NATIONAL OILWELL VARCO INC
Form 10-K/A
February 17, 2006

Table of Contents

FORM 10-K/A

Amendment No. 2

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark one)

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE YEAR ENDED DECEMBER 31, 2004
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 1-12317

NATIONAL-OILWELL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**76-0475815**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*

10000 Richmond Avenue
Houston, Texas
77042-4200

(Address of principal executive offices)
(713) 346-7500

(Registrant s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value $.01	**New York Stock Exchange**
(Title of Class)	*(Exchange on which registered)*

Securities registered pursuant to Section 12(g) of the Act: **None**

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 þ NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes þ No o

The aggregate market value of voting and non-voting common stock held by non-affiliates of the registrant as of June 30, 2004 was $2.7 billion. As of March 1, 2005, there were 86,187,403 shares of the Company s common stock ($0.01 par value) outstanding.

Documents Incorporated by Reference
None.

TABLE OF CONTENTS

Table of Contents

Amendment No. 2 Overview

This Amendment No. 2 on Form 10-K/A is being filed to amend Parts II and IV of our previously filed Annual Report on Form 10-K for the year ended December 31, 2004, as filed on March 8, 2005 and amended on April 29, 2005 to include Part III information (the Original Form 10-K). This Amendment No. 2 is being filed to reflect the restatement of our consolidated financial statements resulting from errors in intercompany and related inventory accounts, as described in Note 1, under Restatement of Previously Issued Financial Statements, of the Consolidated Financial Statements included in this Form 10-K/A. This Amendment No. 2 also contains changes to Item 6, Item 7, and Item 9A of Part II to reflect changes resulting from this restatement. There are no other significant changes to the Original Form 10-K other than those outlined above. This Amendment No. 2 does not reflect events occurring after the filing of the Original Form 10-K, or modify or update disclosures therein in any way other than as required to reflect the amendment set forth below. Among other things, forward-looking statements made in the Original Form 10-K have not been revised to reflect events that occurred or facts that became known to us after the filing of the Original Form 10-K (other than the restatement), and such forward-looking statements should be read in their historical context. In addition, currently-dated certifications from our Chief Executive Officer and Chief Financial Officer have been included as exhibits to this Amendment No. 2.

We changed our name following the filing of the Original Form 10-K to National Oilwell Varco, Inc. We have used our former name throughout this Amendment No. 2 for consistency.

Table of Contents

Part II

Item 5. Market for Registrant s Common Equity and Related Stockholder Matters

Market Information

National Oilwell common stock is listed on the New York Stock Exchange (ticker symbol: NOI). The following table sets forth the stock price range during the past three years:

	2004		2003		2002	
Quarter	High	Low	High	Low	High	Low
First	$ 31.08	$ 21.66	$ 23.44	$ 19.36	$ 26.25	$ 16.43
Second	31.74	25.42	24.78	20.54	28.81	20.91
Third	33.55	31.24	21.80	17.86	21.29	15.19
Fourth	37.38	31.54	22.99	18.01	23.31	17.69

As of March 1, 2005, there were 478 holders of record of National Oilwell common stock. Many stockholders choose to own shares through brokerage accounts and other intermediaries rather than as holders of record so the actual number is unknown but significantly higher. National Oilwell has never paid cash dividends, and none are anticipated during 2005.

Item 6. Selected Financial Data

	Year Ended December 31,				
	2004 (Restated)	**2003 (Restated)**	**2002 (Restated)**	**2001 (Unaudited)**	**2000 (Unaudited)**
	(in millions of U.S. dollars, except per share amounts)(1)				
Operating Data:					
Revenues	$ 2,318.1	$ 2,004.9	$ 1,521.9	$ 1,747.5	$ 1,149.9
Operating income (3)	176.0	164.1	127.7	189.3	48.5
Income before taxes (3)	138.9	121.8	106.7	168.0	27.0
Net income (2)	115.2	79.7	67.1	104.1	13.1
Net income per share					
Basic (2)	1.34	0.94	0.83	1.29	0.17
Diluted (2)	1.33	0.94	0.82	1.27	0.16
Other Data:					
Depreciation and amortization	44.0	39.2	25.0	38.9	35.0
Capital expenditures	39.0	32.4	24.8	27.4	24.6
Balance Sheet Data:					
Working capital	711.0	763.0	734.8	631.3	480.3
Total assets	2,576.5	2,213.1	1,942.5	1,471.7	1,278.9
Long-term debt, less current maturities	350.0	594.0	594.6	300.0	222.5
Stockholders equity	1,270.2	1,059.2	899.3	839.4	739.1

(1)

We restated our consolidated financial statements for 2004, 2003 and 2002 as discussed in Note 1 to the consolidated financial statements. For periods prior to 2002, our internal investigation indicated that total assets and stockholder s equity were overstated by $28.1 million and we have adjusted these amounts based on information available at this time. However, we were not able to determine, with precision, the complete impact on the 2001 and 2000 consolidated financial statements without incurring unreasonable amounts of time, resources and expenses to allocate and consistently apply adjustments to these periods. Therefore, these periods have been labeled unaudited.

