THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

NOV - Q3 2012 National Oilwell Varco Earnings Conference Call

EVENT DATE/TIME: OCTOBER 25, 2012 / 1:00PM GMT

OVERVIEW:

NOV reported 3Q12 revenues of $5.3b and net income of $612m or $1.43 per fully-diluted share.

THOMSON REUTERS

CORPORATE PARTICIPANTS

Pete Miller *National Oilwell Varco Inc - Chairman, President & CEO*

Clay Williams *National Oilwell Varco Inc - EVP, CFO*

CONFERENCE CALL PARTICIPANTS

Doug Becker *BofA Merrill Lynch - Analyst*

Brad Handler *Jefferies & Company - Analyst*

Jim Crandell *Dahlman Rose & Co. - Analyst*

James West *Barclays Capital - Analyst*

Robin Shoemaker *Citigroup - Analyst*

PRESENTATION

Operator

Welcome to the National Oilwell Varco 2012 third-quarter earnings conference call. My name is Christine, and I'll be your operator for today's conference. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session. Please note, today's conference is being recorded.

I will now turn the call over to Chairman and Chief Executive Officer Pete Miller. Sir, you may begin.

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

Thanks, Christine. And good morning, and welcome to the National Oilwell Varco third-quarter 2012 earnings conference call. With me on this call today is Clay Williams, our CFO. Loren Singletary, our VP of Investor Relations, is normally on this call, but he is traveling today and will return when we do the call at the end of the year.

Earlier today we announced quarterly earnings of $612 million, or $1.43 per share on record revenues of $5.3 billion. Included in this number are transaction costs of approximately $57 million pre-tax. Net income for the quarter, excluding the transaction charges, is $650 million or $1.52 per fully diluted share.

We are very pleased with this result, and we believe they reflect the continued excellent execution of our employees around the world, and the demand for our products and services in all areas of the globe. Clay will expand upon these results in just a moment.

Additionally, we announced new capital equipment orders of $2.3 billion for a quarter-ending backlog of $11.7 billion, just below our record backlog that we achieved in the third quarter of 2008. The book-to-bill for this quarter was 1.2 to 1. I will address the backlog later in the call when I give an overview on operations. At this time, I will ask Clay to provide color on these results.

Clay Williams - *National Oilwell Varco Inc - EVP, CFO*

Thanks, Pete. Before I begin this discussion on National Oilwell Varco's financial results for its third quarter ended September 30, 2012, please note that some of the statements we make during this call may contain forecasts, projections, and estimates, including but not limited to comments about our outlook for the Company's business. These are forward-looking statements within the meaning of the federal securities laws, based on limited information as of today, which is subject to change. They are subject to risks and uncertainties, and actual results may differ materially. No one should assume that these forward-looking statements remain valid later in the quarter or later in the year.

I refer you to the latest Forms 10-K and 10-Q National Oilwell Varco has on file with the Securities and Exchange Commission for a more detailed discussion of the major risk factors affecting our business. Further information regarding these, as well as supplemental financial and operating information, may be found within our press release, on our website at www.nov.com, or in our filings with the United States Securities and Exchange Commission. Later on in this call we will answer your questions, which we ask you to limit to two, in order to permit more participation.

Turning to results, as Pete mentioned, National Oilwell Varco generated $1.43 per fully diluted share in earnings in its third quarter of 2012, on $5.3 billion in revenues. Excluding $57 million in pre-tax transaction charges, or $0.09 a share, third-quarter 2012 earnings were $1.52 per fully diluted share, up $0.06 per share or 4% from the second quarter, and up $0.26 per share or 21% from the third quarter of 2011, excluding transaction charges from all periods.

Operating profit, ex-transaction charges, was a record $946 million, up 4% from the second quarter, and up 22% from the third quarter of last year. Below the operating profit line, we saw a variety of puts and takes in the third quarter income statement, as compared to the second. Results were helped by a slightly lower sequential tax rate, but also hurt by lower sequential equity income from our JV, and by higher bank charges and FX expenses, which I will discuss a little bit more later.

Excluding transaction charges, EBITDA was a record $1.1 billion during the third quarter of 2012, up about 2% sequentially, and up 17% from the prior-year quarter. Record sales of $5.3 billion rose 12% sequentially, and 42% year over year. Performance was solid across all three of our segments in the third quarter, owing to terrific execution once again by the professionals who manage these businesses for National Oilwell Varco. All of us here greatly appreciate their dedication and hard work.

This was a complicated quarter, with cross-currents and divergent trends arising across many of our major market areas. While demand for deepwater offshore drilling rigs is high and rising, and most international markets are steadily pushing activity higher, headwinds intensified in North America, as domestic rig counts moved downward with both gas and oil plays affected. Canada is usually up big in the third quarter, but this year's seasonal recovery out of break-up was pretty tepid.

All across North America, it seems everybody is hesitating. Large-cap E&Ps are laying down rigs, and a new parsimoniousness is sweeping through the North American oilfield complex.

However, we are simultaneously hearing a clear chorus of -- drill, baby, drill -- from overseas in Spanish, Russian, Portuguese, Arabic, Bahasa and Mandarin voices. Tenders are picking up, as drilling contractors increasingly adopt modern AC power and electronic controls, and as overseas operators increasingly employ horizontal well pads and hydraulic fracture stimulation techniques refined in North American laboratories.

Following a doubling of US rig count off mid-2009 bottoms, and an unprecedented surge in US oil production, we now seem to face a world with North America playing defense while the rest of the world plays offense. Specifically, Argentina, Kuwait, Algeria, Saudi Arabia, Brazil, Oman, Iraq, Indonesia -- all busy.

