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NOV - Q1 2012 National Oilwell Varco Earnings Conference Call

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**OVERVIEW:**

NOV reported 1Q12 revenue of $4.3b and earnings of $606m or $1.42 per fully diluted share.





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## CORPORATE PARTICIPANTS

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

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**Robin Shoemaker** *Citigroup - Analyst*

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## PRESENTATION

**Operator**

Welcome to the National Oilwell Varco 2012 first quarter earnings call. My name is Dawn and I will your operator for today's call. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session. 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.

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

Thank you Dawn, and welcome everyone to the National Oilwell Varco first quarter 2012 earnings conference call. With me today is Pete Miller, Chairman, CEO and President of National Oilwell Varco, and Clay Williams, Chief Financial Officer. Before we begin this discussion of National Oilwell Varco's financial results for its first quarter ended March 31, 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 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 10K 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 I will turn the call over to Pete for his opening comments.

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

Thanks Loren, and good morning everyone. Earlier today National Oilwell Varco announced first quarter 2012 earnings of $606 million, or a $1.42 per fully diluted share, on revenue of $4.3 billion. Excluding transaction costs, earnings were a $1.44 per fully diluted share. This compares to year earlier results of $0.96 per share on revenues of $3.15 billion. We're extremely pleased with these earnings and feel they are indicative of the great product offerings National Oilwell Varco offers to the industry, and the excellent execution of our outstanding employees. Thank you all for your wonderful efforts. Additionally, we announced new capital orders of $1.91 billion for the quarter, a 15% increase from last quarter, definitive proof of the demand for our market leading, highly technical equipment. Ending backlog for the quarter was $10.4 billion. The first quarter is a nice start to 2012 and exemplifies the full cycle product offerings of NOV. At this time, I will ask Clay to provide color on these results, and I'll return a little later to add a few operational comments. Clay?

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

Thanks, Pete. National Oilwell Varco posted strong earnings for its first quarter of 2012, generating earnings of $1.44 per fully diluted share, up 44% from a year ago, and up 5% from last year, including transaction and devaluation charges from all periods. Revenues were a record $4.3 billion, up 37% from the year earlier quarter, and up slightly from the fourth quarter of 2011. Operating profit ex-transaction charges was $881 million, and consolidating operating margins were 20.5%, both up sequentially and year-over-year. Operating leverage, or flow-through, was 48% on a small sequential revenue gain, and 22% on the 37% year-over-year revenue gain. Our consolidated results show a shift in margins between two segments.

Solid sequential margins gains within Petroleum Services and Supplies offset sequential declines in Rig Technology. Distribution and Transmission margins were down just slightly from a very strong level in Q4. Our businesses performed first quarter, benefiting from high levels of activity in North America and abroad, as well as a great starting backlog of orders. Like others, we are watching closely the impact of low North American gas prices on activity, and we are shifting our operations from gassy basins to liquids rich plays, but we remain cautiously optimistic that rising rig activity will continue to offset falling demand for gas rigs across North America. Elsewhere around the globe, we foresee continued interest in shale gas technologies onshore, and blossoming deepwater activity offshore.

We have made good progress in deploying capital to better position National Oilwell Varco to better serve our customers, through investments in new plants and spare parts and repair inventory to support our installed base, and in acquisitions, and this quarter's results reflect contributions from all three. New facilities for down hole tools, drill pipe, fiberglass pipe, coil tubing units, pressure pumping equipment, tubular inspection and coding and pumps, plus capacity expansions for top drives, blowout preventer, coil tubing, and after-market services are beginning to contribute. We've also been able to step up our acquisitions pace over the past 12 months, with Ameron and NKT Flexibles, and several other smaller deals. We've announced the acquisition of Wilson Supply from Schlumberger, and we hope to close our acquisition of Interflow, a Canadian manufacturer of well stimulation equipment with over 600 employees, within the next few days. All with a view to strengthen NOV's product and service offerings for the benefit of our customers and shareholders for decades to come, as the oil and gas industry transitions to a world where energy needs are met by deepwater technology, by horizontal factory drilling, and by hydraulic facture stimulation, into which NOV is the leading technology provider.