(2) We adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS 142), effective January 1, 2002. The effects of not amortizing goodwill and other intangible assets in periods prior to the adoption of SFAS 142 would have resulted in net income of $115.0 million and $23.1 million for the years ended December 31, 2001 and 2000, respectively; basic earnings per common share of $1.42 and $0.29 for the years ending December 31, 2001 and 2000, respectively; and diluted earnings per common share of $1.41 and $0.29 for the years ending December 31, 2001 and 2000, respectively.

(3) In connection with the IRI International Corporation merger in 2000, we recorded charges of $14.1 million related to direct merger costs, personnel reductions, and facility closures and inventory write-offs of $15.7 million due to product line rationalization.

2

Table of Contents

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations (Restated)

Restatement

We have restated our consolidated financial statements filed with this report as described in Note 1 of the consolidated financial statements filed with this Amendment No. 2.

General Overview

We design, manufacture and sell drilling systems, drilling equipment and downhole products as well as distribute maintenance, repair and operating products to the oil and gas industry. Our revenues and operating results are directly related to the level of worldwide oil and gas drilling and production activities and the profitability and cash flow of oil and gas companies and drilling contractors, which in turn are affected by current and anticipated prices of oil and gas. Oil and gas prices have been and are likely to continue to be volatile. See Risk Factors .

We conduct our operations through the following segments:

Products and Technology

Our Products and Technology segment designs and manufactures complete land drilling and workover rigs, and drilling related systems for offshore rigs. Technology has increased the desirability of one vendor assuming responsibility for the entire suite of components used in the drilling process, as mechanical and hydraulic components are replaced by or augmented with integrated computerized systems. In addition to traditional components such as drawworks, mud pumps, top drives, derricks, cranes, jacking and mooring systems, and other structural components, we provide automated pipehandling, control and electrical power systems. We have also developed new technology for drawworks and mud pumps applicable to the highly demanding offshore markets. We have made strategic acquisitions during the past several years in an effort to expand our product offering and our global manufacturing capabilities, including new operations in Norway, the United Kingdom and China. Product and Technology revenues are directly dependent on the levels of worldwide drilling activity.

Distribution Services

Our Distribution Services segment provides maintenance, repair and operating supplies and spare parts from our network of distribution service centers to drill site and production locations throughout North America and to offshore contractors worldwide. Products are purchased from numerous manufacturers and vendors, including our Products and Technology segment. We have expanded this business to locations outside North America, including Europe, the Middle East, Southeast Asia, and South America. We have made significant investments in systems, staffing and inventory in the international market and, using our information technology platforms and processes, we can provide complete procurement, inventory management, and logistics services to our customers.

Table of Contents

Results of Operations

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

	Year Ended December 31, 2004 (Restated)	2003 (Restated)	2002 (Restated)	
Revenues:				
Revenues from backlog	$ 695.1	$ 623.1	$ 390.4	
Noncapital equipment	841.9	691.5	526.8	
Products and Technology	1,537.0	1,314.6	917.2	
Distribution Services	905.1	792.0	686.2	
Eliminations	(124.0)	(101.7)	(81.5)	
Total	$ 2,318.1	$ 2,004.9	$ 1,521.9	
Operating Income:				
Products and Technology	$ 164.8	$ 170.2	$ 120.4	
Distribution Services	29.6	6.5	18.1	
Corporate	(18.4)	(12.6)	(10.8)	
Total	$ 176.0	$ 164.1	$ 127.7	
Capital equipment backlog:				
Beginning of year	$ 338.9	$ 363.6	$ 384.9	
Add: Orders, net	961.3	598.4	199.1	
Less: Revenues	695.1	623.1	390.4	
End of year	$ 605.1	$ 338.9	$ 363.6	(1)

(1) Includes $170 million Hydralift backlog @ 12/31/02

Products and Technology

Year 2004 versus 2003

Products and Technology revenues in 2004 were $222.4 million (17%) higher than the previous year. Yearly average oil and gas prices in 2004 were $41.37 and $5.95, an increase of 34% and 8% over 2003. These higher oil and gas prices have encouraged many of our customers to order new capital equipment, or refurbish their existing equipment, generating additional capital equipment revenues in 2004 of $72 million. The number of worldwide rigs actively searching for oil and gas increased approximately 10% in 2004 to a yearly average of 2,395 rigs. This metric is a key driver of our noncapital equipment revenues which were $150 million higher in 2004. Drilling spare parts, expendable pumps and related parts, downhole motors and fishing tools, and service work all showed significant increases during 2004. Despite the higher revenues, operating income declined approximately $5 million (3%). Gross margins were negatively impacted by the increase of lower margin capital equipment revenues, higher steel prices during the first half of the year and higher agent commissions. Operating expenses increased primarily due to higher employee benefit costs.