We are investing in Eastern Europe, Russia, Africa, and Latin America to continue to position NOV to support growing activity in these regions. We are developing new fixed cutter bit technologies, a new pad drilling rig design, a new CE ATEX-rated land rig to European standards, to support international growth. We are building out several facilities in Brazil to support Petrobras's ambitious plans for the Santos Basin. And we added new after-market facilities in sub-Saharan Africa this quarter. We are selling more well-stimulation equipment into the Middle East, China and Russia. Offense is fun.

Defense, not so much. Our North American pressure-pumping customers face an over-supplied market and fierce price competition, and have cut orders to about zero. Although we believe land drilling day rates in the US have remained relatively firm, contract terms are continuing to shorten, falling from three years to well-by-well lately. And day rate pressure is likely to emerge soon as rig counts are down 168 rigs since the beginning of the year.

Without payback on a new rig construction project fully locked in contractually, most domestic drillers seem unwilling to build new rigs without better clarity and are reflexively retrenching on all spending. For example, last quarter we referenced slowing orders for new drill pipe, and noted that our backlog declined. Drill pipe is one of many products we manufacture within our Petroleum Services & Supplies segment, which is about 75% sales of manufactured consumable products, or manufactured short-lived capital products.

Although we don't report them publicly, we do track backlogs of orders for certain PS&S products internally. During the third quarter, we saw backlogs drop across most, with many falling 10% to 30% during the quarter. Although 1,839 rigs drilling in the US last week is a solid level of absolute activity, which is consuming an awful lot of what NOV makes, our customers can cut purchases and use their own inventories of consumables for a time if they so desire.

We believe that that's what is happening now. Orders are slowing out of an abundance of caution, as customers across North America hunker down. Price pressure has now emerged, and will take a toll on margins in the fourth quarter as a result.

Interestingly though, domestic demand for certain other products and services have held up well. For instance, our Tuboscope pipe services business remain relatively flat sequentially, with higher tubing and casing volumes offsetting declining drill pipe volumes. Our downhole tools group put up third-quarter revenue gains in the US, even in the face of some price pressure, primarily due to some new technologies we've launched recently that are performing well in the marketplace.

While rentals and leasing of solids control equipment declined in the US, declines were at least partly offset by higher solids control capital equipment sales here. Partly due to rising activity in the US Gulf of Mexico bucking the trend a bit, partly due to offshore new-builds.

Theories about North America abound. We hear anecdotally that E&Ps on this continent have burned through 2012 budgets, and are waiting to reload 2013 budgets before resuming activity. Or that after outspending cash flows for several quarters, they are perhaps unwilling to stretch balance sheets further. Or that they don't believe crude will stay at $90 for WTI, owing to macro concerns like slowing growth in China or one big final European sovereign debt meltdown.

With oil relatively stable around $90 per barrel through the quarter, the last few days notwithstanding, and with gas in the $3.40 range and trending up, we are surprised that North American activity isn't more robust. We are, therefore, optimistic that this North American decline is transient. After all, North America has been the most successful of all regions at growing production.

Solid commodity prices, coupled with drilling and completion costs that are certainly falling sharply right now, should yield improving economics for E&Ps, and a drilling recovery in North America soon. And as a major provider of critical technologies and products into unconventional shale plays, National Oilwell Varco is exceptionally well positioned to benefit from a resumption of North American drilling growth, just as we are benefiting from the steady growth of shale development overseas today. Growth which is helping make dispositions outside North America much sunnier.

The deepwater offshore outlook is very bright, owing to a growing supply gap of floating rigs, which is driving day rates and new-build economics higher. Inbound inquiries for new floating rigs are steady, and offshore drillers are smiling. And we expect a solid quarter of orders again in the fourth quarter, following strong orders in the third. We still have several tenders out in Brazil, which could further contribute to orders in the fourth quarter, or in 2013.

We believe that the strength of deepwater day rates in 2012, despite several years of meaningful fleet growth and highly visible capacity additions, supports our thesis that the world has and will continue to build out a large deepwater capability, well into the 21st century to exploit new deepwater frontiers opened by new technologies. More recently, we have seen a sustained level of interest in deepwater new-builds that, we hope, may be tracing out a new, more stable pattern of orders for NOV's floater drilling equipment packages.

Shipyards are underemployed, hungry, and aggressive on pricing. Deepwater day rates are high and rising. Capital is available and cheap. Construction time is shortening, and execution risk is approaching zero, at least for our customers. Importantly, this situation has been stable for eight-plus quarters, and our deepwater drilling contractor customers seem to be exhibiting a growing confidence with what we hope is a new era.

A number of drillers tell us that they are prepared to move forward with a fixed number of new-builds at any given time, and that as they contract one new-build, they will, in turn, sign up for another. Strategically, we believe that they are comfortable devoting a certain constant level of management bandwidth and risk capital to new-building on spec. But no more and no less. In essence, we believe order patterns may be evolving from ad hoc opportunistic boom-bust to systematic, thoughtful, and strategic.

Offshore rig orders will always be somewhat volatile for NOV. And as we know, things can change quickly in our business. Specifically, a downturn in day rates, an evaporation of credit, tightening shipyard capacity, a spike in steel prices, and 10 other things I can't even think of, can end the party.

But what may be different now is the mindset of our customers, who no longer dismiss new-rig building out of hand, who are less constrained by the dogma of the last generation. This relatively new industrial paradigm, if true, signals a shift in thinking among our customer base that has the potential of generating somewhat steadier order patterns for our Rig Technology segment. Time will tell.

Solid demand for floaters and international activity is helping offset some of the weakness in North American land. We see 58 floaters that should be ordering drill pipe between now and the end of 2013. And already expect orders on the books for large premium offshore drill pipe to partly offset slowing land bookings. Similarly, solids control equipment, Mission pumps and manifolds, and other products within Petroleum Services & Supplies are seeing offshore demand partly offsetting slower land demand.