Turning to our segment operating results, the Rig Technology Group generated revenues of $2.259 billion in the first quarter, down 2% sequentially but up 40% compared to the first quarter of 2011. Operating profit was $551 million, yielding operating margins for the group of 24.4%, down 160 basis points from the prior quarter and down 180 basis points from the first quarter last year. Decremental leverage was 91% on the modest sequential sales decline, and compared the first quarter of 2011, incremental leverage, or flow-through, was 20% on the 40% of sales increased, due to the gradual mix shift toward lower margin projects that we've discussed before. Inquiries and orders have been very strong, and offshore drilling customers euphoric. The stars of $100 crude, high and rising day rates, hungry shipyards, and open capital markets seem to be aligned. We believe [haul] prices are down 1% to 2% from mid-2011 peaks, as shipyards are eager to replace dwindling backlogs of dry bulk shipping and other conventional vessels.

While the outlook for jack-ups is strong too, we would characterize it as less buoyant lesson than the demand for floaters, with more second and third tier contractors, NOCs, and start-up interests for jack-ups then we see in the floater area. While drill ship demand dominated our orders last year, recent interest in semi-submersibles, mostly for the North Sea, has picked up, as have inquiries for subsea construction vessel equipment, like Active Heave Cranes. First quarter bookings totaled $1.911 billion, up 15% sequentially, and included four floating rig packages, one floating well intervention vessel package, and two jack-up packages. We shipped $1.711 billion out of backlog, down 4% sequentially, leaving a quarter end level of $10.363 billion, an improvement of about 2% from the start of the quarter.

At March 31, 2012, about 16% of the Segment's backlog for capital equipment was for land, 84% for offshore, and 14% was for domestic markets, 86% for international markets. Of orders in the backlog at quarter end, we expect $5.2 billion to flow out as revenue through the remainder of the year, $2.9 billion to flow out in 2013, and the balance to convert to revenue thereafter. We delivered five floaters and one jack-up during the first quarter, bringing our total to 132 offshore rigs supplied to the industry since 2005. First quarter bookings did not include any additional rigs for Brazil, although we are working on new drilling equipment package contracts for that market, related to indigenous new build programs by Petrobras and its rig financing arm, Sete. Our previously announced contract with EAS for seven drill ships is being converted from an SHI design to an LNG design, and we look forward to starting to cut the first iron for this programs soon.

On our March 31 balance sheet you'll see that inventory increased $498 million during the first quarter on a consolidated basis. About 0.5 of this increase was in the Rig Technology Segment, due to, one, acceleration of the rig construction process as compared to the 2006, 2010 cycle, which requires NOV drilling equipment package components to be manufactured at a faster pace; two, lower level of completed contracts revenues this quarter, down about $123 million sequentially; and three, our intentional investment in spare parts to support our customers. We've noted on past calls that the shipyards have shaved 10 months or more off the build schedules for drill ships, as their key site resources have loosened. This requires accelerated component velocities through our plants to accommodate their new speedier schedules, and our inventory levels reflect this Demand for individual subsea BOP stacks, not associated with offshore new build rigs, contributed to the strong Q1 order levels, and we expect the same in Q2, as drilling contractors seek replacements for stacks unable to be certified, and for fleet spares. Forgings for these are long lead time items too, which further contributes to our inventory growth. Prompted by EMP operators, more and more new build floaters seem to be adding a second BOP stack. Consequently, we are adding a fifth and sixth rig up pad to or plant in Houston to accommodate all of this demand, and presently training 170 students at one of our five technical colleges located around the globe.

Orders for turret mooring systems for FPSOs remained light in Q1, with a couple of major FPSO owner-operators struggling with cash flow issues, but we believe we are nevertheless very close to signing up a couple of meaningful turret orders later this year, and continue to remain busy with quotations. We will also begin to see some contribution to our subsea production business in Q2, following the closing of our NKT Flexibles acquisition in early April, which brings National Oilwell Varco flexible piping solutions for subsea developments. Land drilling rig demand cooled slightly in the first quarter, which we view as temporary, and perhaps budget related after a strong fourth quarter. We see more tangible operator activism on pulling new technology into the marketplace, the AC powered electronically controlled robotic pipe handling 21st century rigs, that we've referred to on many previous calls. Although terms appear to be shorting from three years down to one or two years, term contracts at strong day rates are being offered nonetheless to drilling contractors to build new 21st century rigs, even as old rigs sit idle, offering pretty compelling evidence that operators prefer these new rigs. The land drilling industry also appears to be moving towards rig replacements and additions in [marga quanta], bigger more systematic build programs as opposed to onesies and twosies, which enables these operators to institutionalize crew training, operating procedures, equipment standardization; in short bring industrially efficient methods to the systematic replacement of their increasingly obsolete old rig fleets.