One of our primary metrics is the capital equipment backlog. New orders are added to backlog only when we receive a firm customer purchase order for major drilling rig components or a signed contract related to a construction project. New orders received in 2004 for capital equipment totaled $961 million, far exceeding the previous year s record of $598 million. The capital equipment backlog was $605 million at December 31,

Table of Contents

2004, $339 million at December 31, 2003 and $364 million at December 31, 2002. All of the current backlog will be delivered by the end of 2006.

Year 2003 versus 2002

Revenues in the Products and Technology segment in 2003 increased $397.4 million over the prior year, with virtually all of the increase attributable to our acquisitions of Hydralift and Monoflo. Major international construction projects are generally long-term contracts, thus less susceptible to changes in oil and gas prices or rig count movements. Our revenues from backlog increased $233 million, primarily resulting from the addition of the Hydralift operations. Sales and rentals of downhole motors and fishing tools increased approximately $32 million, primarily due to the resurging North American drilling rig count. Spare part and service revenues accounted for the remaining incremental revenues. Operating income in 2003 increased $49.8 million over 2002 and generated a flow-through percentage of 12.5%. We use flow-through percentage as a measure of operating leverage. The percentage, or ratio, is derived directly from the Company s financial statements. Incremental means the actual period to period changes in revenues and operating income. A flow-through percentage represents the incremental change in operating income over the incremental change in revenue. While we target a flow-through rate of 25% for this group, this was not expected in 2003 as the increased revenues came from acquisitions which in turn included large amounts of overhead and administrative costs. Operating expenses incurred to generate the margins resulting from the incremental sales volume were approximately $81 million higher than the prior year, due primarily to the addition of Hydralift and Monoflo.

The Products and Technology capital equipment backlog was $339 million at December 31, 2003, $364 million at December 31, 2002 and $385 million at December 31, 2001. Backlog at December 31, 2002 includes $170 million acquired in late December through the purchase of Hydralift ASA. Backlog from Hydralift is also contained in subsequent backlog totals but quantification is not possible due to the overlap with products from our other operations.

Distribution Services

Year 2004 versus 2003

Revenues in 2004 of $905.1 million for the Distribution Services segment established a new record, increasing $113 million (14%) over 2003. The number of drilling rigs actively searching for oil and gas is a key metric for this business. According to the Baker Hughes rig count report, the average number of rigs operating in the world in 2004 continued to climb to levels not seen since 1985. The average rig count in the United States in 2004 was up 15% over the prior year to 1,190 rigs with our U.S. revenues up $49 million (11%). While the Canadian rig count was virtually flat during 2004, our Canadian revenues were up $44 million (24%) primarily due to strong tubular sales and the inclusion of a late 2003 acquisition, Corlac Equipment Ltd., in our Canadian results for the full year. In the international market, our revenue increase of 11% linked favorably with the international rig count increase in 2004 of 8%. From a product perspective, maintenance, repair and operating supplies (MRO) products recorded the most growth, a $78 million increase over the prior year. Sales of our manufactured products increased $20 million and tubular products recorded a $15 million increase over 2003. Operating income increased $23.1 million in 2004 to $29.6 million. Excluding the non-recurring clearing account matter recorded in 2003, operating income increased $16.8 million. Margin on the incremental revenues was partially offset by higher distribution service center costs to handle the increased market activity.

Year 2003 versus 2002

Revenues for the Distribution Services segment increased $105.8 million (15%) over the prior year. North American revenues recorded the largest gains, reflecting the increase in the number of operating rigs. According to the Baker Hughes rig count report, the average number of rigs operating in 2003 in the United

5

States and Canada were 1,032, and 372 increases of 202 and 106 over the prior year. Canadian revenues were up $37 million, or 24%, while the U.S. revenues improved $51 million, or 14%. We expanded our presence in the international market as we recorded revenue gains of $18 million (12%) over the year 2002, primarily due to an alliance in Indonesia and our new operations in Mexico. Our base margin % remained flat as our customers remained sensitive to price changes, which had no significant effect on 2003 revenues. Substantially all of the 2003 revenue growth was in the maintenance, repair and operating supplies (MRO) products. Despite the revenue increase, operating income in 2003 fell $11.6 million to a disappointing $6.5 million. This reduction was primarily due to recording a $6.3 million pre-tax charge related to a clearing account problem uncovered in our purchasing system that had accumulated over a three year period. This amount relates to periods prior to 2003 and we have not restated prior periods as the impact is not considered material. A key financial metric for this low-margin business is % of operating expenses to revenue, which remained flat at 18% for 2003. In November 2003, we acquired Corlac Equipment Ltd., a Canadian pump distributor, and their 2003 revenues and operating income were not significant.

