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NOV - Q4 2014 National Oilwell Varco Inc Earnings Call

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OVERVIEW:

NOV reported 4Q14 revenues of $5.7b and fully diluted EPS of $1.39.

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PRESENTATION

Operator

Welcome to the National Oilwell Varco fourth-quarter and full-year results conference call. My name is Lorraine, and I will be your operator for today's call.

(Operator Instructions)

Please note that this conference is being recorded. I will now turn the call over to Mr. Loren Singletary, Vice President of Investor and Industry Relations. Mr. Singletary, you may begin.

Loren Singletary - *National Oilwell Varco Inc - VP Investor and Industry Relations*

Thank you, Lorraine, and welcome, everyone, to the National Oilwell Varco fourth-quarter and full-year 2014 earnings conference call. With me today is Clay Williams, President, CEO, and Chairman of National Oilwell Varco; and Jeremy Thigpen, Senior Vice President and Chief Financial Officer.

Before we begin this discussion of National Oilwell Varco's financial results for its fourth-quarter and fiscal year ended December 31, 2014, 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 risk 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 SEC.

Later on this call, we will answer your questions, which we ask you to limit to two in order to permit more participation. Now, let me turn the call over to Clay.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Thank you, Loren. And welcome, everyone, to National Oilwell Varco's fourth-quarter 2014 earnings conference call.

This morning, we announced that the Company earned $1.39 per fully diluted share in its fourth quarter ended December 31, 2014. Excluding transaction and asset impairment charges, earnings were a record $1.69 per fully diluted share, an increase of 4% sequentially and 13% year-over-year. Fourth-quarter revenues were $5.7 billion, up 2% sequentially and up 8% year-over-year. Fourth-quarter EBITDA, excluding other items, was $1.2 billion or 21.3% of sales. EBITDA on this basis improved 1% sequentially and 8% year-over-year.

For the full year 2014, GAAP earnings per fully diluted share were $5.82. Excluding other items and impairment charges, earnings were a record $6.07 per fully diluted share, up 12% from the prior year. EBITDA for the year, excluding other items and impairment charges, was a record $4.6 billion, up 14% from the prior year on the same basis.

Looking forward, we obviously face some significant challenges in the markets that we serve. And we will be discussing these through the next hour. But first, I want to take a moment and reflect on the Company's accomplishments in 2014 and say thanks to the world's best oil field services team.

NOV completed the spinout of our distribution services business to our shareholders as NOW Inc in May, which led us to reorganize our remaining business along four new reporting segments and promote several executives into new leadership positions. Our new segment architecture is around customer axis, which opened up new strategic possibilities for us. Our leadership team spent the summer developing long-term strategies for each business. We presented these at our first investor day in November, where we also laid out ambitious five-year goals. 2014 also saw us announce a large increase in our dividend, lifting our payout ratio to within the range of 30%, as well as the authorization of a $3 billion stock buyback.

Given the pace of change here through 2014, it would've been easy to have been distracted. I think the pace of change here makes NOV's 2014 record results doubly impressive. We had several business units post record annual and record quarterly results in 2014. I would like to express my gratitude to every one of our 60,000 employees who continue to execute exceptionally well on behalf of our customers, despite all these changes, to deliver great financial results for our shareholders. Thank you.

As we look forward, though, we face a tough market. With oil prices down more than 50%, our customers are quickly cutting spending. And the downturn we face will be severe in 2015, and possibly beyond. Drilling activity is falling sharply, and our visibility is limited.

The industry finds itself in this downturn, we believe, because rapidly growing North American oil supply, coupled with slowing demand in the OECD, slowing demand growth in China and other emerging economies, and a strong US dollar all contributed to a supply-demand imbalance for oil late last year.

With regards to slow oil demand in Europe and emerging economies, significantly lower energy costs are a meaningful, widespread economic stimulus. As economies in Europe and Asia eventually strengthen, low oil prices and rising economic activity will spur oil demand growth from these regions.

Second, we do not believe that global excess production capacity is excessive by historical standards. We do not face the kind of structural global overhang the industry faced in 1986, when Saudi Arabian production had been curtailed down to about 4 million barrels of oil per day and spare global oil capacity exceeded 15% of demand. We believe that this downturn will be more like 2002 or 2009. In both prior instances, recovery came within about two years.

Third, we believe the recent swing source of incremental global oil supply is coming from North American shales. The production type curve from these basins exhibit extraordinarily steep decline rates, which is well-documented across thousands of wells and multiple shale basins. New shale reservoirs exhibit, perhaps, the highest natural decline rates from any major source of oil in the industry's modern history. We see North American shale drilling slowing dramatically and quickly. Soon, the rate of new shale wells coming online will decline, and the 4 million barrels of oil per day from US shales will then begin to decline, and it will decline steeply. We believe this could lead to modest oil price recoveries early as late 2015.

However, we expect shale production to continue to grow through the first half of 2015 before begins to fall, as the remaining inventory of wellbores is completed and brought online, which means the recovery, once it arrives, may be a slower grind higher despite the decline curve behavior of shale oil.

So in summary, a significant oil demand component to the imbalance driven by macroeconomic conditions, lower oil costs contributing to eventual economic recovery, a major source of supply from extraordinarily high decline curve reservoirs, and a sharp drilling reduction response from the oil industry are a pretty good set of ingredients with which to bake an oil price recovery scenario. Nevertheless, we acknowledge many factors could keep oil prices down for longer -- deteriorating global economic conditions, continued strengthening of the US dollar, or the return to market of oil from certain sideline countries are a few that come to mind. However, given the speed at which we see drilling activity slowing, it is very difficult for us to imagine that we will not see a significant oil supply response relatively soon. We don't believe the world can sustainably grow its oil supply with prices below, say, $75 a barrel. And with prices below $60, oil production will begin to contract. Since oil supply growth will eventually be required at some point in the future, it stands to reason that oil prices must eventually cycle back up above $75, over the long run.

Given our short-term lack of visibility into the timing of the recovery, our approach to 2015 will be to focus on what we can control.

