NATIONAL OILWELL VARCO INC
Form 10-Q
August 10, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark one)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2009

OR

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

Commission File Number 1-12317
NATIONAL OILWELL VARCO, INC.
(Exact name of registrant as specified in its charter)

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

7909 Parkwood Circle Drive
Houston, Texas
77036-6565
(Address of principal executive offices)
(713) 346-7500
(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if smaller reporting company)	Smaller reporting company o

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

As of August 3, 2009 the registrant had 418,199,258 shares of common stock, par value $.01 per share, outstanding.

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

NATIONAL OILWELL VARCO, INC.
CONSOLIDATED BALANCE SHEETS
(In millions, except share data)

	June 30, 2009 (Unaudited)	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,286	$ 1,543
Receivables, net	2,603	3,136
Inventories, net	3,825	3,806
Costs in excess of billings	590	618
Deferred income taxes	215	271
Prepaid and other current assets	391	283
Total current assets	9,910	9,657
Property, plant and equipment, net	1,758	1,677
Deferred income taxes	195	126
Goodwill	5,466	5,225
Intangibles, net	4,134	4,300
Investment in unconsolidated affiliate	387	421
Other assets	89	73
Total assets	$ 21,939	$ 21,479
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 760	$ 852
Accrued liabilities	2,082	2,376
Billings in excess of costs	2,081	2,161
Current portion of long-term debt and short-term borrowings	8	4
Accrued income taxes	236	230
Total current liabilities	5,167	5,623
Long-term debt	873	870
Deferred income taxes	2,150	2,134
Other liabilities	144	128
Total liabilities	8,334	8,755
Commitments and contingencies		

Stockholders equity:				
Common stock par value $.01; 418,192,372 and 417,350,924 shares issued and outstanding at June 30, 2009 and December 31, 2008		4		4
Additional paid-in capital		8,027		7,989
Accumulated other comprehensive loss				(161)
Retained earnings		5,486		4,796
Total Company stockholders equity		13,517		12,628
Noncontrolling interests		88		96
Total stockholders equity		13,605		12,724
Total liabilities and stockholders equity	$	21,939	$	21,479

See notes to unaudited consolidated financial statements.

2

Table of Contents

NATIONAL OILWELL VARCO, INC.
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(In millions, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenue	$ 3,010	$ 3,325	$ 6,491	$ 6,010
Cost of revenue	2,135	2,344	4,577	4,232
Gross profit	875	981	1,914	1,778
Selling, general and administrative	334	274	653	502
Intangible asset impairment	147		147	
Transaction costs	8	16	8	16
Operating profit	386	691	1,106	1,260
Interest and financial costs	(13)	(24)	(26)	(34)
Interest income	2	10	4	26
Equity income in unconsolidated affiliate	16	17	44	17
Other income (expense), net	(38)	(14)	(74)	(1)
Income before income taxes	353	680	1,054	1,268
Provision for income taxes	131	255	359	443
Net income	222	425	695	825
Net income attributable to noncontrolling interests	2	4	5	6
Net income attributable to Company	$ 220	$ 421	$ 690	$ 819
Net income attributable to Company per share:				
Basic	$ 0.53	$ 1.05	$ 1.66	$ 2.16
Diluted	$ 0.53	$ 1.04	$ 1.65	$ 2.15
Weighted average shares outstanding:				
Basic	416	402	416	379
Diluted	418	404	417	381

See notes to unaudited consolidated financial statements.

3

Table of Contents

NATIONAL OILWELL VARCO, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In millions)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Cash flows from operating activities:		
Net income	$ 695	$ 825
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	238	168
Excess tax benefit from exercise of stock options		(36)
Equity income in unconsolidated affiliate	(44)	(17)
Dividend from unconsolidated affiliate	86	
Intangible asset impairment	147	
Other	(5)	43
Change in operating assets and liabilities, net of acquisitions:		
Receivables	590	(507)
Inventories	75	(297)
Costs in excess of billings	28	38
Prepaid and other current assets	(108)	74
Accounts payable	(152)	22
Billings in excess of costs	(80)	556
Other assets/liabilities, net	(185)	375
Net cash provided by operating activities	1,285	1,244
Cash flows from investing activities:		
Purchases of property, plant and equipment	(143)	(160)
Business acquisitions, net of cash acquired	(389)	(2,945)
Business divestitures, net of cash disposed		784
Dividend from unconsolidated affiliate	8	113
Other, net		(1)
Net cash used in investing activities	(524)	(2,209)
Cash flows from financing activities:		
Borrowings against lines of credit and other debt		2,577
Payments against lines of credit and other debt	(34)	(1,928)
Proceeds from exercise of stock options	1	77
Excess tax benefit from exercise of stock options		36
Net cash provided by (used in) financing activities	(33)	762
Effect of exchange rates on cash	15	13
Increase in cash equivalents	743	(190)
Cash and cash equivalents, beginning of period	1,543	1,842

Cash and cash equivalents, end of period	$ 2,286	$ 1,652
Supplemental disclosures of cash flow information:		
Cash payments during the period for:		
Interest	$ 27	$ 30
Income taxes	$ 409	$ 376

See notes to unaudited consolidated financial statements.