Corporate

Corporate charges represent the unallocated portion of centralized and executive management costs. Costs for 2004 totaled $18.4 million, an increase of $5.8 million from the prior year. The majority of this increase is due to expenses incurred in conjunction with our efforts to comply with the Sarbanes Oxley Act of 2002 and consulting fees incurred with various tax initiatives.

Interest Expense

Interest expense incurred in 2004 of $34.4 million is slightly below expense level incurred in the prior year. Our average borrowing cost for the year of 5.6 % was essentially the same as 2003. The $150 million 6 7/8% unsecured Senior Notes will mature on July 1, 2005. In addition, our $175 million unsecured North American revolving credit facility expires July 31, 2005. We plan to arrange financing at reasonable terms and conditions with our existing bank syndication, plus other banks as needed, or utilize surplus cash and certain discretionary credit facilities to refinance these expiring obligations. Interest expense should decline in 2005 due to this repayment.

Year 2003 interest expense of $35.5 million increased $11.4 million from the prior year. Annual interest due on the November 2002 issuance of senior notes accounted for $9.9 million of the increase. Borrowings in Norway attributable to the Hydralift operations incurred approximately $3 million in additional interest which was offset in part by lower borrowing rates on the U.S. revolving credit facility. Our average borrowing cost during 2003 of 5.6% reflected a decrease of 0.8 percentage points from the prior year due to the lower interest rates on the credit facilities.

Interest expense in 2002 totaled $24.1 million, an increase of $1.3 million from the prior year. All of this increase is a direct result of our mid-November 2002 sale of $200 million of 5.65% unsecured senior notes. Our average borrowing cost during 2002 of 6.4% remained the same as 2001.

Other Income (Expense)

The U.S. dollar continued its decline in 2004 against most of the currencies in countries where we operate, especially Canada, Norway and the United Kingdom. We recorded foreign exchange losses of $9.3 million in 2004 and $7.2 million in 2003, primarily related to cash balances and intercompany accounts held in U.S. dollars at these subsidiary locations. The remeasurement of these amounts into the local currency results in an income statement gain or loss, which is offset when the amount is translated back into U.S. currency for consolidation purposes by way of an increase or decrease to Other Comprehensive Income in the equity

section of the balance sheet. During 2004 we recorded a $2.7 million gain on the sale of certain non-strategic assets and a $10.7 million gain on the disposal of an equity investment.

Income Taxes

National Oilwell is subject to U.S. federal, state and foreign taxes and recorded a combined tax rate of 16% in 2004, 29% in 2003 and 36% in 2002. The reduction in the 2004 effective tax rate is primarily due to a non-recurring tax credit of $17 million resulting from the release of a valuation allowance related to the American Jobs Creation Act of 2004. We anticipate our effective tax rate for 2005 will approximate 32%.

The reduction in the 2003 effective tax rate was primarily due to the lower tax rate on increased foreign income and the benefit associated with export sales.

Liquidity and Capital Resources

At December 31, 2004, our working capital totaled $711 million, a decrease of $52 million from December 31, 2003. However, the general increase in market activity has increased our working capital needs. An increase of $19 million in receivables and $118 million in inventories has been offset by an increase in accounts payable of $187 million. Our capital equipment contracts have generated a net asset position of $195 million, an increase of $136 million from December 2003. We have recorded $150 million of our debt obligations to a current liability as the 6 7/8 unsecured senior notes will mature on July 1, 2005. Cash has increased $69 million during the year and our principal source of cash is from operations. Our ability to collect our customer receivables and obtain prepayments from our customers to help fund major projects are critical to our cash generation needs. Our primary cash uses include acquisitions, capital expenditures to enhance our existing operations, and repayment of debt obligations.

Total capital expenditures were $39 million during 2004, $32 million in 2003 and $24 million in 2002. The majority of these capital expenditures represent additions and enhancements to the downhole rental tool fleet and information management and inventory control systems. Capital expenditures are expected to approximate $43 million in 2005, slightly below our anticipated depreciation expense in that year, with continued emphasis on rental tools and information technology. We believe we have sufficient existing manufacturing capacity to meet currently anticipated demand through 2005 for our products and services.

At December 31, 2004, we had two committed credit facilities, a North American and a Norwegian facility, totaling $279 million. Both facilities are available for general corporate purposes and acquisitions, including letters of credit and performance bonds.