Although less evolved then the North American market, we see a similar pull of 21st century rig technology into drilling markets in Latin America, the Far East, the Middle East, and most recently with our new CE ATEX rated rig design, Eastern Europe. We expect this trend to accelerate as operators gain experience with these cool new rig toys. Perhaps contrary to conventional wisdom, orders for well intervention equipment and spares remained very strong in the first quarter, falling just slightly sequentially for pressure pumping equipment and coming in roughly even with high demand levels seen in the first quarter of last year. Oil tuning and pressure pumping equipment is largely sold out until early 2013. To the extent we see any incremental ordering weakness, we would characterize it as small independents and dry gas regions, but nevertheless we won orders from two more North American start-up pressure pumper's just last week, and quoting activity still remains brisk. Our window may not necessarily be representative, since about 40% of well intervention equipment we sell goes overseas, with China and the Middle East particularly hungry for hydro-rig coil tubing equipment and Rolligon frack spreads these days. We also sell ASEP Elmar wireling units through this product line, and have seen good demand and excellent margin performance for these in the first quarter.

Sales of after-market spares and services improved 3% for the Rig Technology Group sequentially, helped by strong demand for BOP and well intervention spares. Non-backlog capital sales declined sequentially. Looking forward into the second quarter of 2012, we expect a good quarter for orders for Rig Technology. Both offshore packages and complete land rig orders should be strong, but we may see pressure pumping equipment cooling. Second quarter revenues for the group are expected to be up in the mid-single digit percentage range, but we expect operating margins to tick down slightly, owing to NKT flowing in and dilutive margins, partly offset by rising margins in offshore drilling equipment.

The Petroleum Service and Supplies Segment posted a bang-up quarter, with revenues of $1.704 billion, up 9% sequentially and up 35% year-over-year. Operating profit was $388 million and operating margins were a stout 22.8%, up 360 basis points sequentially. Compared to the fourth quarter of 2011, the $134 million revenue increase produced 65% operating leverage, or flow-through, and year-over-year flow-through was 32%, both helped by higher volumes, improved pricing, cost reductions in some international areas, and outstanding execution on integration of recent acquisitions within fiberglass systems and mission, in particular. From a regional perspective, US revenues grew 19% sequentially and totalled 54% of the Segment's mix in the first quarter. Canada improved 16% and totaled 8% of the mix, and International revenues declined 2%, due mostly to weather issues in Europe and lower sales in the UAE, offset by gains in Brazil and Russia.

Strong sequential performance was posted in several business units. National Oilwell Varco's down hole tools business had a tremendous quarter, benefiting from steady adoption of horizontal drilling and high interest in drilling optimization. Capacity from our new Houston plant and lean manufacturing initiatives at existing plants enabled us to respond quickly to high demand and helped improve the utilization of our rental fleet. Latin America posted record results, and margins in Europe moved up substantially. Demand for agitators and for our new thermal abrasion resistant Helios Spin technology also contributed to the strong results. Several new Down Hole technologies are in various stages of field trials, so our outlook is bright. Down Hole tools, together with our IntelliServ joint venture with Schlumberger, achieved in important milestone this quarter. We transmitted high-speed real-time down hole drilling mechanics measurements to control the surface machinery on the rig to optimize the drilling process. This is very, very exciting, given that this is the first time, to our knowledge, that anyone in the industry has ever done this on a real well in the field, and the immediate impact on the drilling speed was remarkable.

Fiberglass had a great quarter too. First quarter results included a full quarter of the composite pipe sales from Ameron, which we closed in October of last year. Solid demand and decisive execution of the integration plan lifted combined margins for the business nearly 500 basis points sequentially on strong volume gains, particularly for composite piping systems for FPSOs. The outlook is good as well, as the group proceeds with product rationalization and operational improvements between the two heritage organizations, and as we hit our stride on a newly opened plant in [Ormond]. Drill pipe volumes and margins improved sharply in the first quarter. After spiking last year, purchases of more expensive third party green tube subsided a bit this quarter, lifting margins considerably. Mix was essentially unchanged from Q4, with about two-thirds of our sales consisting of premium pipe. Orders exceeded shipments as offshore new build orders begin to flow in, about 20 in the first quarter, lifting our average price per foot in our backlog and pushing backlog up nearly 60% above year ago levels.