Jack-up demand has slowed in spite of the compelling fleet demographics. 317 jack-ups in service around the globe are more than 25 years old, which means that they must be replaced soon. Lately, price competition has been fierce for the small number of DEPs in play for new-builds in that arena. Generally, inquiries are coming more from second- and third-tier drillers associated with NOCs. Or for a small number of very high-spec jack-ups sponsored by IOCs.

Our Distribution & Transmission segment posted record results, having done a terrific job of pulling together a much larger organization this year. The new mix is a little more heavily weighted towards North America, so lower drilling activity took a toll. But rising midstream activity associated with pipeline buildouts and rising well hookup activity helped offset, particularly in the Permian, Eagle Ford, and Mississippian plays.

Sales of artificial lift equipment and valves into international projects rounded out a solid third-quarter result for the group. Consolidation has proceeded very, very well, and we expect continued success into 2013 as we begin a lot of heavy lifting around converting to a common ERP platform.

One quick update regarding Robbins & Myers. Earlier this month, we announced that we had received a request for information, commonly called a second request, from the US Department of Justice pursuant to their review of the transaction under the Hart-Scott-Rodino Act of 1976. Gathering and submitting this information will take time and resources, but we are nevertheless confident that, after review, the transaction will be able to proceed as planned.

However, this extra step does put pressure on timing, and though we are still targeting a fourth-quarter closing, it is possible that events slip into 2013. We remain very excited about this transaction, and believe it will be a great fit with NOV, expanding our product lines, adding capacity, and strengthening our capabilities to service our customers. We look forward to welcoming the Robbins & Myers employees to the NOV team soon.

Turning to our segment operating results, the Rig Technology Group generated revenues of $2.5 billion in the third quarter, up 6% sequentially, and up 29% compared to the third quarter of 2011. Operating profit was $610 million, and operating margins were 23.9%, up slightly from the prior quarter. Incremental leverage or flow-through was 27% sequentially and 14% year over year.

The segment benefited from a full-quarter's contribution from NKT and Enerflow, as well as higher revenues out of offshore project backlog, which increased 10% sequentially. After-market revenues increased both sequentially and year over year, with higher sequential spare parts, partly offset by lower service revenues. Overall, non-backlog revenues grew 8% sequentially, and our outlook for after-market sales next year is bright.

The first floaters constructed this cycle will begin to turn five years old next year, which means that they will be returning to shipyards for their five-year surveys. Since the opportunity cost of going off day rate in the shipyards is so high, drillers use this time to also perform maintenance and upgrade activities, often buying lots of NOV spares and kit as part of the effort.

The offshore rig delivery curve of the last few years provides a great window into NOV's potential after-market sales for the next few years. And we have been deploying capital into facilities to make sure that we can meet the needs of our customers as their new, sophisticated rigs go in for survey.

Strong demand for floaters this quarter overcame sluggish sales of land rigs and jack-ups, and a sharp downturn in demand for frack spreads. Orders of $2.289 billion were up 3% from the second quarter, excluding $511 million of backlog flowing in, in the second quarter, with the NKT and Enerflow acquisitions.

New orders were partly offset by record revenues out of backlog of $1.913 billion, and led to a backlog of capital equipment orders for the segment of nearly $11.7 billion at September 30, 2012, up 3% sequentially, and up 13% year over year. Approximately 87% of the backlog is offshore, and 13% land. 95% is for international markets, and only 5% is for domestic markets. We expect $1.9 billion to flow out of backlog in the fourth quarter of 2012, $7.1 billion to flow out in 2013, and the balance to flow thereafter.

The Group won orders for drilling equipment packages for seven floaters and one jack-up during the third quarter. Five of the floaters were for Brazil, to be delivered over the next several years. Again, the overall rig costs -- again, with overall rig costs down about 15% from 2008 peaks, day rates high, and financing available at least for established drillers, we expect fourth-quarter orders to be strong.

Orders for flexible pipe for subsea developments were solid this quarter. And orders for FPSO turret mooring systems improved sequentially. However, generally the FPSO market remains soft as vessel operators exhibit little appetite for financing new vessels or assuming project risk as they have in the past.

Nevertheless, all signs point to growing pent-up demand for lots of FPSOs. We believe that a new paradigm must emerge for this industry, one that more fairly partitions risk and capital across participants. We suspect that the ultimate source of demand for these vessels, the IOCs and the NOCs, will bear much more of the capital and risk of execution than they have in the past decade. But until this sorts itself out, orders will likely remain slow.

Interestingly though, the after-market demand for APL has picked up recently, related to interest in extending vessels beyond the end of their original planned service lives.

Looking forward into the fourth quarter of 2012, we expect revenues to grow 1% to 2%, and margins for our Rig Technology segment to be about flat with third-quarter 2012 results. Declining North American pressure-pumping and well-servicing demand, and start-up expenses associated with certain planned expansions abroad are expected to offset gains in offshore projects.

The Petroleum Services & Supplies segment posted revenues of $1.717 billion, down 3% sequentially, and up 18% year over year. Operating profit declined slightly sequentially to $383 million, and operating margins were 22.3%, up slightly from the second quarter, and up 180 basis points from the third quarter of last year. Compared to the second quarter of 2012, the $59 million revenue decline carried 17% decremental operating leverage or flow-through. Compared to the third quarter of 2011, the 18% sales growth generated 33% operating leverage or flow-through.

The Group saw little benefit from sequential recovery out of break-up in Canada, where higher activity-related services were more than offset by lower sequential sales of drilling tools, which led overall Canadian revenues 4% lower in the third quarter. The US saw 9% lower sequential sales, spread across a number of product lines, most notably drill pipe, as land drillers slowed purchases to instead rely on their existing stocks of drill pipe. The Group also saw lower sequential sales of composite pipe, coil tubing, conductor pipe connectors, and mill inspection equipment.