We plan to manage NOV to the market, quarter to quarter, in view of near-term orders and activity, while we steadily reduce costs as utilization levels permit, while also continuing to advance the long-term strategic goals we outlined at our investor day.

We will manage to the realities of the markets we serve, but we plan to emerge from the cyclical downturn a better Company, achieving new, higher levels of operational excellence.

The record fourth-quarter results that we just announced reflect very little of the impending downturn. In fact, many of our operations spent the fourth quarter working three shifts, 24/7, to meet our delivery obligations. Through 2014, we shipped record levels of top drives blowout preventers, fiberglass pipe, jacking systems, and numerous other products. In January, we did begin to see the drop in activity affecting our operations in a more widespread way, most acutely in Wellbore Technologies, but really, all segments seeing some impact. In view of the challenges ahead, we are beginning to bring work in from our suppliers to keep our own facilities better loaded. So for instance, right now, 52% of our machining requirements within Rig Systems & Aftermarket are outsourced. As work declines, we will be repositioning some of that work into our own facilities.

We're examining opportunities to consolidate facilities where possible, and we're working with our suppliers to improve efficiencies and costs, as our customers press us for cost savings for their supply chains. I have tremendous confidence in the NOV team's ability to manage through the downturn and reduce costs. Although we have new leadership and new positions throughout our new organization, I will stress that these leaders are not new to NOV, nor are they new to the industry or to cyclical downturns. By my count, this will be the sixth cyclical downturn we have faced through our careers. Unfortunately, despite our cost reduction measures, we will nevertheless expect to see steep decrimentals for 2015, as pricing pressure and lower absorption on lower volumes will pressure margins.

Orders for all our products have slowed sharply -- offshore, land, drilling, completion, and production. Customers are delaying purchases of both capital and consumables wherever possible, seeking to conserve cash in the face of market uncertainty.

We soon expect to see our customers begin to cannibalize existing equipment for capital components. For instance, pull a top drive off an idle rig within their fleet rather than place a new order for a new one with NOV, in order to keep another contracted rig in need of a top drive working. Our customers will raid the spares inventory from their idle rigs to support those that are contracted and contributing and continuing to work, rather than place a spares order with us. They will redirect drill pipe bits, jars, shakers and other kit, rather than place new orders with us. History teaches us to expect this behavior to continue for at least the next couple of quarters, meaning orders will continue to be slow and our book-to-bill in Rig Systems well below 1.

However, this behavior is not sustainable over the long term. Drilling consumes rigs, much like driving consumes your automobile. The rate of consumption of capital equipment and consumables is declining with drilling activity, but customer spending always seems to over react through cyclical downturns by living off their inventory and postponing maintenance and upgrades wherever they can. That only works for so long.

Maintenance and upgrades can be deferred but cannot be postponed indefinitely for drilling rigs, so demand will return. In the past, this behavior has fuel demand surges for the kit NOV provides. Our markets change quickly in both directions.

Also, we see drilling contractors continuing to upgrade their rigs to meet contractual requirements or simply differentiate their rigs, in a race to offer the most efficient drilling rigs. There remains interest, if only academic for the time being, in what the "next big thing" is for drilling -- configurable drill floors, closed-loop automated drilling systems, automated pipe tailing and stand transfer vehicles for land rigs, retrievable subsea BOP pods, low-cost mid-water floater designs -- concepts which NOV continues to advance, in accordance with our 10-year goals.

Offshore we are seeing customers defer some of their SPS survey work, although our total volume of SPS work continues to rise. As we've described in the past, offshore rigs are required to undergo shipyard surveys and obtain OEM Certificates of Compliance, an activity called a special periodic survey, or SPS, to maintain their class designations and be qualified to drill in those markets. In an $80 oil world, contractors will proceed with the SPS on uncontracted rig to ensure it is qualified for any potential contract which may arise, which would require a pressing spud date. In a $50 oil world, contractors are incrementally less willing to invest in the SPS for an uncontracted rig and be more willing to forego the possibility of missing a quick spud date contract. As an aside, I'll note that, when the recovery comes to the offshore drilling market, shipyard capacity to execute SPS may become a very scarce resource.

In the $50 oil world, contractors become much more circumspect about all investments in older rigs. We expect to see even more rig retirements -- both land and offshore, both announced an unannounced -- in addition to those that we've seen already. This phenomenon has been witnessed in every category of drilling rigs passing through periodic cyclical downturns and incrementally contributes to better supply-demand balance for the fleets.

Rig Systems posted new orders of $470 million, or a book-to-bill of just 21%, reflecting the customer mindset I just discussed. This resulted in a Rig Systems backlog of $12.5 billion to start 2015. This is a high backlog for NOV by historical standards -- 16% higher than we carried into the 2009 downturn, for instance. We expect it to partly, but not fully, mitigate the effect of lower orders for 2015 on our day-to-day operations in Rig Systems. We foresee revenue out of backlog remaining strong through the first quarter 2015, north of $2 billion, but beginning to decline modestly in the second quarter and more steeply in the third and fourth quarters of 2015.

While 2015 orders will be slow, we do continue to see modest demand for certain markets like 20,000 psi deepwater, Middle Eastern land markets, Mexico, and Argentina.

Orders for Completion & Production Solutions did better for the fourth quarter, posting a book-to-bill of 60% on $469 million in orders, which resulted in a backlog of $1.8 billion to start 2015. On the production side, we continued to advance discussions around some large FPSO projects, in spite of the low oil prices. In fact, the downturn in the troubled offshore project execution performance by the majors in NOCs has opened the door to new ideas amongst our large E&P customers.

There's growing interest around doing things differently in deepwater developments to drive lower costs. We're accepting lots of invitations from majors to discuss our modular approach to vessel construction to bring modern supply chain management techniques to bear to produce better results.

Necessity is the mother of invention, and this market is wide open to new approaches. Our new approach is to offer tightly integrated package of NOV kit to minimize the interface conflicts brought about by the fragmented supply chain approach currently used to build these vessels. We seek to recycle designs and avoid reinventing the wheel for each new vessel, which inevitably leads unplanned manufacturing costs and delays.