Our North American facility is a three-year unsecured $175 million revolving credit facility with availability up to $50 million for issuance of letters of credit that expires July 31, 2005. At December 31, 2004, there were no borrowings against this facility and there were $53 million in outstanding letters of credit.

Our Norwegian facility, which expires in 2006, has revolving credit facilities totaling $104 million, with $41 million available for letter of credit purposes. At December 31, 2004, there were no borrowings against this facility and there were $18 million in outstanding letters of credit.

We also have additional uncommitted credit facilities totaling $147 million that are used primarily for letters of credit, bid bonds and performance bonds. At December 31, 2004, there were no borrowings against these additional credit facilities and there were $49 million in outstanding letters of credit and performance bonds.

Table of Contents

In November 2002, we sold $200 million of 5.65% unsecured senior notes due November 15, 2012. Interest is payable on May 15 and November 15 of each year. In March 2001, we sold $150 million of 6.50% unsecured senior notes due March 15, 2011, with interest payable on March 15 and September 15 of each year. In June 1998, we sold $150 million of 6.875% unsecured senior notes due July 1, 2005, with interest payments due annually on January 1 and July 1.

The $150 million 6 7/8% unsecured senior notes will mature on July 1, 2005. In addition, our $175 million unsecured North American revolving credit facility expires July 31, 2005. We plan to arrange financing at reasonable terms and conditions with our existing bank syndication, plus other banks as needed, or utilize surplus cash and certain discretionary credit facilities to refinance these expiring obligations.

We believe cash generated from operations and amounts available under our existing credit facilities and from other sources of debt will be sufficient to fund operations, working capital needs, capital expenditure requirements and financing obligations. We also believe any significant increase in capital expenditures caused by any need to increase manufacturing capacity can be funded from operations or through debt financing.

The senior notes contain reporting covenants and the credit facilities contain financial covenants and ratios regarding maximum debt to capital and minimum interest coverage. We were in compliance with all covenants governing these facilities at December 31, 2004.

We have not entered into any transactions, arrangements, or relationships with unconsolidated entities or other persons which would materially affect liquidity, or the availability of or requirements for capital resources.

A summary of our outstanding contractual obligations and other commercial commitments at December 31, 2004 is as follows (in millions):

		Payments Due by Period			
Contractual Obligations	**Total**	**Less than 1 year**	**1-3 years**	**4-5 years**	**After 5 years**
Long Term Debt	$ 500.0	$ 150.0	$	$	$ 350.0
Operating Leases	76.4	21.3	40.9	6.5	7.7
Total contractual obligations	$ 576.4	$ 171.3	$ 40.9	$ 6.5	$ 357.7

		Amount of Commitment Expiration per Period			
Commercial Commitments	**Total**	**Less than 1 year**	**1-3 years**	**4-5 years**	**After 5 years**
Line of Credit	$ 279.1	$	$ 279.1	$	$
Standby Letters of Credit	120.5	97.5	19.2	3.8	
Total commercial commitments	$ 399.6	$ 97.5	$ 298.3	$ 3.8	$

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 expect to fund future cash acquisitions primarily with cash flow from operations and borrowings, including the unborrowed portion of the credit facility or new debt issuances, but may also issue additional equity either directly or in connection with acquisitions. There can be no assurance that acquisition funds will be available at terms acceptable to us.

Inflation has not had a significant impact on National Oilwell s operating results or financial condition in recent years.

Market Risk Disclosure

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 operations in foreign countries, including Canada, Norway and the United Kingdom, as well as operations in Latin America, China and other European 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 the local currency. These operations also have net assets and liabilities not denominated in the local currency, which exposes us to changes in foreign currency exchange rates that do impact income. We recorded foreign exchange losses in our income statement of approximately $9.3 million in 2004 and $7.2 million in the prior year, primarily related to cash balances and intercompany accounts held in U.S. dollars at these subsidiary locations. The remeasurement of these amounts into the local currency results in an income statement gain or loss, which is offset when the amount is translated back into U.S. currency for consolidation purposes by way of an increase or decrease to Other Comprehensive Income in the equity section of the balance sheet.. We do not believe that a hypothetical 10% movement in these foreign currencies would have a material impact on our earnings.

Some of our revenues in foreign countries are denominated in US dollars, and therefore, changes in foreign currency exchange rates impact our earnings to the extent that costs associated with those US dollar revenues are denominated in the local currency. 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 counterparties to these contracts are major financial institutions, which minimizes counterparty credit risk.