We continue to pursue drill pipe orders for more than 60 new build offshore rigs. Land drillers have moved towards using papered streams to limit demand for premium four-inch XT pipe, a proprietary NOV offering, and maximized use of five-inch API pipe, which they already have in abundance. So pricing leverage for drill pipe appears to be flattening. Our mission pump and flow iron products also enjoyed great demand in the first quarter. Pumps for new build land rigs, two small acquisitions, and sharp sequential demand growth for reciprocating pumps contributed to double-digit sales growth increases, along with higher pressure vessel sales and price increases pushed through last year. The group is developing some flow processing products that will further augmented NOV's product package for SFPOs, produced water de-sanders and de-oilers, separators, and transfer pumps, as well as innovating new flow iron products for land-based hydraulic frack jobs.

The high domestic rig count, coupled with high drilling productivity, has increased the velocity of casing and tubing through the system. As rigs move faster and steadily trim drilling days from wells, tubular consumption rises in the aggregate. Pipe mills add capacity and runs, and our Tuboscope tubular inspection and coding operations are, as a result, full of pipe and busy. Our Houston Sheldon Road pipe yard complex, for example, unloaded nearly 19,000 truckload's of pipe during the first quarter. That's a load every 7 minutes, 24 hours a day, 7 days a week during the quarter. Our Houston tubular coating operation is largely booked through the year, and our crews operating in line QAQC services at external pipe mills and pipe processors across the country inspected 90,000 more pieces in Q1 then the preceding quarter.

Offshore operators are assembling the casing, tubing, and conductor pipe they need along the Gulf Coast as the Gulf of Mexico returns to a more normal level of activity, which has led to rising backlogs for NOV's proprietary conductor pipe connections, provided by XL Systems. This group will open a new plant in Q4 to help meet rising offshore demand. NOV's Well Site Services saw strong demand for solids control equipment and generator rentals across North America during the first quarter, benefiting as well from improvements in the Gulf of Mexico. Despite transition cost arising from the migration of operations from gas basins like the [Haynesville] and Barnett into the oil regions of the Eagle Ford, the Permian, and Bakken, margins were very solid through the quarter.

[Parry] sales were down during after a strong Q4 and project delays in Q1, but Mexico improved due, in part, to a recent acquisition, and Brazil remained strong. Our new coil tubing mill contributed to a nice quarter at Quality Tubing, which saw demand for coiled tubing continue to climb, as NOV steadily adds to the worldwide coil tubing unit fleet. We are constructing yet another new mill, which will be online in early 2013, and see continued strong demand for the next several years. Looking into the second quarter of 2012, we expect Petroleum Services and Supplies Segment sales to be roughly flat with the first quarter, but at lower margins. While we expect sequential growth in demand for certain products and services the segment offers, these will be partly offset by seasonal declines in Canada due to breakup, when authorities enact road bans on large loads during the Spring fall to prevent damage.

Canadian breakup began a little early this year, but we are hopeful it will be shorter than is typical, but it nevertheless usually hits our financial statements with very high operating leverage. We are also watching costs closely, as freight and resin and certain grades of steel are starting to rise, perhaps following the price of oil. Turning to our Distribution and Transmission Segment, first quarter sales were $564 million, up 1% from the fourth quarter of 2011, and up 38% from the first quarter of 2011. Operating profit was $43 million, and operating margins were a solid 7.6% of sales. Year-over-year incremental flow-through, or operating leverage, was 10%. Mix for the group's first quarter was 72% North America, and 28% International. Distribution Services is benefiting from the capacity additions in pressure pumping, which appears to be accelerating the completion of wells previously.

The hook-up of a liquids well with its tank batteries and plumbing at $50,000 to $70,000 can easily be 10 times that of a dry gas well hook-up for us. As [frack] horsepower tightness has eased in oil regions, completions appear to be accelerating, helping the unit achieve high single digit sequential growth in North America. While top line growth was good, we saw margins drift lower due to reduced supplier discounts and rebates tied to annual purchase volumes in the first quarter as compared to the fourth quarter, as we restarted our purchase volume meters at the beginning of the year. The Distribution Services Group rolled out a new consigned inventory business model for land rigs last month, which we are pretty excited about. The first container full of MRO drilling supplies went into service for a major land drilling contractor, and while we are working out the procedures around physical inventory counts and resupply, I'd say so far, so good. And IOC has contracted for five of these units, and we are excited about pioneering a new business model with their support.

