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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

OR

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

NATIONAL OILWELL VARCO, INC.

(Exact name of registrant as specified in its charter)

Delaware	76-0475815
(State or other jurisdiction of 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 x No ¨

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

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

Large accelerated filer x	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 x

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

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

NATIONAL OILWELL VARCO, INC.

CONSOLIDATED BALANCE SHEETS

(In millions, except share data)

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

Commitments and contingencies				
Stockholders equity:				
Common stock - par value $.01; 1 billion shares authorized; 375,735,085 and 418,977,608 shares issued and outstanding at September 30, 2015 and December 31, 2014		4		4
Additional paid-in capital		6,201		8,341
Accumulated other comprehensive loss		(1,477)		(834)
Retained earnings		13,398		13,181
Total Company stockholders equity		18,126		20,692
Noncontrolling interests		80		80
Total stockholders equity		18,206		20,772
Total liabilities and stockholders equity	$	29,628	$	33,562

See notes to unaudited consolidated financial statements.

NATIONAL OILWELL VARCO, INC.

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(In millions, except per share data)

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

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

See notes to unaudited consolidated financial statements.

NATIONAL OILWELL VARCO, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(In millions)

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

See notes to unaudited consolidated financial statements.

NATIONAL OILWELL VARCO, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In millions)

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

Cash dividends paid	(537)	(507)
Share repurchases	(2,221)	
Proceeds from stock options exercised	6	107
Other	(2)	9
Net cash used in continuing financing activities	(1,939)	(393)
Discontinued operations		
Net cash used in financing activities	(1,939)	(393)
Effect of exchange rates on cash	(91)	(33)
Increase (decrease) in cash and cash equivalents	(1,690)	655
Cash and cash equivalents, beginning of period	3,536	3,436
Cash and cash equivalents, end of period	$ 1,846	$ 4,091
Supplemental disclosures of cash flow information:		
Cash payments during the period for:		
Interest	$ 57	$ 57
Income taxes	$ 760	$ 1,097

See notes to unaudited consolidated financial statements.

NATIONAL OILWELL VARCO, INC.

Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

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

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

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

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

Fair Value of Financial Instruments

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

2. Spin-off of Distribution Business

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

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

		Period Ended May 30, 2014
Revenue from discontinued operations	$	1,701
Income from discontinued operations before income taxes		83
Income tax expense		31
Income from discontinued operations	$	52

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

3. Inventories, net

Inventories consist of (in millions):

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

4. Accrued Liabilities

Accrued liabilities consist of (in millions):

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

Service and Product Warranties

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

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

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

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

5. Costs and Estimated Earnings on Uncompleted Contracts

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

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

6. Accumulated Other Comprehensive Income (Loss)

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

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

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

	Three Months Ended September 30,	
	2015	2014

	Currency Translation Adjustments	Derivative Financial Instruments	Defined Benefit Plans	Total	Currency Translation Adjustments	Derivative Financial Instruments	Defined Benefit Plans	Total
Revenue	$	$ (10)	$	$ (10)	$	$ (4)	$	$ (4)
Cost of revenue		82		82		6		6
Tax effect		(21)		(21)				
	$	$ 51	$	$ 51	$	$ 2	$	$ 2

	Nine Months Ended September 30,							
	2015				2014			
	Currency Translation Adjustments	Derivative Financial Instruments	Defined Benefit Plans	Total	Currency Translation Adjustments	Derivative Financial Instruments	Defined Benefit Plans	Total
Revenue	$	$ (11)	$	$ (11)	$	$ (25)	$	$ (25)
Cost of revenue		234		234		5		5
Tax effect		(65)		(65)		5		5
	$	$ 158	$	$ 158	$	$ 15	$	$ 15

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

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

7. Business Segments

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

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

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

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

	Three Months Ended September 30, 2015	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2015	Nine Months Ended September 30, 2014
Other items:				

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

8. Debt

Debt consists of (in millions):

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

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

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

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

The fair value of the Company s debt is estimated using Level 2 inputs in the fair value hierarchy and is based on quoted prices for those or similar instruments. At September 30, 2015 and December 31, 2014, the fair value of the Company s unsecured Senior Notes approximated $2,704 million and $2,974 million, respectively. At September 30, 2015 and December 31, 2014, the carrying value of the Company s unsecured Senior Notes approximated $2,992 million and $3,143 million, respectively. The carrying value of the Company s variable rate borrowings approximates fair value.

