays in deliveries to our shipyard customers in Brazil, along with temporary suspension of performance under our supply contracts, and could result in attempted cancellation or other breaches of our contracts by our shipyard customers.

In other jurisdictions, our shipyard customers' customers in some instances have, and may in the future, sought suspension, delay or cancellation of the contracts or payment due between our shipyard customers and their customers. Further, customers in other markets may seek delay or suspension of deliveries, extending delivery into future periods, or may attempt cancellations. While we manage deliveries and collection of payment to achieve percentage of completion payments that mitigate our financial risk, such delays, suspensions, attempted cancellations, breaches of contract or other similar circumstances, could adversely affect our operating results, collections of accounts receivable and financial condition and could reduce our backlog.

Sanctions imposed by the United States, European Union and other countries could adversely impact our business activities in or related to Russia and certain Russian companies, including prohibitions of certain sales of goods and services, delay in executing construction or manufacturing projects, credit risk and adverse impacts due to currency fluctuations. To date, we have not identified any material adverse financial impact to our business from these sanctions. Future trade regulations or sanctions, however, could result in adverse impacts on our operating results and financial condition.

We have received U.S. federal grand jury subpoenas and subsequent inquiries from U.S. governmental agencies requesting records related to our compliance with U.S. export trade laws and regulations. We have cooperated fully with agents from the Department of Justice, the Bureau of Industry and Security, the Office of Foreign Assets Control, and U.S. Immigration and Customs Enforcement in responding to the inquiries. We have also cooperated with an informal inquiry from the Securities and Exchange Commission in connection with the inquiries previously made by the aforementioned federal agencies. We have conducted our own internal review of this matter. At the conclusion of our internal review in the fourth quarter of 2009, we identified possible areas of concern and discussed these areas of concern with the relevant agencies. We are currently negotiating a potential resolution with the agencies involved related to these matters. We currently anticipate that any administrative fine or penalty agreed to as part of a resolution would be within established accruals, and would not have a material effect on our financial position or results of operations. To the extent a resolution is not negotiated as anticipated, we cannot predict the timing or effect that any resulting government actions may have on our financial position or results of operations.

**Item 4. Mine Safety Disclosures**

Information regarding mine safety and other regulatory actions at our mines is included in Exhibit 95 to this Form 10-Q.

**Item 6. Exhibits**

Reference is hereby made to the Exhibit Index commencing on page 41.



**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: October 30, 2015

*By: /s/ Scott K. Duff*

Scott K. Duff

Senior Vice President, Corporate Controller & Chief  
Accounting Officer

(Duly Authorized Officer, Principal Accounting Officer)

## INDEX TO EXHIBITS

(a) Exhibits

- 3.1 Fifth Amended and Restated Certificate of Incorporation of National Oilwell Varco, Inc. (Exhibit 3.1) (1)
- 3.2 Amended and Restated By-laws of National Oilwell Varco, Inc. (Exhibit 3.1) (2)
- 10.1 Credit Agreement, dated as of September 28, 2012, among National Oilwell Varco, Inc., the financial institutions signatory thereto, including Wells Fargo Bank, N.A., in their capacities as Administrative Agent, Co-Lead Arranger and Joint Book Runner. (Exhibit 10.1) (3)
- 10.2 Amendment No. 2 to the Credit Agreement, dated as of September 28, 2012, among National Oilwell Varco, Inc., the financial institutions signatory thereto, including Wells Fargo Bank, N.A., as Administrative Agent, the other agents named therein, and the lenders parties thereto. (Exhibit 10.1) (4)
- 10.3 National Oilwell Varco Long-Term Incentive Plan, as amended and restated. (5)\*
- 10.4 Form of Employee Stock Option Agreement. (Exhibit 10.1) (6)
- 10.5 Form of Non-Employee Director Stock Option Agreement. (Exhibit 10.2) (6)
- 10.6 Form of Performance-Based Restricted Stock. (18 Month) Agreement (Exhibit 10.1) (7)
- 10.7 Form of Performance-Based Restricted Stock. (36 Month) Agreement (Exhibit 10.2) (7)
- 10.8 Form of Performance Award Agreement (Exhibit 10.1) (8)
- 10.9 Form of Executive Employment Agreement. (Exhibit 10.1) (9)
- 10.10 Form of Executive Severance Agreement. (Exhibit 10.2) (9)
- 31.1 Certification pursuant to Rule 13a-14a and Rule 15d-14(a) of the Securities and Exchange Act, as amended.
- 31.2 Certification pursuant to Rule 13a-14a and Rule 15d-14(a) of the Securities and Exchange Act, as amended.
- 32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 95 Mine Safety Information pursuant to section 1503 of the Dodd-Frank Act.
- 101 The following materials from our Quarterly Report on Form 10-Q for the period ended September 30, 2015 formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to the Consolidated Financial Statements, tagged as block text. (10)

\* Compensatory plan or arrangement for management or others.

- (1) Filed as an Exhibit to our Quarterly Report on Form 10-Q filed on August 5, 2011.
- (2) Filed as an Exhibit to our Current Report on Form 8-K filed on August 17, 2011.
- (3) Filed as an Exhibit to our Current Report on Form 8-K filed on October 1, 2012
- (4) Filed as an Exhibit to our Current Report on Form 8-K filed on May 13, 2015.

- (5) Filed as Appendix I to our Proxy Statement filed on April 10, 2013.
- (6) Filed as an Exhibit to our Current Report on Form 8-K filed on February 23, 2006.
- (7) Filed as an Exhibit to our Current Report on Form 8-K filed on March 27, 2007.
- (8) Filed as an Exhibit to our Current Report on Form 8-K filed on March 27, 2013.
- (9) Filed as an Exhibit to our Current Report on Form 8-K filed on November 24, 2014.
- (10) As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

We hereby undertake, pursuant to Regulation S-K, Item 601(b), paragraph (4) (iii), to furnish to the U.S. Securities and Exchange Commission, upon request, all constituent instruments defining the rights of holders of our long-term debt not filed herewith.