Table of Contents

NATIONAL OILWELL VARCO, INC.
Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

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

The accompanying unaudited consolidated financial statements of National Oilwell Varco, Inc. (the Company) present information in accordance with GAAP in the United States for interim financial information and the instructions to Form 10-Q and applicable rules of Regulation S-X. They do not include all information or footnotes required by GAAP in the United States for complete consolidated financial statements and should be read in conjunction with our 2008 Annual Report on Form 10-K.

In our opinion, the consolidated financial statements include all adjustments, all of which are of a normal, recurring nature, necessary for a fair presentation of the results for the interim periods. The results of operations for the three and six months ended June 30, 2009 are not necessarily indicative of the results to be expected for the full year. The Company has evaluated subsequent events for potential recognition or disclosure in the consolidated financial statements included through August 7, 2009.

Fair Value of Financial Instruments

The carrying amounts of financial instruments including cash and cash equivalents, receivables, and payables approximated fair value because of the relatively short maturity of these instruments. Cash equivalents include only those investments having a maturity date of three months or less at the time of purchase. The carrying values of other financial instruments approximate their respective fair values.

2. Grant Prideco Merger and Other Acquisitions

The Grant Prideco merger was accounted for as a purchase business combination. Assets acquired and liabilities assumed were recorded at their fair values as of April 21, 2008. The total purchase price is $7,199 million, including Grant Prideco stock options assumed and acquisition related transaction costs and is comprised of (in millions):

Consideration given to acquire the outstanding common stock of Grant Prideco:	
Shares issued totaled approximately 56.9 million shares at $72.74 per share	$ 4,135
Cash paid at $23.20 per share	2,932
Grant Prideco stock options assumed	55
Merger related transaction costs	77
Total purchase price	$ 7,199

Table of Contents

Purchase Price Allocation

The following table, set forth below, displays the total purchase price allocated to Grant Prideco s net tangible and identifiable intangible assets based on their fair values as of April 21, 2008 (in millions):

Cash and cash equivalents	$ 171
Receivables	420
Assets held for sale, net	784
Inventories	611
Prepaid and other current assets	210
Property, plant and equipment	392
Goodwill	2,772
Intangibles	3,696
Investment in unconsolidated affiliate	512
Other assets	98
Accounts payable and accrued liabilities	(316)
Accrued income taxes	(624)
Long-term debt	(176)
Deferred income taxes	(1,305)
Minority interest	(25)
Other liabilities	(21)
Total purchase price	$ 7,199

Unaudited Pro Forma Financial Information

The unaudited financial information in the table below summarizes the combined results of operations of National Oilwell Varco and Grant Prideco, on a pro forma basis, as though the companies had been combined as of the beginning of 2008. The pro forma financial information is presented for informational purposes only and may not be indicative of the results of operations that would have been achieved if the merger had taken place at the beginning of 2008. The pro forma financial information for the three and six month periods ended June 30, 2008 includes the business combination accounting effect on historical Grant Prideco revenues, adjustments to depreciation on acquired property, amortization charges from acquired intangible assets, financing costs on new debt in connection with the merger and related tax effects. (in millions, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Total revenues	$ 3,010	$ 3,444	$ 6,491	$ 6,613
Net income attributable to Company	$ 220	$ 446	$ 690	$ 898
Basic net income attributable to Company per share	$ 0.53	$ 1.08	$ 1.66	$ 2.17
Diluted net income attributable to Company per share	$ 0.53	$ 1.07	$ 1.65	$ 2.16

Table of Contents

Other Acquisitions

In the three and six months ended June 30, 2009, the Company completed five acquisitions for an aggregate purchase price of $389 million, net of cash acquired. These acquisitions included:

The shares of ASEP Group Holding B.V., a Netherlands-based manufacturer of well service equipment.

The shares of ANS (1001) Ltd. (Anson), a U.K.-based manufacturer of pumps and fluid expendibles.

The business and assets of Spirit Drilling Fluids Ltd., a U.S.-based company that provides drilling fluids and related well-site services to exploration and production companies.

The business and assets of Spirit Minerals L.P., a U.S.-based company that mines, processes and distributes barite to the oil and gas drilling fluid industry.

From the dates of acquisition, the results of operations from ASEP are included in the Rig Technology segment and the results of operations from Anson, Spirit Drilling Fluids, and Spirit Minerals are included in the Petroleum Services & Supplies segment.

The following table summarizes the preliminary purchase price allocation of the assets acquired and liabilities assumed at the date of acquisition of the 2009 acquisitions (in millions):

	Total
Current assets, net of cash acquired	$ 213
Property, plant and equipment	57
Intangible assets	85
Goodwill	198
Total assets acquired	553
Current liabilities	113
Long-term debt	42
Other liabilities	9
Total liabilities	164
Cash consideration, net of cash acquired	$ 389

3. Asset Impairment

Generally accepted accounting principles require the Company to test goodwill and other indefinite-lived intangible assets for impairment at least annually or more frequently whenever events or circumstances occur indicating that such assets might be impaired.