Interest Rate Risk

Our long term borrowings consist of $150 million in 6.875% senior notes, $150 million in 6.5% senior notes and $200 million in 5.65% senior notes. We had no borrowings under our other facilities at December 31, 2004. Our revolving credit facilities may have borrowings during the year 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 the prime interest rate, LIBOR, NIBOR or EURIBOR. Under our credit facilities, 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 6 months. Our objective in maintaining a portion of our debt in variable rate borrowings is the flexibility obtained regarding early repayment without penalties and lower overall cost as compared with fixed-rate borrowings.

Critical Accounting Policies and Estimates

The preparation of our financial statements requires us to make certain estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Our estimation process generally relates to potential bad debts, obsolete and slow moving inventory, revenue recognition on long term contracts, value of intangible assets, and deferred income tax accounting. Note 1 to the consolidated financial

statements contains the accounting policies governing each of these matters. Our estimates are based on historical experience and on our future expectations that we believe to be reasonable under the circumstances. The combination of these factors result in the amounts shown as carrying values of assets and liabilities in the financial statements and accompanying notes. Actual results could differ from our current estimates and those differences may be material.

We believe the following accounting policies are the most critical in the preparation of our consolidated financial statements:

We maintain an allowance for doubtful accounts for accounts receivables by providing for specifically identified accounts where collectibility is doubtful and a general allowance based on the aging of the receivables compared to past experience and current trends. A majority of our revenues come from drilling contractors, independent oil companies, international oil companies and government-owned or government-controlled oil companies, and we have receivables, some denominated in local currency, in many foreign countries. If, due to changes in worldwide oil and gas drilling activity or changes in economic conditions in certain foreign countries, our customers were unable to repay these receivables, additional allowances would be required.

Allowances for inventory obsolescence are determined based on our historical usage of inventory on-hand as well as our future expectations related to our substantial installed base and the development of new products. Changes in worldwide oil and gas drilling activity and the development of new technologies associated with the drilling industry could require additional allowances to reduce the value of inventory to the lower of its cost or net realizable value.

We recognize revenue on long-term construction contracts using the percentage of completion method and is an output based measure focused on engineering estimates and manufacturing progress. This method is used because we believe this is the most meaningful measurement of the extent of progress toward completion. This methodology requires us to make estimates regarding the total costs of the project, our progress against the project schedule and the estimated completion date, all of which impact the amount of revenue and gross margin we recognize in each reporting period. Changes in job performance, job conditions, and estimated profitability, including those arising from contract penalty provisions, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Profit incentives are included in revenues when their realization is reasonably assured. Provisions for anticipated losses on uncompleted contracts are recorded in full when such losses become evident.

We account for our defined benefit pension plans in accordance with Statement of Financial Accounting Standards No. 87, Employers Accounting for Pensions (FAS 87), which requires that amounts recognized in the financial statements be determined on an actuarial basis. Significant elements in determining our pension income or expense in accordance with FAS 87 are the discount rate assumption and the expected return on plan assets. The discount rate used approximates the weighted average rate of return on high-quality fixed income investments whose maturities match the expected payouts. The expected return on plan assets is based upon the geometric mean of historical returns of a number of different equities, including stocks, bonds and U.S. treasury bills. The assumed long-term rate of return on assets is applied to a calculated value of plan assets, which results in an estimated return on plan assets that is included in current year pension income or expense. The difference between this expected return and the actual return on plan assets is deferred and amortized against future pension income or expense. A substantial portion of our pension amounts relate to our defined benefit plans in the United States, Norway and the United Kingdom. Between the years 2000-2003, we assumed that the expected long-term rate of return on plan assets for these plans would be between 6.3% and 8.5%. Prior to 2001, our actual cumulative long-term rate of return on the pension assets of these plans was in excess of these amounts; however, these plans assets have recently earned substantially less than the assumed rates of return. The impact of our pension plans on our 2004 results of operations, cash flow and

Table of Contents

liquidity has been immaterial but recent actual returns of the plan assets may effect future contributions to the plans and our earnings. The amount of unrecognized losses on pension assets is $21.0 million.

Business acquisitions are accounted for using the purchase method of accounting. The cost of the acquired company is allocated to identifiable tangible and intangible assets based on estimated fair value, with the excess allocated to goodwill. On at least an annual basis, we assess whether goodwill is impaired. Our annual impairment tests are performed at the beginning of the 4th quarter of each year. If we determine that goodwill is impaired, we measure that impairment based on the amount by which the book value of goodwill exceeds its implied fair value. 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. Additional impairment assessments may be performed on an interim basis if we encounter events or changes in circumstances that would indicate that, more likely than not, the carrying amount of goodwill has been impaired. The fair value of the reporting units is determined based on internal management estimates which consider multiple valuation techniques.