We are opening six DSEs in North America through the first half of 2012, shifting our base of support to better conform with the migration of rigs into liquids areas, and we are opening two DSEs internationally, in Columbia and Sumatra. Industrial demand for mono-pumps was surprisingly strong in the US, China, ad Latin America for the group through the first quarter. We face some supply chain issues out of Asia and Argentina, and we are beginning to see costs rise for some of the specialty steels we purchased. We have taken steps to address these with our supply chain. Rig count driven demand for power sections for drilling motors and artificial lift products is very high, although a couple of large artificial lift products sales were delayed out of the first quarter. I mentioned earlier our agreement with Schlumberger to acquire their Wilson Supply business, and we are working to try to close that transaction sometime this summer. Wilson is an outstanding franchise that, like us, dates back to the early days of the oil-field. It will bring new channels into new midstream and downstream markets to our considerable portfolio of NOV products, and we are excited about the many new opportunities that lay ahead for our combined businesses, and eager to welcome Wilson's 2500 employees to NOV.

Looking into the second quarter of 2012, we expect Distribution and Transmission Group revenues and margins to decline slightly, primarily due to seasonal declines in Canada, due to breakup, partly offset by higher sequential sales from transmission and mono group efforts. Turning to National Oilwell Varco's consolidated first quarter income statement, SG&A G&A decreased $37 million, due to lower incentive compensation accruals and overhead reductions quarter-to-quarter, associated the Ameron acquisition last year. SG&A as a percentage of sales was 9.1% in the first quarter, down from 10% last quarter, and down from 11.6% last year. Equity income at our Voest-Alpine joint venture was $17 million, up $5 million sequentially on much higher casing shipments into North America. We expect equity income to decline in the second quarter.

Other expense was change from the fourth quarter. The tax rate from the first quarter was lower than expected at 30.8%, which benefited from discrete FX movements in our European operations. We expect next quarter our tax rate will return to the range of 33%. Unallocated expenses and eliminations on our supplemental segment schedule was $101 million in the first quarter, up $12 million sequentially, due to higher inter-segment sales eliminations, partly offset by sequentially improved -- lower incentive compensation and other items. Depreciation and amortization was $148 million, up $6 million from the fourth quarter on acquisitions and high 2011 CapEx. EBIDTA, excluding transaction charges, was a record $1.038 billion, up $31 million sequentially to 24.1% of sales.

National Oilwell Varco's March 31, 2012 balance sheet employed working capital, excluding cash and debt, of $4.4 billion, or 25.3% of annualized sales, up $842 million from the fourth quarter, due to several factors. Inventory accounted for about 60% of our working capital growth, due in part to backlog requirements in Rig Technology that I discussed earlier, and in part to new plants that we've been opening, and new acquisitions that we've made across our other segments. Additionally, customer financing of our backlog through the net of prepayments and billings in excess of cost, less costs in excess of billings, declined $175 million sequentially, and the payout of annual incentive compensation during the first quarter also increased working capital by reducing accrued liabilities. Cash flow used by operations was $64 million for the first quarter, due primarily to the working capital I just mentioned. CapEx declined sharply, down $53 million sequentially to $113 million, but we expect CapEx to pick back up in the second quarter, and for the full year 2012 to be in the range of $650 million, as we continue to pursue a number of expansion opportunities.

NOV's cash balance was $3.4 billion at March 31, 2012, and is presently about $2.7 billion following the NKT acquisition, with about 88% of it located overseas.

Now I will turn it back to Pete.

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

Thanks Clay, and I just want to make a few brief comments and kind of reiterate some of the things that Clay had talked about. We're really -- in the past few years we've been expanding very rapidly in a lot of the international arenas, and we're also doing a lot of capacity expansion and capacity changes here in the United States. We think these things are going to bode very well for the future. We're starting to see that in some of the numbers that we're even talking about today, but just this past quarter we opened up our new facility in Abu Dhabi in which we have pipe inspection, pipe coating, drill pipe manufacturing, and down hole tool manufacturing, and that's really kind of support the entire Middle East, but we have things like this going on all over the world.

We have expansions going on in Russia right now. We hope to be able to build rigs there very soon. We're doing down hole tools, we're doing wire line units, we're doing some of the fracking systems. Have a lot of things going on, and if you take a look at the shales, which we always mention on these calls, in China, Australia, Latin America we really are positioning ourselves to be able to take advantage of this. We're doing things in the United States at our pressure control facility in West Little York here in Houston, our hydro rig facilities up in Fort Worth, our facilities out in Orange, California, in which we're expanding our top drive production capabilities, and even though we know there's a good chance for softness the second half of the year in North America, especially in natural gas, now's the time to do these things because we're true believer in long-term of what you're seeing here, and as you push out to the long-term, shale gas, the things that we can do the United States with natural gas, whether it's export it with LNG plays very, very well to what we're doing.