NOV has a tremendous track record of success in bringing this modular package approach to the construction of offshore drilling rigs through the last decade. Our extensive experience in working closely with shipyards to execute, install, and commission these complex construction projects uniquely positions NOV to help the industry pioneer a better way.

Although a large integrated package FPSO order for NOV is still a ways away, we've made great progress in securing customer "buy-in" to our new approach on two specific FPSO projects, which we ultimately expect to turn into firm orders, perhaps as early as late 2015.

For both the Rig Systems and Completion & Production Solutions segments, we are glad to be able to carry strong backlogs into this downturn. Except for minor exceptions, the firm contracts governing our backlog projects do not permit cancellation for convenience. In 2009, we saw about 4% of our backlog evaporate -- not really from cancellations, but rather from customer payment defaults. We expect the vast majority of our current backlog to be executed in accordance with the agreed terms, like we experienced six years ago. In certain instances we are considering customer requests for delivery delays, which can help us better manage costs in our currently stretched supply chain. But generally, we expect the continued on-time execution of our backlog to continue. Our 2009 stress test provides good empirical evidence for this outlook.

Our 22 Brazil Atlas Project floating rigs constitute about $3.5 billion of our backlog. We are ahead on progress payments on each of these projects, meaning we have collected more than we have invested in the inventory delivered on these, as planned, as we continue to fabricate components. We will begin installation and commissioning operations soon, and are commencing riser manufacturing in Brazil currently.

Generally, progress has been steady but a little slower than originally planned, which has not surprised us. While we have had some payment delays with some of our Brazilian shipyard customers who are building out their new shipyard facilities, we are confident in the successful completion of these rigs, due to the financing package provided to [Sete], the shipyards customer, by the Brazilian Development Bank and consortium of banks a few weeks ago to fund the next 18 months of construction. Additionally, the shipyards have Asian partners who are, in some instances, providing additional capital to complete the construction of their facilities. The country of Brazil is all-in on this, and the rigs will be completed successfully.

Like I said earlier, NOV will emerge from this downturn a stronger and better Company. We are continuing to advance new technologies like closed-loop automated drilling, which has significantly improved drilling performance through several pilot programs. Other innovations like our WaterWolf Oil Recovery System for produced waters, thermal cutting desorption technologies, TUNDRA MAX mud coolers, automated pipe handling equipment for land rigs, and retrievable pods for subsea BOPs will continue to make the oil field safer and more productive.

We have a strong balance sheet to help weather this downturn. We are seeking to invest opportunistically through this downturn. We continue to pursue our singles and doubles acquisition strategy, which improves our capabilities in global reach and our technology portfolio. We have seven letters of intent in place and probably triple that in potential prospects. We also began investing in a share repurchase program during the fourth quarter. To date we have repurchased over 11.6 million shares of NOV for $779 million, which is a 2.7% reduction in our share count. Thus far, we have been able to accomplish this using cash on our balance sheet, which we have been able to repatriate from overseas locations. The $2.2 billion remaining on our current authorization -- we plan to continue to repurchase NOV shares through the downturn, including, if necessary, using modest levels of debt from time to time to bridge to the next opportunity to repatriate cash from overseas.

Importantly, we acknowledged at our recent investor day that this is a cyclical business, and once or twice every decade, oil as a commodity tests it's microeconomic variable cash cost floor of the marginal barrel. In setting our long-term strategies, we intentionally look through the cyclical downturn to entrepreneurially focus on actionable opportunities that we see ahead. My sixth cyclical downturn has not dissuaded me from the basic pieces we outlined in November, in line with Exxon Mobil's outlook 2040 study. That the world's population will grow from 7 billion to 9 billion by the year 2040, economic growth will continue, standards of living will rise, oil and gas production will grow from a combination of shales and deepwater to fuel the world's appetite for energy and a better life. Specifically, the Exxon study calls for 25% growth in oil and 65% growth in gas through the next 25 years.

In the near-term, the E&P industry will sharpen its focus on improving economic efficiency and marginal costs for production of oil from all sources of oil, as it has always done. And as the leading provider of innovation and technology and industrial capability to this critical entrepreneurial industry, National Oilwell Varco will play a key role in making that happen and emerge better-positioned for the inevitable upturn.

With that, let me turn it over to Jeremy to take you through our fourth quarter and outlook. Jeremy?

Jeremy Thigpen - *National Oilwell Varco Inc - SVP, CFO*

Thanks, Clay. Since Clay already covered the consolidated results, I'll just dive straight into our segment operating performance for the fourth quarter and the fiscal year, ended December 31, 2014 and then attempt to provide a little color on the outlook for 2015.

The Rig Systems segment generated quarterly revenues of $2.6 billion in the fourth quarter, down 4% from a record third quarter, as revenue out of backlog on offshore projects was not quite as strong, sequentially. Compared to the fourth quarter of 2013, Rig Systems revenues were up 7%, due to heightened demand for high-spec land rigs and equipment and our recent capacity additions, which have enabled us to convert more revenue out of backlog over the prior year. Operating profit for this segment was $511 million, and operating margins were 20%, which were flat with the previous quarter, despite the 4% sequential decline in revenue, and up 90 basis points from the prior year. Fourth-quarter EBITDA for this segment was $534 million, or 20.9% of sales. For the full-year 2014, Rig Systems posted record revenues of $9.8 billion, up 16.5% over 2013, and produced operating profit of almost $2 billion, or 20.3% of sales, which resulted in year-over-year flow-through or leverage of 27%.

Let's transition to the capital equipment orders for our Rig Systems segment for the fourth quarter of 2014 and our resulting backlog. In the quarter, we recognized $2.3 billion of revenue out of backlog and captured $470 million in new orders, resulting in a quarter-ending backlog of $12.5 billion. In the quarter, we secured three each drilling equipment packages for jack-ups, five each land rigs, and a smattering of offshore land components. Of the total $12.5 billion in quarter-ending backlog, approximately 91% is offshore and 91% is destined for international markets.