9. Tax

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

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

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

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

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

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

10. Stock-Based Compensation

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

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

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

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

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

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

11. Derivative Financial Instruments

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

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

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

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

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

Cash Flow Hedging Strategy

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

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

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

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

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

Non-designated Hedging Strategy

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

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

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

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

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

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

The Effect of Derivative Instruments on the Consolidated Statements of Income

($ in millions)

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

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

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

(a) The Company expects that $(235) million of the Accumulated Other Comprehensive Income (Loss) will be reclassified into earnings within the next twelve months with an offset by gains from the underlying transactions resulting in no impact to earnings or cash flow.

(b) The amount of gain (loss) recognized in income represents $(27) million and $1 million related to the ineffective portion of the hedging relationships for each of the nine months ended September 30, 2015 and 2014, respectively, and $1 million and $25 million related to the amount excluded from the assessment of the hedge effectiveness for the nine months ended September 30, 2015 and 2014, respectively.

12. Asset Impairment

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

13. Net Income Attributable to Company Per Share

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

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

ASC Topic 260, Earnings Per Share requires companies with unvested participating securities to utilize a two-class method for the computation of Net income attributable to Company per share. The two-class method requires a portion of Net income attributable to Company to be allocated to participating securities, which are unvested awards of share-based payments with non-forfeitable rights to receive dividends or dividend equivalents, if declared. Net income attributable to Company allocated to these participating securities was immaterial for three and nine months ended September 30, 2015 and therefore not excluded from Net income attributable to Company per share calculation.

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

14. Cash Dividends

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

15. Share Repurchase Program

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

16. Commitments and Contingencies

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

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

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

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

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

17. Recently Issued Accounting Standards

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

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

Introduction

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

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

Rig Systems

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

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

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

Rig Aftermarket

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

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

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

Wellbore Technologies

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

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

Completion & Production Solutions

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

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

Discontinued Operations

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

Critical Accounting Policies and Estimates

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

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

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

The carrying values of these assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. An impairment loss is recorded in the period in which it is determined that the carrying amount is not recoverable based on estimated future undiscounted cash flows. We estimate the fair value of these intangible and fixed assets using an income approach. This requires the Company to make long-term forecasts of its future revenues and costs related to the assets subject to review. These forecasts require assumptions about demand for the Company s products and services, future market conditions and technological developments. The forecasts are dependent upon assumptions regarding oil and gas prices, the general outlook for economic growth worldwide, available financing for the Company s customers, political stability in major oil and gas producing areas, and the potential obsolescence of various types of equipment we sell, among other factors. The financial and credit market volatility directly impacts our fair value measurement through our income forecast as well as our weighted-average cost of capital, both key assumptions used in our calculation. Changes to these assumptions, including, but not limited to: sustained declines in worldwide rig counts below current analysts forecasts, collapse of spot and futures prices for oil and gas, significant deterioration of external financing for our customers, higher risk premiums or higher cost of equity, or any other significant adverse economic news could require a provision for impairment in a future period.

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

Goodwill and Other Indefinite-Lived Intangible Assets

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

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

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

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

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

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

EXECUTIVE SUMMARY

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

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

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

Oil & Gas Equipment and Services Market

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

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

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

Segment Performance

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

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

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

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

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

Outlook

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

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

Our outlook for the Company s Wellbore Technologies and Completion and Production Solutions segments remains cautious as drilling activity is not expected to improve substantially in the rest of 2015. In order to keep contracted rigs running, our customers could reposition components and consumables, including drill pipe, bits, jars and shakers off of idle rigs within their fleets, as opposed to placing new orders for these items with NOV. Drilling consumes rigs, and the rate of capital equipment and consumables consumption will decline with lower drilling activity, while customers will live off of current inventory and postpone maintenance and upgrades when possible. However, this behavior is not sustainable over the long term. When customers exhaust current on-hand inventory, demand could recover for the equipment and services NOV provides once drilling activity recovers.

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