As I noted earlier, backlog for most products declined, pointing to a difficult quarter ahead, with weakness mostly seen in domestic markets. International markets generally appear to be continuing on a growth track. Overall, the segment's third-quarter sales mix was approximately 60% North American and 40% international.

As we enter the fourth quarter of 2012, we expect Petroleum Services & Supplies segment sales to be about flat to down slightly compared to the third quarter, due to declining North American sales. Margins will decline with rising price pressure we began to see late in the third quarter, and are likely to end up around 20%.

The Distribution & Transmission segment posted 69% higher sequential sales from the second quarter to the third, and 174% higher year-over-year sales, due to its additions of Wilson Supply, CE Franklin, and Engco over the past few quarters, which have flowed in at a little lower margins. Revenues were $1.3 billion, and operating profit was $78 million. Operating margins were 5.9% of sales, down from the second quarter due to the changing mix.

Sequential flow-through, or operating leverage, was 4%. And year-over-year operating leverage was 5%. Mix for the Group's third quarter was 84% North America and 16% international.

In addition to rising midstream and well hook-up demand I mentioned earlier, Distribution Services also benefited from the recovery of deepwater drilling in the US Gulf of Mexico, along with rising demand for cables and other components into new-build offshore rig projects in Asia. Transmission grew sequentially with the addition of Wilson's tubular business.

Looking into the fourth quarter of 2012, we expect Distribution & Transmission Group revenues to decline in the mid-single-digit range, owing to North American headwinds. But for the Group to produce operating margins in line with the third quarter, as continued cost savings roughly offset volume decline effects.

Turning to National Oilwell Varco's consolidated third-quarter 2012 income statement. Gross margin declined 137 basis points, due primarily to NOV's much higher mix of Distribution revenues as compared to the second quarter. SG&A increased $51 million, primarily due to the new business additions as well. SG&A as a percent of sales was 8.7% in the third quarter, unchanged from last quarter, and down from 10.5% last year.

Interest expense of $10 million was up due to new debt taken on through the Summer. Equity income in our Voest-Alpine JV was $7 million, down $12 million sequentially, due to lower OCTG sales, poorer mix, and two weeks of shutdown for mill maintenance in the third quarter.

Other expense increased $9 million from Q2 to $14 million, due to higher bank charges and FX expense, and we expect about the same in the fourth quarter. The book tax rate for the third quarter was 30.3%, lower than our expected rate of 32% to 33%, due to a higher mix of overseas income at lower rates, lower non-deductible expenses in foreign jurisdictions, and higher US manufacturing deductions in the third quarter. We expect the fourth-quarter tax rate to return to the mid-32% range.

Unallocated expenses and eliminations on our supplemental segment schedule was $125 million in the third quarter, up $14 million sequentially due to acquisitions, IT costs, and higher inter-segment sales eliminations. Depreciation and amortization was $157 million, flat with the second quarter. EBITDA, excluding transaction charges, was a record $1.1 billion, up $17 million sequentially. EBITDA was 20.8% of sales.

National Oilwell Varco's September 30, 2012 balance sheet includes total debt of $1.5 billion, an increase of $81 million sequentially, to finance cash working-capital and tax payments made during the quarter. Cash was $1.7 billion at quarter end, with approximately 94% of the balance located overseas. Consolidated working capital, excluding cash and debt, was $6.6 billion, up $733 million from the second quarter, due in part to changes in customer progress billings on new rig orders. The net of billings in excess of cost, customer prepayments, and cost in excess of billings, was a use of cash of $198 million during the third quarter.

Additionally, acquisitions added $166 million, and inventory in Rig Technology grew $266 million, related to after-market BOPs and backlog. Faster shipyard construction cycles are accelerating component deliveries from us, requiring more inventory to support deliveries.

Working capital as a percentage of annualized sales was unchanged from the second quarter at 31.2%. Our current utilization of working capital is a little higher than we'd like, and we plan to focus on better inventory management, in particular, in the next couple of quarters.

Cash flow generated by operations was $137 million for the third quarter, with levered cash flow of $769 million offset by changes in working capital items. CapEx was $129 million in Q3. And we expect it to rise in Q4, and to finish the year in the range of about $600 million.

Now let me turn it back to Pete.

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

Thanks, Clay. Those of you that have listened to our calls in the past know that we have some fairly common themes. And I want to hit those themes again because I think they all really are staying with a lot of traction, and they're really what's kind of dictating the business as we go forward. And those themes are essentially shales, the deepwater, our international presence, and the best-in-class technology.

And as I look at these, on shales, the reality is, it's all about efficiency today. When you look at the efficiency gains, if you've listened to some of the service companies on calls here in the past couple of weeks or the past week or so, they've talked about the great gains that you're seeing in shales. A lot of those gains are because of the equipment that we manufacture. When you talk about fit-for-purpose rigs, when you talk about downhole tools, our new bits, motors, frack spreads, different things like that, you're starting to see those efficiencies really come into focus a lot.

And we're also starting to see much more of the international presence in shales. We've always talked about that coming. It would be a little bit slower, but we believe over the next couple of years, that's going to be a very attractive amount of business for NOV.

The deepwater demand continues. As Clay pointed out, we had a good quarter of deepwater rigs. We expect, as we look to the future, there's still an awful lot of interest. And the bottom line is, with our unparalleled execution and our state-of-the-art equipment, we're positioned very, very well to benefit greatly as we look at this.

And in addition to that, we're starting to see more drilling permits come on the deepwater, which in fact helps all of our other businesses, our PS&S and our Distribution business as well. So, we don't see any abatement at all in the near future of what's going on in the deepwater. And we think that's going to be something that will be very, very attractive for NOV.

In the international arena, again, our presence there is felt. As Clay pointed out in his comments, the international business continues to be a good business, a robust business. And we really have the footprint to be able to take advantage of that.