The Rig Aftermarket segment posted record revenues of $850 million in the fourth quarter of 2014, up 2% sequentially and up 12% over the fourth quarter of 2013, as our large and growing installed base of equipment, combined with the investments that we have made in additional personnel, training, global infrastructure, and inventory have resulted in solid growth. Operating profit for this segment was $245 million, or 28.8% of revenue. That's up 140 basis points sequentially and up 300 basis points from the prior year, on more favorable mix, with a higher percentage of high-margin service work and an unseasonably lower percentage of lower-margin repair work. For the quarter, EBITDA for this segment was $252 million, or 29.6% of revenue. For the full year 2014, Rig Aftermarket posted record revenues of $3.2 billion, or 19.7%, over 2013; and, produced operating profit of $882 million, or 27.4% of sales, which represented 29% leverage on the incremental revenue.

The Wellbore Technologies segment posted record revenues of $1.5 billion, up 4% sequentially and up 11.5% compared to the fourth quarter of 2013. In the quarter, several businesses -- including our drilling intervention, formally downhole; our Grant Prideco drill pipe; our IntelliServ wired pipe; and our well site services businesses delivered record or near record results for customer revenue, which explains both the sequential and year-over-year increases.

Operating profit for this segment was $276 million, or 18.1% of sales, down 80 basis points sequentially but up 20 basis points over the prior year. The slight sequential decline in margin was expected, as the holidays invariably lead to under absorption in our manufacturing and service facilities. For the quarter, EBITDA for the segment was $387 million, or 25.3% of sales. For the full-year 2014, Wellbore Technologies posted record revenues of $5.7 billion, up 12% over 2013, and produced operating profit of $1 billion, or 18.3% of sales, which represented 31% leverage on the incremental revenues.

The Completion & Production Solutions segment generated revenues of $1.3 billion, up 11% sequentially and up 15% from the fourth quarter of 2013. On a sequential basis, the revenue growth was driven by strong deliveries of intervention and stimulation equipment, which were up 24%, and floating production equipment, which was up 29%, as well as solid sales of fiberglass systems and subsea production equipment. On a year-over-year basis, most businesses within the segment delivered low- to mid-teens percentage growth, with the exception of our intervention and stimulation equipment business, which posted a 40% gain over the fourth quarter of 2013. Operating profit for this segment was $215 million, or 16.2% of revenues, which was up 80 basis points from the third quarter of 2014 and 30 basis points from the fourth quarter of 2013. Fourth-quarter EBITDA for the segment was $273 million, or 20.6% of sales. For the full year 2014, the Completion & Production Solutions segment posted record revenues of $4.6 billion, up 7.8% over 2013, and produced operating profit of $700 million, or 15.1% of sales.

Now, let's transition to the capital equipment orders for our Completion & Production Solutions segment. During the quarter, the segment secured $469 million in new orders, which were more than offset by record shipments of $776 million out of backlog, resulting in a quarter-ending backlog of $1.8 billion. Sequentially, orders for production-related equipment increased slightly. However, this increase was more than offset by a 45% reduction in orders for intervention and stimulation equipment into the North American land market.

Overall, it was another solid quarter that marked the end of a transformative and record-breaking year for NOV. So like Clay, I would like to thank each and every member from the NOV family for their commitment, their focus, and hard work in the fourth quarter and throughout 2014.

As we move into 2015, it's clear that the sharp decline in oil prices will negatively impact our business. While we have some visibility into the first quarter of 2015, our forecast for the balance of the year seems to be changing by the day.

For the first quarter, we believe that Rig Systems revenues could decline in the high single-digit percentage range and that margins could erode on lower volumes. A higher percentage of Brazil-related revenue and additional expenses associated with customer requested scheduling changes, with some customers requesting that we slightly delay projects and others actually asking us to expedite deliveries. And from an order perspective, we believe that the pace and composition of orders could look somewhat similar to the pace and composition of orders that we received in the fourth quarter of 2014. However, continued market uncertainty could lead to indefinite delays on some of these expected orders, which could result in even lower booking sequentially.

For our Rig Aftermarket business as we move into the first quarter of 2015, we believe that revenues could actually decline slightly for two reasons. Number one, our customers clearly started scaling back in the fourth quarter, as evidenced by the noticeable reduction in bookings for spare parts and fluid-end expendables. And two, we are facing significant and rising pricing pressure from our customers, which could lead -- and probably will lead -- to some pricing concessions and negatively impact our top line and our margins.

For our Wellbore Technologies segment, it's important to remember that this segment is driven by drilling activity. More rigs drilling more wells and more footage creates more opportunity for the various businesses within Wellbore Technologies. Unfortunately, given the precipitous declines in oil prices and the active rig count, our customers are dramatically cutting spending while simultaneously demanding significant discounts. As such, for the first quarter, we believe that Wellbore Technologies segment revenues could decline in the mid-teens percentage range, with decrimentals in the 50% to 60% range.

And finally, for our Completion & Production Solutions segment, we believe that first-quarter 2015 revenues could decline by as much as 25%, with decrimentals in the mid-30% range, as we expect sharp declines in our higher-margin intervention and stimulation equipment business as orders for coil tubing units and pressure pumping equipment and consumables have virtually disappeared.

Predicting the full-year 2015 is impossible in this environment. Still, I will make a few comments about each segment that I hope are helpful. At our analyst day in November, when oil was $75 a barrel, we included a chart that essentially forecasted a 10% year-over-year revenue decline in our Rig Systems segment. And in the Q&A section, we specifically stated that despite this 10% decline in revenue, Rig Systems margins could hold fairly steady at that 20% range. Unfortunately, after watching oil prices plummet below $50 a barrel, our underlying assumptions have changed. In November, we expected about $7 billion to $7.5 billion of our third-quarter ending backlog to flow out as revenue in 2015, and we expected demand for land rigs and for discrete components for both land and offshore to remain strong in the fourth quarter of 2014 and well into 2015. But as evidenced by the $470 million in fourth-quarter 2015 bookings and the recent announcements from our land and offshore drilling customers, the previously expected book-and-turn revenue in 2015 is now clearly in question.