In accordance with the provisions of SFAS No. 109, *Accounting for Income Taxes*, we account for income taxes using the asset and liability method. In determining income (loss) for financial statement purposes, we must make certain estimates and judgments. These estimates and judgments affect the calculation of certain tax liabilities and the determination of the recoverability of certain of the deferred tax assets, which arise from temporary differences between the tax and financial statement recognition of revenue and expense. Deferred tax assets are also reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods. In evaluating our ability to recover our deferred tax assets we consider all available positive and negative evidence including our past operating results, the existence of cumulative losses in the most recent years and our forecast of future taxable income. In estimating future taxable income, we develop assumptions including the amount of future state, federal and international pretax operating income, reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates we are using to manage the underlying businesses.

We currently have recorded significant valuation allowances that we intend to maintain until it is more likely than not the deferred tax assets will be realized. Other than valuation allowances associated with tax attributes acquired through acquisitions, our income tax expense recorded in the future will be reduced to the extent of decreases in our valuation allowances. The realization of our remaining deferred tax assets is primarily dependent on future taxable income. Any reduction in future taxable income including but not limited to any future restructuring activities may require that we record an additional valuation allowance against our deferred tax assets. An increase in the valuation allowance would result in additional income tax expense in such period and could have a significant impact on our future earnings. If a change in a valuation allowance occurs, which was established in connection with an acquisition, such adjustment may impact goodwill rather than the income tax provision. In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations in a multitude of jurisdictions across our global operations. We recognize potential liabilities and record tax reserves for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional taxes will be due. These tax liabilities are reflected net of related tax loss carryforwards. We adjust these reserves in light of changing facts and circumstances; however, due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from our current estimate of the tax liabilities. If our estimate of tax liabilities proves to be less than the ultimate assessment, an additional charge to expense would result. If payment of these amounts ultimately proves to be less than the recorded amounts, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the reserves are no longer necessary. If the tax liabilities relate to tax uncertainties existing at the date of the acquisition of a business, the adjustment of such tax liabilities will result in an adjustment to the goodwill recorded at the date of acquisition.

11

Table of Contents

Recently Issued Accounting Standards

In May 2004, the FASB issued Staff Position No. 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (FSP 106-2). FSP 106-2 provides guidance on accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) for employers that sponsor postretirement health care plans that provide prescription drug benefits. FSP 106-2 is effective for the first interim or annual period beginning after June 15, 2004. The adoption of FSP 106-2 did not have a material effect on our financial position, results of operations or cash flows.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, Inventory Costs an amendment of ARB 43, Chapter 4 (SFAS 151). SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. Paragraph 5 of Accounting Research Bulletin (ARB) 43, Chapter 4 Inventory Pricing, previously stated that under certain circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current-period charges. SFAS 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal. In addition, SFAS 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for fiscal years beginning after June 15, 2005. We do not believe the implementation of SFAS 151 will have a material impact on our financial position, results of operations or cash flows.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123-Revised 2004 (Revised SFAS 123), Share-Based Payment. This is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes APB No. 25, Accounting for Stock Issued to Employees. Currently, we do not record compensation expense for stock-based compensation. Under Revised SFAS 123, we will be required to measure the cost of employee services received in exchange for stock based on the grant-date fair value (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). The fair value will be estimated using an option-pricing model. Excess tax benefits, as defined in Revised SFAS 123, will be recognized as an addition to paid-in capital. This is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. Revised SFAS 123 permits public companies to adopt its requirements using one of two methods: 1) a *modified prospective* method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Revised SFAS 123 for all share-based payments granted after the effective date and (b) based on the requirements of Revised SFAS 123 for all awards granted to employees prior to the effective date of Revised SFAS 123 that remain unvested on the effective date, or 2) a *modified retrospective* method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under Statement 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption. We are currently in the process of evaluating the impact of Revised SFAS 123 on our financial statements, including different option-pricing models. The pro forma table in Note 1 of the Notes to Consolidated Financial Statements illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004 (FSP 109-1) and FASB Staff Position No. FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004 (FSP 109-2). FSP 109-1 clarifies the guidance in FASB Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (Statement 109) that applies to the new deduction for qualified domestic production activities under the American Jobs Creation Act of 2004 (the Act). FSP 109-1 clarifies that the deduction should be accounted for as a special deduction under Statement 109, not as a tax-rate reduction, because the deduction is contingent on performing activities identified in the Act. As a result, companies qualifying for the special deduction will not have a one-time adjustment of deferred tax assets and liabilities in the period the Act is enacted. FSP 109-2 addresses the effect of the Act s one-time deduction for qualifying repatriations of foreign earnings. FSP 109-2 allows additional time for companies to determine whether any foreign earnings will be repatriated under the Act s one-time deduction for repatriated earnings and how the Act affects whether undistributed earnings continue to qualify for Statement 109 s exception from recognizing deferred tax liabilities. FSP 109-1 and FSP 109-2 were both effective upon issuance. We have implemented FSP 109-1 and FSP 109-2 in the quarter ended December 31, 2004 and have included the required disclosures in Note 10 of the Notes to Consolidated Financial Statements.