So we're excited, and now's the time to strike and make sure that we're positioned to the things that are going to be happening in 2015, '16, and beyond. One of the things I'm most excited about is we're building a test rig facility in Conroe, north of Houston. This is really going to be a state-of-the-art facility. It's really going to allow us to test everything that we do in this Company, from drill pipe, to down hole tools, to mud, to all the rig equipment that we have. It'll be better than anything the industry's seen, and I think it really is going to enhance the new product offerings that we're going to be able to make for this industry. We're excited about it. We're actually going to be drilling a well. I'll advise you, though, that we are not going to become EMP people. We are watching that very closely. If we do discover oil and gas, though, I'll be very excited, bit it gives us an opportunity to really test things out before they go into the field and to make sure that we're taking care of our customers in the way that they need, and we are staying on the edge of making sure that we have the best equipment in the industry.

Having said that, next week is the Offshore Technology Conference, and you've heard me say before, the lifeblood of any company are new products, and we're good to be doing a lot of exciting things and showing exciting things at OTC. In particular, and probably one of the things I'm most excited about, and Clay mentioned this in his comments, is our National Oilwell Varco Automation Suite, or what we call NOVA. This is a unique system in which we have an equipment suite called NOVAS that's on the surface, and we have a sub-surface suite called Nemesis. These two tie together, and it allows things that go on down hole to be able to talk to the equipment on the surface, and things like mud pumps. If you say, I've got to have more volume. So I've got to pick up the strokes on my mud pump. All of these things are going be happening automatically.

The thing that's neat about Nemesis down hole is it's going to be open architecture. So you'll be able to put just about anybody's tools on there, but I'd recommend our tools. They're the best ones. So the fact of the matter is, I think this has an opportunity to really change the way things are controlled on a drilling rig, and we're the natural provider of this. We're the world's largest provider of drilling rigs and equipment, and now we want to take this NOVA suite of equipment and put it out there. Another thing we're very excited about, and you'll be able to see a little bit of it here, is our BOP monitoring system, and we'll actually be able to monitor subsea BOPs from land, and be able to see that on a real-time basis. We'll be able to put the things on things like iPads and iPhones, and you'll be able to monitor this equipment, and I'll also say NOVA will actually have some apps that you'll be able to use on iPads and iPhones. So we've got some people really working on some cool things.

One additional thing is our 30,000 psi BOP that was made by our Texas oil tool folks. This is really kind of a unique wire line BOP. First one that's 30,000 psi, been used in the field already. I'm very excited, and if you around OTC I'd really recommend you taking a look at that, and the other thing we'll have there will be a full array of our FPSO offerings and the things that we're providing in what I call now kind of the post-cycle. So we've got the full cycle of early, mid, and late type equipment, and now you've got the post-cycle, which is going to be the production equipment, the FPSOs that we're very excited about.

And having said that, I'd like to welcome all of our folks from NKT into the Company. We closed that this quarter. It'll now be known as NOV Flexibles, and especially the majority of the employees in Denmark, welcome to the NOV family. So at that point, Dawn, I'd like to turn it over for any questions that our callers and listeners might have.

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## QUESTIONS AND ANSWERS

**Operator**

Thank you. We will now begin the question and answer session. (Operator Instructions) Jim Crandall, Dahlman Rose.

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

Pete, in the past few weeks we've seen some big ultra-deepwater discoveries, higher day rates for ultra-deepwater rigs, and Seadrill in particular, stepping in and ordering more floaters. How is this, just in the past few weeks, changed the psychology toward ordering more ultra-deepwater rigs out there?

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

Jim, it's changed the psychology to be very positive. I think you've heard me say before, Seadrill is kind of a harbinger of what's going on in the industry. They're clearly very progressive, and when you take a look at the economics that are out there today, and some of these day rates that these deepwater rigs are getting, then you tie that back to what the shipyards are charging for these rigs today in conjunction with our DEP, or Drilling Equipment Packages, and you then -- I think the other third part of it that's really cool, what Clay mentioned, is cutting almost a year off the delivery time. Those economics, the discoveries that you're talking about, really shows that the world needs more of these deepwater rigs. We think it's going to be a very positive ordering environment over the next few quarters, and we're excited about what we're seeing out there in the industry. Again, it's a pretty compelling financial argument when you look at it and you see the payback for these drilling contractors, it's is a very good ROI.

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

Good. That's great to hear, Pete. The second question I had, is there any way that you and Clay could try to quantify for me the ordering of additional BOP stacks by contract drillers for deepwater? To what extent are they ordering additional stacks for their rigs, to what extent are they ordering additional stacks for a number of rigs, and I guess, what kind of increment should we build on our assumptions for new blowout preventer orders, in addition to the number of rigs being ordered?

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

Jim, it's been slowly rising. Obviously interest in the BOP equipment has been slowly rising ever since the Summer 2010, and this quarter it really showed up in the form of several loose BOPs, we call them, BOPs that aren't necessarily associated with a new build rig, but rather subsea stacks that are either to support a fleet of rigs out there in case the stack were to get dropped, or they need a change-out of a stack, or to support even an individual rig. We hear that the EMP community is more and more expressing an interest in each rig having a second redundant stack to speed operations and be available to be run on riser quickly. Then kind of the third is this level of maintenance that must go on with offshore equipment. As you know, offshore rigs need to come into the shipyard every five years, and all of the components go through a major overhaul. So having spare stacks available to support that effort just speeds that up and ultimately makes the fleet more efficient. So we're seeing this quarter solid demand from a couple of joint contractors going into their fleets, and then also we see that to recur in Q2 as well, with good orders.

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**Operator**

Robin Shoemaker, Citi.

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**Robin Shoemaker** - *Citigroup - Analyst*

Wanted to ask about Rig Tech margin in the quarter. You mentioned there was an impact from the addition of NKT on Rig Tech margin. But I'm also thinking that first quarter of '12 kind of roughly corresponds to the low point in the rig ordering cycle, and probably pricing cycle in the first half of '10. Now, you mentioned that second quarter Rig Tech margin, I think, would be slightly lower. So apart from NKT, would the first quarter of '12 be the low point reflecting the first half of '10 pricing dynamics?

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

I think the first half of '10 pricing dynamics contributed to the margin this quarter, Robin, but it's not as one-for-one as you might otherwise think, because we sell lots of different pieces of equipment and kit that flow out at different times, so it's really a compilation of pricing, probably dating back to even 2009 all the way up through items that were sold in late 2011. So it's more of an aggregation of all of the pricing through that period that came out during the first quarter. I do want to correct one thing. We did not close NKT until the first week of April, and so there is no NKT Flexibles contribution to the P&L results that you're seeing here for the first quarter. That's something, though, that we do expect to start contributing nearly a full quarter's performance in the second quarter 2012. So we'll get not quite 90 days, but pretty close to 90 days, from NKT, and that'll bring the margins down again. Right now our forecast calls for margins to move down just a little bit more in Q2. So we're 24.4% operating margins for this quarter, and down in probably the 24% range in Q2. And although I didn't explore it in much detail in my earlier comments, it's probably worth reiterating.

The basis for that margin decline, which has been pretty steady over the past two years, really comes out of the orders that were won by NOV in 2007, 2008, that were delivered two years later, early 2010 in a more deflationary environment, and so we benefited from, really, a lot less inflation then we had forecast. Actually, lower cost. We were executing rigs in early 2010, less overtime, and probably most important was the fact that we had, by the time, delivered a lot of offshore rigs and scaled learning curve, and we're seeing the learning curve effects in our operations in early 2010. So that led to much higher margins than we expected, and so for the first half of 2010, we were a little bit over 30% and since the we've been guiding folks towards margin declines. So this quarter, the downturn in margins, 160 basis points, really reflects the continuation of that trend. And although we may not be quite at bottom yet, we're pretty close.

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**Robin Shoemaker** - *Citigroup - Analyst*

Okay, and 26%, I think you've said in the past. is kind of like a normalized margin for Rig Tech?

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

Yes. I think so. I think we can work our way back up. We did get improving pricing in Rig Technology through 2011, and in fact here in the last quarter or two, I think we probably pick up another 1% or 2% in pricing for the DEPs that we're selling. So we think there is a little bit of expansion ahead. But also too, I'll caution you, we've added NKT to the mix, which is going to be diluted. APL as well, our turret mooring systems, are going to be a little bit dilutive. But I would characterize it as something in the mid 20%s is probably what's more normal for this group, and also point out as well that manufacturing business producing 24%, 25%, 26% operating margins makes an extraordinary high return on capital. In fact, last quarter, the quarter that you're looking at here, first quarter 2012, if you annualize the results from Rig Technology on a notepad basis, tax effect to operating profit, divided by the capital employed in that business, we did about 31% return on book capital, and I think 64% or 65% return on tangible book capital. So very, very strong returns that go along with the 20% margins.