Some of the more interesting areas right now are Latin America. We're starting to see --obviously, everybody that has followed us knows about Brazil. But we're seeing more and more things in countries like Colombia, Argentina, Ecuador, and other parts of Latin America. We think that's going to be something that will really help drive a lot of our business as we look into the future.

Russia is a very attractive place for us right now. Clay mentioned that we're making investments there. We are building a facility there that will handle a lot of our PS&S equipment, as well as build rigs. We're excited about the prospects for this new facility. And we think it's really going to enhance our market position there as we look to the future.

The Middle East continues to be a very positive arena. As we look at land rigs in particular, we have a very good set-up in Dubai, the Jebel Ali Trade Free Zone, where we're able to manufacture rigs. And that really in fact reduces a lot of the lead times associated with that. You know, a lot of times when the land drillers want rigs, they want them now. When you're talking about the deepwater guys, they know they have to wait a couple years, 2.5 years, to get their rig. But the land drillers want it now.

And being able to build rigs in places like Russia and Dubai and China really makes the logistics line that much slower. And we can actually deliver the rigs much more quickly, which is a real, we believe, competitive advantage. We think that's going to continue well into the future.

And then you take a look at Asia, China, and Australia, again, are very attractive markets for us. I think they will also be markets that will parlay a lot into the shale plays. And the advantages that we'll be able to bring to bear, to bring our equipment into those arenas so that we can, in fact, help them really exploit their shale plays. So, I think, again, that the shales and the deepwater and the international arena all fit very, very well to what we're doing today.

And then, finally, it's the best-in-class technology. It's really about having what I believe are the new products that are out there that really get the marketplace excited.

Just here recently, we won two of the World Oil Awards for some of the best products to be introduced in the past year. And that included our NOVA automation system and our IntelliServ smart drill pipe. We're very proud of those awards, but we think they're definitive of what we're doing, and show that we're kind of leading the way when it comes to new product development.

Other things that we're working on, you take a look at 20,000 psi BOPs, more robust top drives, and our roughnecks. There are top drives now that can actually deliver 100,000 foot-pounds of torque to be able to drill these much more challenging wells that are out there.

A biggie, a big one for us is going to be smart equipment, as we go to the future, and we're building smart equipment now. We're going to be able to remotely monitor this smart equipment, and be able to help reduce the cost to our customers, which we think puts us in great shape when people are looking at what they want to build.

Clay mentioned the new CE ATEX rig that we're building for the shales in Eastern Europe and different places like that. And we're also working on a new design FPSO, one that we really think will help the industry be able to standardize, if you will, and be able to not have to work every project like it's a separate one-off.

So, there's a lot of exciting things going on in that arena. We continue to invest in that.

Our backlog, as I pointed out earlier, was just below a record. And we feel very good about where the order intake is going. And I will also tell you that on some of the acquisitions that we've done, our integrations are going very, very well. And we're very pleased, and we welcome all of our new employees to the National Oilwell Varco family.

So, at this point, Christine, I will end my comments and turn it over to anybody that might have any questions for us.

QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions) Doug Becker from Bank of America.

Doug Becker - *BofA Merrill Lynch - Analyst*

Okay, thanks. Maybe just starting off on PSS. Revenues really seem to be hanging in there very well in light of what the rig count is doing. You did highlight that there could be some margin pressure in the fourth quarter. But just wanted to calibrate what you're thinking about in terms of rig activity in North America. And how that relationship should be with revenues as we go forward.

Clay Williams - *National Oilwell Varco Inc - EVP, CFO*

Yes, Doug. We think -- I guess -- first, let me qualify. I don't think our crystal ball is any better than anyone else's. But in terms of the next quarter or two, a little more of the same.

You know, we're hearing specific plans of customers in Canada, for instance, trimming drilling programs, more cuts to come in North America. The flip side is, though, we see continued growth overseas. So net-net, I can't tell you that ends up a net increase or not. But call it, you know, flat to maybe a little bit of a downward bias in terms of activity.

The nature of our PS&S business, though, may be just a little different than what a lot of investors perceive, in that it is more manufacturing than other service businesses that may be viewed as comparable or peers.

And that's one of the things I tried to highlight in my comments. About three-quarters of PS&S is actually manufacturing of consumables and short-lived capital. And so what that does in a way is to just delay by maybe a month or two kind of the effect of a downturn in activity, when we see it in PS&S.

Some of the businesses are services and they're very rig count-driven, and we feel it in rig time. But others have a little bit of a backlog, maybe a few weeks of orders that help us kind of buffer that.

So that enabled PS&S to post pretty good revenues. They were down 3% sequentially in Q3, and kind of forestall a downturn in sales. But Q4, we're calling for maybe a little more of the same. I would say flat to maybe down slightly.

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

And also, Doug, one of the things that's good about our PS&S side, when I talked about the efficiency gains in a lot of the wells being drilled. While the demand for rigs is declining a little bit, the efficiency gains in the footage being drilled is still pretty good. And a lot of the tools that we're putting in there, whether they're Helios drilling bits or whether they're our new downhole motors, are really doing very, very well.

So it's kind of a two-sided coin right there. But we do have some positive things because of those efficiency gains.

Doug Becker - *BofA Merrill Lynch - Analyst*

Makes sense. So if US rig count were to kind of flatten out as we go into 2013, international presumably still improving, would you expect margins to still be kind of around the 20% level? Or actually improve?

Clay Williams - *National Oilwell Varco Inc - EVP, CFO*

I think if we have growth overseas, you know, that's a good foundation for margin expansion as we kind of move through 2013. And so, you know, if North America just hangs in there and stabilizes, we can certainly -- we've got terrific managers who are good at managing the cost side of the equation here. And then, with a little growth overseas -- and we see the same sorts of adoption of new technologies of these new products blossom in shale plays overseas, you're moving from one continent to another, five or six, that's a pretty good tailwind in 2013 to drive margins a little higher towards the end of the year.