Additionally, as you might expect, we've received requests from some customers to delay specific projects and shipments on select projects, which could ultimately push some revenue out of 2015 and into 2016. And since we may not receive the higher-margin book-and-turn orders that we expected, and since we may have to juggle manufacturing, delivery, and installation and commissioning schedules -- all of which could add cost -- we believe that margins could tick down slightly on the additional revenue reduction.

For our Rig Aftermarket segment, we do not really know what to expect on the top line. However, we know that rig counts are falling and that customers are uncertain about their future prospects. And when customers are uncertain about their future prospects, they often curtail spending, consume existing inventories, cannibalize underutilized assets, and indefinitely postpone upgrades. So when you couple that customer behavior with pricing concessions, we do not expect to see the same mid-teens percentage year-over-year growth that we have come to enjoy in previous years, and we believe that margins could erode slightly from 2014 levels.

It's based on drilling activity and because we do not know how quickly or how far the rig count will ultimately fall, forecasting the full year for Wellbore Technologies segment is equally challenging. If one wanted to use the 2008 to 2009 timeframe as a proxy for 2014 to 2015, one could predict revenues to fall between 20% and 25% with steep 50% to 60% decrimental margins. As a point of reference, Wellbore Technologies segment revenues for the full year of 2009 -- excluding non-recurring items -- were 9.8%. Obviously, faced with the top line decline similar to 2008 to 2009, we will make every effort to maximize profitability and improve upon the margins that we posted in 2009. However, it's important to remember that this segment is already facing substantial pricing pressure, and it carries a heavy D&A load, including manufacturing and service facility infrastructure, sizable rental fleets, and intangibles associated with prior acquisitions, that work together to challenge profitability in a severe downturn.

Finally, our Completion & Production Solutions segment is perhaps the most difficult to forecast, due to the fact that it supplies both long lead time capital equipment and short cycle consumables to support a very volatile completions market and a sometimes frustratingly slow to materialize offshore production market. As we move throughout 2015, we believe that demand for pressure pumping and coil tubing units will most likely be very soft in the US with pockets of opportunity internationally, and we think that demand for floating and subsea production equipment will continue to be lumpy. Since we're entering the year with a reasonably healthy backlog, we would expect revenues to slightly outperform the decline in the overall market. And depending on the suddenness and magnitude of that top-line decline, we believe that decrimental leverage for this segment could be between 40% and 50%.

So 2015 could certainly prove to be challenging. But as Clay stated and as we've clearly demonstrated in the past, we remain confident in the ability of this organization to adapt and not just survive, but thrive, in a cyclical downturn.

So with that, let's turn to some of the remaining elements of National Oilwell Varco's consolidated fourth-quarter 2014 income statement. Gross margin declined 20 basis points sequentially but increased 60 basis points year-over-year, to 27.1%. For the full year 2014, gross margin also improved 60 basis points, to 27.1%.

SG&A decreased $7 million sequentially but increased $46 million year-over-year. As a percent of revenue, SG&A declined 40 basis points sequentially and increased 10 basis points year-over-year, to 9.2%. For the full year 2014, SG&A increased $214 million, or 11.7%, but as a percentage of sales, SG&A actually declined slightly to 9.5%.

Other items, which includes the impairment of some indefinite lived tradenames within our Wellbore Technologies segment, as well as the loss associated with the sale of a non-core industrial business that was acquired in the Robbins & Myers transaction, were $163 million in the quarter. For the year, other items were $214 million versus $53 million in 2013.

Interest expense was flat sequentially, at $26 million, and interest income increased $1 million to $5 million. As compared to 2013, interest expense decreased $6 million, and interest income increased $6 million.

Equity income in Voest-Alpine JV increased $7 million sequentially to $16 million as the plant was once again fully operational following its annual maintenance in the third quarter. Compared to the fourth quarter of 2013, equity income was flat, and compared to the full year 2013, equity income declined $5 million to $58 million. For the first quarter and full-year 2015, we believe that equity income will fall as demand for drill pipe, and therefore Green Tube, will moderate.

Other expense for the quarter was $20 million, which represents a $29 million delta sequentially, but is more consistent with historical trends. For the full-year, other expense was $32 million versus $30 million in 2013.

The effective tax rate for the fourth quarter was 28.1%, which was 70 basis points lower than the 28.8% rate that we posted in the third quarter of 2014 and 200 to 300 basis points lower than historical trends and our expectations. Excluding discrete items in the quarter, the Company's effective tax rate would have been closer to 30%. Therefore, as we move into 2015, we believe that 30% to 31% continues to be a realistic estimate of NOV's effective tax rate.

If you now quickly turn to the first supplemental schedule, you'll see that eliminations were $556 million for the quarter, down slightly from $569 million in the third quarter of 2014. Unallocated expenses and eliminations were $229 million for the quarter, down $6 million sequentially on the lower volume of inter-segment revenues. As compared to the full year 2013, eliminations increased 38.6% on higher volumes, and unallocated expenses and eliminations increased 31.7%.

And finally, if you turn to the last supplemental schedule, you will see that depreciation and amortization expense in the quarter was $199 million, up $1 million from the third quarter and up $4 million from the previous year. For the full-year, depreciation and amortization expense was $778 million, up 5.4% from 2013. EBITDA for the fourth quarter, excluding other items, was $1.2 billion, or 21.3% of sales. For the full-year 2014, EBITDA was a record $4.6 billion, up 13.9% from 2013.

Turning to the balance sheet, our December 31, 2014 balance sheet employed working capital, excluding cash and debt, of $5.4 billion, down $125 million or 2.3% sequentially. Looking more closely at working capital, accounts receivable decreased $66 million, or 1.5% sequentially, despite the $122 million sequential increase in revenue. Inventory declined $183 million, or 3.3% sequentially, as reductions in Rig Systems, Wellbore Technologies, and Completion & Production Solutions were partially offset by inventory growth in Rig Aftermarket.