During the second quarter of 2009, the worldwide average rig count was 2,009 rigs, down 41% from the fourth quarter 2008 average of 3,395 and down 25% from the first quarter 2009 average of 2,681. The second quarter 2009 average rig count represented the lowest quarterly average in the past six years. In addition, the Company s updated forecast was behind the Company s previous forecast completed at the beginning of 2009. While operating profit for the first quarter of 2009 was in line with the Company s first quarter 2009 operating profit forecast, the Company s consolidated operating profit for the second quarter of 2009 was below its second quarter 2009 forecast. As a result of the substantial decline in the worldwide rig count, and the decline in actual/forecasted results compared to the original

2009 forecast, the Company concluded that events or circumstances had occurred indicating that goodwill and other indefinite-lived intangible assets might be impaired as described under SFAS 142.

Therefore, the Company performed its interim impairment test of goodwill for all its reporting units at the end of the second quarter of 2009. The implied fair value of goodwill is determined by deducting the fair value of a reporting unit s identifiable assets and liabilities from the fair value of that reporting unit as a whole. Fair value of the reporting units is determined in accordance with SFAS 157 using significant unobservable inputs, or level 3 in the fair value hierarchy. These inputs are based on internal management estimates, forecasts and judgments, using a combination of three methods: discounted cash flow, comparable companies, and representative transactions. While the Company primarily uses the discounted cash flow method to assess fair value, the Company uses the comparable companies and representative transaction methods to validate the discounted cash flow analysis and further support management s expectations, where possible.

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

Projections for the remainder of 2009 also reflected declines compared to the original 2009 annual forecast. The Company updated its 2009 operating forecast, long-term forecast, and discounted cash flows based on this information. The goodwill impairment analysis that we performed during the second quarter of 2009 did not result in goodwill impairment as of June 30, 2009.

Table of Contents

Other indefinite-lived intangible assets, representing trade names management intends to use indefinitely, were valued using significant unobservable inputs (level 3) and are tested for impairment using the Relief from Royalty Method, a form of the Income Approach. An impairment is measured and recognized based on the amount the book value of the indefinite-lived intangible assets exceeds its estimated fair value as of the date of the impairment test. Included in the impairment test are assumptions, for each trade name, regarding the related revenue streams attributable to the trade names which are determined consistent with the forecasting process described above, the royalty rate, and the discount rate applied. Based on the Company s indefinite-lived intangible asset impairment analysis performed during the second quarter of 2009, the Company incurred an impairment charge of $147 million in the Petroleum Services & Supplies segment related to a partial impairment of the Company s Grant Prideco trade name. The impairment charge was primarily the result of the substantial decline in worldwide rig counts through June 2009, declines in current forecasts in rig activity for the remainder of 2009, 2010, and 2011 compared to rig count forecast at the beginning of 2009, and a current decline in the revenue forecast for the drill pipe business unit for the next three years (2009, 2010, and 2011).

4. Inventories, net

Inventories consist of (in millions):

	June 30, 2009	December 31, 2008
Raw materials and supplies	$ 782	$ 739
Work in process	1,507	1,326
Finished goods and purchased products	1,536	1,741
Total	$ 3,825	$ 3,806

5. Accrued Liabilities

Accrued liabilities consist of (in millions):

	June 30, 2009	December 31, 2008
Compensation	$ 185	$ 258
Customer prepayments and billings	547	912
Warranty	162	114
Interest	12	11
Taxes (non income)	57	76
Insurance	56	50
Accrued purchase orders	743	688
Fair value of derivatives	83	59
Other	237	208
Total	$ 2,082	$ 2,376

Service and Product Warranties

The Company provides service and warranty policies on certain of its products. The Company accrues liabilities under service and warranty policies based upon specific claims and a review of historical warranty and service claim experience in accordance with SFAS 5. Adjustments are made to accruals as claim data and historical experience change. In addition, the Company incurs discretionary costs to service its products in connection with product performance issues and accrues for them when they are encountered.

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

Balance, December 31, 2008	$ 114
Net provisions for warranties issued during the year	75
Amounts incurred	(29)
Foreign currency translation	2
Balance, June 30, 2009	$ 162

8

6. Costs and Estimated Earnings on Uncompleted Contracts

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

	June 30, 2009	December 31, 2008
Costs incurred on uncompleted contracts	$ 5,734	$ 4,776
Estimated earnings	2,987	2,277
	8,721	7,053
Less: Billings to date	10,212	8,596
	$ (1,491)	$ (1,543)
Costs and estimated earnings in excess of billings on uncompleted contracts	$ 590	$ 618
Billings in excess of costs and estimated earnings on uncompleted contracts	(2,081)	(2,161)
	$ (1,491)	$ (1,543)

7. Comprehensive Income

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net income	$ 222	$ 425	$ 695	$ 825
Currency translation adjustments, net of tax	112	11	57	38
Changes in derivative financial instruments, net of tax	83		105	21
Changes in defined benefit plans, net of tax	(1)	1	(1)	
Comprehensive income	416	437	856	884
Comprehensive income attributable to noncontrolling interest	2	4	5	6
Comprehensive income attributable to Company	$ 414	$ 433	$ 851	