Doug Becker - *BofA Merrill Lynch - Analyst*

Okay. And then, Pete, I think I know the answer to this, but Clay was mentioning the potential of a new paradigm for rig orders, just more stable. And I guess I'd argue all else equal, that should mean higher multiples for the stock.

What does this make you think about capital allocation? Does it make share repurchases more attractive in your eyes? Or you still tend to focus more on the acquisition and dividend angle?

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

You know, Doug, I think our -- we're going to probably continue more on the M&A and the dividend issue. But we look at everything all the time. I mean, whenever we have a Board meeting, we review with our Board strategically where we are and what the best allocation of capital is. And I've got an awfully good Board, an astute Board. And I think they will chime in and give us their guidance as well.

But I would say right now, we still believe we do M&A very, very well and will continue to look at that. And of course, our dividend payments will remain there.

But you're right, and I think that as we take a look at, you know, this new paradigm, what we believe is there, we also believe that we do deserve a higher multiple, so I will certainly not argue with you on that one. But again, as I tell everybody, everything's always on the table for us. It's just a matter of what the best determination is at that point in time.

Clay Williams - *National Oilwell Varco Inc - EVP, CFO*

Yes, we've -- you know, I think the key thing here is we've used both acquisitions as well as capital investments internally to support our customers to meet their needs. We've seen rising demand across a lot of our businesses, and throughout Rig Technology and PS&S both, as well as some businesses in Distribution. We've deployed a lot of capital, our CapEx.

Our plan was that CapEx move up very sharply in 2012. We're actually probably going to under spend what we budgeted for, simply because our eyes were a little bigger than our stomach. But the capital is available there to grow these businesses and we're happy to put it to work to take care of our customers.

Doug Becker - *BofA Merrill Lynch - Analyst*

Thank you very much.

Operator

Brad Handler from Jefferies & Company.

Brad Handler - *Jefferies & Company - Analyst*

Thanks, good morning, guys. A couple of unrelated things, please. And I guess they're both pretty quick. The first is, I guess I was surprised -- I know you tend not to talk about specific rigs, so I'm just going to ask you to reach however you can. But I was a little surprised that the orders this quarter included five rigs from Brazil. Maybe it's almost that it didn't include other things. So I was sort of anticipating less from Brazil and more from the rest of the world.

If there's any color you can add to that, to the timing of how that plays out, and maybe suggestions about your anticipation for Q4 or Q1 in that context, I'd appreciate it.

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

Sure, Brad. You know, as we've talked many, many times, you know, the timing of the backlog is always a very interesting phenomena. And we cut it off. You know, we basically -- if we don't have an order by the 30th of September, that's that.

And a lot of the times, what you'll see, people will be making announcements about we're going to do this or we're going to do that. We also don't put anything notional on our backlog. It's got to have a signed document and it's got money with it normally, as well. And so, a lot of the things that you read about that people say we're ordering, they aren't necessarily ordered last quarter and they'll push out into another quarter.

That's one of the reasons that we talk about this all the time, about as you take a look at backlog, you really have to look at it over a more extended period. Because, again, of that date-certain that we always cut things off. I think if you look over the last four or five quarters, you can see that we've always been over -- I can't remember the last quarter that we weren't over a 1-to-1 book-to-bill. But the orders have stayed very, very steady. And we feel very good about where we're going into the future.

Clay Williams - *National Oilwell Varco Inc - EVP, CFO*

Yes, actually eight out of the last nine quarters I think our book-to-bill was in excess of 1. In this quarter, we had record revenue out of backlog, and orders exceeded that by 20%. So 120% of record revenue book-to-bill is pretty strong.

Brad Handler - *Jefferies & Company - Analyst*

Absolutely, no question about it. I guess I was -- well, maybe a constructive question is to ask, were the five coming out of the Sete Brasil orders?

Clay Williams - *National Oilwell Varco Inc - EVP, CFO*

Yes.

Brad Handler - *Jefferies & Company - Analyst*

Okay, all right, fair enough. The unrelated follow-up, if I may, is maybe just a little help on the Distribution guidance. In the third quarter, how much of the quarter included CE Franklin as well as Wilson?

Clay Williams - *National Oilwell Varco Inc - EVP, CFO*

We had a full quarter of Wilson, and almost a full quarter of CE Franklin.

Brad Handler - *Jefferies & Company - Analyst*

Almost, okay, so in other words --

Clay Williams - *National Oilwell Varco Inc - EVP, CFO*

You're getting a pretty good window in sort of a go-forward capability of Distribution & Transmission. And, you know, the other point on that, too, and I mentioned this in my comments, but the mix shifted towards North America, which is slowing a little bit. So that's the headwind in Q4 baked into the guidance on Distribution & Transmission I gave a few minutes ago.

Brad Handler - *Jefferies & Company - Analyst*

Got it, understand, all right. So it's a pretty straight comparison quarter-on-quarter. Okay, very good, thanks, guys.

Operator

Jim Crandell from Dahlman Rose.

Jim Crandell - *Dahlman Rose & Co. - Analyst*

Good morning, Pete and Clay. You know, just to follow up on that was my last question, that was my exact question, too. I'd expected these BrasFELS orders to fall into the fourth quarter and beyond, I didn't think you were near. Are we talking about the BrasFELS orders when you say yes from Sete?

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

Jim, you know us when it comes to orders. We always let our customer kind of tell you what it is. In this particular case, they are from Sete. I mean, that's pretty well known because Sete is doing just about everything there. But we always defer to our customers to talk about that.

Jim Crandell - *Dahlman Rose & Co. - Analyst*

So BrasFELS hasn't ordered any rigs through you? Or they would come through Sete, as well?

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

The way Brazil is working right now, Jim, and we've kind of talked a lot about this. Sete is actually the people that are ordering rigs. And then the customers, they come to us and we work with them. And so the ultimate customer on those is in fact Sete.

But there's -- you know, the bottom line on it, to put Brazil in context, there's more rigs to come out of Brazil yet. There's still some that have not been -- orders have not been placed. And we would expect those orders to be placed probably in the next quarter to half a year. So it could be Q4 of 2012, could be Q1 of 2013.

Jim Crandell - *Dahlman Rose & Co. - Analyst*

Okay, good, that's what I needed.

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

I think that's probably what you really wanted to get to.

Jim Crandell - *Dahlman Rose & Co. - Analyst*

Yes, I think so.

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

(multiple speakers) More to come there.

Jim Crandell - *Dahlman Rose & Co. - Analyst*

Pete, are you having any discussions today with customers that haven't ordered rigs before? People that might not be in the business? And we're talking about ultra deepwater rigs, here. Are there likely to be ultra deep rig orders coming from other companies or investors in the business?

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

Jim, I think the potential is there. You know, if you go back and look historically, and you think about what Seadrill did and people like Pacific and DryShips and folks like that back in the '05-'06 time frame, I think there will be some others that will come out.

But today it's probably being driven much more by what I would call your traditional players, when you look at the Atwood Oceanics and the Rowans and the Diamonds of the world that are actually out there with those rigs today. There will be some nontraditional folks out there. But a lot of our emphasis today is really on some of those more traditional, conventional players.

Jim Crandell - *Dahlman Rose & Co. - Analyst*

Pete, and my last question. You know that I think that competing with National Oilwell Varco in deepwater rig orders is probably about the most challenging thing any company could ever undertake. And in that context, do you think you're at risk at all to losing any of your traditional customers to a new player for deepwater rig packages?

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

Jim, I like the way we do things. This is a complex business and I think a lot of people don't really realize the complexities associated with what it is we're doing. Because we do it quite well. We've got a bunch of people that really know how to get it done.

The key in all this stuff is execution. You know, I listened to a couple calls earlier, and people talk about supply chain challenges and different things like that. You've got to really know how to do those things. And if you look at our track record over the past six or seven years on being able to deliver these things on time, on budget, that's pretty darned attractive to our customers.

So we think the best defense against anything is just to continue to execute, and execute flawlessly. And if we can do that, we like where we are.

Jim Crandell - *Dahlman Rose & Co. - Analyst*

Okay, wonderful. Thank you, Pete.

Operator

James West from Barclays.

James West - *Barclays Capital - Analyst*

Good morning, Pete. Good morning, Clay. Guys -- or Clay, really, in your comments you talked about on deepwater this new industrial paradigm, and how the deepwater drillers are starting to really embrace this new era. Are you suggesting that we could see, you know, a deepwater driller or a series of deepwater drillers come out and say something along the lines of -- we're going to build a couple of deepwater rigs per year for the next decade? Or are you just kind of commenting that it will be more of the same? This kind of, we get a contract for a new-build rig and let me order another one.

Clay Williams - *National Oilwell Varco Inc - EVP, CFO*

Yes, I'm not sure if they're going to come out and talk in those precise terms and for that kind of time period. I guess my comments are more around -- I get the feeling that they're more comfortable with a certain level of building. That the projects are going pretty well, they're able to finance them, they're able to contract these rigs at attractive day rates. I think there's a growing level of comfort in rig-building that wasn't there 3, 4, 5, 10 years ago. And that's more what I'm referring to.

Strategically, I can't tell you. They're not sharing with us something that long-range. Although internally, they may be considering it. But I just get the sense that they buy in to this idea that worldwide production is going to continue to shift more and more into deepwater. That's the new frontier for the 21st century. It takes a lot of rigs to make that happen. And that their internal organizational effort and financing efforts going into new-build rigs is working pretty well.

And, you know, we saw this on the land side maybe a few years earlier with drillers like H&P. They set up a system internally, for instance, in that case to build flex rigs. And once they got it up and running, it worked pretty well. You sort of develop a more systematic process around building these rigs, the rig design, staffing the rigs, training crews, financing the rigs.

And I think that's what's at work amongst the more established drillers now is that it's becoming a more systematic process. They're comfortable with it. Strategically, it's a great path to earnings growth and a great path to deployment of capital for their shareholders, and just a kind of a more steady state world.

Let me, though, also point out though that we get the fact -- this is always going to be a cyclical business. And we're always going to be subject to external factors like the availability of credit, steel costs, shipyard slots, et cetera. So this is going to have some volatility in it. The point I'm trying to make is, that what's really changed and what we're trying to highlight is that perhaps the strategic thinking of our customers is evolving and shifting in a positive way for NOV.

James West - *Barclays Capital - Analyst*

Okay, that's very helpful, Clay. And then one last unrelated follow-up for me on the M&A side of the business. Obviously, Robbins & Myers is a big transaction for you. I know you guys are still focused on M&A, along with dividends. Not share buybacks, necessarily.

But are you comfortable with that scale of a transaction, given the series of transactions you've made over the last couple of quarters, plus Robbins & Myers probably coming to fruition and closing some point later this year or early next year?

Clay Williams - *National Oilwell Varco Inc - EVP, CFO*

Yes, we put a lot of capital to work through acquisitions in 2012. And as a result of that, our folks are very, very busy. They have a day job in that they devote a lot of effort into taking care of our customers. And then in addition to that, they're integrating all these new businesses as well. So we've been very, very busy.

In the long run, yes, we -- as Pete mentioned earlier, we view that as an important strategic initiative at NOV. We think we're good at integrating businesses and buying businesses. And so we want to continue to deploy capital through that pipeline. And we'll see what 2013 holds.

James West - *Barclays Capital - Analyst*

Okay, fair enough. Thanks, guys.

Operator

Robin Shoemaker from Citi.

Robin Shoemaker - *Citigroup - Analyst*

Thank you, good morning, Pete and Clay. Wanted to just clarify a couple of things on these Brazilian orders. Were these complete packages, rig equipment packages, including BOPs?

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

I can't -- I don't recall. (laughter) I don't know if it's --

---

Clay Williams - *National Oilwell Varco Inc - EVP, CFO*

They were good orders, Robin.

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

Yes, they were good orders, and --

Robin Shoemaker - *Citigroup - Analyst*

Okay. Well, the first seven that you booked, I guess a year ago, were -- included BOP systems.

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

Right. They did. They did for sure. I think this does, but I don't know that for sure.

Robin Shoemaker - *Citigroup - Analyst*

Okay. And on the -- are these very long lead-time kind of -- these are long backlog items, right? As are the original seven? Are these like for rigs that will be completed in 2016 or 2017?

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

Yes, Robin. I mean, obviously in the time frame that we're talking about here, it's going to be a little bit longer than what you're doing in Korea. Because these shipyards are dealing with a little bit more of a learning curve. But you know, you start recognizing revenues earlier than that. But I would say most of these deliveries are in the four-year time frame.

Robin Shoemaker - *Citigroup - Analyst*

Right. And I think you've commented before in this kind of rig construction cycle, margins on Rig Tech are -- you kind of guided to mid-20%s versus high-20%s in the last rig construction cycle. Is that still your view, that the margins that you are achieving in Rig Technology sales are a little lower than in the past cycle?

Clay Williams - *National Oilwell Varco Inc - EVP, CFO*

Yes, Robin, that's a good question and probably worth taking a couple minutes to speak to the factors. There's a lot of factors at work there in 2012 and 2013 that are a little different than what we saw in 2007 and 2008, which is kind of our prior peak as part of the cycle.

So, to start with, pricing has never returned to where it was early 2008. We're probably 6%, 7%, 8% lower on drilling equipment packages than we were winning in 2008, today. And the reasons for that is, it's a little bit different world in the sense that -- if you remember back '07, '08, the very capable shipyards at building rigs had very -- they were pretty filled up with other vessels, and had very few slots to devote to building drilling rigs.

Today there's a lot of idle quayside space amongst the most capable rigs in Asia. And there's less urgency in the system as a result of that. So the drillers, I think, can order more at their leisure. So they can put more energy into beating up their DEP providers like NOV. And so it's kind of a little slower pace of orders and less urgency that's kept pricing down a little bit.

We also face price competition out there. As Pete mentioned, I think we have the best execution, and we still command premium prices when it comes to our kit. But we've got a lot of competitors shooting at us and bidding below us. So that's made a little bit of a difference, too.

But pricing is down from 2008, is number one. Number two is, we talked a lot on previous calls about the fact that the shipyards are delivering rigs faster than they used to. They've shaved, you know, 12 months to 18 months off of a drill ship, for instance. And what that has done, if you think about NOV manufacturing pieces of kit to go into that project, it has stepped up the velocity of kit through our system.

Now you might assume that that equals better absorption for our Rig Technology Group, and it does. But what we're finding is that that's more than offset by some inefficiencies that arise out of the higher velocity, more urgent pace that we have internally.

For instance, we're going to more second- and third-shifts to accomplish the manufacturing that we need to accomplish. And those are usually less efficient than the first shifts. We're going to second- and third- and fourth-tier suppliers to help us with our needs. We're doing more outsourcing.

There's just generally a lot more complexity in our system now because of the higher velocity to fit with the vessel construction schedule. And that's taken a little bit of toll as the marginal cost of the last few pieces of kit that we make rises a little bit.

The third factor is, we have a lot of organic expansion underway across Rig Technology. With the growth in demand and the growth in velocities through our system, we've expanded places like our West Little York plant, where we make blowout preventers. We're now adding a sixth and a seventh rig-up pad. And to do that, we had to rearrange a lot of our operations and actually move offices and the like, and that's very disruptive.

We're expanding our plant out in California where we make top drives. And to accomplish that, we moved products out of there into a plant in Mexico. And so that's -- this rearrangement, this expansion is carrying some start-up costs in that business that are going to be with us for the next several quarters.

The fourth factor is, as you know, we've added a couple businesses in Rig Technology in the last couple years that are in the deepwater space, FPSOs and flexible pipe. And those have flowed in at margins that are a little lower than the segment margins.

And then the fifth, which is more of a later development here in the last quarter, is that demand for pressure pumping and land equipment in North America is clearly falling. So that's a little bit of a headwind.

So you kind of go through all of that. And it means that getting margins back up into the high-20%s where they were a couple years ago, while we see a path to margins above 25%, the next few quarters at least are going to be a little more challenged.

It is worth pointing out, though, this segment in the third quarter, the one we just reported, on a NOPAT, after-tax operating profit basis, generated about 25% returns on capital, which is outstanding. And returns on tangible capital north of 50%. So the business is performing very, very well. And you know, 23%, 24% operating margins for a manufacturing businesses is fairly rare. So our guys are doing a great job.

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

And Robin, to also demonstrate the wonderful execution of NOV, after I said that I wasn't sure on the BOPs, I just did get some e-mails that said yes, in fact, those rigs in Brazil include the BOPs. So that should answer that question for you, as well.

Robin Shoemaker - *Citigroup - Analyst*

Okay, very impressive. All right, thank you, Pete.

Operator

That concludes today's question-and-answer session. I'll now turn the call back for final remarks.

Pete Miller - *National Oilwell Varco Inc - Chairman, President & CEO*

Thank you, Christine. And I appreciate everybody who dialed in today, and I'll look forward to talking to you on our next call for the year-ending results of 2012. Thank you very, very much.

Operator

Thank you for participating in the National Oilwell Varco 2012 third-quarter earnings conference call. This concludes the conference for today. You may all disconnect at this time.