Also leading to a sequential reduction in working capital, accounts payable and accrued liabilities increased $138 million. Unfortunately, due to the sequential decline in bookings for off-shore new builds, costs incurred on major projects significantly outpaced milestone invoicing, which resulted in a $297 million sequential decline in customer financing.

For the quarter, the Company generated $736 million in cash flow from operations. Capital spending for the fourth quarter was $231 million, up almost 38% sequentially, due to better-than-expected progress on several significant ongoing construction projects.

In the quarter, we also invested $110 million in three acquisitions, we made dividend payments of $196 million, and we spent $779 million to repurchase shares. As a result, we ended the fourth quarter of 2014 with a cash balance of $3.5 billion, down $555 million sequentially but up $100 million from the prior year. And we ended the year in a net cash position of $370 million, as we were able to make the previously mentioned investments without assuming any incremental debt. Of the $3.5 billion in cash, almost 16% of the balance was in the US at December 31, 2014.

As we move into 2015, we will continue to invest in our 10-year strategies. However, we will do so at a more measured pace than previously envisaged. As a result, we will expect to reduce year-to-year capital spending by 15%.

Now, let me turn it back to Clay.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Thank you, Jeremy. With that, Lorraine, I think we're ready to open it for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jim Crandell, Cowen.

Jim Crandell - *Cowen Securities LLC - Analyst*

Thank you. Good morning, everyone.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Good morning, Jim.

Jim Crandell - *Cowen Securities LLC - Analyst*

Clay, you just touched on M&A, and you described your efforts as mainly a continuation of the singles and doubles strategy, which NOV has done very well at over the past 15 years. But you've also done very well at the home run strategy, and you have a great record at that the last 15 years.

In order to execute the home run strategy, I think you'd agree you need to be proactive. What kind of place in the Company strategy does proactively looking for larger acquisitions have, at the current time?

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Well, thanks for your kind comments, Jim.

We absolutely are continuing to look for larger transactions. Those typically take much longer to cultivate, and so we have had conversations with a few larger potential counterparties out there.

What we generally find is, in a declining market, it's hard to get the bid and the ask to converge. And most of those transactions are better accomplished and you get more agreement between the counterparties as markets are increasing. So I think until we begin to start to see a little bit of a recovery and a little bit stronger outlook, it's going to be hard to get the bids and the asks to come together.

We're always out there looking for opportunities to deploy capital into good return opportunities and recognize that those conversations are long-term investments. We do have a couple going on now, but nothing to report. I don't think there's any sort of transaction out there that's imminent in the near-term.

Jim Crandell - *Cowen Securities LLC - Analyst*

Okay.

And my follow-up, guys, is -- could you hit on your major businesses in North America and talk about the magnitude of pricing weakness at such things like Tuboscope and Grant Prideco and Mission and some of your other important domestic businesses?

Jeremy Thigpen - *National Oilwell Varco Inc - SVP, CFO*

Yes. I will say that our customers are being very aggressive and seem to have the same firm letter that they are sending to everyone who will receive a letter and are demanding very high discounts -- double-digit percentage discounts. We are responding to those by sitting around the table with those customers by product line -- nothing that's across the board -- and discussing ways that we can work together to mutually drive cost out of the system. I think every business is handling it individually, by customer.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Yes. Trying to make lemonade out of lemons, we're also trying to turn those conversations more towards volume-based rebates so that we get more volume out of the concessions that we're making. Ideas like that are what we're trying to push forward.

Jim Crandell - *Cowen Securities LLC - Analyst*

Great. Okay. Good job, guys. Thank you.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Thank you, Jim.

Operator

Jud Bailey, Wells Fargo.

Jud Bailey - *Wells Fargo Securities - Analyst*

Thanks. Good morning.

Question on -- trying to think about your revenue out of backlog for this year, and trying to think about margins at Rig Systems. Understanding your customers are bombarding you with odd requests -- like you said, delaying or accelerating -- did you give an exact number on what you think revenue out of backlog could be?

And on top of that, how quickly can you adjust your cost structure, as you have to delay projects? Help us think about, as you bring your production in-house, how quickly can you preserve margins at Rig Systems?

Jeremy Thigpen - *National Oilwell Varco Inc - SVP, CFO*

Yes. Jed, thanks.

In the prepared remarks, I talked about -- at the end of Q3, and as we got to our analyst day we actually thought that about $7 billion to $7.5 billion would flow out of our current backlog. That was the backlog at the end of Q3. We then assumed that we'd get some book-and-turn in Q4 and throughout 2015 that would take that number up.

Given the pace of orders, we think it's probably going to be closer to that $7 billion range, in terms of revenue flowing out of backlog this year -- based on what we see today. Now, we could receive some orders here in the next few months, that we can turn into revenue before the end of the year. But right now, it's looking pretty soft. So I think somewhere in the $7 billion range is probably reasonable.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

With regards to the margin, we're probably a little beyond our optimal kind of efficiency, in terms of margin production in the backlog. Meaning, we've had more work. We're relying on graveyard shifts and a lot of overtime and third- and fourth- and fifth-tier suppliers.

I think there is some benefit as volumes start to back off just a little bit, in terms of reducing some overtime, of reverting to our most productive shifts and reverting to our most productive sub-suppliers. That will help on the margin front.

I would add to that, too, our own suppliers -- we're in discussions about reducing the prices that they charge us. We're hesitant, though, to wrap margin improvement around that scenario because, no doubt we're going to continue to see price pressure and face challenges that are coming out of the current slow market.

Jud Bailey - *Wells Fargo Securities - Analyst*

Okay.

My follow-up is a bigger-picture question -- when you think about the decline in oil today -- and people like to reference 2009 -- but as we stand today, deepwater rig rates are coming down much more quickly, in general. The backlogs of the offshore drillers is much less than that timeframe, and there's probably a legitimate discussion that offshore rig rates could good close to cash breakeven.

How do you think about Rig Systems and orders over the next two to three years if that happens? And how you think shipyards will react, from a price standpoint? Last time, they reduced price, which helped, but will it really help if rig rates are at such a depressed level that -- do they even bother to reduce price because no one is going to order anyway?

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

I don't think lower cost or price of rigs delivered is going to catalyze much demand, right now. As I said in the opening remarks, our plan is to manage to the market realities quarter by quarter. We have a great backlog, which we will burn off over the next several quarters.

As we find ourselves -- let's say, this time next year -- without a resumption in orders in the offshore world, we expect two things to happen. One is, our installation and commissioning efforts around the rigs that are being built will continue strong through 2015 and well into 2016. As that starts to wind down a little bit, we'll have good opportunities to pivot and refocus the technical capabilities of that group and the infrastructure that supports that group towards SPS's, which we do see rising, in spite of the market challenges.

We see opportunities to pivot and refocus that group towards more onshore aftermarket support. I think there's great potential out there for NOV to build on its franchise in the land side and provide better aftermarket support of those customers. Likewise, on manufacturing, we expect to pivot and refocus in the aftermarket opportunity around that.

Secondly, we're going to be sizing to what the market dictates. As I also mentioned in my opening comments, we're outsourcing more than half of our machining work in Rig Systems, for instance. So we have a lot of flexible supply chain that supports our efforts that we can diminish.

Thirdly, we've got two other big segments that have different cyclical behaviors. And so recovery in rig counts in 2016 would do a lot to very rapidly lift demand by Wellbore Technologies -- for machining capabilities, for assembly. And likewise, Completion & Production Solutions is on a little different cyclical trajectory. By having three different segments that have different cyclical behaviors, it gives us an opportunity to refocus resources into places that may need them.

Jud Bailey - *Wells Fargo Securities - Analyst*

All right, great. I'll turn it back, and I appreciate the commentary.

Jeremy Thigpen - *National Oilwell Varco Inc - SVP, CFO*

Thanks, Jud.

Operator

Marshall Adkins, Raymond James.

Marshall Adkins - *Raymond James & Associates, Inc. - Analyst*

Good morning, guys. Thank you for all the detail in the sub-sector. That's very helpful.

Clay, I want to ask a bigger-picture question -- you touched a little bit on it, so far. Typically, in downturns, you guys win, in that you have strong cash flows and you pursue this M&A strategy. Now, it looks like you have the stock buybacks going on, as well, as a possibility, which you didn't have before.

Walk me through how you prioritize those and time it out. You mentioned M&A is going to be slow to develop, given the bid-ask spread. But how are you thinking about it, in terms of the timing of spending the excess cash over the next couple of years?

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Well I think, Marshall, we came into this downturn with $4.1 billion of cash on our balance sheet at the beginning of Q4, a lot of credit capacity, and expectation that as business slows, we will have cash come out of working capital and off of our balance sheet -- plus a $14.3 billion backlog translates to a pretty significant margin embedded in that backlog, which will turn to cash over the next year or two. So we entered this downturn with a lot of resources. And I think we have the capability to really do all the above.

And so we have very intentionally stepped up our focus on M&A, mostly around the smaller Company opportunities, because, frankly, they're more doable in this kind of market downturn. I think it's challenging for a public Company to enter into an agreement to sell itself. It's not distressed when its stock price is way below its 52-week high. And so it makes it difficult to do a larger transaction in this kind of environment.

It's not to say, like I mentioned earlier to Jim, that were not continuing conversations and surveying landscape out there. In terms of how we prioritize, I think we can do all the above, and do so in a way that doesn't sacrifice future flexibility, and do so in a way that keeps some powder dry for those opportunities as they arise. So that's the thought process that we're going through.

Specifically, with regard to the share buyback, this is the Company we know best. We can combine shares with no purchase premium, and we can size those transactions to whatever size we feel comfortable with, which is why, at our analyst day we linked the application of capital in the share buyback program to the repatriation of cash from overseas.

Marshall Adkins - *Raymond James & Associates, Inc. - Analyst*

Okay.

Just one quick, unrelated follow-up. We're going to see a lot of rig retirements, both on land and offshore -- or stacking. I presume that hurts your aftermarket business, but help me to understand how that flows through for you all, as you retire rigs. I presume, that's a lot less aftermarket stuff, but I'm not sure about that.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

No. That's exactly correct.

The older rigs are far less aftermarket-intensive than the new rigs. And so the rigs that are coming out of the shipyard now -- that have come out of the shipyard in the last few years -- have much higher levels of electronic controls, many more miles of wiring and cabling, and more precision machined components that help them work more efficiently. And what we know is that kind of equipment is going to be much more aftermarket-intensive than the old rigs that are being laid down.

So the old rigs, yes. We've got some level of participation, really, in all rigs. So the old rigs, there's a little bit of aftermarket that goes away, but it's a good trade for us. All things considered, we much prefer a new rig, in terms of its aftermarket potential.

Marshall Adkins - *Raymond James & Associates, Inc. - Analyst*

Perfect. Thanks, guys.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Thank you, Marshall.

Operator

Jeff Tillery, Tudor, Pickering, Holt.

Jeff Tillery - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Hi, good morning.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Hi, Jeff.

Jeff Tillery - *Tudor, Pickering, Holt & Co. Securities - Analyst*

For the Rig Aftermarket business, could you just provide some qualitative color around the mix of that, in terms of onshore versus offshore and then, the deepwater component? And do I think about that -- the level of business for you guys -- as tracking working deepwater rig count? Just trying to think of different ways to forecast the business over the next year.

Jeremy Thigpen - *National Oilwell Varco Inc - SVP, CFO*

Sure, Jeff. Obviously, it moves around a little bit, depending on the quarter. But by and large, it's about 80/20 split, offshore to land.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Yes. Which gives us the belief that there's more to do there on land and think, longer-term, there's opportunities to grow that business to focus on the land fleet.

The other interesting observation about our aftermarket business is that, as our customers have become a lot more focused on their expenditures, they're probably going to be more open to repairing old drilling equipment, rather than replacing it with new drilling equipment. So we think there will be lots of instances where, rather than selling, for instance, a new set of drawworks out of Rig Systems, that we'll actually have our Rig Aftermarket business now fixing an older set of drawworks and getting them back up and running. And so that may actually help the aftermarket business a little later in the year.

Jeff Tillery - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Good. Thank you.

And for the Wellbore Technologies segment -- if I think about the composition of the business today versus 2009, walk us through the puts and takes that would make either the 2009 comparison valid, or something that drives either better or worse decrimental performance, relative to the 2009 cycle.

Jeremy Thigpen - *National Oilwell Varco Inc - SVP, CFO*

Yes. I think, obviously, all of the businesses are larger now. In terms of the percentage of total revenue, they're probably fairly similar to the way they were in 2009. I think that comparison is probably fair. It won't be exactly that, but it will be reasonably close, I would think.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Yes.

Jeremy Thigpen - *National Oilwell Varco Inc - SVP, CFO*

It could be, if the market deteriorates as quickly as it did and as deeply as it did from 2008 to 2009 and 2014 to 2015.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Generally, they're all very high operating leverage businesses. So we'll feel that, as they come back down. Not sure pricing ever got up to the levels we had in 2008.

Jeremy Thigpen - *National Oilwell Varco Inc - SVP, CFO*

No.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

I've heard some of the other oilfield service companies referencing that, which they're pointing to as potentially limiting decrimentals. I'm probably hesitant to forecast that. Previous downturns point to pretty high decrimentals in our Wellbore Technologies business. And we're probably likely to see the same thing in 2015.

Jeremy Thigpen - *National Oilwell Varco Inc - SVP, CFO*

The one thing that could be encouraging, Jeff, is if you look back to 2008, 2009, you had a number of years of steady increases. Here, we went through a de-stock in late 2012 and throughout 2013.

I'm not sure that we -- our customers actually built inventory levels in 2014 to the degree they did in 2008. So that would suggest, hopefully, that as the market starts to rebound, that demand comes back to us more quickly than it did -- just because I don't think we have the same inventory overhang as we did back in 2008.

Jeremy Thigpen - *National Oilwell Varco Inc - SVP, CFO*

And/or 2012, as well.

Jeff Tillery - *Tudor, Pickering, Holt & Co. Securities - Analyst*

That's very helpful color.

Did pricing erode more than 10% in 2009? I'm trying to think, on balance. I seem to remember 5% to 10% is what's stuck in my head for pricing reductions.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Yes. I actually believe it was probably north of 10% for a lot of business this year.

Jeff Tillery - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Okay thank you

Jeremy Thigpen - *National Oilwell Varco Inc - SVP, CFO*

Thank you

Operator

Robin Shoemaker, KeyBanc Capital Markets.

Robin Shoemaker - *KeyBanc Capital Markets - Analyst*

Yes. Thanks a lot.

I was wondering if you could update us on the portion of the $12.5 billion of Rig Systems backlog that relates to Brazil. And how has this ongoing internal investigation in Petrobras -- that's clearly slowed down drilling -- how has it affected the pace of rig construction or shipyard construction -- the things that you referred to?

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Yes. Thanks, Robin.

Thankfully for us, it really hasn't created a big impact on our programs. If you remember back a few years ago, when Petrobras settled this up, they set up a separate financing arm called Sete in Brazil that is actually the customer. It went out and secured its equity partner investors and secured its bank financings.

And so it's moving along separately, there's virtually no capital support from Petrobras into those projects to construct the rigs. Where the support comes is in the contracts to operate those rigs once they're delivered, and that's still a couple years out.

Based upon Sete placing orders to construct these rigs with their partners, shipyards jumped in the fray and concluding a couple of new shipyards that were constructed for this program. Those have been proceeding along relatively smoothly. That's not to say without some delays and some issues and some challenges that we fully expected, but by and large, those projects are moving ahead.

We expect the first rig to be delivered, I think, Q3 or Q4 this year -- the first of 22 rigs that we're signed up to deliver. The specific challenges that group of projects and shipyards have faced have been more around cost overruns on the construction of the shipyards. That led to a few payment delays for us. We're working through that.

The good news, here, within the past few weeks, a couple of financing packages have been made available to Sete. I mentioned in my opening comments, the Development Bank of Brazil -- I think the Central Bank is involved and Banco do Brasil. And some of the Asian partners to some of the shipyards are also financing the completion of the construction of those yards.

So net-net, we're in pretty decent shape. I think, important for NOV shareholders is, that we are ahead. We've received more payments than we have delivered equipment into these projects. And so very important to us, that we maintain that position from our risk management. We're in pretty good shape on these, Robin.

Robin Shoemaker - *KeyBanc Capital Markets - Analyst*

Okay/

On the pricing discussions that you're having with customers and where they're coming to you, I just wanted to clarify that -- does any of that pertain to existing backlog in Rig Systems or Completion & Production Solutions? Or is it entirely on new orders?

Jeremy Thigpen - *National Oilwell Varco Inc - SVP, CFO*

Entirely on new orders and, really, mostly around the short-cycle consumable type of items.

Robin Shoemaker - *KeyBanc Capital Markets - Analyst*

Sure. Okay. (multiple speakers)

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

To the extent we're entertaining any changes in the backlog at all, it's usually around delivery dates, like I said. (Inaudible) If we push things out just a little bit, we can actually save money.

Robin Shoemaker - *KeyBanc Capital Markets - Analyst*

Right.

And in reference to my earlier question, did you want to give a portion of your Rig Systems backlog that pertains to Brazil?

Jeremy Thigpen - *National Oilwell Varco Inc - SVP, CFO*

Oh, yes. $3.5 billion--

Robin Shoemaker - *KeyBanc Capital Markets - Analyst*

Okay, great.

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Is out of the $12.5 billion is still Atlas Project, 22 floating rigs.

Robin Shoemaker - *KeyBanc Capital Markets - Analyst*

Thank you

Operator

Thank you. I will now turn the call over to Mr. Clay Williams for closing remarks

Clay Williams - *National Oilwell Varco Inc - President, CEO, and Chairman*

Thank you, Lorraine, and thanks to all of you for joining us. And we look forward to speaking with you in April, as we update you on the first quarter.

Operator

Thank you. And thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.