Table of Contents

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, will, expect, anticipate, estimate, and similar words, although some forward-looking statements are expressed differently. 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 and worldwide economic activity. You should also consider carefully the statements under Risk Factors 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 7A. Quantitative and Qualitative Disclosures About Market Risk

Incorporated by reference to Item 7 above, Market Risk Disclosure.

Item 8. Financial Statement and Supplementary Data

Attached hereto and a part of this report are financial statements and supplementary data listed in Item 15.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Table of Contents

Item 9A. Controls and Procedures

Evaluation of disclosure controls and procedures

Subsequent to the initial filing of this annual report on Form 10-K, the Company discovered unreconciled differences in materials-in-transit inventory accounts between its consolidated subsidiaries. The Company s investigation of inventory and related intercompany accounts discovered unreconciled differences related to materials-in-transit and intercompany account balances from December 31, 2001 through September 30, 2005. Upon evaluation of the results of this investigation, management of the Company determined that the Company had a deficiency in controls relating to materials-in-transit and intercompany accounts, and further concluded that such deficiency represented a material weakness in internal control over financial reporting as of December 31, 2004.

For the reasons stated above, our chief executive officer and chief financial officer, based on their evaluation of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) or 15d-15(e)), have revised the previous conclusions of management of the Company stated in the initial filing of this annual report on Form 10-K and concluded that our disclosure controls and procedures were ineffective as of the end of the period covered by this report.

Management s annual report on internal control over financial reporting

A revised annual report of management of the Company on internal control over financial reporting is included in Item 15 of this annual report on Form 10-K/A.

Attestation report of the registered public accounting firm.

A revised annual report of Ernst &Young LLP on internal control over financial reporting of the Company is included in Item 15 of this annual report on Form 10-K/A.

Changes in internal control over financial reporting

During 2005 the Company implemented the following steps, among others, to remediate and strengthen its internal controls over materials-in-transit inventory and intercompany account reconciliations:

1. The Company has changed its reconciliation process to require individual subsidiaries to reconcile all intercompany balances with counterparties on a monthly and transaction-by transaction basis in a timely manner;

2. The Company appointed a worldwide intercompany controller to monitor the effectiveness of intercompany controls; and

3. The Company has corrected errors and improved processes to develop detailed support for its outstanding materials-in-transit account balances.

As a result of these improvements, management of the Company believes that its internal controls relating to the materials-in-transit and intercompany accounts are functioning effectively.

There were no other changes in the Company s internal control over financial reporting that occurred during the Company s last fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

Table of Contents

Part IV

Item 15. Exhibits, Financial Statement Schedules

a) Financial Statements and Exhibits

1. Financial Statements
The following financial statements are presented in response to Part II, Item 8:

2. Financial Statement Schedule

All schedules, other than Schedule II, are omitted because they are not applicable, not required or the information is included in the financial statements or notes thereto.

3. Exhibits

2.1 Amended and Restated Agreement and Plan of Merger, effective as of August 11, between National-Oilwell, Inc. and Varco International, Inc. (4).

3.1 Amended and Restated Certificate of Incorporation of National-Oilwell, Inc. (Exhibit 3.1) (1).

3.2 By-laws of National-Oilwell, Inc. (Exhibit 3.2) (5).

10.1 Employment Agreement dated as of January 1, 2002 between Merrill A. Miller, Jr. and National Oilwell, with a similar agreement with Steven W. Krablin (Exhibit 10.1) (2).

10.2 Employment Agreement dated as of January 1, 2002 between Dwight W. Rettig and National Oilwell, with similar agreements with Robert L. Bloom, Howard E. Davis, Kevin A. Neveu, Mark A. Reese, Jeremy D. Thigpen and Robert R. Workman (Exhibit 10.2) (2).

10.3 Employment Agreement dated as of June 28, 2000 between Gary W. Stratulate and IRI International, Inc., which has now merged into National Oilwell (Exhibit 10.3) (2).

10.4 Amended and Restated Stock Award and Long-Term Incentive Plan (Exhibit 10.1) (3)*.

10.4.1 Form of Stock Option Agreement (Exhibit 10.1) (6)

10.5 Loan Agreement dated July 30, 2002 (Exhibit 10.2) (3).

21.1 Subsidiaries of the Company**.

23.1 Consent of Ernst & Young LLP

24.1 Power of Attorney (included on signature page hereto)**.

31.1 Certification pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended

31.2 Certification pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended