

DRIL-QUIP INC
Form 10-K
February 27, 2015
Table of Contents

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

FORM 10-K

(MARK ONE)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2014

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to .

Commission file number: 001-13439

Dril-Quip, Inc.

(Exact name of registrant as specified in its charter)

| | |
|--|--|
| Delaware (State or other jurisdiction of incorporation or organization) 6401 N. Eldridge Parkway Houston, Texas (Address of principal executive offices) Registrant's telephone number, including area code: (713) 939-7711 | 74-2162088 (IRS Employer Identification No.) 77041 (Zip code) |
|--|--|

Securities registered pursuant to Section 12(b) of the Act:

| Title of Each Class | Name of Each Exchange On Which Registered |
|--|--|
| Common Stock, \$.01 par value per share | New York Stock Exchange |
| Rights to Purchase Series A Junior Participating | New York Stock Exchange |
| Preferred Stock | |

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 regulations 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 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.

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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

At June 30, 2014, the aggregate market value of the registrant's Common Stock held by non-affiliates of the registrant was approximately \$4,341,800,000 based on the closing price of such stock on such date of \$109.24.

At February 20, 2015, the number of shares outstanding of registrant's Common Stock was 38,771,150.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for its 2015 Annual Meeting of Stockholders to be filed pursuant to Regulation 14A are incorporated by reference in Part III of this Form 10-K.

Table of Contents

TABLE OF CONTENTS

| | |
|--|----|
| <u>PART I</u> | |
| Item 1. <u>Business</u> | 4 |
| Item 1A. <u>Risk Factors</u> | 15 |
| Item 1B. <u>Unresolved Staff Comments</u> | 25 |
| Item 2. <u>Properties</u> | 25 |
| Item 3. <u>Legal Proceedings</u> | 26 |
| Item 4. <u>Mine Safety Disclosure</u> | 26 |
| <u>PART II</u> | |
| Item 5. <u>Market for Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 27 |
| Item 6. <u>Selected Financial Data</u> | 28 |
| Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 29 |
| Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 40 |
| Item 8. <u>Financial Statements and Supplementary Data</u> | 42 |
| Item 9. <u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u> | 65 |
| Item 9A. <u>Controls and Procedures</u> | 65 |
| Item 9B. <u>Other Information</u> | 65 |
| <u>PART III</u> | |
| Item 10. <u>Directors, Executive Officers and Corporate Governance</u> | 66 |
| Item 11. <u>Executive Compensation</u> | 66 |
| Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | 66 |
| Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u> | 66 |
| Item 14. <u>Principal Accountant Fees and Services</u> | 66 |
| <u>PART IV</u> | |
| Item 15. <u>Exhibits and Financial Statement Schedules</u> | 66 |
| <u>Signatures</u> | 69 |

Table of Contents

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K includes certain statements that may be deemed to be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Statements contained in all parts of this document that are not historical facts are forward-looking statements that involve risks and uncertainties that are beyond the control of Dril-Quip, Inc. (the Company or Dril-Quip). You can identify the Company s forward-looking statements by the words anticipate, estimate, expect, may, project, believe and similar expressions, or by the Company s discussion of strategies or trends. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, no assurances can be given that these expectations will prove to be correct. These forward-looking statements include the following types of information and statements as they relate to the Company:

future operating results and cash flow;

scheduled, budgeted and other future capital expenditures;

working capital requirements;

the availability of expected sources of liquidity;

the introduction into the market of the Company s future products;

the market for the Company s existing and future products;

the Company s ability to develop new applications for its technologies;

the exploration, development and production activities of the Company s customers;

compliance with present and future environmental regulations and costs associated with environmentally related penalties, capital expenditures, remedial actions and proceedings;

effects of pending legal proceedings;

changes in customers future product and service requirements that may not be cost effective or within the Company s capabilities; and

future operations, financial results, business plans and cash needs.

These statements are based on assumptions and analyses in light of the Company's experience and perception of historical trends, current conditions, expected future developments and other factors the Company believes were appropriate in the circumstances when the statements were made. Forward-looking statements by their nature involve substantial risks and uncertainties that could significantly impact expected results, and actual future results could differ materially from those described in such statements. While it is not possible to identify all factors, the Company continues to face many risks and uncertainties. Among the factors that could cause actual future results to differ materially are the risks and uncertainties discussed under Item 1A. Risk Factors in this report and the following:

the volatility of oil and natural gas prices;

the cyclical nature of the oil and gas industry;

uncertainties associated with the United States and worldwide economies;

uncertainties regarding political tensions in the Middle East, Africa and elsewhere;

current and potential governmental regulatory actions in the United States and regulatory actions and political unrest in other countries;

uncertainties regarding future oil and gas exploration and production activities in the U.S. Gulf of Mexico and elsewhere, including new regulations, customs requirements and product testing requirements;

Table of Contents

operating interruptions (including explosions, fires, weather-related incidents, mechanical failure, unscheduled downtime, labor difficulties, transportation interruptions, spills and releases and other environmental risks);

project terminations, suspensions or scope adjustments to contracts reflected in the Company's backlog;

the Company's reliance on product development;

technological developments;

the Company's reliance on third-party technologies;

the Company's dependence on key employees and skilled machinists, fabricators and technical personnel;

the Company's reliance on sources of raw materials;

impact of environmental matters, including future environmental regulations;

competitive products and pricing pressures;

fluctuations in foreign currency;

the ability of the Organization of Petroleum Exporting Countries (OPEC) to set and maintain production levels and pricing;

the Company's reliance on significant customers;

creditworthiness of the Company's customers;

fixed-price contracts;

changes in general economic, market or business conditions;

access to capital markets;

negative outcome of litigation, threatened litigation or government proceedings;

terrorist threats or acts, war and civil disturbances; and

the interpretation of foreign tax laws with respect to our foreign subsidiaries.

Many of such factors are beyond the Company's ability to control or predict. Any of the factors, or a combination of these factors, could materially affect the Company's future results of operations and the ultimate accuracy of the forward-looking statements. Management cautions against putting undue reliance on forward-looking statements or projecting any future results based on such statements or present or prior earnings levels. Every forward-looking statement speaks only as of the date of the particular statement, and the Company undertakes no obligation to publicly update or revise any forward-looking statement.

PART I

Item 1. *Business* General

Dril-Quip, Inc., a Delaware corporation (the "Company" or "Dril-Quip"), designs, manufactures, sells and services highly engineered offshore drilling and production equipment that is well suited for use in deepwater, harsh environments and severe service applications. The Company's principal products consist of subsea and surface wellheads, subsea and surface production trees, subsea control systems and manifolds, mudline hanger systems, specialty connectors and associated pipe, drilling and production riser systems, liner hangers, wellhead connectors and diverters. Dril-Quip's products are used by major integrated, large independent and foreign

Table of Contents

national oil and gas companies in offshore areas throughout the world. Dril-Quip also provides technical advisory assistance on an as-requested basis during installation of its products, as well as rework and reconditioning services for customer-owned Dril-Quip products. In addition, Dril-Quip's customers may rent or purchase running tools from the Company for use in the installation and retrieval of the Company's products.

Dril-Quip has developed its broad line of subsea equipment, surface equipment and offshore rig equipment primarily through its internal product research and development efforts. The Company believes that it has achieved significant market share and brand name recognition with respect to its established products due to the technological capabilities, reliability, cost effectiveness and operational timesaving features of these products.

The Company's operations are organized into three geographic segments: Western Hemisphere (including North and South America; headquartered in Houston, Texas), Eastern Hemisphere (including Europe and Africa; headquartered in Aberdeen, Scotland) and Asia-Pacific (including the Pacific Rim, Southeast Asia, Australia, India and the Middle East; headquartered in Singapore). Each of these segments sells similar products and services and the Company has major manufacturing facilities in all three of its headquarter locations as well as in Macae, Brazil. The Company maintains additional facilities for fabrication and/or reconditioning in Australia, Norway, Denmark, Nigeria, China, Egypt, Ghana and Qatar. The Company's manufacturing operations are vertically integrated, allowing it to perform substantially all of its forging, heat treating, machining, fabrication, inspection, assembly and testing at its own facilities. The Company's major subsidiaries are Dril-Quip (Europe) Limited (DQE), located in Aberdeen with branches in Denmark, Norway and Holland; Dril-Quip Asia Pacific PTE Ltd. (DQAP), located in Singapore; Dril-Quip do Brasil LTDA (DQB), located in Macae, Brazil; and DQ Holdings Pty Ltd. (DQH), located in Perth, Australia. Other subsidiaries include Dril-Quip (Ghana) Ltd. located in Takoradi, Ghana, PT DQ Oilfield Services Indonesia located in Jakarta, Indonesia, Dril-Quip (Nigeria) Ltd. located in Port Harcourt, Nigeria, Dril-Quip Egypt for Petroleum Services S.A.E. located in Alexandria, Egypt, Dril-Quip Oilfield Services (Tianjin) Co. Ltd. located in Tianjin, China and Dril-Quip Qatar LLC, located in Doha, Qatar. For additional discussion of our geographic segments, please see Note 11 of Notes to Consolidated Financial Statements.

Dril-Quip markets its products through its offices and sales representatives located in the major international energy markets throughout the world. In 2014, the Company generated approximately 63% of its revenues from foreign sales compared to 67% in 2013 and 74% in 2012.

The Company makes available, free of charge on its website, its Annual Report on Form 10-K and quarterly reports on Form 10-Q (in both HTML and XBRL formats), current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after it electronically files such reports with, or furnishes them to, the Securities and Exchange Commission (SEC). The Company's website address is www.dril-quip.com. Documents and information on the Company's website, or on any other website, are not incorporated by reference into this Form 10-K. Any materials the Company files with the SEC may be read and copied at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information concerning the Public Reference Room may be obtained by calling 1-800-SEC-0330. In addition, the SEC maintains a website (www.sec.gov) that contains reports the Company has filed with the SEC.

The Company also makes available free of charge on its website (www.dril-quip.com/govern.html) its:

Corporate Governance Guidelines,

Code of Business Conduct and Ethical Practices,

Audit Committee Charter,

Nominating and Governance Committee Charter, and

Compensation Committee Charter.

Table of Contents

Any stockholder, who so requests, may obtain a printed copy of any of these documents from the Company. Changes in or waivers to our Code of Business Conduct and Ethical Practices involving directors and executive officers of the Company will be posted on its website.

Overview and Industry Outlook

Both the market for offshore drilling and production equipment and services and the Company's business are substantially dependent on the condition of the oil and gas industry and, in particular, the willingness of oil and gas companies to make capital expenditures on exploration, drilling and production operations offshore. The level of capital expenditures has generally been dependent upon the prevailing view of future oil and gas prices, which are influenced by numerous factors affecting the supply and demand for oil and gas, including worldwide economic activity, interest rates and the cost of capital, environmental regulation, tax policies, and the ability of OPEC and other producing nations to set and maintain production levels and prices. The price of crude oil began to drop sharply during the fourth quarter of 2014. In November 2014, OPEC met and decided to continue its 30 million barrel per day production target in an effort to retain its market share. OPEC's December 2014 and January 2015 production averaged 30.24 million barrels per day and 30.37 million barrels per day, respectively. Production at this rate could produce a market oversupply which would cause prices to continue to decline amid softening demand and global economic weakness. Capital expenditures are also dependent on the cost of exploring for and producing oil and gas, the availability, expiration date and price of offshore leases, the discovery rate of new oil and gas reserves in offshore areas and technological advances. Oil and gas prices and the level of offshore drilling and production activity have historically been characterized by significant volatility. Declines in oil and gas prices may adversely affect the willingness of some oil and gas companies to make capital expenditures on exploration, drilling and production operations offshore, which could have an adverse impact on the Company's results of operations, financial position and cash flows.

In 2012, Brent Crude oil prices ranged between \$88.69 per barrel and \$128.14 per barrel with an average price of \$111.57 per barrel and ended the year at \$110.80 per barrel. In 2013, Brent Crude oil prices ranged between \$96.84 per barrel and \$118.90 per barrel with an average price of \$108.56 per barrel and ended the year at \$109.95 per barrel. In 2014, Brent Crude oil prices ranged between \$55.27 per barrel and \$115.19 per barrel with an average price of \$98.97 per barrel and ended the year at \$55.27 per barrel. We expect this decrease to have a significant effect on major integrated, large independent and foreign national oil and gas companies' capital expenditure budgets. Many companies have already announced significant reductions in their 2015 capital budget plans.

The Company expects continued volatility in both crude oil and natural gas prices, as well as in the level of drilling and production related activities. Even during periods of high prices for oil and natural gas, companies exploring for oil and gas may cancel or curtail programs, or reduce their levels of capital expenditures for exploration and production, for a variety of reasons. A significant and prolonged decline in hydrocarbon prices would likely have a material adverse effect on the Company's results of operations. See Item 1A. Risk Factors A material or extended decline in expenditures by the oil and gas industry could significantly reduce our revenue and income.

Products and Services

Dril-Quip's revenues are generated from two sources: products and services. Product revenues are derived from the sale of offshore drilling and production equipment. Service revenues are earned when the Company provides technical advisory assistance services for installation of the Company's products, reconditioning services of its customer-owned products and rental of running tools for installation and retrieval of the Company's products. In 2014, the Company derived 83% of its revenues from the sale of its products and 17% of its revenues from services compared to 84% and 16% in 2013 and 83% and 17% in 2012, respectively.

Table of Contents*Products*

Dril-Quip designs, manufactures, fabricates, inspects, assembles, tests and markets subsea equipment, surface equipment and offshore rig equipment. The Company's products are used to explore for oil and gas from offshore drilling rigs, such as floating rigs and jack-up rigs, and for drilling and production of oil and gas wells on offshore platforms, tension leg platforms (TLPs), Spars and moored vessels such as FPSOs. TLPs are floating production platforms that are connected to the ocean floor via vertical mooring tethers. A Spar is a floating cylindrical structure approximately six or seven times longer than its diameter and is anchored in place. FPSOs are floating production, storage and offloading monohull moored vessels.

Subsea Equipment. Subsea equipment is used in the drilling and production of offshore oil and gas wells around the world. Included in the subsea equipment product line are subsea wellheads, mudline hanger systems, specialty connectors and associated pipe, production riser systems, subsea production trees, liner hangers, subsea control systems and subsea manifolds.

Subsea wellheads are pressure-containing forged and machined metal housings in which casing hangers are landed and sealed subsea to suspend casing (downhole pipe). As drilling depth increases, successively smaller diameter casing strings are installed, each suspended by an independent casing hanger. Subsea wellheads are utilized when drilling from floating drilling rigs, either semi-submersible or drillship types, and TLPs and Spars. The Company's SS-20 BigBore II-H Subsea Wellhead System is designed to accommodate additional casing strings installed through a conventional marine riser and a subsea blowout preventer.

Mudline hanger systems are used in jack-up drilling operations to support the weight of the various casing strings at the ocean floor while drilling a well. They also provide a method to disconnect the casing strings in an orderly manner at the ocean floor after the well has been drilled, and subsequently reconnect to enable production of the well by either tying it back vertically to a subsequently installed platform or by installing a subsea tree.

Large diameter weld-on *specialty connectors* (threaded or stab type) are used in offshore wells drilled from floating drilling rigs, jack-up rigs, fixed platforms, TLPs and Spars. Specialty connectors join lengths of conductor or large diameter (16-inch or greater) casing. Specialty connectors provide a more rapid connection than other methods of connecting lengths of pipe. Connectors may be sold individually or as an assembly after being welded to sections of Company or customer supplied pipe. Dril-Quip's weld-on specialty connectors are designed to prevent cross threading and provide a quick, convenient method of joining casing joints with structural integrity compatible with casing strength.

Production riser systems are generally designed and manufactured to customer specifications. Production risers provide a vertical conduit from the subsea wellhead to a TLP, Spar or FPSO.

A *subsea production tree* is an assembly composed of valves, a wellhead connector, control equipment and various other components installed on a subsea wellhead or a mudline hanger system and used to control the flow of oil and gas from a producing well. Subsea trees may be either stand alone satellite type or template mounted cluster arrangements. Both types typically produce via flowlines to a central control point located on a platform, TLP, Spar or FPSO. The use of subsea production trees has become an increasingly important method for producing wells located in hard-to-reach deepwater areas or economically marginal fields located in shallower waters. The Company is an established manufacturer of complicated dual-bore production trees, which are used in severe service applications. In addition, Dril-Quip manufactures a patented single bore (SingleBore) subsea completion system which features a hydraulic mechanism instead of a wireline-installed mechanism that allows the operator to plug the tubing hanger annulus remotely from the surface via a hydraulic control line and subsequently unplug it when the well is put on

production. This mechanism eliminates the need for an expensive multibore installation and workover riser, thereby saving both cost and installation time. Dril- Quip s guidelineless subsea production tree is used in ultra-deepwater applications. This tree features remote multiple flowline and control connections, utilizing remotely operated intervention tools. The Company s subsea production trees are generally custom designed and manufactured to customer specifications.

Table of Contents

A *liner hanger* is used to hang-off and seal casing into a previously installed casing string in the well bore, and can provide a means of tying back the liner for production to surface. Dril-Quip has developed a state-of-the-art liner hanger system and has installed its liner hangers in a number of difficult well applications, resulting in improved industry recognition and market opportunities.

A *subsea control system* provides control of subsea trees, manifolds and other ocean floor process equipment. Dril-Quip has developed a variety of subsea control systems, including fiber optic based multiplex control systems that provide real time access to tree functions and tree equipment status. The control system can be packaged for shallow water or deepwater applications. Dril-Quip also manufactures control systems used in the installation, retrieval and workover of production equipment.

A *subsea manifold* is a structure located on the ocean floor consisting of valves, chokes, flowline connections and a control module used to collect and control the flow of oil and gas from subsea wells for delivery to a terminal.

Surface Equipment. Surface equipment is principally used for flow control on offshore production platforms, TLPs and Spars. Included in the Company's surface equipment product line are platform wellheads, platform production trees and riser tensioners. Dril-Quip's development of platform wellheads and platform production trees was facilitated by adaptation of its existing subsea wellhead and tree technology to surface wellheads and trees.

Platform wellheads are pressure-containing forged and machined metal housings in which casing hangers are landed and sealed at the platform deck to suspend casings. The Company emphasizes the use of metal-to-metal sealing wellhead systems with operational time-saving features which can be used in high pressure, high temperature and corrosive drilling and production applications.

After installation of a wellhead, a *platform production tree*, consisting of gate valves, a wellhead connector, controls, tree cap and associated equipment, is installed on the wellhead to control and regulate oil or gas production. Platform production trees are similar to subsea production trees but utilize less complex equipment and more manual, rather than hydraulically activated, valves and connectors. Platform wellheads and platform production trees and associated equipment are designed and manufactured in accordance with customer specifications.

Riser tensioners are used on a floating drilling/production vessel to provide a continuous and reliable upward force on a riser, independent of the movement of the floating vessel.

Offshore Rig Equipment. Offshore rig equipment includes drilling riser systems, wellhead connectors and diverters. The *drilling riser system* consists of (i) lengths of riser pipe and associated riser connectors that secure one to another; (ii) the telescopic joint, which connects the entire drilling riser system to the diverter at the rig and provides a means to compensate for vertical motion of the rig relative to the ocean floor; and (iii) the wellhead connector, which provides a means for remote connection and disconnection of the drilling riser system to and from the blowout preventer stack. The *wellhead connector* provides remote connection/disconnection of the blowout preventer stack, production tree or production riser to/from the wellhead. *Diverters* are used to provide protection from shallow gas blowouts and to divert gases off of the rig during the drilling operation.

Wellhead connectors and drilling riser systems are also used on both TLPs and Spars, which are being installed more frequently in deepwater applications. The principal markets for offshore rig equipment are new rigs, rig upgrades, TLPs and Spars. Drilling risers, wellhead connectors and diverters are generally designed and manufactured to customer specifications.

Certain products of the Company are used in potentially hazardous drilling, completion and production applications that can cause personal injury, product liability and environmental claims. See Item 1A. Risk Factors

Table of Contents

Our business involves numerous operating hazards that may not be covered by insurance. The occurrence of an event not fully covered by insurance could have a material adverse effect on our results of operations, financial position and cash flows.

Services

Services provided by Dril-Quip include technical advisory assistance services, reconditioning of its customer-owned products, and rental of running tools for installation and retrieval of its products. These services are provided from the Company's worldwide locations and represented approximately 17% of revenues in 2014 and 16% in 2013 compared to 17% in 2012.

Technical Advisory Assistance. Dril-Quip does not install products for its customers, but provides technical advisory assistance to the customer, if requested, in the installation of its products. The customer is not obligated to utilize these services and may use its own personnel or a third party to perform these services. Technical advisory assistance services performed by the Company are negotiated and sold separately from the Company's products. These services are not a prerequisite to the sale of the Company's products as its products are fully functional on a stand alone basis. The Company's technicians provide assistance in the onsite installation of the Company's products and are available on a 24-hour call out from the Company's facilities located in Houston, Texas; Aberdeen, Scotland; Singapore; Macae, Brazil; New Orleans, Louisiana; Perth, Australia; Stavanger, Norway; Esbjerg, Denmark; Port Harcourt, Nigeria; Tianjin, China; Alexandria, Egypt; Takoradi, Ghana and Doha, Qatar.

Reconditioning. The Company provides reconditioning of its customer-owned products at its facilities in Houston, Texas; Aberdeen, Scotland; Singapore; Macae, Brazil; Perth, Australia; Stavanger, Norway; Esbjerg, Denmark; Port Harcourt, Nigeria; Tianjin, China; Alexandria, Egypt; Takoradi, Ghana; Balikpapan, Indonesia and Doha, Qatar. The Company does not typically service, repair or recondition its competitors' products.

Rental. The Company rents running and installation tools for use in installing its products. These tools are used to install and retrieve the Company's products which are purchased by customers. Rental or purchase of running tools is not a condition of the sale of the Company's products and are contracted for separately from product sales and other services offered by the Company. Running tools are available from Dril-Quip's locations in Houston, Texas; Aberdeen, Scotland; Macae, Brazil; Stavanger, Norway; Esbjerg, Denmark; Beverwijk, Holland; Singapore and Perth, Australia.

Manufacturing

Dril-Quip has major manufacturing facilities in Houston, Texas; Aberdeen, Scotland; Singapore and Macae, Brazil. The Houston facility provides forged and heat treated products to all of its major manufacturing facilities. Dril-Quip maintains its high standards of product quality through the implementation of Advanced Product Quality Planning (APQP) methodologies, as well as through the use of quality control specialists.

The Company's Houston, Aberdeen, Singapore and Macae manufacturing plants are ISO 14001, OHSAS 18001 and ISO 9001:2008 certified. The Houston, Aberdeen and Singapore plants are also licensed to applicable API product specifications. See Item 2. Properties Major Control Manufacturing Facilities. Dril-Quip maintains its high standards of product quality through the use of quality control specialists who work with product manufacturing personnel throughout the manufacturing process by inspecting and documenting equipment as it is processed through the Company's manufacturing facilities. The Company has the capability to manufacture various products from each of its product lines at its major manufacturing facilities and believes that this localized manufacturing capability is essential in order to compete with the Company's major competitors.

The Company's manufacturing processes are vertically integrated, providing capability for the majority of its forging and heat treating and essentially all of its machining, fabrication, inspection, assembly and testing to

Table of Contents

be performed in-house. The Company's primary raw material is cast steel ingots, from which it produces steel shaped forgings at its forging and heat treatment facility in Houston, Texas. The Company routinely purchases steel ingots from multiple suppliers on a purchase order basis and does not have any long-term supply contracts. The Company's Houston facility provides forgings and heat treatment for its Houston, Aberdeen, Singapore and Macae facilities. The Company's major competitors depend on outside sources for all or a substantial portion of their forging and heat treatment requirements. The Company has made significant capital investments in developing its vertically integrated manufacturing capability. Prolonged periods of low demand in the market for offshore drilling and production equipment could have a greater effect on the Company than on certain of its competitors that have not made such large capital investments in their facilities.

Dril-Quip's manufacturing facilities utilize state-of-the-art computer numerically controlled (CNC) machine tools and equipment, which contribute to the Company's product quality and timely delivery. The Company has also developed a cost effective, in-house machine tool rebuild capability which produces like new machine upgrades with customized features to enhance the economic manufacture of its specialized products. The Company purchases quality used machine tools as they become available and stores them at its facilities to be rebuilt and upgraded as the need arises. Rebuilding used machine tools allows for greater customization suitable for manufacturing Dril-Quip proprietary product lines. This strategy provides the added advantage of in-house expertise for repairs and maintenance of these machines. A significant portion of the Company's manufacturing capacity growth has been through the rebuild/upgrade of quality used machine tools, including the replacement of outdated control systems with state-of-the-art CNC controls.

Customers

The Company's principal customers are major integrated, large independent and foreign national oil and gas companies. Offshore drilling contractors and engineering and construction companies also represent a portion of the Company's customer base. The Company's customers are generally oil and gas companies that are well-known participants in offshore exploration and production.

The Company is not dependent on any one customer or group of customers. In 2014, the Company's top 15 customers represented approximately 61% of total revenues and Chevron and related companies accounted for approximately 10% of total revenues. In 2013 the Company's top 15 customers represented approximately 64% of total revenues and Petroleo Brasileiro S.A. (Petrobras) accounted for approximately 11% of the Company's total revenues. In 2012, the Company's top 15 customers represented approximately 62% of total revenues and Petrobras accounted for approximately 12% of the Company's total revenues. No other customer accounted for more than 10% of the Company's total revenues in 2014, 2013 or 2012. The number and variety of the Company's products required in a given year by any one customer depends upon the amount of that customer's capital expenditure budget devoted to offshore exploration and production and on the results of competitive bids for major projects. Consequently, a customer that accounts for a significant portion of revenues in one fiscal year may represent an immaterial portion of revenues in subsequent years. While the Company is not dependent on any one customer or group of customers, the loss of one or more of its significant customers could, at least on a short-term basis, have an adverse effect on the Company's results of operations.

Backlog

Backlog consists of firm customer orders of Dril-Quip products for which a purchase order or signed contract has been received, satisfactory credit or financing arrangements exist and delivery is scheduled. Historically, the Company's revenues for a specific period have not been directly related to its backlog as stated at a particular point in time. The Company's product backlog was approximately \$1.2 billion at both December 31, 2014 and 2013 and \$881 million at

Edgar Filing: DRIL-QUIP INC - Form 10-K

December 31, 2012. The backlog at the end of 2014 and 2013 represents an increase of approximately \$319 million, or 36%, from the end of 2012.

The Company expects to fill approximately 60% to 65% of the December 31, 2014 product backlog by December 31, 2015. The remaining backlog at December 31, 2014 consists of longer-term projects which are

Table of Contents

being designed and manufactured to customer specifications requiring longer lead times. In August 2012, the Company's Brazilian subsidiary, Dril-Quip do Brasil LTDA, was awarded a four-year contract by Petrobras, Brazil's national oil company. At exchange rates in effect at the signing date (2.04 Brazilian Reals to 1.00 U.S. Dollar), the contract was valued at \$650 million, net of Brazilian taxes, if all the equipment under the contract is ordered. The Company cannot provide assurance that Petrobras will order all of the equipment under the contract. Amounts are included in the Company's backlog as purchase orders under the contract are received. Revenues of approximately \$69 million have been recognized on this contract through December 31, 2014. As of December 31, 2014, the Company's backlog included \$96 million (at the December 31, 2014 exchange rate of 2.67 Brazilian real to 1.00 U.S. dollar) of purchase orders under this Petrobras contract. The Company has not recognized revenue of approximately \$9 million as of December 31, 2014 for certain items of equipment that were completed but not yet accepted for delivery by Petrobras. If Petrobras does not ultimately accept these items for delivery or if they refuse to accept these or similar items completed in the future, the Company's results of operations may be adversely affected. See Item 1A. Risk Factors Our backlog is subject to unexpected adjustments and cancellations and is, therefore, an uncertain indicator of our future revenues and earnings.

Marketing and Sales

Dril-Quip markets its products and services throughout the world directly through its sales personnel in two domestic and twenty international locations. In addition, in certain foreign markets the Company utilizes independent sales agents or representatives to enhance its marketing and sales efforts.

Some of the locations in which Dril-Quip has sales agents or representatives are Trinidad, Brazil, Indonesia, Malaysia, China, Saudi Arabia and United Arab Emirates. Although they do not have authority to contractually bind the Company, these representatives market the Company's products in their respective territories in return for sales commissions. The Company advertises its products and services in trade and technical publications targeted to its customer base. The Company also participates in industry conferences and trade shows to enhance industry awareness of its products.

The Company's customers generally order products on a purchase order basis. Orders, other than those considered to be long-term projects, are typically filled within nine to twelve months after receipt of a purchase order, depending on the type of product and whether it is sold out of inventory or requires some customization. Contracts for certain of the Company's larger, more complex products, such as subsea production trees, drilling risers and equipment for TLPs and Spars can take a year or more to complete.

The primary factors influencing a customer's decision to purchase the Company's products are the quality, reliability and reputation of the product, technologically superior features and price. Timely delivery of equipment is also very important to customer operations and the Company maintains an experienced sales coordination staff to help assure such delivery. For large drilling and production system orders, project management teams coordinate customer needs with the Company's engineering, manufacturing and service organizations, as well as with subcontractors and vendors.

A portion of the Company's business consists of designing, manufacturing and selling equipment, as well as offering technical advisory assistance services during installation of the equipment, for major projects pursuant to competitive bids. The number of such projects in any year may fluctuate. The Company's profitability on such projects is critically dependent on making accurate and cost effective bids and performing efficiently in accordance with bid specifications. Various factors can adversely affect the Company's performance on individual projects, with potential material adverse effects on project profitability.

Product Development and Engineering

The technological demands of the oil and gas industry continue to increase as offshore exploration and drilling expand into more hostile environments. Conditions encountered in these environments include water depths in excess of 10,000 feet, well pressures exceeding 15,000 psi (pounds per square inch), well flowing temperatures beyond 350° F (Fahrenheit), and mixed flows of oil, gas and water that may also be highly corrosive and impact material properties.

Table of Contents

Since its founding in 1981, Dril-Quip has actively engaged in continuing development efforts to generate new products and improve existing products. When developing new products, the Company typically seeks to design the most technologically advanced version for a particular application to establish its reputation and qualification in that product. Thereafter, the Company leverages its expertise in the more technologically advanced product to produce less costly and complex versions of the product for less demanding applications. The Company also focuses its activities on reducing the overall cost to the customer, which includes not only the initial capital cost but also operating, installation and maintenance costs associated with its products.

In the 1980s, the Company introduced its first product, specialty connectors, as well as mudline suspension systems, template systems and subsea wellheads. In the 1990s, the Company introduced a series of new products, including diverters, wellhead connectors, SingleBore subsea trees, improved severe service dual bore subsea trees, subsea and platform valves, platform wellheads, platform trees, subsea tree workover riser systems, drilling riser systems and TLP and Spar production riser systems. Since 2000, Dril-Quip has introduced multiple new products including liner hangers, subsea control systems, subsea manifolds and riser tensioners.

Dril-Quip's product development work is primarily conducted at its facilities in Houston, Texas and Aberdeen, Scotland. In addition to the work of its product development staff, the Company's application engineering staff provides technical services to customers in connection with the design and sales of its products. The Company's ability to develop new products and maintain technological advantages is important to its future success. See Item 1A. Risk Factors Our business could be adversely affected if we do not develop new products and secure and retain patents related to our products.

The Company believes that the success of its business depends more on the technical competence, creativity and marketing abilities of its employees than on any individual patent, trademark or copyright. Nevertheless, as part of its ongoing product development and manufacturing activities, Dril-Quip's policy has been to seek patents when appropriate on inventions concerning new products and product improvements. All patent rights for products developed by employees are assigned to the Company and almost all of the Company's products have components that are covered by patents.

In 2014, Dril-Quip completed the construction of a high-load horizontal test machine that generates over 20 million ft-lbs of bending and 13 million pounds of tension or compression load to test the strength of a complete subsea wellhead and BOP wellhead connector as a system. The Company delivered its first Offshore Technology Conference (OTC) technical presentation, outlining the results of both its analysis and rigorous testing of the system. The Company believes this project will help the Company's subsea wellhead product line remain an industry leader of subsea wellhead technology. Additionally, the Company utilized this test machine to develop and test several innovations to our specialty connector product family, and the Company is continuing development efforts in our subsea completion systems and capital equipment product lines.

Dril-Quip has numerous U.S. registered trademarks, including Dril-Quip®, Quik-Thread®, Quik-Stab®, Multi-Thread®, MS-15®, SS-15®, SS-10® and SU-90®. The Company has registered its trademarks in the countries where such registration is deemed material.

Although in the aggregate, the Company's patents and trademarks are of considerable importance to the manufacturing and marketing of many of its products, the Company does not consider any single patent or trademark or group of patents or trademarks to be material to its business as a whole, except the Dril-Quip® trademark. The Company also relies on trade secret protection for its confidential and proprietary information. The Company routinely enters into confidentiality agreements with its employees and suppliers. There can be no assurance, however, that others will not independently obtain similar information or otherwise gain access to the Company's trade secrets.

Table of Contents

Competition

Dril-Quip faces significant competition from other manufacturers and suppliers of exploration and production equipment. Several of its primary competitors are diversified multinational companies with substantially larger operating staffs and greater capital resources than those of the Company and which, in many instances, have been engaged in the manufacturing business for a much longer period of time than the Company. The Company competes principally with GE Oil and Gas (formerly Vetco Gray), and the petroleum production equipment segments of OneSubsea (a joint venture of Cameron International Corporation and Schlumberger, Ltd.), FMC Technologies, Inc. and Aker Solutions.

Because of their relative size and diversity of products, several of the Company's competitors have the ability to provide turnkey services for offshore drilling and production applications, which enables them to use their own products to the exclusion of Dril-Quip's products. See Item 1A. Risk Factors We may be unable to successfully compete with other manufacturers of drilling and production equipment. The Company also competes to a lesser extent with a number of other companies in various products. The principal competitive factors in the petroleum drilling and production equipment markets are quality, reliability and reputation of the product, price, technology, service and timely delivery.

Employees

The total number of the Company's employees as of December 31, 2014 was 2,720. Of these, 1,403 were located in the United States. Substantially all of the Company's employees are not covered by collective bargaining agreements, and the Company considers its employee relations to be good.

The Company's operations depend in part on its ability to attract quality employees. While the Company believes that its wage and salary rates are competitive and that its relationship with its labor force is good, a significant increase in the wages and salaries paid by competing employers could result in a reduction of the Company's labor force, increases in the wage and salary rates paid by the Company or both. If either of these events were to occur, in the near-term, the profits realized by the Company from work in progress would be reduced and, in the long-term, the production capacity and profitability of the Company could be diminished and the growth potential of the Company could be impaired. See Item 1A. Risk Factors Loss of our key management or other personnel could adversely impact our business.

Governmental Regulations

Many aspects of the Company's operations are affected by political developments and are subject to both domestic and foreign governmental regulations, including those relating to oilfield operations, the discharge of materials into the environment from our manufacturing or other facilities, health and worker safety aspects of our operations, or otherwise relating to human health and environmental protection. In addition, the Company depends on the demand for its services from the oil and gas industry and, therefore, is affected by changing taxes, price controls and other laws and regulations relating to the oil and gas industry in general, including those specifically directed to offshore operations. The adoption of laws and regulations curtailing exploration and development drilling for oil and gas for economic or other policy reasons could adversely affect the Company's operations by limiting demand for the Company's products. See Item 1A. Risk Factors Our operations and our customers' operations are subject to a variety of governmental laws and regulations that may increase our costs, limit the demand for our products and services or restrict our operations.

In recent years, increased concern has been raised over the protection of the environment. Legislation to regulate emissions of greenhouse gases has been introduced in the U.S. Congress, and there has been a wide-ranging policy debate, both nationally and internationally, regarding the impact of these gases and possible means for their regulation. In addition, efforts have been made and continue to be made in the international community toward the adoption of international treaties or protocols that would address global climate change issues, such as the annual United Nations Climate Change Conferences. In November 2014, the United States

Table of Contents

and China agreed to new targets for carbon emissions reductions. Also, the U.S. Environmental Protection Agency (EPA) has undertaken new efforts to collect information regarding greenhouse gas emissions and their effects. Following a finding by the EPA that certain greenhouse gases represent a danger to human health, the EPA has expanded its regulations relating to those emissions and has adopted rules imposing permitting and reporting obligations. The results of the permitting and reporting requirements could lead to further regulation of these greenhouse gases by the EPA. Moreover, specific design and operational standards apply to U.S. outer continental shelf vessels, rigs, platforms, vehicles, structures and equipment. The U.S. Bureau of Safety and Environmental Enforcement (BSEE) regulates the design and operation of well control and other equipment at offshore production sites, among other requirements. BSEE has adopted stricter requirements for subsea drilling production equipment and is proposing new requirements for blowout preventers. In addition, offshore drilling in certain areas has been opposed by environmental groups and, in certain areas, has been restricted. To the extent that new laws or other governmental actions prohibit or restrict offshore drilling or impose additional environmental protection requirements that result in increased costs to the oil and gas industry in general and the offshore drilling industry in particular, the business of the Company could be adversely affected. The Company cannot determine to what extent its future operations and earnings may be affected by new legislation, new regulations or changes in existing regulations. See Item 1A. Risk Factors Our business and our customers' businesses are subject to environmental laws and regulations that may increase our costs, limit the demand for our products and services or restrict our operations.

Our operations are also governed by laws and regulations related to workplace safety and worker health, such as the occupational Safety and Health Act and regulations promulgated thereunder.

Based on the Company's experience to date, the Company does not currently anticipate any material adverse effect on its business or consolidated financial position as a result of future compliance with existing environmental, health and safety laws. However, future events, such as changes in existing laws and regulations or their interpretation, more vigorous enforcement policies of or by regulatory agencies, or stricter or different interpretations of existing laws and regulations, may require additional expenditures by the Company, which may be material.

Executive Officers of the Registrant

Pursuant to Instruction 3 to Item 401(b) of Regulation S-K and General Instruction G(3) to Form 10-K, the following information is included in Part I of this Form 10-K:

The following table sets forth the names, ages (as of February 20, 2015) and positions of the Company's executive officers:

| Name | Age | Position |
|------------------|------------|--|
| Blake T. DeBerry | 55 | President, Chief Executive Officer and Director |
| James A. Gariepy | 57 | Senior Vice President and Chief Operating Officer |
| Jerry M. Brooks | 63 | Vice President Finance and Chief Financial Officer |
| James C. Webster | 45 | Vice President, General Counsel and Secretary |

Blake T. DeBerry has been President and Chief Executive Officer and a member of the Board of Directors of the Company, since October 2011. Mr. DeBerry was Senior Vice President Sales and Engineering from July 2011 until October 2011, and was Vice President Dril-Quip Asia-Pacific (which covers the Pacific Rim, Asia, Australia, India and the Middle East) from March 2007 to July 2011. He has been an employee of the Company since 1988 and has held a number of management and engineering positions in the Company's domestic and international offices. Mr. DeBerry holds a Bachelor of Science degree in mechanical engineering from Texas Tech University.

Table of Contents

James A. Gariepy is Senior Vice President and Chief Operating Officer, a position he has held since October 2011. Mr. Gariepy was Senior Vice President Manufacturing, Project Management and Service from July 2011 until October 2011, and was Vice President Dril-Quip Europe (which covers Europe, Africa and Northern Eurasia) from March 2007 to July 2011. He has held domestic and international management positions since joining the Company in 2004. Mr. Gariepy holds a Bachelor of Science degree in mechanical engineering from the Lawrence Technological University and an MBA from the University of St. Thomas.

Jerry M. Brooks is Vice President Finance and Chief Financial Officer. He has been Vice President since 2007 and Chief Financial Officer since 1999. From 2009 until May 2011, he also served as Secretary of the Company. From 1992 until March 1999, Mr. Brooks served as Chief Accounting Officer. From 1980 to 1991, he held various positions with Chiles Offshore Corporation, most recently as Chief Financial Officer, Secretary and Treasurer. Mr. Brooks holds a BBA in Accounting and a MBA in Finance from the University of Texas at Austin.

James C. Webster is Vice President, General Counsel and Secretary. He joined the Company in February 2011 as Vice President and General Counsel and was elected to the additional position of Secretary in May 2011. From September 2005 until September 2010, he was Vice President, General Counsel and Secretary of M-I SWACO, at the time, a joint venture between Smith International, Inc. and Schlumberger Ltd., and then was an area general counsel for Schlumberger from September 2010 to February 2011 following Schlumberger's acquisition of Smith International. From 1999 to September 2005, he was an associate with, and later a partner in, the law firm of Gardere Wynne Sewell LLP in Houston. Mr. Webster holds an economics degree from the University of Arizona and a joint Law/MBA from Loyola University.

Item 1A. Risk Factors

In this Item 1A. the terms we, our, us, and Dril-Quip used herein refer to Dril-Quip, Inc. and its subsidiaries unless otherwise indicated or as the context so requires.

A material or extended decline in expenditures by the oil and gas industry could significantly reduce our revenue and income.

Our business depends upon the condition of the oil and gas industry and, in particular, the willingness of oil and gas companies to make capital expenditures on exploration, drilling and production operations offshore. The level of capital expenditures is generally dependent on the prevailing view of future oil and gas prices, which are influenced by numerous factors affecting the supply and demand for oil and gas, including:

worldwide economic activity;

the level of exploration and production activity;

interest rates and the cost of capital;

environmental regulation;

federal, state and foreign policies regarding exploration and development of oil and gas;

the ability of OPEC to set and maintain production levels and pricing;

governmental regulations regarding future oil and gas exploration and production in the U.S. Gulf of Mexico and elsewhere;

the cost of exploring and producing oil and gas;

the cost of developing alternative energy sources;

the availability, expiration date and price of offshore leases in the United States and overseas;

the discovery rate of new oil and gas reserves in offshore areas;

Table of Contents

the success of drilling for oil and gas in unconventional resource plays such as shale formations;

technological advances; and

weather conditions.

Oil and gas prices and the level of offshore drilling and production activity have been characterized by significant volatility in recent years. Worldwide military, political and economic events have contributed to oil and natural gas price volatility and are likely to continue to do so in the future. Brent crude oil prices in 2014 ranged from \$55.27 per barrel to \$115.19 per barrel. Oil prices declined sharply in the fourth quarter of 2014 and ended the year at \$55.27 per barrel. Brent crude oil prices in 2013 ranged from \$96.84 per barrel to \$118.90 per barrel. Brent Crude oil prices in 2012 ranged from \$88.69 per barrel to \$128.14 per barrel. Brent crude oil prices in 2011 peaked at \$126.64 per barrel and ended the year at \$108.09 per barrel. We expect continued volatility in both crude oil and natural gas prices, as well as in the level of drilling and production related activities. Even during periods of high prices for oil and natural gas, companies exploring for oil and gas may cancel or curtail programs, seek to renegotiate contract terms, including the price of our products and services, or reduce their levels of capital expenditures for exploration and production for a variety of reasons. These risk are greater during periods of low or declining commodity prices. Continued significant or prolonged declines in hydrocarbon prices have had, and may continue to have, a material adverse effect on our results of operations.

We may not be able to satisfy technical requirements, testing requirements or other specifications under contracts and contract tenders.

Our products are used in deepwater, harsh environments and severe service applications. Our contracts with customers and customer requests for bids typically set forth detailed specifications or technical requirements for our products and services, which may also include extensive testing requirements. We anticipate that such testing requirements will become more common in our contracts. In addition, recent scrutiny of the offshore drilling industry has resulted in more stringent technical specifications for our products and more comprehensive testing requirements for our products to ensure compliance with such specifications. We cannot assure you that our products will be able to satisfy the specifications or that we will be able to perform the full-scale testing necessary to prove that the product specifications are satisfied in future contract bids or under existing contracts, or that the costs of modifications to our products to satisfy the specifications and testing will not adversely affect our results of operations. If our products are unable to satisfy such requirements, or we are unable to perform any required full-scale testing, our customers may cancel their contracts and/or seek new suppliers, and our business, results of operations, cash flows or financial position may be adversely affected.

We rely on technology provided by third parties and our business may be materially adversely affected if we are unable to renew our licensing arrangements with them.

We have existing contracts and may enter into new contracts with customers that require us to use technology or to purchase components from third parties, including some of our competitors. In the ordinary course of our business, we have entered into licensing agreements with some of these third parties for the use of such technology, including a license from a competitor of a technology important to our subsea wellheads. We may not be able to renew our existing licenses or to purchase these components on terms acceptable to us, or at all. If we are unable to use a technology or purchase a component, we may not be able to meet existing contractual commitments without increased costs or modifications or at all. In addition, we may need to stop selling products incorporating that technology or component or to redesign our products, either of which could result in a material adverse effect on our business and

operations.

We may be unable to successfully compete with other manufacturers of drilling and production equipment.

Several of our primary competitors are diversified multinational companies with substantially larger operating staffs and greater capital resources than ours and which have been engaged in the manufacturing

Table of Contents

business for a much longer time than us. If these competitors substantially increase the resources they devote to developing and marketing competitive products and services, we may not be able to compete effectively. Similarly, consolidation among our competitors could enhance their product and service offerings and financial resources, further intensifying competition.

The loss of a significant customer could have an adverse impact on our financial results.

Our principal customers are major integrated oil and gas companies, large independent oil and gas companies and foreign national oil and gas companies. Offshore drilling contractors and engineering and construction companies also represent a portion of our customer base. In 2014, our top 15 customers represented approximately 61% of total revenues and Chevron and other related companies accounted for approximately 10% of the Company's total revenues. In 2013, our top 15 customers represented approximately 64% of total revenues, and Petrobras accounted for approximately 11% of our total revenues. In 2012, our top 15 customers represented approximately 62% of total revenues and Petrobras accounted for approximately 12% of our total revenues. While we are not dependent on any one customer or group of customers, the loss of one or more of our significant customers could have an adverse effect on our results of operations, financial position and cash flows.

Our customers' industries are undergoing continuing consolidation that may impact our results of operations.

The oil and gas industry is rapidly consolidating and, as a result, some of our largest customers have consolidated and are using their size and purchasing power to seek economies of scale and pricing concessions. This consolidation may result in reduced capital spending by some of our customers or the acquisition of one or more of our primary customers, which may lead to decreased demand for our products and services. We cannot assure you that we will be able to maintain our level of sales to a customer that has consolidated or replace that revenue with increased business activity with other customers. As a result, the acquisition of one or more of our primary customers may have a significant negative impact on our results of operations, financial position or cash flows. We are unable to predict what effect consolidations in the industry may have on price, capital spending by our customers, our selling strategies, our competitive position, our ability to retain customers or our ability to negotiate favorable agreements with our customers.

Increases in the cost of raw materials and energy used in our manufacturing processes could negatively impact our profitability.

Any increases in commodity prices for items such as nickel, molybdenum and heavy metal scrap that are used to make the steel alloys required for our products would result in an increase in our raw material costs. Similarly, any increase in energy costs would increase our product costs. If we are not successful in raising our prices on products to compensate for any increased raw material or energy costs, our margins will be negatively impacted.

We depend on third-party suppliers for timely deliveries of raw materials, and our results of operations could be adversely affected if we are unable to obtain adequate supplies in a timely manner.

Our manufacturing operations depend upon obtaining adequate supplies of raw materials from third parties. The ability of these third parties to deliver raw materials may be affected by events beyond our control. Any interruption in the supply of raw materials needed to manufacture our products could adversely affect our business, results of operations and reputation with our customers.

Conditions in the global financial system may have impacts on our business and financial position that we currently cannot predict.

Uncertainty in the credit markets may negatively impact the ability of our customers to finance purchases of our products and services and could result in a decrease in, or cancellation of, orders included in our backlog or

Table of Contents

adversely affect the collectability of our receivables. If the availability of credit to our customers is reduced, they may reduce their drilling and production expenditures, thereby decreasing demand for our products and services, which could have a negative impact on our financial position. Additionally, unsettled conditions could have an impact on our suppliers, causing them to be unable to meet their obligations to us. Although we do not currently anticipate a need to access the credit markets in the short term, a prolonged constriction on future lending by banks or investors could result in higher interest rates on future debt obligations or could restrict our ability to obtain sufficient financing to meet our long-term operational and capital needs.

Our backlog is subject to unexpected adjustments and cancellations and is, therefore, an uncertain indicator of our future revenues and earnings.

The revenues projected in our backlog may not be realized or, if realized, may not result in profits. All of the projects currently included in our backlog are subject to change and/or termination at the option of the customer. In the case of a change or termination, the customer is generally required to pay us for work performed and other costs necessarily incurred as a result of the change or termination.

We can give no assurance that our backlog will remain at current levels. Sales of our products are affected by prices for oil and natural gas, which have fluctuated significantly and may continue to do so in the future. When drilling and production levels are depressed, a customer may no longer need the equipment or services currently under contract or may be able to obtain comparable equipment or services at lower prices. As a result, customers may exercise their termination rights or attempt to renegotiate contract terms. Continued declines in oil and natural gas prices could also reduce new customer orders, possibly causing a decline in our future backlog. If we experience significant project terminations, suspensions or scope adjustments to contracts reflected in our backlog, our financial condition, results of operations and cash flows may be adversely impacted.

Our international operations expose us to instability and changes in economic and political conditions and other risks inherent to international business, which could have a material adverse effect on our results of operations, financial position or cash flows.

We have substantial international operations, with approximately 63%, 67% and 74% of our revenues derived from foreign sales in 2014, 2013 and 2012, respectively. We operate our business and market our products and services in many of the significant oil and gas producing areas in the world and are, therefore, subject to the risks customarily attendant to international operations and investments in foreign countries. Risks associated with our international operations include:

volatility in general economic, social and political conditions;

terrorist threats or acts, war and civil disturbances;

expropriation or nationalization of assets;

renegotiation or nullification of existing contracts;

foreign taxation, including changes in laws or interpretations of existing laws;

assaults on property or personnel;

restrictive action by local governments;

foreign and domestic monetary policies;

limitations on repatriation of earnings;

travel limitations or operational problems caused by public health threats; and

changes in currency exchange rates.

Any of these risks could have an adverse effect on our ability to manufacture products abroad or the demand for our products and services in some locations. To date, we have not experienced any significant problems in

Table of Contents

foreign countries arising from local government actions or political instability, but there is no assurance that such problems will not arise in the future. Interruption of our international operations could have a material adverse effect on our overall operations.

Our international operations expose us to compliance risks.

Doing business on a worldwide basis exposes us and our subsidiaries to risks inherent in complying with the laws and regulations of a number of different nations, including various anti-bribery laws. We do business and have operations in a number of developing countries that have relatively underdeveloped legal and regulatory systems compared to more developed countries. Several of these countries are generally perceived as presenting a higher than normal risk of corruption, or as having a culture in which requests for improper payments are not discouraged. Maintaining and administering an effective anti-bribery compliance program under the U.S. Foreign Corrupt Practices Act, the United Kingdom's Bribery Act of 2010, and similar statutes of other nations, in these environments presents greater challenges than is the case in more developed countries.

In addition, our import and export activities are governed by unique customs laws and regulations in each of the countries where we operate. The laws and regulations concerning import and export activity, recordkeeping and reporting, import and export control and economic sanctions are complex and subject to frequent change.

The precautions we take to prevent and detect misconduct, fraud or non-compliance with applicable laws and regulations may not be able to prevent such occurrences, and we could face unknown risks or losses. Our failure to comply with applicable laws or regulations or acts of misconduct could subject us to fines, penalties or other sanctions, including debarment from government contracts, seizure of shipments and loss of import and export privileges, which could have a material adverse effect on our business and our results of operations, financial position and cash flows.

We are subject to taxation in many jurisdictions and there are inherent uncertainties in the final determination of our tax liabilities.

As a result of our international operations, we are subject to taxation in many jurisdictions. Therefore, the final determination of our tax liabilities involves the interpretation of the statutes and requirements of taxing authorities worldwide. Foreign income tax returns of foreign subsidiaries and related entities are routinely examined by foreign tax authorities. These tax examinations may result in assessments of additional taxes, interest or penalties. Refer to Item 3. Legal Proceedings regarding tax assessments in Brazil.

Our excess cash is invested in various financial instruments which may subject us to potential losses.

We invest excess cash in various financial instruments including interest bearing accounts, money market mutual funds and funds which invest in U.S. Treasury obligations and repurchase agreements backed by U.S. Treasury obligations. However, changes in the financial markets, including interest rates, as well as the performance of the issuers, can affect the market value of our short-term investments.

We may suffer losses as a result of foreign currency fluctuations and limitations on the ability to repatriate income or capital to the United States.

We conduct a portion of our business in currencies other than the U. S. dollar, and our operations are subject to fluctuations in foreign currency exchange rates. We cannot assure you that we will be able to protect the Company against such fluctuations in the future. Historically, we have not conducted business in countries that limit repatriation

of earnings. However, as we expand our international operations, we may begin operating in countries that have such limitations. Further, we cannot assure you that the countries in which we currently operate will not adopt policies limiting repatriation of earnings in the future.

Table of Contents

Our foreign subsidiaries also hold significant amounts of cash that may be subject to both U.S. income taxes (subject to adjustment for foreign tax credits) and withholding taxes of the applicable foreign country if we dividend that cash to its parent company located in the United States.

Our business involves numerous operating hazards that may not be covered by insurance. The occurrence of an event not fully covered by insurance could have a material adverse effect on our results of operations, financial position and cash flows.

Our products are used in potentially hazardous drilling, completion and production applications that can cause personal injury, product liability and environmental claims. In addition, certain areas where our products are used, including in and near the U.S. Gulf of Mexico, are close to high population areas and subject to hurricanes and other extreme weather conditions on a relatively frequent basis. A catastrophic occurrence at a location where our equipment and/or services are used may expose us to substantial liability for personal injury, wrongful death, product liability, environmental damage or commercial claims. Our general liability insurance program includes an aggregate coverage limit of \$200 million for claims with respect to property damage, injury or death and pollution. However, our insurance policies may not cover fines, penalties or costs and expenses related to government-mandated cleanup of pollution. In addition, our insurance does not provide coverage for all liabilities, and we cannot assure you that our insurance coverage will be adequate to cover claims that may arise or that we will be able to maintain adequate insurance at rates we consider reasonable. The occurrence of an event not fully covered by insurance could have a material adverse effect on our results of operations, financial position and cash flows.

We attempt to further limit our liability through contractual indemnification provisions with our customers. We generally seek to enter into contracts for the provision of our products and services that provide for (1) the responsibility of each party to the contract for personal injuries to, or the death of, its employees and damages to its property, (2) cross-indemnification with other contractors providing products and/or services to the other party to the contract with respect to personal injury, death and property damage and (3) the operator being responsible for claims brought by third parties for personal injury, death, property loss or damage relating to pollution or other well control events. We may not be able to successfully obtain favorable contractual provisions, and a failure to do so may increase our risks and costs, which could materially impact our results of operations. In addition, we cannot assure you that any party that is contractually obligated to indemnify us will be financially able to do so.

We may lose money on fixed-price contracts.

A portion of our business consists of the designing, manufacturing and selling of our equipment for major projects pursuant to competitive bids, and is performed on a fixed-price basis. Under these contracts, we are typically responsible for all cost overruns, other than the amount of any cost overruns resulting from requested changes in order specifications. Our actual costs and any gross profit realized on these fixed-price contracts may vary from the estimated amounts on which these contracts were originally based. This may occur for various reasons, including:

errors in estimates or bidding;

changes in availability and cost of labor and materials; and

variations in productivity from our original estimates.

These variations and the risks inherent in our projects may result in reduced profitability or losses on projects. Depending on the size of a project, variations from estimated contract performance could have a material adverse impact on our operating results.

Table of Contents

Our business could be adversely affected if we do not develop new products and secure and retain patents related to our products.

Technology is an important component of our business and growth strategy, and our success as a company depends to a significant extent on the development and implementation of new product designs and improvements. Whether we can continue to develop systems and services and related technologies to meet evolving industry requirements and, if so, at prices acceptable to our customers will be significant factors in determining our ability to compete in the industry in which we operate. Many of our competitors are large multinational companies that may have significantly greater financial resources than we have, and they may be able to devote greater resources to research and development of new systems, services and technologies than we are able to do.

Our ability to compete effectively will also depend on our ability to continue to obtain patents on our proprietary technology and products. Although we do not consider any single patent to be material to our business as a whole, the inability to protect our future innovations through patents could have a material adverse effect.

We may be required to recognize a charge against current earnings because of percentage-of-completion accounting.

Revenues and profits on long-term project contracts are recognized on a percentage-of-completion basis. We calculate the percent complete and apply the percentage to determine revenues earned and the appropriate portion of total estimated costs. Accordingly, purchase order price and cost estimates are reviewed periodically as the work progresses, and adjustments proportionate to the percentage complete are reflected in the period when such estimates are revised. To the extent that these adjustments result in a reduction or elimination of previously reported profits, we would have to recognize a charge against current earnings, which could be significant depending on the size of the project or the adjustment.

Loss of our key management or other personnel could adversely impact our business.

We depend on the services of Blake DeBerry, President and Chief Executive Officer, and James Gariepy, Senior Vice President and Chief Operating Officer. Together, Mr. DeBerry and Mr. Gariepy have over 30 years with the Company and approximately 60 years of relevant industry experience. The loss of either of these officers could have a material adverse effect on our results of operations, financial position and cash flows.

In addition, competition for skilled machinists, fabricators and technical personnel among companies that rely heavily on engineering and technology is intense, and the loss of qualified employees or an inability to attract, retain and motivate additional highly skilled employees required for the operation and expansion of our business could hinder our ability to conduct research activities successfully and develop and produce marketable products and services. A significant increase in the wages paid by competing employers could result in a reduction of our skilled labor force, increase in the wage rates paid by us or both. If either of these events were to occur, in the near-term, the profits realized by us from work in progress would be reduced and, in the long-term, our production capacity and profitability could be diminished and our growth potential could be impaired.

Acquisitions, dispositions and investments may not result in anticipated benefits and may present risks not originally contemplated, which could have a material adverse effect on our financial condition, results of operations and cash flows.

From time to time, we evaluate purchases and sales of assets, businesses or other investments. These transactions may not result in the anticipated realization of savings, creation of efficiencies, offering of new products or services,

generation of cash or income or reduction of risk. In addition, acquisitions may be financed

Table of Contents

by borrowings, requiring us to incur debt, or by the issuance of our common stock. These transactions involve numerous risks, and we cannot ensure that:

any acquisition would be successfully integrated into our operations and internal controls;

the due diligence conducted prior to an acquisition would uncover situations that could result in financial or legal exposure;

the use of cash for acquisitions would not adversely affect our cash available for capital expenditures and other uses;

any disposition, investment, acquisition or integration would not divert management resources from the operation of our business; or

any disposition, investment, acquisition or integration would not have a material adverse effect on our financial condition, results of operations or cash flows.

Our operations and our customers' operations are subject to a variety of governmental laws and regulations that may increase our costs, limit the demand for our products and services or restrict our operations.

Our business and our customers' businesses may be significantly affected by:

federal, state, local and foreign laws and other regulations relating to the oilfield operations, worker safety and the protection of the environment;

changes in these laws and regulations; and

the level of enforcement of these laws and regulations.

In addition, we depend on the demand for our products and services from the oil and gas industry. This demand is affected by changing taxes, price controls and other laws and regulations relating to the oil and gas industry in general, including those specifically directed to offshore operations. For example, the adoption of laws and regulations curtailing exploration and development drilling for oil and gas for economic or other policy reasons could adversely affect our operations by limiting demand for our products. We cannot determine the extent to which our future operations and earnings may be affected by new legislation, new regulations or changes in existing regulations and enforcement thereof.

Various new regulations intended to improve offshore safety systems and environmental protection have been issued since 2010 that have increased the complexity of the drilling permit process and may limit the opportunity for some operators to continue deepwater drilling in the U.S. Gulf of Mexico, which could adversely affect the Company's

financial operations. Third party challenges to industry operations in the U.S. Gulf of Mexico may also serve to further delay or restrict activities. If the new regulations, policies, operating procedures and possibility of increased legal liability are viewed by our current or future customers as a significant impairment to expected profitability on projects, they could discontinue or curtail their offshore operations, thereby adversely affecting our financial operations by decreasing demand for our products.

Because of our foreign operations and sales, we are also subject to changes in foreign laws and regulations that may encourage or require hiring of local contractors or require foreign contractors to employ citizens of, or purchase supplies from, a particular jurisdiction. If we fail to comply with any applicable law or regulation, our business, results of operations, financial position and cash flows may be adversely affected.

Table of Contents**Our businesses and our customers' businesses are subject to environmental laws and regulations that may increase our costs, limit the demand for our products and services or restrict our operations.**

Our operations and the operations of our customers are also subject to federal, state, local and foreign laws and regulations relating to the protection of human health and the environment. These environmental laws and regulations affect the products and services we design, market and sell, as well as the facilities where we manufacture our products. For example, our operations are subject to numerous and complex laws and regulations that, among other things, may regulate the management and disposal of hazardous and non-hazardous wastes; require acquisition of environmental permits related to our operations; restrict the types, quantities and concentrations of various materials that can be released into the environment; limit or prohibit operation activities in certain ecologically sensitive and other protected areas; regulate specific health and safety criteria addressing worker protection; require compliance with operational and equipment standards; impose testing, reporting and record-keeping requirements; and require remedial measures to mitigate pollution from former and ongoing operations. We are required to invest financial and managerial resources to comply with such environmental, health and safety laws and regulations and anticipate that we will continue to be required to do so in the future. In addition, environmental laws and regulations could limit our customers' exploration and production activities. These laws and regulations change frequently, which makes it impossible for us to predict their cost or impact on our future operations. For example, legislation to regulate emissions of greenhouse gases has been introduced in the U.S. Congress, and there has been a wide-ranging policy debate, both nationally and internationally, regarding the impact of these gases and possible means for their regulation. In addition, efforts have been made and continue to be made in the international community toward the adoption of international treaties or protocols that would address global climate change issues, such as the annual United Nations Climate Change Conferences. Also, the EPA has undertaken new efforts to collect information regarding greenhouse gas emissions and their effects. Following a finding by the EPA that certain greenhouse gases represent a danger to human health, the EPA has expanded its regulations relating to those emissions and has adopted rules imposing permitting and reporting obligations. The results of the permitting and reporting requirements could lead to further regulation of these greenhouse gases by the EPA. To date, there has been no significant legislative progress in cap and trade proposals or greenhouse gas emission reductions. The adoption of legislation or regulatory programs to reduce greenhouse gas emissions could also increase the cost of consuming, and thereby reduce demand for, the hydrocarbons that our customers produce. Consequently, such legislation or regulatory programs could have an adverse effect on our financial condition and results of operations. It is too early to determine whether, or in what form, further regulatory action regarding greenhouse gas emissions will be adopted or what specific impact a new regulatory action might have on us or our customers. Generally, the anticipated regulatory actions do not appear to affect us in any material respect that is different, or to any materially greater or lesser extent, than other companies that are our competitors. However, our business and prospects could be adversely affected to the extent laws are enacted or modified or other governmental action is taken that prohibits or restricts our customers' exploration and production activities or imposes environmental protection requirements that result in increased costs to us or our customers.

Environmental laws may provide for strict liability for damages to natural resources or threats to public health and safety, rendering a party liable for environmental damage without regard to negligence or fault on the part of such party. Sanctions for noncompliance may include revocation of permits, corrective action orders, administrative or civil penalties, and criminal prosecution. Some environmental laws and regulations provide for joint and several strict liability for remediation of spills and releases of hazardous substances. In addition, we may be subject to claims alleging personal injury or property damage as a result of alleged exposure to hazardous substances, as well as damage to natural resources. These laws and regulations also may expose us to liability for the conduct of or conditions caused by others, or for our acts that were in compliance with all applicable laws and regulations at the time such acts were performed. Any of these laws and regulations could result in claims, fines or expenditures that could be material to results of operations, financial position and cash flows.

Table of Contents

Our business could be adversely affected by a failure or breach of our information technology systems.

Our business operations depend on our information technology (IT) systems. Despite our security and back-up measures, our IT systems are vulnerable to computer viruses, natural disasters and other disruptions or failures. The failure of our IT systems to perform as anticipated for any reason or any significant breach of security could disrupt our business and result in numerous adverse consequences, including reduced effectiveness and efficiency of our operations and those of our customers, inappropriate disclosure of confidential information, increased overhead costs, loss of intellectual property and damage to our reputation, which could have a material adverse effect on our business and results of operations. In addition, we may be required to incur significant costs to prevent or respond to damage caused by these disruptions or security breaches in the future.

The market price of our common stock may be volatile.

The trading price of our common stock and the price at which we may sell common stock in the future are subject to large fluctuations in response to any of the following:

limited trading volume in our common stock;

quarterly variations in operating results;

general financial market conditions;

the prices of natural gas and oil;

announcements by us and our competitors;

our liquidity;

changes in government regulations;

our ability to raise additional funds;

our involvement in litigation; and

other events.

We do not anticipate paying dividends on our common stock in the near future.

We have not paid any dividends in the past and do not intend to pay cash dividends on our common stock in the foreseeable future. Our Board of Directors review this policy on a regular basis in light of our earnings, financial position and market opportunities. We currently intend to retain any earnings for the future operation and development of our business.

Provisions in our corporate documents and Delaware law could delay or prevent a change in control of the Company, even if that change would be beneficial to our stockholders.

The existence of some provisions in our corporate documents and Delaware law could delay or prevent a change in control of our company, even if that change would be beneficial to our stockholders. Our certificate of incorporation and bylaws contain provisions that may make acquiring control of our company difficult, including:

provisions relating to the classification, nomination and removal of our directors;

provisions regulating the ability of our stockholders to bring matters for action at annual meetings of our stockholders;

provisions requiring the approval of the holders of at least 80% of our voting stock for a broad range of business combination transactions with related persons; and

the authorization given to our Board of Directors to issue and set the terms of preferred stock.

Table of Contents

Our stockholder rights plan could also make it more difficult for a third party to acquire, or could discourage a third party from acquiring, our company or a large block of our common stock. In addition, the Delaware General Corporation Law imposes restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties**Major Manufacturing Facilities**

| Location | Building Size (Approximate Square Feet) | Land (Approximate Acreage) | Owned or Leased |
|---------------------|--|---|------------------------|
| Houston, Texas | | | |
| Hempstead Highway | 175,000 | 12.9 | Owned |
| N. Eldridge Parkway | 1,722,000 | 218.0 | Owned |
| Aberdeen, Scotland | 222,800 | 24.1 | Owned |
| Singapore | 293,200 | 14.4 | Leased |
| Macaé, Brazil | 169,600 | 10.6 | Owned |

Dril-Quip has manufacturing facilities in Houston, Aberdeen, Singapore and Macaé. The Houston facility at Eldridge produces in-house a majority of the Company's forging and heat treatment requirements.

Sales, Service and Reconditioning Facilities

| Location(1) | Building Size (Approximate Square Feet) | Land (Approximate Acreage) | Activity |
|-----------------------------------|--|---|--|
| New Orleans, Louisiana | 2,300 | | Sales/Service |
| Beverwijk, Holland | 5,200 | 0.4 | Sales/Warehouse |
| Perth and Welshpool, Australia | 28,100 | 2.9 | Sales/Service/Reconditioning/Warehouse |
| Stavanger, Norway | 42,000 | 6.1 | Sales/Service/Reconditioning/Warehouse/Fabrication |
| Esbjerg, Denmark | 19,100 | 2.6 | Sales/Service/Reconditioning/Warehouse |
| Port Harcourt, Nigeria | 6,600 | 0.1 | Service/Reconditioning/Warehouse |
| Tianjin, China | 12,200 | | Service/Reconditioning/Warehouse |

Edgar Filing: DRIL-QUIP INC - Form 10-K

| | | | |
|--------------------------|-------|-----|----------------------------------|
| Shekou, China | 1,000 | | Sales |
| Cairo, Egypt | 2,200 | | Sales |
| Balikpapan, Indonesia | 2,000 | | Reconditioning |
| Alexandria, Egypt | 5,200 | 0.6 | Service/Reconditioning/Warehouse |
| Takoradi, Ghana | 2,500 | 0.8 | Service/Reconditioning/Warehouse |
| Doha, Qatar | 8,900 | | Service/Reconditioning/Warehouse |

(1) All facilities are leased except Stavanger, Norway, which is owned. The Company also performs sales, service and reconditioning activities at its facilities in Houston, Aberdeen, Singapore and Macae.

Table of Contents

Item 3. Legal Proceedings

Brazilian Tax Issue

From 2002 to 2007, the Company's Brazilian subsidiary imported goods through the State of Espirito Santo in Brazil and subsequently transferred them to its facility in the State of Rio de Janeiro. During that period, the Company's Brazilian subsidiary paid taxes to the State of Espirito Santo on its imports. Upon the final sale of these goods, the Company's Brazilian subsidiary collected taxes from customers and remitted them to the State of Rio de Janeiro net of the taxes paid on importation of those goods to the State of Espirito Santo in accordance with the Company's understanding of Brazilian tax laws.

In August 2007, the State of Rio de Janeiro served the Company's Brazilian subsidiary with assessments to collect a state tax on the importation of goods through the State of Espirito Santo from 2002 to 2007 claiming that these taxes were due and payable to it under applicable law. The Company settled these assessments with payments to the State of Rio de Janeiro of \$12.2 million in March 2010 and \$3.9 million in December 2010. Approximately \$7.8 million of these settlement payments were attributable to penalties, interest and amounts that had expired under the statute of limitations so that amount was recorded as an expense. The remainder of the settlement payments generated credits (recorded as a prepaid tax) that can be used to offset future state taxes on sales to customers in the State of Rio de Janeiro once certified by the tax authorities under a process that is currently ongoing. When the credits are certified, the Company will have a five-year period in which to utilize them.

In December 2010 and January 2011, the Company's Brazilian subsidiary was served with two additional assessments totaling approximately \$13.0 million from the State of Rio de Janeiro to cancel the credits associated with the tax payments to the State of Espirito Santo (Santo Credits) on the importation of goods from July 2005 to October 2007. The Santo Credits are not related to the credits described above. The Company has objected to these assessments on the grounds that they would represent double taxation on the importation of the same goods and that the Company is entitled to the credits under applicable Brazilian law. With regard to the December 2010 assessment, the Company's Brazilian subsidiary has filed an appeal with a State of Rio de Janeiro judicial court to annul the tax assessment following a ruling against the Company by the tax administration's highest council. In connection with that appeal, the Company was required to deposit with the court approximately \$3.1 million (at the December 31, 2014 exchange rate of 2.67 Brazilian real to 1.00 U.S. dollar) as the full amount of the assessment with penalties and interest. The Company intends to file a similar appeal in the judicial system if the tax administration's highest council rules against the Company with regard to the January 2011 assessment. The Company believes that these credits are valid and that success in the judicial court process is probable. Based upon this analysis, the Company has not accrued any liability in conjunction with this matter.

Since 2007, the Company's Brazilian subsidiary has paid taxes on the importation of goods directly to the State of Rio de Janeiro and the Company does not expect any similar issues to exist for periods subsequent to 2007.

For a further description of the Company's legal proceedings, see Commitments and Contingencies, Note 9 of Notes to Consolidated Financial Statements. The Company also is involved in a number of legal actions arising in the ordinary course of business. Although no assurance can be given with respect to the ultimate outcome of such legal actions, in the opinion of management, the ultimate liability with respect thereto will not have a material adverse effect on the Company's results of operations, financial position or cash flows.

Item 4. Mine Safety Disclosure

Not applicable.

Table of Contents**PART II****Item 5. Market for Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The Company's Common Stock is publicly traded on the New York Stock Exchange under the symbol DRQ. The following table sets forth the quarterly high and low sales prices of the Common Stock as reported on the New York Stock Exchange for the indicated quarters of fiscal 2014 and 2013.

| Quarter Ended | Sales Price (\$) | | | |
|---------------|------------------|----------|-----------|-----------|
| | 2014 | | 2013 | |
| | High | Low | High | Low |
| March 31 | \$ 112.86 | \$ 94.99 | \$ 88.12 | \$ 73.70 |
| June 30 | 116.53 | 99.00 | 95.44 | 76.44 |
| September 30 | 110.23 | 88.98 | 115.56 | 89.97 |
| December 31 | \$ 93.54 | \$ 69.38 | \$ 121.07 | \$ 104.52 |

There were approximately 100 stockholders of record of the Company's Common Stock as of December 31, 2014. This number includes the Company's employees and directors that hold shares, but does not include the number of security holders for whom shares are held in a nominee or street name.

The Company has not paid any dividends in the past. The Company currently intends to retain any earnings for the future operation and development of its business and does not currently anticipate paying any dividends in the foreseeable future. The Board of Directors will review this policy on a regular basis in light of the Company's earnings, financial position and market opportunities.

Information concerning securities authorized for issuance under equity compensation plans is included in Note 12 of Notes to Consolidated Financial Statements.

Repurchase of Equity Securities

In June 2012, the Company announced that its Board of Directors authorized a stock repurchase plan under which the Company was authorized to repurchase up to \$100 million of its common stock. In the fourth quarter of 2013, the Company repurchased and cancelled 85,840 shares at a total cost of \$10 million. In the first half of 2014, the Company repurchased and cancelled 869,699 shares for \$90 million. As of May 27, 2014, the Company had repurchased the maximum amount authorized under the stock repurchase plan.

On June 12, 2014, the Company announced that its Board of Directors authorized an additional stock repurchase plan in which the Company was authorized to repurchase up to \$100 million of its common stock. In the third quarter of 2014, the Company repurchased and cancelled 512,053 shares at an average price of \$98.11 and a total cost of \$50.2 million. In the fourth quarter of 2014 the Company repurchased and cancelled 639,550 shares at an average cost of \$77.85 for a total cost of \$49.8 million. As of December 24, 2014, the Company had repurchased the maximum amount authorized under the stock repurchase plan. Activity for this plan for the three months ended December 31, 2014 is detailed below:

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of a Publicly Announced Plan or Program | Maximum Dollar Value (in millions) of Shares that May Yet Be Purchased Under the Program |
|---------------------|---|-------------------------------------|---|---|
| October 1-31, 2014 | | \$ | | \$ 49.8 |
| November 1-30, 2014 | 128,050 | 87.13 | 128,050 | 38.6 |
| December 1-31, 2014 | 511,500 | 75.53 | 511,500 | |
| Total | 639,550 | \$ 77.85 | 639,550 | \$ |

Table of Contents**Item 6. Selected Financial Data**

The information set forth below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and Notes thereto included elsewhere in this report on Form 10-K.

| | Year ended December 31, | | | | |
|---|---|-------------------|-------------------|------------------|-------------------|
| | 2014 | 2013 | 2012 | 2011 | 2010 |
| | (In thousands, except per share amounts) | | | | |
| Statement of Operations Data: | | | | | |
| Revenues: | | | | | |
| Products | \$ 773,205 | \$ 731,617 | \$ 610,218 | \$ 511,650 | \$ 486,050 |
| Services | 157,752 | 140,755 | 122,813 | 89,692 | 80,201 |
| Total revenues | 930,957 | 872,372 | 733,031 | 601,342 | 566,251 |
| Cost and expenses: | | | | | |
| Cost of sales: | | | | | |
| Products | 428,125 | 436,359 | 384,513 | 303,995 | 272,619 |
| Services | 85,402 | 77,547 | 67,153 | 57,853 | 49,988 |
| Total cost of sales | 513,527 | 513,906 | 451,666 | 361,848 | 322,607 |
| Selling, general and administrative | 92,762 | 94,806 | 82,218 | 70,510 | 61,069 |
| Engineering and product development | 45,920 | 40,115 | 37,455 | 34,626 | 29,202 |
| Special items | | | | 4,719 | 14,660 |
| Operating income | 278,748 | 223,545 | 161,692 | 129,639 | 138,713 |
| Interest income | 667 | 587 | 462 | 418 | 321 |
| Interest expense | (35) | (35) | (32) | (53) | (131) |
| Income before income taxes | 279,380 | 224,097 | 162,122 | 130,004 | 138,903 |
| Income tax provision | 70,668 | 54,270 | 42,913 | 34,737 | 36,677 |
| Net income | \$ 208,712 | \$ 169,827 | \$ 119,209 | \$ 95,267 | \$ 102,226 |
| Earnings per common share: | | | | | |
| Basic | \$ 5.22 | \$ 4.18 | \$ 2.96 | \$ 2.38 | \$ 2.57 |
| Diluted | \$ 5.19 | \$ 4.16 | \$ 2.94 | \$ 2.36 | \$ 2.55 |
| Weighted average common shares outstanding: | | | | | |
| Basic | 39,964 | 40,648 | 40,332 | 40,071 | 39,828 |
| Diluted | 40,190 | 40,865 | 40,523 | 40,322 | 40,060 |
| Statement of Cash Flows Data: | | | | | |
| Net cash provided by (used in) operating activities | 149,313 | 162,229 | (8,159) | \$ 101,854 | \$ 107,160 |
| Net cash used in investing activities | (41,571) | (41,873) | (48,999) | (54,187) | (72,950) |
| Net cash provided by (used in) financing activities | (186,827) | 3,367 | 12,257 | 5,098 | 14,634 |
| Other Data: | | | | | |
| Depreciation and amortization | \$ 31,155 | \$ 29,340 | \$ 26,224 | \$ 23,013 | \$ 20,875 |
| Capital expenditures | 42,549 | 42,633 | 50,773 | 56,213 | 74,815 |

| | 2014 | 2013 | December 31, 2012 | 2011 | 2010 |
|----------------------------|----------------|------------|----------------------|------------|------------|
| | (In thousands) | | | | |
| Balance Sheet Data: | | | | | |
| Working capital | \$ 928,498 | \$ 931,563 | \$ 769,299 | \$ 648,302 | \$ 576,920 |
| Total assets | 1,449,251 | 1,396,805 | 1,249,708 | 1,094,715 | 948,551 |
| Total debt | | | | 57 | 326 |
| Total stockholders equity | 1,245,192 | 1,242,018 | 1,066,432 | 925,244 | 828,014 |

Table of Contents**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following is management's discussion and analysis of certain significant factors that have affected aspects of the Company's financial position, results of operations, comprehensive income and cash flows during the periods included in the accompanying consolidated financial statements. This discussion should be read in conjunction with the Company's consolidated financial statements and notes thereto presented elsewhere in this Report.

Overview

Dril-Quip designs, manufactures, sells and services highly engineered offshore drilling and production equipment that is well suited for use in deepwater, harsh environments and severe service applications. The Company designs and manufactures subsea equipment, surface equipment and offshore rig equipment for use by major integrated, large independent and foreign national oil and gas companies in offshore areas throughout the world. The Company's principal products consist of subsea and surface wellheads, subsea and surface production trees, subsea control systems and manifolds, mudline hanger systems, specialty connectors and associated pipe, drilling and production riser systems, liner hangers, wellhead connectors and diverters. Dril-Quip also provides technical advisory assistance services on an as-requested basis during installation of its products, as well as rework and reconditioning services for customer-owned Dril-Quip products. In addition, Dril-Quip customers may rent or purchase running tools from the Company for use in the installation and retrieval of the Company's products.

Oil and Gas Prices

Both the market for offshore drilling and production equipment and services and the Company's business are substantially dependent on the condition of the oil and gas industry and, in particular, the willingness of oil and gas companies to make capital expenditures on exploration, drilling and production operations offshore. Oil and gas prices and the level of offshore drilling and production activity have historically been characterized by significant volatility. See Item 1A. Risk Factors. A material or extended decline in expenditures by the oil and gas industry could significantly reduce our revenue and income.

According to the Energy Information Administration (EIA) of the U.S. Department of Energy, average Brent Crude oil and natural gas (Henry Hub) closing prices are listed below for periods covered by this report:

| | Year ended December 31, | | |
|----------------------------------|--------------------------------|-------------|-------------|
| | 2014 | 2013 | 2012 |
| Closing Crude Oil (\$/Bbl) | \$ 55.27 | \$ 109.95 | \$ 110.80 |
| Average Crude Oil (\$/Bbl) | 98.97 | 108.56 | 111.57 |
| Closing Natural Gas (\$/per Mcf) | 3.24 | 4.44 | 3.54 |
| Average Natural Gas (\$/per Mcf) | 4.51 | 3.85 | 2.84 |

In 2012, Brent Crude oil prices ranged between \$88.69 per barrel and \$128.14 per barrel with an average price of \$111.57 per barrel price. Crude oil ended 2012 at \$110.80 per barrel. In 2013, the Brent Crude oil price ranged between a low of \$96.84 per barrel and a high of \$118.90 per barrel with an average of \$108.56 per barrel and ended the year at \$109.95 per barrel. In 2014, Brent Crude oil prices ranged between a low of \$55.27 per barrel and a high of \$115.19 per barrel with an average price of \$98.97 per barrel. Brent Crude oil ended the year at \$55.27 per barrel.

According to the January 2015 release of the Short-Term Energy Outlook published by the EIA, Brent Crude oil prices are projected to average \$57.58 per barrel in 2015 and \$75.00 in 2016.

In its January 2015 report, the EIA expects Henry Hub natural gas prices to average \$3.55 per Mcf in 2015 and \$3.98 per Mcf in 2016. Henry Hub natural gas price was \$3.24 per Mcf at the end of December 2014.

Table of Contents

In its January 2015 Oil Market Report, the International Energy Agency projected global oil demand was 92.4 million barrels per day in 2014 rising to an estimated average of 93.3 million barrels per day in 2015.

According to the EIA, between January 1, 2015 and February 2, 2015, the price of Brent Crude oil ranged from \$45.13 per barrel to \$55.38 per barrel, closing at \$51.74 per barrel on February 2, 2015. For the same period, Henry Hub natural gas price ranged from \$2.97 per Mcf to \$3.42 per Mcf, closing at \$2.97 per Mcf on January 27, 2015.

Rig Count

Detailed below is the average contracted offshore rig count for the Company's geographic regions for the years ended December 31, 2014, 2013 and 2012. The rig count data includes floating rigs (semi-submersibles and drillships) and jack-up rigs. The Company has included only these types of rigs as they are the primary end users of the Company's products.

| | 2014 | | 2013 | | 2012 | |
|--------------------|---------------|--------------|---------------|--------------|---------------|--------------|
| | Floating Rigs | Jack-up Rigs | Floating Rigs | Jack-up Rigs | Floating Rigs | Jack-up Rigs |
| Western Hemisphere | 125 | 96 | 129 | 89 | 128 | 83 |
| Eastern Hemisphere | 100 | 96 | 94 | 89 | 88 | 83 |
| Asia-Pacific | 54 | 260 | 50 | 248 | 48 | 220 |
| Total | 279 | 452 | 273 | 426 | 264 | 386 |

Source: IHS Petrodata RigBase December 31, 2014, 2013 and 2012

The table above represents rigs under contract and includes rigs currently drilling as well as rigs committed, but not yet drilling. According to IHS-Petrodata RigBase, as of December 31, 2014, there were 66 rigs under contract (48 floating rigs and 18 jack-up rigs) in the U.S. Gulf of Mexico, 63 of which were actively drilling (46 floating rigs and 17 jack-up rigs). As of December 31, 2013, there were 76 rigs under contract in the U.S. Gulf of Mexico (43 floating rigs and 33 jack-up rigs), of which 69 were actively drilling (39 floating rigs and 30 jack-up rigs), and as of December 31, 2012, there were 69 rigs under contract in the U.S. Gulf of Mexico (38 floating rigs and 31 jack-up rigs), of which 65 were actively drilling (34 floating rigs and 31 jack-up rigs).

The global offshore count for rigs under contract dropped 2% from December 2014 to February 2015. Unlike the land rigs, the effects of the decline in oil prices is not expected to significantly affect offshore rig counts for approximately three to six months or more.

The Company believes that the number of rigs (semi-submersibles, drillships and jack-up rigs) under construction impacts its revenues because in certain cases, its customers order some of the Company's products during the construction of such rigs. As a result, an increase in rig construction activity tends to favorably impact the Company's backlog while a decrease in rig construction activity tends to negatively impact the Company's backlog. According to IHS-Petrodata, at the end of 2014, 2013 and 2012, there were 228, 233 and 186 rigs, respectively; under construction and the expected delivery dates for the rigs under construction on February 10, 2015 are as follows:

Total

| | Floating Rigs | Jack- Ups | |
|---|--------------------------|----------------------|-----|
| 2015 | 32 | 71 | 103 |
| 2016 | 22 | 53 | 75 |
| 2017 | 20 | 15 | 35 |
| 2018 | 9 | | 9 |
| After 2018 or unspecified delivery date | 6 | | 6 |
| | 89 | 139 | 228 |

Table of Contents*Regulation*

The demand for the Company's products and services is also affected by laws and regulations relating to the oil and gas industry in general, including those specifically directed to offshore operations. The adoption of new laws and regulations, or changes to existing laws or regulations that curtail exploration and development drilling for oil and gas for economic or other policy reasons could adversely affect the Company's operations by limiting demand for its products.

Business Environment

Historically, oil and gas prices and the level of offshore drilling and production activity have been characterized by significant volatility in recent years. Worldwide military, political, economic and other events have contributed to oil and natural gas price volatility and are likely to continue to do so in the future. In 2012 the Brent Crude oil prices ranged between \$88.69 per barrel and \$128.14 per barrel with an average price of \$111.57 per barrel and ended the year at \$110.80 per barrel. In 2013 Brent Crude oil prices ranged between \$96.84 per barrel and \$118.90 per barrel with an average price of \$108.56 per barrel and ended the year at \$109.95 per barrel. The average price for 2014 was \$98.97 per barrel and reached a high of \$115.19 per barrel. In the fourth quarter of 2014, Brent Crude oil prices had fallen to a low of \$55.27 per barrel. A significant and prolonged decline in hydrocarbon prices would likely have a material adverse effect on the Company's results of operations. The Company expects continued volatility in both crude oil and natural gas prices, as well as in the level of drilling and production related activities. Even during periods of high prices for oil and natural gas, companies exploring for oil and gas may cancel or curtail programs, or reduce their levels of capital expenditures for exploration and production for a variety of reasons.

The Company operates its business and markets its products and services in most of the significant oil and gas producing areas in the world and is, therefore, subject to the risks customarily attendant to international operations and investments in foreign countries. These risks include nationalization, expropriation, war, acts of terrorism and civil disturbance, restrictive action by local governments, limitation on repatriation of earnings, change in foreign tax laws and change in currency exchange rates, any of which could have an adverse effect on either the Company's ability to manufacture its products in its facilities abroad or the demand in certain regions for the Company's products or both. To date, the Company has not experienced any significant problems in foreign countries arising from local government actions or political instability, but there is no assurance that such problems will not arise in the future. Interruption of the Company's international operations could have a material adverse effect on its overall operations. See Item 1A. Risk Factors. Our international operations expose us to instability and changes in economic and political conditions and other risks inherent to international business, which could have a material adverse effect on our results of operations, financial position or cash flows.

Revenues. Dril-Quip's revenues are generated from two sources: products and services. Product revenues are derived from the sale of offshore drilling and production equipment. Service revenues are earned when the Company provides technical advisory assistance for installation of the Company's products, reconditioning services and rental of running tools for installation and retrieval of the Company's products. In 2014, the Company derived 83% of its revenues from the sale of its products and 17% of its revenues from services compared to 84% and 16% in 2013 and 83% and 17% in 2012, respectively. Service revenues generally correlate to revenues from product sales because increased product sales typically generate increased demand for technical advisory assistance services during installation and rental of running tools. The Company has substantial international operations, with approximately 63%, 67% and 74% of its revenues derived from foreign sales in 2014, 2013 and 2012, respectively. Substantially all of the Company's domestic revenue relates to operations in the U. S. Gulf of Mexico. Domestic revenue approximated 37%, 33% and 26%, respectively, of the Company's total revenues for 2014, 2013 and 2012.

Product contracts are typically negotiated and sold separately from service contracts. In addition, service contracts are not typically included in the product contracts or related sales orders and are not offered to the customer as a condition of the sale of the Company's products. The demand for products and services is

Table of Contents

generally based on world-wide economic conditions in the offshore oil and gas industry, and is not based on a specific relationship between the two types of contracts. Substantially all of the Company's sales are made on a purchase order basis. Purchase orders are subject to change and/or termination at the option of the customer. In case of a change or termination, the customer is required to pay the Company for work performed and other costs necessarily incurred as a result of the change or termination.

Generally, the Company attempts to raise its prices as its costs increase. However, the actual pricing of the Company's products and services is impacted by a number of factors, including global oil prices, competitive pricing pressure, the level of utilized capacity in the oil service sector, maintenance of market share, the introduction of new products and general market conditions.

The Company accounts for larger and more complex projects that have relatively longer manufacturing time frames on a percentage-of-completion basis. During 2014, there were 17 projects that were accounted for using the percentage-of-completion method, which represented approximately 11%, of the Company's total revenues and 13% of the Company's product revenues. During 2013 and 2012, there were 21 projects that were accounted for using the percentage-of-completion method which represented 15% and 20%, respectively of the company's total revenue and 18% and 24% of the Company's product revenues, respectively. This percentage may fluctuate in the future. Revenues accounted for in this manner are generally recognized based upon a calculation of the percentage complete, which is used to determine the revenue earned and the appropriate portion of total estimated cost of sales. Accordingly, price and cost estimates are reviewed periodically as the work progresses, and adjustments proportionate to the percent complete are reflected in the period when such estimates are revised. Losses, if any, are recorded in full in the period they become known. Amounts received from customers in excess of revenues recognized are classified as a current liability. See Item 1A. Risk Factors We may be required to recognize a charge against current earnings because of percentage-of-completion accounting.

The following table sets forth, for the periods indicated, a breakdown of the Company's U.S. Gulf of Mexico products and services revenues:

| | Year Ended December 31, | | |
|---|--------------------------------|-----------------|-----------------|
| | 2014 | 2013 | 2012 |
| | (In millions) | | |
| Revenues: | | | |
| Products | | | |
| Subsea equipment | \$ 233.8 | \$ 209.7 | \$ 118.5 |
| Surface equipment | 6.5 | 3.8 | 0.4 |
| Offshore rig equipment | 45.2 | 16.6 | 19.7 |
| Total products | 285.5 | 230.1 | 138.6 |
| Services | 56.2 | 53.6 | 50.3 |
| Total U.S. Gulf of Mexico revenues | \$ 341.7 | \$ 283.7 | \$ 188.9 |

Numerous subsea equipment orders were completed and shipped, contributing to the large increase in subsea equipment revenue for the year ended December 31, 2014 and 2013 as compared to the same period for 2012. The change in offshore rig equipment revenues for 2014 compared to the same period of 2013 resulted primarily from an increase of revenues from projects accounted for under the percentage-of-completion method for offshore rig

equipment projects. For 2014, 2013 and 2012 the Company's U.S. Gulf of Mexico service revenues as a percentage of worldwide revenue was 6.0% and 6.1% and 6.9%, respectively.

Cost of Sales. The principal elements of cost of sales are labor, raw materials and manufacturing overhead. Cost of sales as a percentage of revenues is influenced by the product mix sold in any particular period, costs from projects accounted for under the percentage-of-completion method and market conditions. The Company's costs related to its foreign operations do not significantly differ from its domestic costs.

Table of Contents

Selling, General and Administrative Expenses. Selling, general and administrative expenses include the costs associated with sales and marketing, general corporate overhead, business development expenses, compensation expense, stock-based compensation expense, legal expenses, foreign currency transaction gains and losses and other related administrative functions.

Engineering and Product Development Expenses. Engineering and product development expenses consist of new product development and testing, as well as application engineering related to customized products.

Income Tax Provision. The Company's overall effective income tax rate has historically been lower than the statutory rate primarily due to foreign income tax rate differentials, research and development credits and deductions related to domestic manufacturing activities.

Results of Operations

The following table sets forth, for the periods indicated, certain consolidated statements of income data expressed as a percentage of revenues:

| | Year Ended December 31, | | |
|-------------------------------------|--------------------------------|--------------|--------------|
| | 2014 | 2013 | 2012 |
| Revenues: | | | |
| Products | 83.1% | 83.9% | 83.2% |
| Services | 16.9 | 16.1 | 16.8 |
| Total revenues | 100.0 | 100.0 | 100.0 |
| Cost of sales: | | | |
| Products: | 46.0 | 50.0 | 52.5 |
| Services | 9.2 | 8.9 | 9.1 |
| Total cost of sales | 55.2 | 58.9 | 61.6 |
| Selling, general and administrative | 10.0 | 10.9 | 11.2 |
| Engineering and product development | 4.9 | 4.6 | 5.1 |
| Operating income | 29.9 | 25.6 | 22.1 |
| Interest income | 0.1 | 0.1 | 0.1 |
| Interest expense | | | |
| Income before income taxes | 30.0 | 25.7 | 22.2 |
| Income tax provision | 7.6 | 6.2 | 5.9 |
| Net income | 22.4% | 19.5% | 16.3% |

The following table sets forth, for the periods indicated, a breakdown of our products and service revenues:

| 2014 | 2013 | 2012 |
|-------------|-------------|-------------|
|-------------|-------------|-------------|

(In millions)

| | | | |
|------------------------|----------|----------|----------|
| Revenues: | | | |
| Products | | | |
| Subsea equipment | \$ 684.4 | \$ 646.5 | \$ 518.6 |
| Surface equipment | 35.2 | 35.8 | 38.5 |
| Offshore rig equipment | 53.6 | 49.3 | 53.1 |
| Total products | 773.2 | 731.6 | 610.2 |
| Services | 157.8 | 140.8 | 122.8 |
| Total revenues | \$ 931.0 | \$ 872.4 | \$ 733.0 |

Table of Contents*Year Ended December 31, 2014 Compared to Year Ended December 31, 2013*

Revenues. Revenues increased by \$58.6 million, or approximately 6.7%, to \$931.0 million in 2014 from \$872.4 million in 2013. Product revenues increased by approximately \$41.6 million for the year ended December 31, 2014 compared to the same period in 2013 as a result of increased revenues of \$37.9 million in subsea equipment and an increase of \$4.3 million in offshore rig equipment, partially offset by decreases of \$0.6 million in surface equipment. The increase in subsea equipment revenue was primarily due to increased revenues of \$24.1 million in subsea equipment in the U.S. Gulf of Mexico as numerous subsea equipment orders were completed and shipped. Product revenues increased in the Western Hemisphere by \$10.2 million, \$19.1 million in the Eastern Hemisphere and in Asia-Pacific by \$12.3 million. Service revenues increased by approximately \$17.0 million resulting from increased service revenues in the Western Hemisphere of \$2.2 million, \$13.1 million in the Eastern Hemisphere and \$1.7 million in Asia-Pacific. The majority of the increases in service revenues related to increased technical advisory assistance services and rental of the Company's running and installation tools.

Cost of Sales. Cost of sales decreased by \$0.4 million, or less than 1.0%, to \$513.5 million for 2014 from \$513.9 million for the same period in 2013. As a percentage of revenues, cost of sales were approximately 55.2% in 2014 and 58.9% in 2013. Cost of sales as a percentage of revenue decreased in 2014 primarily due to pricing increases and changes in the product mix.

Selling, General and Administrative Expenses. For 2014, selling, general and administrative expenses decreased by approximately \$2.0 million, or 2.1%, to \$92.8 million from \$94.8 million in 2013. The decrease in selling, general and administrative expenses was primarily due to foreign currency translation gains of \$4.5 million in 2014 as compared to losses of \$6.0 million in 2013. The gains were partially offset by an increase in stock-based compensation expense of \$11.9 million in 2014 as compared to \$8.9 million in 2013. Personnel and related expenses totaled \$86.0 million for 2014 as compared to \$79.3 million for 2013. Selling, general and administrative expenses as a percentage of revenues were 10.0% in 2014 and 10.9% in 2013.

Engineering and Product Development Expenses. For 2014, engineering and product development expenses increased by approximately \$5.8 million, or 14.5%, to \$45.9 million from \$40.1 million in 2013. The increase was primarily due to additional personnel required to meet the demands of the backlog related to long-term projects. Engineering and product development expenses as a percentage of revenues increased to 4.9% in 2014 from 4.6% in 2013.

Income tax provision. Income tax expense for 2014 was \$70.7 million on income before taxes of \$279.4 million, resulting in an effective income tax rate of approximately 25.3%. Income tax expense in 2013 was \$54.3 million on income before taxes of \$224.1 million, resulting in an effective tax rate of approximately 24.2%. The increase in the effective income tax rate reflects the \$1.2 million Research and Development tax credit from the American Taxpayer Relief Act of 2012 recognized on the 2012 U.S. income tax return, but not recorded until 2013 for financial statement purposes in accordance with GAAP. Also contributing to the increased tax rate is the difference in income tax rates between the Company's three geographic areas, which have different income tax rates.

Net Income. Net income was approximately \$208.7 million in 2014 and \$169.8 million in 2013 for the reasons set forth above.

Year ended December 31, 2013 Compared to Year Ended December 31, 2012

Revenues. Revenues increased by \$139.4 million, or approximately 19.0%, to \$872.4 million in 2013 from \$733.0 million in 2012. Product revenues increased by approximately \$121.4 million for the year ended December 31, 2013 compared to the same period in 2012 as a result of increased revenues of \$127.9 million in subsea equipment, partially

offset by decreases of \$2.7 million in surface equipment and \$3.8 million in offshore rig equipment. The increase in subsea equipment revenue was primarily due to increased revenues of \$91.2 million in subsea equipment in the U.S. Gulf of Mexico as numerous subsea equipment orders were

Table of Contents

completed and shipped. Product revenues increased in the Western Hemisphere by \$121.6 million and in Asia-Pacific by \$10.1 million, partially offset by a decrease of \$10.3 million in the Eastern Hemisphere. Service revenues increased by approximately \$18.0 million resulting from increased service revenues in the Western Hemisphere of \$3.4 million, \$9.4 million in the Eastern Hemisphere and \$5.2 million in Asia-Pacific. The majority of the increases in service revenues related to increased technical advisory assistance services and reconditioning of the Company's running and installation tools.

Cost of Sales. Cost of sales increased by \$62.2 million, or approximately 13.8%, to \$513.9 million for 2013 from \$451.7 million for the same period in 2012. As a percentage of revenues, cost of sales were approximately 58.9% in 2013 and 61.6% in 2012. Cost of sales as a percentage of revenue decreased in 2013 primarily due to changes in the product mix and decreases in unabsorbed manufacturing overhead expenses.

Selling, General and Administrative Expenses. For 2013, selling, general and administrative expenses increased by approximately \$12.6 million, or 15.3%, to \$94.8 million from \$82.2 million in 2012. The increase in selling, general and administrative expenses was primarily due to increased personnel and related expenses, foreign currency transaction losses and an increase in stock-based compensation. Personnel and related expenses were higher by \$6.1 million in 2013 as compared to 2012. The Company recognized approximately \$6.0 million in foreign currency transaction losses during 2013 compared to approximately \$5.2 million of losses during 2012. Stock-based compensation expense for 2013 totaled \$8.9 million compared to \$5.7 million in 2012. Selling, general and administrative expenses as a percentage of revenues were 10.9% in 2013 and 11.2% in 2012.

Engineering and Product Development Expenses. For 2013, engineering and product development expenses increased by approximately \$2.6 million, or 6.9%, to \$40.1 million from \$37.5 million in 2012. The increase was primarily due to additional personnel required to meet the demands of the backlog related to long-term projects. Engineering and product development expenses as a percentage of revenues decreased to 4.6% in 2013 from 5.1% in 2012.

Income tax provision. Income tax expense for 2013 was \$54.3 million on income before taxes of \$224.1 million, resulting in an effective income tax rate of approximately 24.2%. Income tax expense in 2012 was \$42.9 million on income before taxes of \$162.1 million, resulting in an effective tax rate of approximately 26.4%. The decrease in the effective income tax rate reflects the \$1.2 million Research and Development tax credit from the American Taxpayer Relief Act of 2012 recognized on the 2012 U.S. income tax return, but not recorded until 2013 for financial statement purposes in accordance with GAAP. Also contributing to the decreased tax rate is the difference in income tax rates between the Company's three geographic areas.

Net Income. Net income was approximately \$169.8 million in 2013 and \$119.2 million in 2012 for the reasons set forth above.

Liquidity and Capital Resources

Cash flows provided by (used in) operations by type of activity were as follows:

| | Year ended December 31, | | |
|----------------------|--------------------------------|-------------|-------------|
| | 2014 | 2013 | 2012 |
| | (In thousands) | | |
| Operating activities | \$ 149,313 | \$ 162,229 | \$ (8,159) |
| Investing activities | (41,571) | (41,873) | (48,999) |

Edgar Filing: DRIL-QUIP INC - Form 10-K

| | | | |
|--|-------------|------------|-------------|
| Financing activities | (186,827) | 3,367 | 12,257 |
| | (79,085) | 123,723 | (44,901) |
| Effect of exchange rate changes on cash activities | (6,566) | 3,442 | 3,516 |
| Increase (decrease) in cash and cash equivalents | \$ (85,651) | \$ 127,165 | \$ (41,385) |

Table of Contents

Statements of cash flows for entities with international operations that are local currency functional exclude the effects of the changes in foreign currency exchange rates that occur during any given year, as these are non-cash changes. As a result, changes reflected in certain accounts on the Consolidated Statements of Cash Flows may not reflect the changes in corresponding accounts on the Consolidated Balance Sheets.

The primary liquidity needs of the Company are (i) to fund capital expenditures to improve and expand facilities and manufacture additional running tools and (ii) to fund working capital. The Company's principal source of funds is cash flows from operations.

Net cash provided by operating activities decreased \$12.9 million in 2014 compared to 2013, primarily due to decreases in operating assets and liabilities of \$54.4 million, offset by higher net income of \$38.9 million and non-cash income adjustments of \$2.6 million. Net cash provided by operating activities increased \$170.4 million in 2013 compared to 2012, primarily due to higher net income of \$50.6 million and non-cash income adjustments of \$4.6 million and changes in operating assets and liabilities of \$115.2 million in 2013.

Net income increased by \$38.9 million to \$208.7 million in 2014 from \$169.8 million in 2013. Net income increased by \$50.6 million to \$169.8 million in 2013 from \$119.2 million in 2012. The reasons for the changes in net income are set forth in the Results of Operations section above.

The change in operating assets and liabilities of \$99.1 million during 2014 primarily reflected an increase in trade receivables of \$102.7 million and an increase in inventory of \$36.8 million. Trade receivables increased due to the growth of revenues in 2014 and an increase in unbilled revenues of \$15.1 million related to long-term projects. Inventory increased due to higher balances in raw materials and finished goods to accommodate the backlog requirements related to long-term projects. Prepaids and other assets increased by \$13.2 million mostly due from advances to suppliers related to long-term projects. Accounts payable and accrued expenses were higher by approximately \$54.2 million which included an increase of \$26.2 million in customer prepayments.

The change in operating assets and liabilities of \$44.7 million during 2013 primarily reflected an increase in trade receivables of \$17.3 million and an increase in inventory of \$10.6 million. Trade receivables increased due to the growth of revenues in 2013, partially offset by a decrease in unbilled receivables. Inventory increased due to higher balances in work in progress to accommodate the backlog requirements related to long-term projects. Prepaids and other assets decreased by \$6.2 million. Accounts payable and accrued expenses decreased by approximately \$20.2 million.

Capital expenditures by the Company were \$42.5 million, \$42.6 million and \$50.8 million in 2014, 2013 and 2012, respectively. Capital expenditures in 2014, 2013 and 2012 included expanding worldwide manufacturing facilities as well as increased expenditures on machinery and equipment and running tools. The capital expenditures for 2014 were primarily \$3.0 million for facilities, \$27.0 million for machinery and equipment, \$8.3 million for running tools and other expenditures of \$4.2 million. Capital expenditures in 2013 were comprised of \$7.2 million for facilities, \$23.6 million for machinery and equipment, \$7.7 million for running tools and other expenditures of \$4.1 million. In 2012, capital expenditures were primarily \$9.3 million for facilities, \$26.9 million for machinery and equipment, \$10.5 million for running tools and other expenditures of \$4.1 million.

The exercise of stock options generated cash to the Company of \$2.8 million, \$10.5 million and \$10.8 million in 2014, 2013, and 2012 respectively. Under a share repurchase plan approved by its Board of Directors in 2012, the Company repurchased and cancelled 869,699 shares, at a total cost of \$90.0 million during 2014. On June 12, 2014 the Company announced that its Board of Directors had authorized another stock repurchase plan under which the Company was authorized to repurchase up to \$100 million of its common stock. The Company repurchased 1,151,603

shares under this plan in 2014 for a total of \$100.0 million. All repurchased shares were subsequently cancelled during the period.

Table of Contents

The following table presents long-term contractual obligations of the Company and the related payments in total and by year as of December 31, 2014:

| Contractual Obligations | Payments due by year | | | | | | Total |
|-----------------------------|----------------------|--------|--------|--------|--------|------------|---------|
| | 2015 | 2016 | 2017 | 2018 | 2019 | After 2019 | |
| | (In millions) | | | | | | |
| Operating lease obligations | \$ 2.5 | \$ 1.4 | \$ 0.7 | \$ 0.5 | \$ 0.4 | \$ 4.6 | \$ 10.1 |

In addition to the above, the Company has issued purchase orders in the ordinary course of business for the purchase of goods and services. These purchase orders are enforceable and legally binding. However, none of the Company's purchase obligations call for deliveries of goods or services for time periods in excess of one year.

The Company believes that cash generated from operations plus cash on hand will be sufficient to fund operations, working capital needs and anticipated capital expenditure requirements for the next twelve months. However, any significant future decline in hydrocarbon prices, catastrophic events or significant changes in regulations affecting the Company or its customers could have a material adverse effect on the Company's liquidity. Should market conditions result in unexpected cash requirements, the Company believes that borrowing from commercial lending institutions would be available and adequate to meet such requirements.

Backlog

Backlog consists of firm customer orders of Dril-Quip products for which a purchase order or signed contract has been received, satisfactory credit or financing arrangements exist and delivery is scheduled. Historically, the Company's revenues for a specific period have not been directly related to its backlog as stated at a particular point in time. The Company's product backlog was approximately \$1.2 billion at both December 31, 2014 and 2013 and \$881 million at December 31, 2012. The backlog at the end of 2014 and 2013 represents an increase of approximately \$319 million, or 36%, from the end of 2012.

The Company expects to fill approximately 60% to 65% of the December 31, 2014 product backlog by December 31, 2015. The remaining backlog at December 31, 2014 consists of longer-term projects which are being designed and manufactured to customer specifications requiring longer lead times. In August 2012, the Company's Brazilian subsidiary, Dril-Quip do Brasil LTDA, was awarded a four-year contract by Petrobras, Brazil's national oil company. At exchange rates in effect at the signing date (2.04 Brazilian Reis to 1.00 U.S. Dollar), the contract was valued at \$650 million, net of Brazilian taxes, if all the equipment under the contract is ordered. The Company cannot provide assurance that Petrobras will order all of the equipment under the contract. Amounts are included in the Company's backlog as purchase orders under the contract are received. Revenues of approximately \$69 million have been recognized on this contract through December 31, 2014. As of December 31, 2014, the Company's backlog included \$96 million (at the December 31, 2014 exchange rate of 2.67 Brazilian real to 1.00 U.S. dollar) of purchase orders under this Petrobras contract. The Company has not yet recognized revenue of approximately \$9 million as of December 31, 2014 for certain items of equipment that were completed but not accepted for delivery by Petrobras. If Petrobras does not ultimately accept these items for delivery or if they refuse to accept these or similar items completed in the future, the Company's results of operations may be adversely affected. See Item 1A. Risk Factors Our backlog is subject to unexpected adjustments and cancellations and is, therefore, an uncertain indicator of our future revenues and earnings.

Geographic Segments

The Company's operations are organized into three geographic segments: Western Hemisphere (including North and South America; headquartered in Houston, Texas), Eastern Hemisphere (including Europe and Africa; headquartered in Aberdeen, Scotland) and Asia-Pacific (including the Pacific Rim, Southeast Asia, Australia, India and the Middle East; headquartered in Singapore). Each of these segments sells similar products and services and the Company has major manufacturing facilities in all three of its headquarter locations as well as in Macae, Brazil.

Table of Contents

Revenues for each of these segments are dependent upon the ultimate sale of products and services to the Company's customers. For information on revenues by geographic segment, see Note 11 of Notes to Consolidated Financial Statements. Revenues of the Western Hemisphere are also influenced by its sale of products to the Eastern Hemisphere and Asia-Pacific segments. Accordingly, the operating incomes of each area are closely tied to third-party sales, and the operating income of the Western Hemisphere is also dependent upon its level of intercompany sales.

Currency Risk

Through its subsidiaries, the Company conducts a portion of business in currencies other than the U. S. dollar, principally the British pound sterling and the Brazilian real. The Company generally attempts to minimize its currency exchange risk by seeking international contracts payable in local currency in amounts equal to the Company's estimated operating costs payable in local currency and in U.S. dollars for the balance of the contracts. Because of this strategy, the Company does not anticipate such exposure to be material in the future. The Company had, net of income taxes, transaction gains of \$3.4 million in 2014, and transaction losses of \$4.6 million and \$3.8 million in 2013 and 2012, respectively. There is no assurance that the Company will be able to protect itself against such fluctuations in the future.

Historically, the Company has not conducted business in countries that limit repatriation of earnings. However, as the Company expands its international operations, it may begin operating in countries that have such limitations. Further, there can be no assurance that the countries in which the Company currently operates will not adopt policies limiting repatriation of earnings in the future. The Company also has significant investments in countries other than the United States, principally its manufacturing operations in Scotland, Singapore, Brazil and, to a lesser extent, Norway. The functional currency of these foreign operations is the local currency except for Singapore, where the U.S. dollar is used. Financial statement assets and liabilities in the functional currency are translated at the end of the period exchange rates. Resulting translation adjustments are reflected as a separate component of stockholders' equity and have no current effect on earnings or cash flow.

Critical Accounting Policies

The Company's discussion and analysis of its financial condition and results of operations are based on the Company's consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of the consolidated financial statements requires the Company to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. There can be no assurance that actual results will not differ from those estimates. The Company believes the following accounting policies affect its more significant judgments and estimates used in preparation of its consolidated financial statements.

Revenue Recognition.

Product Revenue

The Company recognizes product revenues from two methods:

product revenues recognized under the percentage-of-completion method; and

product revenues from the sale of products that do not qualify for the percentage-of-completion method.
Revenues recognized under the percentage-of-completion method

The Company uses the percentage-of-completion method on long-term contracts that have the following characteristics:

The contracts call for products which are designed to customer specifications;

Table of Contents

The structural designs are unique and require significant engineering and manufacturing efforts generally requiring more than one year in duration;

The contracts contain specific terms as to milestones, progress billings and delivery dates; and

Product requirements cannot be filled directly from the Company's standard inventory.

For each project, the Company prepares a detailed analysis of estimated costs, profit margin, completion date and risk factors which include availability of material, production efficiencies and other factors that may impact the project. On a quarterly basis, management reviews the progress of each project, which may result in revisions of previous estimates, including revenue recognition. The Company calculates the percent complete and applies the percentage to determine the revenues earned and the appropriate portion of total estimated costs. Losses, if any, are recorded in full in the period they become known. Historically, the Company's estimates of total costs and costs to complete have approximated actual costs incurred to complete the project.

Under the percentage-of-completion method, billings do not always correlate directly to the revenue recognized. Based upon the terms of the specific contract, billings may be in excess of the revenue recognized, in which case the amounts are included in customer prepayments as a liability on the Consolidated Balance Sheets. Likewise, revenue recognized may exceed customer billings in which case the amounts are reported in trade receivables. Unbilled revenues are expected to be billed and collected within one year. At December 31, 2014 and 2013, receivables included \$68.0 million and \$52.9 million of unbilled receivables, respectively. During 2014, there were 17 projects representing approximately 11% and 13% of the Company's total revenues and product revenues, respectively, which were accounted for using percentage-of-completion accounting, and 21 projects during 2013 representing approximately 15% of the Company's total revenues and 18% of product revenues, respectively.

Revenues not recognized under the percentage-of-completion method

Revenues from the sale of inventory products, not accounted for under the percentage-of-completion method, are recorded at the time the manufacturing processes are complete and ownership is transferred to the customer.

Service revenue

The Company earns service revenues from three sources:

technical advisory assistance;

rental of running tools; and

rework and reconditioning of customer owned Dril-Quip products.

The Company does not install products for its customers, but it provides technical advisory assistance. At the time of delivery of the product, the customer is not obligated to buy or rent the Company's running tools and the Company is not obligated to perform any subsequent services relating to installation. Technical advisory assistance service revenue is recorded at the time the service is rendered. Service revenues associated with the rental of running and installation

tools are recorded as earned. Rework and reconditioning service revenues are recorded when the refurbishment process is complete.

The Company normally negotiates contracts for products, including those accounted for under the percentage-of-completion method, and services separately. For all product sales, it is the customer's decision as to the timing of the product installation as well as whether Dril-Quip running tools will be purchased or rented. Furthermore, the customer is under no obligation to utilize the Company's technical advisory assistance services. The customer may use a third party or their own personnel.

Table of Contents

Inventories. Inventory costs are determined principally by the use of the first-in, first-out (FIFO) costing method and are stated at the lower of cost or market. Company manufactured inventory is valued principally using standard costs, which are calculated based upon direct costs incurred and overhead allocations and approximate actual costs. Inventory purchased from third party vendors is principally valued at the weighted average cost. Periodically, obsolescence reviews are performed on slow-moving inventories and reserves are established based on current assessments about future demands and market conditions. The inventory values have been reduced by a reserve for excess and slow-moving inventories of \$34.6 million and \$33.2 million as of December 31, 2014 and 2013, respectively. If market conditions are less favorable than those projected by management, additional inventory reserves may be required.

Contingent liabilities. The Company establishes reserves for estimated loss contingencies when the Company believes a loss is probable and the amount of the loss can be reasonably estimated. Revisions to contingent liabilities are reflected in net income in the period in which different or additional facts or information become known or circumstances change that affect the Company's previous assumptions with respect to the likelihood or amount of loss. Reserves for contingent liabilities are based upon the Company's assumptions and estimates regarding the probable outcome of the matter. Should the outcome differ from the Company's assumptions and estimates, revisions to the estimated reserves for contingent liabilities would be required.

Off-Balance Sheet Arrangements

The Company has no derivative instruments and no off-balance sheet hedging or financing arrangements, contracts or operations.

New Accounting Standards

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606). The amendment applies a new five-step revenue recognition model to be used in recognizing revenues associated with customer contracts. The amendment requires disclosure sufficient to enable readers of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill the contract. The standard is effective for fiscal years beginning after December 15, 2016, including interim periods within that reporting period. The Company is currently evaluating the new guidance to determine the impact on its consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The Company is currently exposed to certain market risks related to interest rate changes on its short-term investments and fluctuations in foreign exchange rates. The Company does not engage in any material hedging transactions, forward contracts or currency trading which could mitigate the market risks inherent in such transactions. There have been no material changes in market risks for the Company from December 31, 2013.

Foreign Exchange Rate Risk

Through its subsidiaries, the Company conducts a portion of its business in currencies other than the United States dollar, principally the British pound sterling and the Brazilian real. The Company has not experienced significant transaction gains or losses associated with changes in currency exchange rates and does not anticipate such exposure to be material in the future. However, there is no assurance that the Company will be able to protect itself against

currency fluctuations in the future. In periods where the dollar is strong as compared to other currencies, it is possible that foreign sales may experience some decline in profits due to translation. It does not appear the Company's sales have experienced significant profit declines. See Management's Discussion and Analysis of Financial Condition and Results of Operations Currency Risk in Item 7 of this report.

Table of Contents

The Company uses a sensitivity analysis model to measure the potential impact on revenue and net income of a 10% adverse movement of foreign currency exchange rates for the British pound sterling and the Brazilian real against the U.S. dollar over the previous year. Based upon this model, a 10% decrease would have resulted in a decrease in revenues of approximately \$37 million and a decrease in net income of approximately \$14 million for 2014. There can be no assurance that the exchange rate decrease projected above will materialize as fluctuations in exchange rates are beyond the Company's control.

Table of Contents

Item 8. *Financial Statements and Supplementary Data*

| | Page |
|--|-------------|
| <u>Management's Annual Report on Internal Control over Financial Reporting</u> | 43 |
| <u>Reports of Independent Registered Public Accounting Firms</u> | 44 |
| <u>Consolidated Statements of Income for the Three Years in the Period Ended December 31, 2014</u> | 46 |
| <u>Consolidated Statements of Comprehensive Income for the Three Years in the Period Ended December 31, 2014</u> | 47 |
| <u>Consolidated Balance Sheets as of December 31, 2014 and 2013</u> | 48 |
| <u>Consolidated Statements of Cash Flows for the Three Years in the Period Ended December 31, 2014</u> | 49 |
| <u>Consolidated Statements of Stockholders' Equity for the Three Years in the Period Ended December 31, 2014</u> | 50 |
| <u>Notes to Consolidated Financial Statements</u> | 51 |

Table of Contents

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Management has designed its internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our principal executive officers and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control - Integrated Framework* (2013), our management has concluded that our internal control over financial reporting was effective as of December 31, 2014.

PricewaterhouseCoopers LLP, the independent registered public accounting firm, who audited the consolidated financial statements included in this Annual Report on Form 10-K, has also audited the effectiveness of our internal control over financial reporting, and their report is set forth on page 44.

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of

Dril-Quip, Inc.

In our opinion, the accompanying consolidated balance sheet as of December 31, 2014 and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the year then ended present fairly, in all material respects, the financial position of Dril-Quip, Inc. and its subsidiaries at December 31, 2014, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provide a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Houston, Texas

February 27, 2015

Table of Contents

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

Dril-Quip, Inc.

Houston, Texas

We have audited the accompanying consolidated balance sheet of Dril-Quip, Inc. (the Company) as of December 31, 2013 and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2013. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Dril-Quip, Inc. at December 31, 2013 and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO USA, LLP

Houston, Texas

February 26, 2014

Table of Contents**DRIL-QUIP, INC.****CONSOLIDATED STATEMENTS OF INCOME**

| | Year Ended December 31, | | |
|--|--|-------------|-------------|
| | 2014 | 2013 | 2012 |
| | (In thousands, except per share data) | | |
| Revenues: | | | |
| Products | \$ 773,205 | \$ 731,617 | \$ 610,218 |
| Services | 157,752 | 140,755 | 122,813 |
| Total revenues | 930,957 | 872,372 | 733,031 |
| Cost and expenses: | | | |
| Cost of sales: | | | |
| Products | 428,125 | 436,359 | 384,513 |
| Services | 85,402 | 77,547 | 67,153 |
| Total cost of sales | 513,527 | 513,906 | 451,666 |
| Selling, general and administrative | 92,762 | 94,806 | 82,218 |
| Engineering and product development | 45,920 | 40,115 | 37,455 |
| Total costs and expenses | 652,209 | 648,827 | 571,339 |
| Operating income | 278,748 | 223,545 | 161,692 |
| Interest income | 667 | 587 | 462 |
| Interest expense | (35) | (35) | (32) |
| Income before income taxes | 279,380 | 224,097 | 162,122 |
| Income tax provision | 70,668 | 54,270 | 42,913 |
| Net income | \$ 208,712 | \$ 169,827 | \$ 119,209 |
| Earnings per common share: | | | |
| Basic | \$ 5.22 | \$ 4.18 | \$ 2.96 |
| Diluted | \$ 5.19 | \$ 4.16 | \$ 2.94 |
| Weighted average common shares outstanding: | | | |
| Basic | 39,964 | 40,648 | 40,332 |
| Diluted | 40,190 | 40,865 | 40,523 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**DRIL-QUIP, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

| | Year Ended December 31, | | |
|--|--------------------------------|-------------|-------------|
| | 2014 | 2013 | 2012 |
| | (In thousands) | | |
| Net income | \$ 208,712 | \$ 169,827 | \$ 119,209 |
| Other comprehensive income (loss), net of tax: | | | |
| Foreign currency translation adjustments | (30,034) | (6,340) | 4,613 |
| Total comprehensive income | \$ 178,678 | \$ 163,487 | \$ 123,822 |

The accompanying notes are an integral part of these consolidated financial statements

Table of Contents**DRIL-QUIP, INC.****CONSOLIDATED BALANCE SHEETS**

| | December 31, | |
|--|-----------------------|---------------------|
| | 2014 | 2013 |
| | (In thousands) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 298,705 | \$ 384,356 |
| Trade receivables, net | 373,993 | 279,253 |
| Inventories, net | 392,559 | 368,354 |
| Deferred income taxes | 23,569 | 20,491 |
| Prepays and other current assets | 38,314 | 28,552 |
| Total current assets | 1,127,140 | 1,081,006 |
| Property, plant and equipment, net | 309,525 | 304,806 |
| Other assets | 12,586 | 10,993 |
| Total assets | \$ 1,449,251 | \$ 1,396,805 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 53,837 | \$ 45,454 |
| Accrued income taxes | 16,903 | 13,628 |
| Customer prepayments | 71,177 | 45,025 |
| Accrued compensation | 21,527 | 21,556 |
| Other accrued liabilities | 35,198 | 23,780 |
| Total current liabilities | 198,642 | 149,443 |
| Deferred income taxes | 5,417 | 5,344 |
| Total liabilities | 204,059 | 154,787 |
| Commitments and contingencies (Note 9) | | |
| Stockholders' equity: | | |
| Preferred stock: 10,000,000 shares authorized at \$0.01 par value (none issued) | | |
| Common stock: | | |
| 100,000,000 and 50,000,000 shares authorized at \$0.01 par value at December 31, 2014 and 2013, 38,932,508 and 40,822,627 issued and outstanding at December 31, 2014 and 2013 | 388 | 407 |
| Additional paid-in capital | 16,480 | 191,965 |
| Retained earnings | 1,278,528 | 1,069,816 |
| Accumulated other comprehensive losses | (50,204) | (20,170) |

| | | |
|--|--------------|--------------|
| Total stockholders' equity | 1,245,192 | 1,242,018 |
| Total liabilities and stockholders' equity | \$ 1,449,251 | \$ 1,396,805 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**DRIL-QUIP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Year Ended December 31, | | |
|---|--------------------------------|-------------|-------------|
| | 2014 | 2013 | 2012 |
| | (In thousands) | | |
| Operating activities | | | |
| Net income | \$ 208,712 | \$ 169,827 | \$ 119,209 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Depreciation and amortization | 31,155 | 29,340 | 26,224 |
| Stock-based compensation expense | 11,856 | 8,900 | 5,748 |
| Loss (gain) on sale of equipment | (146) | 124 | 239 |
| Deferred income taxes | (3,145) | (1,235) | 338 |
| Changes in operating assets and liabilities: | | | |
| Trade receivables, net | (102,696) | (17,250) | (81,566) |
| Inventories, net | (36,814) | (10,562) | (81,884) |
| Prepays and other assets | (13,239) | 6,161 | (8,510) |
| Excess tax benefits of stock options and awards | (558) | (2,863) | (1,487) |
| Accounts payable and accrued expenses | 54,188 | (20,213) | 13,530 |
| Net cash provided by (used in) operating activities | 149,313 | 162,229 | (8,159) |
| Investing activities | | | |
| Purchase of property, plant and equipment | (42,549) | (42,633) | (50,773) |
| Proceeds from sale of equipment | 978 | 760 | 1,774 |
| Net cash used in investing activities | (41,571) | (41,873) | (48,999) |
| Financing activities | | | |
| Repurchase of common stock | (190,234) | (10,002) | |
| Principal payments on debt | | | (39) |
| Proceeds from exercise of stock options | 2,849 | 10,506 | 10,809 |
| Excess tax benefits of stock options and awards | 558 | 2,863 | 1,487 |
| Net cash provided by (used in) financing activities | (186,827) | 3,367 | 12,257 |
| Effect of exchange rate changes on cash activities | (6,566) | 3,442 | 3,516 |
| Increase (decrease) in cash and cash equivalents | (85,651) | 127,165 | (41,385) |
| Cash and cash equivalents at beginning of year | 384,356 | 257,191 | 298,576 |
| Cash and cash equivalents at end of year | \$ 298,705 | \$ 384,356 | \$ 257,191 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**DRIL-QUIP, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

| | Common Stock | Additional Paid-In Capital | Retained Earnings (In thousands) | Accumulated Other Comprehensive Income (Loss) | Total |
|--|-------------------------|---|---|--|--------------|
| Balance at December 31, 2011 | \$ 402 | \$ 162,505 | \$ 780,780 | \$ (18,443) | \$ 925,244 |
| Foreign currency translation adjustment | | | | 4,613 | 4,613 |
| Net income | | | 119,209 | | 119,209 |
| Comprehensive income | | | | | 123,822 |
| Options exercised (299,635 shares) | 3 | 10,806 | | | 10,809 |
| Stock-based compensation | | 5,748 | | | 5,748 |
| Excess tax benefits stock options and awards | | 809 | | | 809 |
| Balance at December 31, 2012 | 405 | 179,868 | 899,989 | (13,830) | 1,066,432 |
| Foreign currency translation adjustment | | | | (6,340) | (6,340) |
| Net income | | | 169,827 | | 169,827 |
| Comprehensive income | | | | | 163,487 |
| Options exercised and awards vested (284,653 shares) | 3 | 10,503 | | | 10,506 |
| Stock-based compensation | | 8,900 | | | 8,900 |
| Excess tax benefits stock options and awards | | 2,695 | | | 2,695 |
| Treasury stock (85,840 shares) | (1) | (10,001) | | | (10,002) |
| Balance at December 31, 2013 | 407 | 191,965 | 1,069,816 | (20,170) | 1,242,018 |
| Foreign currency translation adjustment | | | | (30,034) | (30,034) |
| Net income | | | 208,712 | | 208,712 |
| Comprehensive income | | | | | 178,678 |
| Options exercised and awards vested (48,523 shares) | 1 | 2,848 | | | 2,849 |
| Stock-based compensation | | 11,856 | | | 11,856 |
| Excess tax benefits stock options and awards | | 25 | | | 25 |
| Treasury stock (2,023,172 shares) | (20) | (190,214) | | | (190,234) |

Edgar Filing: DRIL-QUIP INC - Form 10-K

| | | | | | |
|------------------------------|--------|-----------|--------------|-------------|--------------|
| Balance at December 31, 2014 | \$ 388 | \$ 16,480 | \$ 1,278,528 | \$ (50,204) | \$ 1,245,192 |
|------------------------------|--------|-----------|--------------|-------------|--------------|

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**DRIL-QUIP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****1. Organization**

Dril-Quip, Inc., a Delaware corporation (the Company or Dril-Quip), designs, manufactures, sells and services highly engineered offshore drilling and production equipment that is well suited for use in deepwater, harsh environment and severe service applications. The Company's principal products consist of subsea and surface wellheads, subsea and surface production trees, subsea control systems and manifolds, mudline hanger systems, specialty connectors and associated pipe, drilling and production riser systems, liner hangers, wellhead connectors and diverters. Dril-Quip's products are used by major integrated, large independent and foreign national oil and gas companies in offshore areas throughout the world. Dril-Quip also provides technical advisory assistance on an as-requested basis during installation of its products, as well as rework and reconditioning services for customer-owned Dril-Quip products. In addition, Dril-Quip's customers may rent or purchase running tools from the Company for use in the installation and retrieval of the Company's products.

The Company's operations are organized into three geographic segments: Western Hemisphere (including North and South America; headquartered in Houston, Texas), Eastern Hemisphere (including Europe and Africa; headquartered in Aberdeen, Scotland) and Asia-Pacific (including the Pacific Rim, Southeast Asia, Australia, India and the Middle East; headquartered in Singapore). Each of these segments sells similar products and services and the Company has major manufacturing facilities in all three of its headquarter locations as well as in Macae, Brazil. The Company's major subsidiaries are Dril-Quip (Europe) Limited (DQE), located in Aberdeen with branches in Denmark, Norway and Holland; Dril-Quip Asia Pacific PTE Ltd. (DQAP), located in Singapore; Dril-Quip do Brasil LTDA (DQB), located in Macae, Brazil; and DQ Holdings Pty Ltd. (DQH), located in Perth, Australia. Other subsidiaries include Dril-Quip (Ghana) Ltd. located in Takoradi, Ghana, PT DQ Oilfield Services Indonesia located in Jakarta, Indonesia, Dril-Quip (Nigeria) Ltd. located in Port Harcourt, Nigeria, Dril-Quip Egypt for Petroleum Services S.A.E. located in Alexandria, Egypt, Dril-Quip Oilfield Services (Tianjin) Co. Ltd. located in Tianjin, China and Dril-Quip Qatar, LLC located in Doha, Qatar.

2. Significant Accounting Policies*Principles of Consolidation*

The consolidated financial statements include the accounts of the Company and its subsidiaries. All material intercompany accounts and transactions have been eliminated.

Revisions

The Company has corrected its 2013 consolidated balance sheet to reflect a \$4.5 million reclassification adjustment of deferred income tax, which reduced current deferred tax assets and long-term deferred tax liabilities. This adjustment had no impact on the Company's consolidated statements of income, comprehensive income, cash flows or stockholders' equity for any periods presented. In addition, the Company corrected its 2013 consolidated balance sheet to reflect a \$6.7 million reclassification from accounts payable and accrued expenses to prepaids and other current assets for vendor prepayments that were originally recorded as a reduction of accounts payable. This adjustment had no impact on the Company's consolidated statements of income, comprehensive income, or stockholders' equity for any periods presented. After similar reclassification adjustments were made to its 2012 and 2011 consolidated balance sheets (not presented herein), the Company's 2013 and 2012 statements of cash flows were revised to reflect the

reclassification of \$11.6 million and \$9.4 million, respectively, from changes in prepaids and other assets to changes in accounts payable and accrued expenses. There was no impact on the net cash from operating activities or any other reported cash flow amounts as a result of the reclassifications. The Company has evaluated the impact of these revisions and determined that they were not material.

Table of Contents*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent 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. Some of the Company's more significant estimates are those affected by critical accounting policies for revenue recognition, inventories and contingent liabilities.

Cash and cash equivalents

Short-term investments that have a maturity of three months or less from the date of purchase are classified as cash equivalents. The Company invests excess cash in interest bearing accounts, money market mutual funds and funds which invest in U.S. Treasury obligations and repurchase agreements backed by U.S. Treasury obligations. The Company's investment objectives continue to be the preservation of capital and the maintenance of liquidity.

Trade Receivables

The Company maintains an allowance for doubtful accounts on trade receivables equal to amounts estimated to be uncollectible. This estimate is based upon historical collection experience combined with a specific review of each customer's outstanding trade receivable balance. Management believes that the allowance for doubtful accounts is adequate; however, actual write-offs may exceed the recorded allowance. The following is a summary of activity relating to the allowance for doubtful accounts for the years ended December 31, 2012, 2013 and 2014:

| | In thousands |
|-------------------------------|---------------------|
| Balance at December 31, 2011 | \$ 1,160 |
| Charges to costs and expenses | 1,469 |
| Recoveries/write-offs | (516) |
| Balance at December 31, 2012 | 2,113 |
| Charges to costs and expenses | 910 |
| Recoveries/write-offs | (659) |
| Balance at December 31, 2013 | 2,364 |
| Charges to costs and expenses | 4,832 |
| Recoveries/write-offs | (955) |
| Balance at December 31, 2014 | \$ 6,241 |

Inventories

Inventory costs are determined principally by the use of the first-in, first-out (FIFO) costing method and are stated at the lower of cost or market. Company manufactured inventory is valued principally using standard costs, which are calculated based upon direct costs incurred and overhead allocations and approximate actual costs. Inventory purchased from third party vendors is principally valued at the weighted average cost. Periodically, obsolescence reviews are performed on slow-moving inventories and reserves are established based on current assessments about

future demands and market conditions. The inventory values have been reduced by a reserve for excess and slow-moving inventories. Inventory reserves of \$34.6 million and \$33.2 million were recorded as of December 31, 2014 and 2013, respectively. If market conditions are less favorable than those projected by management, additional inventory reserves may be required.

Property, Plant and Equipment

Property, plant and equipment are carried at cost, with depreciation provided on a straight-line basis over their estimated useful lives.

Table of Contents

Impairment of Long-Lived Assets

Long-lived assets, including property, plant and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the carrying amount of an asset exceeds the estimated undiscounted future cash flows expected to be generated by the asset, an impairment charge is recognized by reflecting the asset at its fair value. No impairments of long-lived assets were recorded in 2014, 2013 or 2012.

Income Taxes

The Company accounts for income taxes using the asset and liability method. Current income taxes are provided on income reported for financial statement purposes, adjusted for transactions that do not enter into the computation of income taxes payable in the same year. Deferred tax assets and liabilities are measured using enacted tax rates for the expected future tax consequences of temporary differences between the carrying amounts and the tax basis of assets and liabilities. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Revenue Recognition

Product Revenue

The Company recognizes product revenues from two methods:

product revenues recognized under the percentage-of-completion method; and

product revenues from the sale of products that do not qualify for the percentage-of-completion method.

Revenues recognized under the percentage-of-completion method

The Company uses the percentage-of-completion method on long-term project contracts that have the following characteristics:

The contracts call for products which are designed to customer specifications;

The structural designs are unique and require significant engineering and manufacturing efforts generally requiring more than one year in duration;

The contracts contain specific terms as to milestones, progress billings and delivery dates; and

Product requirements cannot be filled directly from the Company's standard inventory.

For each project, the Company prepares a detailed analysis of estimated costs, profit margin, completion date and risk factors which include availability of material, production efficiencies and other factors that may impact the project. On a quarterly basis, management reviews the progress of each project, which may result in revisions of previous estimates, including revenue recognition. The Company calculates the percent complete and applies the percentage to determine the revenues earned and the appropriate portion of total estimated costs. Losses, if any, are recorded in full in the period they become known. Historically, the Company's estimates of total costs and costs to complete have approximated actual costs incurred to complete the project.

Under the percentage-of-completion method, billings do not always correlate directly to the revenue recognized. Based upon the terms of the specific contract, billings may be in excess of the revenue recognized, in which case the amounts are included in customer prepayments as a liability on the Consolidated Balance Sheets. Likewise, revenue recognized may exceed customer billings in which case the amounts are reported in trade receivables. Unbilled revenues are expected to be billed and collected within one year. At December 31, 2014 and 2013, receivables included \$68.0 million and \$52.9 million of unbilled receivables, respectively. For the year ended December 31, 2014, there were 17 projects representing approximately 11% of the Company's total

Table of Contents

revenues and approximately 13% of its product revenues that were accounted for using percentage-of-completion accounting, and 21 projects during 2013 which represented 15% of the Company's total revenue and 18% of its product revenues.

Revenues not recognized under the percentage-of-completion method

Revenues from the sale of inventory products, not accounted for under the percentage-of-completion method, are recorded at the time the manufacturing processes are complete and ownership is transferred to the customer.

Service revenue

The Company earns service revenues from three sources:

technical advisory assistance;

rental of running tools; and

rework and reconditioning of customer owned Dril-Quip products.

The Company does not install products for its customers, but it does provide technical advisory assistance. At the time of delivery of the product, the customer is not obligated to buy or rent the Company's running tools and the Company is not obligated to perform any subsequent services relating to installation. Technical advisory assistance service revenue is recorded at the time the service is rendered. Service revenues associated with the rental of running and installation tools are recorded as earned. Rework and reconditioning service revenues are recorded when the refurbishment process is complete.

The Company normally negotiates contracts for products, including those accounted for under the percentage-of-completion method, and services separately. For all product sales, it is the customer's decision as to the timing of the product installation as well as whether Dril-Quip running tools will be purchased or rented. Furthermore, the customer is under no obligation to utilize the Company's technical advisory assistance services. The customer may use a third party or their own personnel.

Foreign Currency

The financial statements of foreign subsidiaries are translated into U.S. dollars at period-end exchange rates except for revenues and expenses, which are translated at average monthly rates. Translation adjustments are reflected as a separate component of stockholders' equity and have no effect on current earnings or cash flows.

Foreign currency exchange transactions are recorded using the exchange rate at the date of the settlement. An exchange gain of approximately \$3.4 million in 2014 and exchange losses of \$4.6 million in 2013, and \$3.8 million in 2012, net of income taxes. These amounts are included in selling, general and administrative costs in the Consolidated Statements of Income on a pre-tax basis.

Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and cash equivalents, receivables and payables. The carrying values of these financial instruments approximate their respective fair values as they are short-term in nature.

Concentration of Credit Risk

Financial instruments which subject the Company to concentrations of credit risk primarily include trade receivables. The Company grants credit to its customers, which operate primarily in the oil and gas industry. The Company performs periodic credit evaluations of its customers' financial condition and generally does not

Table of Contents

require collateral. The Company maintains reserves for potential losses, and such losses have historically been within management's expectations.

In addition, the Company invests excess cash in interest bearing accounts, money market mutual funds and funds which invest in obligations of the U.S. Treasury and repurchase agreements backed by U.S. Treasury obligations. Changes in the financial markets and interest rates could affect the interest earned on short-term investments.

Earnings Per Share

Basic earnings per share are computed by dividing net income by the weighted average number of shares of common stock outstanding during the year. Diluted earnings per common share are computed considering the dilutive effect of stock options and awards using the treasury stock method.

3. New Accounting Standards

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606). The amendment applies a new five-step revenue recognition model to be used in recognizing revenues associated with customer contracts. The amendment requires disclosure sufficient to enable readers of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill the contract. The standard is effective for fiscal years beginning after December 15, 2016, including interim periods within that reporting period. The Company is currently evaluating the new guidance to determine the impact on its consolidated financial statements.

4. Inventories

Inventories consist of the following:

| | December 31, | |
|---|-----------------------|-------------|
| | 2014 | 2013 |
| | (In thousands) | |
| Raw materials and supplies | \$ 107,357 | \$ 85,670 |
| Work in progress | 112,514 | 119,929 |
| Finished goods | 207,295 | 195,971 |
| | 427,166 | 401,570 |
| Less: allowance for obsolete and excess inventory | (34,607) | (33,216) |
| Total inventory | \$ 392,559 | \$ 368,354 |

Summary of allowance for excess and slow-moving inventory:

| | In thousands |
|------------------------------|---------------------|
| Balance at December 31, 2011 | \$ 26,228 |

Edgar Filing: DRIL-QUIP INC - Form 10-K

| | |
|-------------------------------|-----------|
| Charges to costs and expenses | 4,651 |
| Write-offs of inventory | (453) |
| Balance at December 31, 2012 | 30,426 |
| Charges to costs and expenses | 3,554 |
| Write-offs of inventory | (764) |
| Balance at December 31, 2013 | 33,216 |
| Charges to costs and expenses | 3,951 |
| Write-offs of inventory | (2,560) |
| Balance at December 31, 2014 | \$ 34,607 |

Table of Contents**5. Property, Plant and Equipment**

Property, plant and equipment consists of:

| | Estimated Useful Lives | December 31, 2014 2013 (In thousands) | |
|-------------------------------------|-----------------------------------|---|------------|
| Land and improvements | 10-25 years | \$ 26,854 | \$ 26,927 |
| Buildings | 15-40 years | 194,587 | 192,024 |
| Machinery, equipment and other | 3-10 years | 340,279 | 313,772 |
| | | 561,720 | 532,723 |
| Less accumulated depreciation | | (252,195) | (227,917) |
| Total property, plant and equipment | | \$ 309,525 | \$ 304,806 |

Depreciation expense totaled \$31.2 million, \$29.3 million and \$26.2 million for 2014, 2013 and 2012, respectively.

6. Income Taxes

The Company is required to recognize the impact of a tax position that is more likely than not to be sustained upon examination based upon the technical merits of the position, including resolution of any appeals. Based on the Company's evaluation, the Company has concluded that there are no significant uncertain tax positions requiring recognition in the Company's financial statements. The evaluation was performed for the tax years which remain subject to examination by major tax jurisdictions as of December 31, 2014, which are the years ended December 31, 2007 through December 31, 2013. The Company has occasionally been assessed interest or penalties by major tax jurisdictions; these assessments historically have not materially impacted the Company's financial results. Interest expense assessed by tax jurisdictions is included with interest expense and assessed penalties are included in selling, general and administrative expenses.

The Company evaluates uncertain tax positions for recognition and measurement in the consolidated financial statements. To recognize a tax position, the Company determines whether it is more likely than not that the tax positions will be sustained upon examination, including resolution of any related appeals or litigation, based on the technical merits of the position. A tax position that meets the more likely than not threshold is measured to determine the amount of benefit to be recognized in the consolidated financial statements. The amount of tax benefit recognized with respect to any tax position is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement. The Company had no uncertain tax positions that required recognition in the consolidated financial statements at December 31, 2014 and 2013. If it is more likely than not that the related tax benefits will not be realized, a valuation allowance would be established to reduce deferred tax assets. As of December 31, 2014 and 2013, the Company determined that a valuation allowance was not necessary.

Income before income taxes consisted of the following:

Year ended December 31,

Edgar Filing: DRIL-QUIP INC - Form 10-K

| | 2014 | 2013 | 2012 |
|--------------|-----------------------|-------------------|-------------------|
| | (In thousands) | | |
| Domestic | \$ 124,571 | \$ 98,883 | \$ 65,271 |
| Foreign | 154,809 | 125,214 | 96,851 |
| Total | \$ 279,380 | \$ 224,097 | \$ 162,122 |

Table of Contents

The income tax provision (benefit) consists of the following:

| | Year ended December 31, | | |
|-----------------------|--------------------------------|------------------|------------------|
| | 2014 | 2013 | 2012 |
| | (In thousands) | | |
| Current: | | | |
| Federal | \$ 43,652 | \$ 30,962 | \$ 20,033 |
| Foreign | 30,022 | 24,543 | 22,542 |
| Total current | 73,674 | 55,505 | 42,575 |
| Deferred: | | | |
| Federal | (5,916) | (1,299) | 440 |
| Foreign | 2,910 | 64 | (102) |
| Total deferred | (3,006) | (1,235) | 338 |
| Total | \$ 70,668 | \$ 54,270 | \$ 42,913 |

The difference between the effective income tax rate reflected in the provision for income taxes and the U.S. federal statutory rate was as follows:

| | Year ended December 31, | | |
|--------------------------------------|--------------------------------|--------------|--------------|
| | 2014 | 2013 | 2012 |
| Federal income tax statutory rate | 35.0% | 35.0% | 35.0% |
| Foreign income tax rate differential | (6.0) | (6.0) | (5.5) |
| Foreign development tax incentive | (1.6) | (2.6) | (1.6) |
| Manufacturing benefit | (1.7) | (1.4) | (1.2) |
| Other | (0.4) | (0.8) | (0.3) |
| Effective income tax rate | 25.3% | 24.2% | 26.4% |

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Based upon existing market conditions and the Company's earnings prospects, it is anticipated that all deferred tax assets will be realized in future years. Significant components of the Company's net deferred tax assets (liabilities) are as follows:

| | December 31, | |
|---|-----------------------|-------------|
| | 2014 | 2013 |
| | (In thousands) | |
| Net current deferred tax assets: | | |
| Inventory | \$ 10,835 | \$ 9,086 |

Edgar Filing: DRIL-QUIP INC - Form 10-K

| | | |
|--|-----------|-----------|
| Inventory reserve | 8,535 | 7,807 |
| Allowance for doubtful accounts | 1,022 | 396 |
| Reserve for accrued liabilities | 510 | 370 |
| Other | 2,667 | 2,832 |
| Net current deferred tax assets | 23,569 | 20,491 |
| Net non-current deferred tax liability: | | |
| Property, plant and equipment | (11,295) | (9,804) |
| Stock options | 5,735 | 4,323 |
| Other | 143 | 137 |
| Net non-current deferred tax liabilities | (5,417) | (5,344) |
| Net deferred tax asset | \$ 18,152 | \$ 15,147 |

Table of Contents

Undistributed earnings of the Company's foreign subsidiaries are considered to be indefinitely reinvested and, accordingly, no provision for U.S. federal income taxes has been provided thereon. The estimate of undistributed earnings of the Company's foreign subsidiaries amounted to \$671 million as of December 31, 2014. Upon distribution of those earnings in the form of dividends or otherwise, the Company may be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to the various foreign countries. Determination of the amount of unrecognized deferred U.S. income tax liability is not practicable.

On January 2, 2013, the American Taxpayer Relief Act of 2012 extended the Research and Development tax credit retroactive to January 1, 2012 and was extended through December 31, 2013. The Research and Development credit for 2012 of \$1.2 million was recognized on the Company's 2012 U.S. federal income tax return but was recorded for financial statement purposes in the first quarter of 2013 in accordance with ASC 740.

The Company paid \$69.9 million, \$41.0 million and \$37.9 million in income taxes in 2014, 2013 and 2012, respectively.

7. Other Accrued Liabilities

Other accrued liabilities consist of the following:

| | December 31, | |
|---------------------------------|-----------------------|------------------|
| | 2014 | 2013 |
| | (In thousands) | |
| Payroll taxes | \$ 3,354 | \$ 3,559 |
| Property, sales and other taxes | 12,702 | 6,398 |
| Commissions payable | 3,917 | 2,160 |
| Accrued vendor costs | 10,162 | 7,384 |
| Other | 5,063 | 4,279 |
| Total | \$ 35,198 | \$ 23,780 |

8. Employee Benefit Plans

The Company has a defined-contribution 401(k) plan covering domestic employees and a defined-contribution pension plan covering certain foreign employees. The Company generally makes contributions to the plans equal to each participant's eligible contributions for the plan year up to a specified percentage of the participant's annual compensation. The Company's contribution expense was \$5.9 million, \$4.9 million and \$4.4 million in 2014, 2013 and 2012, respectively.

9. Commitments and Contingencies

The Company leases certain offices, shop and warehouse facilities, automobiles and equipment. Total lease expense incurred was \$4.2 million, \$3.5 million and \$2.9 million in 2014, 2013 and 2012, respectively. Future annual minimum lease commitments at December 31, 2014 are as follows: 2015 \$2.5 million; 2016 \$1.4 million, 2017 \$0.7 million; 2018 \$0.5 million; 2019 \$0.4 million and thereafter \$4.6 million.

Brazilian Tax Issue

From 2002 to 2007, the Company's Brazilian subsidiary imported goods through the State of Espirito Santo in Brazil and subsequently transferred them to its facility in the State of Rio de Janeiro. During that period, the Company's Brazilian subsidiary paid taxes to the State of Espirito Santo on its imports. Upon the final sale of these goods, the Company's Brazilian subsidiary collected taxes from customers and remitted them to the State of Rio de Janeiro net of the taxes paid on importation of those goods to the State of Espirito Santo in accordance with the Company's understanding of Brazilian tax laws.

Table of Contents

In August 2007, the State of Rio de Janeiro served the Company's Brazilian subsidiary with assessments to collect a state tax on the importation of goods through the State of Espirito Santo from 2002 to 2007 claiming that these taxes were due and payable to it under applicable law. The Company settled these assessments with payments to the State of Rio de Janeiro of \$12.2 million in March 2010 and \$3.9 million in December 2010. Approximately \$7.8 million of these settlement payments were attributable to penalties, interest and amounts that had expired under the statute of limitations so that amount was recorded as an expense. The remainder of the settlement payments generated credits (recorded as a prepaid tax) that can be used to offset future state taxes on sales to customers in the State of Rio de Janeiro once certified by the tax authorities under a process that is currently ongoing. When the credits are certified, the Company will have a five-year period in which to utilize them.

In December 2010 and January 2011, the Company's Brazilian subsidiary was served with two additional assessments totaling approximately \$13.0 million from the State of Rio de Janeiro to cancel the credits associated with the tax payments to the State of Espirito Santo (Santo Credits) on the importation of goods from July 2005 to October 2007. The Santo Credits are not related to the credits described above. The Company has objected to these assessments on the grounds that they would represent double taxation on the importation of the same goods and that the Company is entitled to the credits under applicable Brazilian law. With regard to the December 2010 assessment, the Company's Brazilian subsidiary has filed an appeal with a State of Rio de Janeiro judicial court to annul the tax assessment following a ruling against the Company by the tax administration's highest council. In connection with that appeal, the Company was required to deposit with the court approximately \$3.1 million (at the December 31, 2014 exchange rate of 2.67 Brazilian real to 1.00 U.S. dollar) as the full amount of the assessment with penalties and interest. The Company intends to file a similar appeal in the judicial system if the tax administration's highest council rules against the Company with regard to the January 2011 assessment. The Company believes that these credits are valid and that success in the judicial court process is probable. Based upon this analysis, the Company has not accrued any liability in conjunction with this matter.

Since 2007, the Company's Brazilian subsidiary has paid taxes on the importation of goods directly to the State of Rio de Janeiro and the Company does not expect any similar issues to exist for periods subsequent to 2007.

General

The Company operates its business and markets its products and services in most of the significant oil and gas producing areas in the world and is, therefore, subject to the risks customarily attendant to international operations and dependency on the condition of the oil and gas industry. Additionally, products of the Company are used in potentially hazardous drilling, completion, and production applications that can cause personal injury, product liability, and environmental claims. Although exposure to such risk has not resulted in any significant problems in the past, there can be no assurance that ongoing and future developments will not adversely impact the Company.

The Company is also involved in a number of legal actions arising in the ordinary course of business. Although no assurance can be given with respect to the ultimate outcome of such legal action, in the opinion of management, the ultimate liability with respect thereto will not have a material adverse effect on the Company's results of operations, financial position or cash flows.

10. Stockholders' Equity

Under a Stockholder Rights Plan adopted by the Board of Directors on November 24, 2008, each share of common stock includes one right to purchase from the Company a unit consisting of one one-hundredth of a share (a Fractional Share) of Series A Junior Participating Preferred Stock at a specific purchase price per Fractional Share, subject to adjustment in certain events. The rights will cause substantial dilution to any person or group that attempts to acquire

the Company without the approval of the Company's Board of Directors.

Table of Contents**11. Geographic Areas**

| | Year ended December 31, | | |
|-----------------------------------|--------------------------------|-------------------|-------------------|
| | 2014 | 2013 | 2012 |
| | (In thousands) | | |
| <i>Revenues:</i> | | | |
| Western Hemisphere | | | |
| Products | \$ 430,597 | \$ 420,439 | \$ 298,853 |
| Services | 74,544 | 72,328 | 68,938 |
| Intercompany | 55,094 | 51,767 | 65,803 |
| Total | \$ 560,235 | \$ 544,534 | \$ 433,594 |
| Eastern Hemisphere | | | |
| Products | \$ 205,185 | \$ 186,074 | \$ 196,328 |
| Services | 59,794 | 46,653 | 37,307 |
| Intercompany | 10,719 | 1,254 | 4,065 |
| Total | \$ 275,698 | \$ 233,981 | \$ 237,700 |
| Asia-Pacific | | | |
| Products | \$ 137,423 | \$ 125,104 | \$ 115,037 |
| Services | 23,414 | 21,774 | 16,568 |
| Intercompany | 3,165 | 9,155 | 968 |
| Total | \$ 164,002 | \$ 156,033 | \$ 132,573 |
| Summary | | | |
| Products | \$ 773,205 | \$ 731,617 | \$ 610,218 |
| Services | 157,752 | 140,755 | 122,813 |
| Intercompany | 68,978 | 62,176 | 70,836 |
| Eliminations | (68,978) | (62,176) | (70,836) |
| Total | \$ 930,957 | \$ 872,372 | \$ 733,031 |
| <i>Income before income taxes</i> | | | |
| Western Hemisphere | \$ 143,206 | \$ 111,498 | \$ 76,771 |
| Eastern Hemisphere | 79,146 | 49,672 | 44,904 |
| Asia-Pacific | 54,302 | 55,136 | 33,478 |
| Eliminations | 2,726 | 7,791 | 6,969 |
| Total | \$ 279,380 | \$ 224,097 | \$ 162,122 |
| <i>Total Long-Lived Assets:</i> | | | |
| Western Hemisphere | \$ 221,597 | \$ 216,104 | \$ 215,340 |
| Eastern Hemisphere | 45,517 | 43,430 | 36,194 |

Edgar Filing: DRIL-QUIP INC - Form 10-K

| | | | |
|----------------------|--------------|--------------|--------------|
| Asia-Pacific | 57,923 | 59,192 | 58,484 |
| Eliminations | (2,926) | (2,927) | (2,959) |
| Total | \$ 322,111 | \$ 315,799 | \$ 307,059 |
| <i>Total Assets:</i> | | | |
| Western Hemisphere | \$ 731,448 | \$ 805,399 | \$ 745,503 |
| Eastern Hemisphere | 375,781 | 316,473 | 275,868 |
| Asia-Pacific | 354,329 | 292,463 | 261,319 |
| Eliminations | (12,307) | (17,530) | (32,982) |
| Total | \$ 1,449,251 | \$ 1,396,805 | \$ 1,249,708 |

Table of Contents

The Company's operations are organized into three geographic segments: Western Hemisphere (including North and South America; headquartered in Houston, Texas), Eastern Hemisphere (including Europe and Africa; headquartered in Aberdeen, Scotland) and Asia-Pacific (including the Pacific Rim, Southeast Asia, Australia, India and the Middle East; headquartered in Singapore). Each of these segments sells similar products and services and the Company has major manufacturing facilities in all three of its headquarter locations as well as in Macae, Brazil.

Eliminations of operating profits are related to intercompany inventory transfers that are deferred until shipment is made to third party customers.

In 2014 Chevron accounted for approximately 10% of the Company's total revenues. In 2013 and 2012, Petrobras accounted for approximately 11% and 12% respectively, of the Company's total revenues. No other customer accounted for more than 10% of the Company's total revenues in 2014, 2013 or 2012.

12. Stock-Based Compensation and Stock Awards*Stock Options*

On May 13, 2004, the Company's stockholders approved the 2004 Incentive Plan of Dril-Quip, Inc. (as amended in 2012, the "2004 Plan"), which reserved up to 2,696,294 shares of Common Stock to be used in connection with the 2004 Plan. Persons eligible for awards under the 2004 Plan are employees holding positions of responsibility with the Company or any of its subsidiaries and members of the Board of Directors. Options granted under the 2004 Plan have a term of ten years and become exercisable in cumulative annual increments of one-fourth of the total number of shares of Common Stock subject thereto, beginning on the first anniversary of the date of the grant.

The fair value of stock options granted was estimated on the grant date using the Black-Scholes option pricing model. The expected life was based on the Company's historical trends, and volatility is based on the historical volatility over the expected life of the options. The risk-free interest rate is based on U.S. Treasury yield curve at the grant date. The Company does not pay dividends and, therefore, there is no assumed dividend yield.

Option activity for the year ended December 31, 2014 was as follows:

| | Number of Options | Weighted Average Price | Aggregate intrinsic value (in millions) | Weighted Average Remaining Contractual Life (in years) |
|----------------------------------|------------------------------|---------------------------------------|--|---|
| Outstanding at December 31, 2013 | 512,895 | 56.25 | | |
| Granted | | | | |
| Exercised | (48,523) | 58.74 | | |
| Forfeited | (5,125) | 68.18 | | |
| Outstanding at December 31, 2014 | 459,247 | \$ 55.86 | \$ 9.6 | 5.2 |
| Exercisable at December 31, 2014 | 417,123 | \$ 54.59 | \$ 9.2 | 5.0 |

The total intrinsic value of stock options exercised in 2014, 2013 and 2012 was \$2.0 million, \$10.7 million and \$7.6 million, respectively. The income tax benefit realized from stock options exercised was \$718,000 for the year ended December 31, 2014. There were no anti-dilutive stock option shares on December 31, 2014.

Stock-based compensation is recognized as selling, general and administrative expense in the accompanying Consolidated Statements of Income. During the years ended December 31, 2014, 2013 and 2012, stock-based compensation expense for stock option awards totaled \$2.5 million, \$3.4 million and \$3.8 million, respectively. No stock-based compensation expense was capitalized during 2014, 2013 or 2012.

Table of Contents

Options granted to employees vest over four years and the Company recognizes compensation expense on a straight-line basis over the vesting period of the options. At December 31, 2014, there was \$1.2 million of total unrecognized compensation expense related to nonvested stock options. This expense is expected to be recognized over a weighted average of 0.8 years.

Restricted Stock Awards

On October 28, 2013 and 2014 pursuant to the 2004 Plan, the Company awarded officers, directors and key employees restricted stock awards (RSA), which is an award of common stock subject to time vesting. In May 2012, the Board of Directors amended the 2004 Plan to include non-employee directors as eligible for restricted stock awards. RSAs issued under this plan are restricted as to transference, sale and other disposition. These RSAs vest ratably over a three year period. The RSAs may also vest in case of a change of control. Upon termination, whether voluntary or involuntary, the RSAs that have not vested will be returned to the Company resulting in stock forfeitures. The fair market value of the stock on the date of grant is amortized and charged to selling, general and administrative expense over the stipulated time period over which the RSAs vest on a straight-line basis, net of estimated forfeitures.

The Company's RSA activity and related information is presented below:

| | RSA Number of Shares | Weighted Average Grant Date Fair Value Per Share |
|--|-------------------------------------|---|
| Nonvested balance at December 31, 2013 | 148,753 | \$ 90.75 |
| Granted | 86,476 | 91.02 |
| Vested | (71,925) | 83.92 |
| Forfeited | (3,150) | 99.81 |
| Nonvested balance at December 31, 2014 | 160,154 | \$ 93.78 |

Restricted stock awards compensation expense for the year ended December 31, 2014 totaled \$6.3 million and \$3.9 million for 2013 and \$1.7 million for 2012. For 2014, total income tax benefit recognized in net income for restricted stock awards was \$2.2 million. As of December 31, 2014, there was \$13.7 million of total unrecognized compensation cost related to nonvested RSAs, which is expected to be recognized over a weighted average period of 1.6 years. There were 15,400 anti-dilutive restricted shares on December 31, 2014.

Performance Unit Awards

On October 28, 2014 and 2013, the Company awarded 45,729 and 31,707 performance unit awards (Performance Units) pursuant to the 2004 Plan to officers and key employees. The Performance Units were valued based on a Monte Carlo simulation at \$126.84 for 2014 grants and \$138.31 for the 2013 grants, approximately 139.4% and 118.4%, respectively, of the grant share price. Under the plan, participants may earn from 0% to 200% of their target award based upon the Company's relative total share return (TSR) in comparison to the 15 component companies of the Philadelphia Oil Service Index (OSX index). The TSR is calculated over a three year period from October 1, 2013 and 2014 to September 30, 2016 and 2017 and assumes reinvestment of dividends for companies within the index that pay dividends, which Dril-Quip does not. Assumptions used in the Monte Carlo simulation are as follows:

| | <u>2013</u> | <u>2014</u> |
|-------------------------|---------------------------------------|---------------------------------------|
| Grant date | October 28, 2013 | October 28, 2014 |
| Performance period | October 1, 2013 to September 30, 2016 | October 1, 2014 to September 30, 2017 |
| Volatility | 34.4% | 27.8% |
| Risk-free interest rate | 0.569% | 0.8081% |
| Grant date price | \$116.83 | \$91.02 |

Table of Contents

The Company's Performance Unit activity and related information is presented below:

| | Number of Performance Units | Weighted Average Grant Date Fair Value Per Performance Unit |
|--|--|--|
| Nonvested balance at December 31, 2013 | 78,057 | \$ 106.45 |
| Granted | 45,729 | 126.84 |
| Vested | | |
| Forfeited | | |
| Nonvested balance at December 31, 2014 | 123,786 | \$ 113.98 |

Performance Unit compensation expense for the year ended December 31, 2014 totaled \$3.1 million, \$1.6 million for 2013 and \$0.2 million for 2012. As of December 31, 2014, there was \$9.2 million (based on 100% result rate) of total unrecognized compensation expense related to nonvested Performance Units which is to be recognized over a weighted average period of 1.6 years. There were 8,144 anti-dilutive performance share units at December 31, 2014.

Director Stock Compensation Awards

In June 2014, the Board of Directors authorized a stock compensation program for the directors pursuant to the 2004 Plan. Under this program, the Directors may elect to receive all or a portion of their fees in the form of restricted directors stock awards (DSA) in an amount equal to 125% of the fees in lieu of cash. The awards are made quarterly on the first business day after the end of each calendar quarter and vest on January 1 on the second year after the grant date.

The Company DSA activity for December 31, 2014 is presented below:

| | DSA Number of Shares | Weighted Average Grant Date Fair Value Per Performance Unit |
|--|---------------------------------|--|
| Nonvested balance at December 31, 2013 | | \$ |
| Granted | 1,204 | 89.40 |
| Vested | | |
| Forfeited | | |
| Nonvested balance at December 31, 2014 | 1,204 | \$ 89.40 |

Director stock compensation awards expense for 2014 was \$21,600. There was \$85,500 of unrecognized compensation expense related to nonvested DSAs, which is expected to be recognized over a weighted average period of one year. There were 303 anti-diluted DSA shares on December 31, 2014.

Table of Contents

The following table summarizes information for equity compensation plans in effect as of December 31, 2014:

| Plan category | Number of securities to be issued upon exercise of outstanding options(1) (a) | Weighted-average exercise price of outstanding options (b) | Number of securities remaining available for future issuance under equity compensation plan (excluding securities reflected in column (a)) (c) |
|--|--|---|---|
| Equity compensation plans approved by stockholders | | | |
| Stock options | 459,247 | \$ 55.86 | 639,327 |
| Equity compensation plans not approved by stockholders | | not applicable | |
| Total | 459,247 | \$ 55.86 | 639,327 |

(1) Excludes 161,358 shares of unvested restricted stock awards (including DSAs) and 123,786 of unvested performance units, which were granted pursuant to the 2004 Plan approved by the stockholders.

13. Earnings Per Share

The following is a reconciliation of the basic and diluted earnings per share computation.

| | Year Ended December 31, | | |
|--|---|-------------|-------------|
| | 2014 | 2013 | 2012 |
| | (In thousands, except per share amounts) | | |
| Net income | \$ 208,712 | \$ 169,827 | \$ 119,209 |
| Weighted average basic common shares outstanding | 39,964 | 40,648 | 40,332 |
| Effect of dilutive securities stock options and awards | 226 | 217 | 191 |
| Total shares and dilutive securities | 40,190 | 40,865 | 40,523 |
| Basic earnings per common share | \$ 5.22 | \$ 4.18 | \$ 2.96 |
| Diluted earnings per common share | \$ 5.19 | \$ 4.16 | \$ 2.94 |

14. Stock Repurchase Plan

In June 2012, the Company announced that its Board of Directors authorized a stock repurchase plan under which the Company was authorized to repurchase up to \$100 million of its common stock. In the fourth quarter of 2013, the Company repurchased and cancelled 85,840 shares at a total cost of \$10.0 million. In the first half of 2014, the Company repurchased and cancelled 869,699 shares for \$90.0 million. As of May 27, 2014, the Company had repurchased the maximum amount authorized under the stock repurchase plan.

On June 12, 2014 the Company announced that its Board of Directors authorized an additional stock repurchase plan in which the Company was authorized to repurchase up to \$100 million of its common stock. As of December 24, 2014, a total of 1,151,603 shares at a price of \$100 million, the maximum authorized under the stock repurchase plan, had been repurchased and subsequently cancelled.

Table of Contents**15. Quarterly Results of Operations (Unaudited):**

| | Quarter Ended | | | |
|---------------------|--|----------------|-----------------|----------------|
| | March 31 | June 30 | Sept. 30 | Dec. 31 |
| | (In thousands, except per share data) | | | |
| (Unaudited) | | | | |
| 2014 | | | | |
| Revenues | \$ 204,073 | \$ 230,315 | \$ 241,750 | \$ 254,819 |
| Cost of sales | 110,787 | 124,993 | 135,250 | 142,497 |
| Gross profit | 93,286 | 105,322 | 106,500 | 112,322 |
| Operating income | 58,567 | 68,954 | 72,992 | 78,235 |
| Net income | 42,618 | 51,324 | 55,683 | 59,087 |
| Earnings per share: | | | | |
| Basic(1) | \$ 1.05 | \$ 1.27 | \$ 1.41 | \$ 1.51 |
| Diluted(1) | 1.04 | 1.27 | 1.40 | 1.50 |
| 2013 | | | | |
| Revenues | \$ 193,155 | \$ 222,031 | \$ 224,724 | \$ 232,462 |
| Cost of sales | 116,328 | 133,203 | 132,131 | 132,244 |
| Gross profit | 76,827 | 88,828 | 92,593 | 100,218 |
| Operating income | 52,177 | 56,215 | 51,985 | 63,168 |
| Net income | 39,842 | 42,927 | 39,995 | 47,063 |
| Earnings per share: | | | | |
| Basic(1) | \$ 0.98 | \$ 1.06 | \$ 0.98 | \$ 1.16 |
| Diluted(1) | 0.98 | 1.05 | 0.98 | 1.15 |

- (1) The sum of the quarterly per share amounts may not equal the annual amount reported, as per share amounts are computed independently for each quarter and for the full year.

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

None.

Item 9A. Controls and Procedures

In accordance with Exchange Act Rules 13a-15 and 15d-15, the Company carried out an evaluation, under the supervision and with the participation of management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2014 to provide reasonable assurance that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and such information is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure.

Management's Annual Report on Internal Control over Financial Reporting appears on page 43 of this Annual Report on Form 10-K.

There has been no change in the Company's internal controls over financial reporting that occurred during the three months ended December 31, 2014 that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

Item 9B. Other Information

None.

Table of Contents

PART III

Item 10. *Directors, Executive Officers and Corporate Governance*

The information required by this item is set forth under the captions Election of Directors, Corporate Governance Matters and Section 16(a) Beneficial Ownership Reporting Compliance in the Company's definitive Proxy Statement (the 2015 Proxy Statement) for its annual meeting of stockholders to be held on May 16, 2015, which sections are incorporated herein by reference.

Pursuant to Item 401(b) of Regulation S-K, the information required by this item with respect to executive officers of the Company is set forth in Part I of this report.

Item 11. *Executive Compensation*

The information required by this item is set forth in the sections entitled Director Compensation, Executive Compensation and Corporate Governance Matters in the 2015 Proxy Statement, which sections are incorporated herein by reference.

Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*

The information required by this item is set forth in the sections entitled Security Ownership of Certain Beneficial Owners and Management and Executive Compensation Equity Compensation Plan Information in the 2015 Proxy Statement, which sections are incorporated herein by reference.

Item 13. *Certain Relationships and Related Transactions, and Director Independence*

The information required by this item is set forth in the section entitled Corporate Governance Matters in the 2015 Proxy Statement, which section is incorporated herein by reference.

Item 14. *Principal Accountant Fees and Services*

The information required by this item is set forth in the sections entitled Approval of Appointment of Independent Public Accounting Firm Fees and Audit Committee Pre-Approval Policy for Audit and Non-Audit Services in the 2015 Proxy Statement, which sections are incorporated herein by reference.

PART IV

Item 15. *Exhibits and Financial Statement Schedules*

(a)(1) Financial Statements

All financial statements of the registrant are set forth under Item 8 of this Annual Report on Form 10-K.

(a)(2) Financial Statement Schedules

All schedules and other statements are omitted because of the absence of conditions under which they are required or because the required information is presented in the financial statements or notes thereto.

(a)(3) Exhibits

Table of Contents

Dril-Quip will furnish any exhibit to a stockholder upon payment by the stockholder of the Company's reasonable expenses to furnish the exhibit.

| Exhibit No. | Description |
|--------------------|--|
| *3.1 | Restated Certificate of Incorporation of the Company (incorporated herein by reference to Exhibit 3.1 to the Company's report on Form 8-K filed May 20, 2014). |
| *3.2 | Certificate of Designations of Series A Junior Participating Preferred Stock of the Company (incorporated herein by reference to Exhibit 3.1 to the Company's report on Form 8-K dated November 25, 2008). |
| *3.3 | Amended and Restated Bylaws of the Company (incorporated herein by reference to Exhibit 3.2 to the Company's report on Form 8-K filed May 20, 2014). |
| *4.1 | Form of certificate representing Common Stock (incorporated herein by reference to Exhibit 4.2 the Company's Registration Statement on Form S-1 (Registration No. 333-33447)). |
| *4.2 | Rights Agreement dated as of November 24, 2008 between Dril-Quip, Inc. and Mellon Investor Services LLC, as Rights Agent (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on November 25, 2008). |
| *+10.1 | Employment Agreement between the Company and Mr. DeBerry (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 12, 2011). |
| *+10.2 | Employment Agreement between the Company and Mr. Gariepy (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on December 12, 2011). |
| *+10.3 | Employment Agreement between the Company and Mr. Brooks (incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on December 12, 2011). |
| *+10.4 | Employment Agreement between the Company and Mr. Webster (incorporated herein by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on December 12, 2011). |
| *+10.5 | Amended and Restated 2004 Incentive Plan of Dril-Quip, Inc. (incorporated herein by reference to Exhibit A to the Company's Proxy Statement filed on April 6, 2012). |
| *+10.6 | Short-Term Incentive Plan of Dril-Quip, Inc. (incorporated herein by reference to Exhibit B to the Company's Proxy Statement filed on April 6, 2012). |
| *+10.7 | Form of Standard Non-Qualified Stock Option Agreement (incorporated herein by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on December 19, 2008). |
| *+10.8 | Form of Restricted Stock Award Agreement (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 12, 2011). |
| *+10.9 | Form of Restricted Stock Award Agreement for Directors (incorporated herein by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012). |

**+10.10

Summary of Executive Officer and Non-employee Director Compensation.

Table of Contents

| Exhibit No. | Description |
|--------------------|---|
| *10.11 | Contract for Goods and Services dated August 20, 2012 between Petroleo Brasileiro S.A. and Dril-Quip, do Brasil LTDA (English translation) (incorporated herein by reference to Exhibit 10.1 to the Company's report on Form 10-Q filed on November 8, 2012). |
| *+10.12 | 2012 Performance Unit Award Agreement (incorporated herein by reference to Exhibit 10.1 to the Company's report on Form 8-K filed on October 19, 2012). |
| *+10.13 | Form of Indemnification Agreement (incorporated herein by reference to the Company's Current Report on Form 8K/A on January 18, 2012). |
| *+10.14 | 2013 Performance Unit Award Agreement (incorporated herein by reference to Exhibit 10.1 to the Company's report on Form 8-K filed on October 22, 2013). |
| *+10.15 | Stock Compensation Program for Directors (incorporated herein by reference to Exhibit 10.1 to the Company's report on Form 10-Q filed on July 29, 2014). |
| *16.1 | Letter of BDO USA, LLP to the Securities and Exchange Commission dated June 2, 2014 (incorporated herein by reference to Exhibit 16.1 to the Company's report on Form 8-K filed on June 2, 2014). |
| **21.1 | Subsidiaries of the Registrant |
| **23.1 | Consent of PricewaterhouseCoopers LLP. |
| **23.2 | Consent of BDO USA, LLP. |
| **31.1 | Rule 13a-14(a)/15d-14(a) Certification of Blake T. DeBerry. |
| **31.2 | Rule 13a-14(a)/15d-14(a) Certification of Jerry M. Brooks. |
| **32.1 | Section 1350 Certification of Blake T. DeBerry. |
| **32.2 | Section 1350 Certification of Jerry M. Brooks. |
| **101.INS | XBRL Instance Document |
| **101.SCH | XBRL Schema Document |
| **101.CAL | XBRL Calculation Document |
| **101.DEF | XBRL Definition Linkbase Document |
| **101.LAB | XBRL Label Linkbase Document |
| **101.PRE | XBRL Presentation Linkbase Document |

* Incorporated herein by reference as indicated.

** Filed with this report.

+ Management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K.

Table of Contents**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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 on February 27, 2015.

DRIL-QUIP, INC.

By: /s/ BLAKE T. DEBERRY
Blake T. DeBerry

President and Chief Executive Officer

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Name | Capacity | Date |
|---|---|-------------------|
| /s/ JOHN V. LOVOI JOHN V. LOVOI | Chairman of the Board | February 27, 2015 |
| /s/ BLAKE T. DEBERRY BLAKE T. DEBERRY | President, Chief Executive Officer and Director (Principal Executive Officer) | February 27, 2015 |
| /s/ JERRY M. BROOKS JERRY M. BROOKS | Vice President Finance and Chief Financial Officer (Principal Financial and Accounting Officer) | February 27, 2015 |
| /s/ L.H. DICK ROBERTSON L.H. DICK ROBERTSON | Director | February 27, 2015 |
| /s/ A.P. SHUKIS A.P. SHUKIS | Director | February 27, 2015 |
| /s/ TERENCE B. JUPP TERENCE B. JUPP | Director | February 27, 2015 |