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**Operator**

Scott Gruber, Bernstein.

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**Scott Gruber** - *Sanford C. Bernstein & Co. - Analyst*

Clay, you mentioned here your hope for a few FPSO orders before year end. I may be reading too much into several comments you've made in the past, but is that an increase from previous expectations?

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

Yes. What I was referring to there is our turret mooring business we acquired late 2010, a business called APL, and 2011, like a lot of the provider of surf equipment and subsea equipment, orders were pretty slow, and I think we agree with the prevailing view out there that 2012 should be stronger. We have said over the past couple of quarters that we've seen rising levels of inquiries. Quotations have been very, very busy, and a lot of people interested in subsea developments, and so we're quoting equipment into that. In fact, the management of APL tells us that the level of quotations is at record levels. We're learning along the way, though, that these projects have a tendency to push out to the right a little bit. and they're tough to bring to fruition. So we still feel pretty good about orders for the year. We just hadn't seen a lot through the first quarter within APL.

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**Scott Gruber** - *Sanford C. Bernstein & Co. - Analyst*

Correct me if I'm wrong. Previously I think the hope was for at least one, but now you're suggesting it could be more before year and?

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

Yes. We've got a number, lots of projects for quoting equipment into, and specifically what I'm referring to here are the turret mooring systems for FPSOs that we provide through our APL unit. That's in addition to cranes, mooring systems, hose reel systems, riser pull systems, now fiberglass piping systems, and also I referenced some flow fluid processing equipment as well. So we can sell a lot more than those into FPSOs, and I'll add that we have sold a lot of the more ancillary equipment along the way, as well as some turret-related equipment in 2011. But in terms of big, high dollar needle moving type orders, those have been a little slow in coming. Through 2011, 2012, though, our outlook is a lot brighter.

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**Scott Gruber** - *Sanford C. Bernstein & Co. - Analyst*

Okay, and then just turning to Brazil. There's significant movement between Sete and the yards with placing additional orders recently. How are you think about how the equipment orders flow from here? Are those going to be primarily driven by the yards, such that we'll see several tranches of orders, equipment orders. placed over the next 12 months or so?

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

Yes, essentially it is driven by the yards. What happens is Sete picks the yard and then we sell the DEP, or the Drilling Equipment Package to the yard, and they pretty well drive the timing of that. But also remember it is Brazil and things kind of move in a different time frame. It's really no different than a lot of the things that we do in Korea. For instance, when we're selling DEPs, we sell them to Samsung, Hyundai, Daewood, folks like that. The contractor who's going to own the rig pretty well identifies what they want, and here, obviously, Petrobras knows who we are, knows what our equipment is, we're technically qualified, and the shipyards pick it up from there. I think you'll see movement on that through the remainder of the year.

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**Operator**

Brian Uhlmer, Global Hunter.

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**Brian Uhlmer** - *Global Hunter Securities, LLC - Analyst*

Wanted to talk about Interflow a little bit here and the rationale for that acquisition, and whether that's a consolidating move or whether it's to gain new customer base up in Canada, and kind of along those lines also. following up on the cash component of your cash that's based in the US, if that number is going to be adjusted after you make this Interflow, and how we should look at cash component and further acquisitions in the United States?

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

One good thing about the Interflow acquisition being in Canada was that we could use our international cash, and so it certainly makes it a lot easier to do that transaction. Brian, as you are aware, most of our cash is overseas. Currently about 88% of our cash balance is located overseas. To bring that back to the US we would incur a tax haircut, and so it just makes it easier for us to do acquisitions internationally. Plus our outlook for international markets is very, very bright. So for lots of reasons that made our NKT acquisition and the Interflow acquisition very attractive. But all that notwithstanding, financing notwithstanding, Wilson, which is US-based, will be a US use of cash, is a business that we think is terrific, and it's going to be a great fit with our Distribution Services Operation. So we will use our revolver partially to fund that acquisition, but are confident that with our strong cash flow in the US, we're going to be able to pay that down quickly.

On the Interflow acquisition, that's a great business, a great franchise. locations both in the US and Canada. They've got excellent technology, and it's very complementary, I think, to what we already sell to pressure pumpers and well stimulation operations. And like us, they're seeing rising demand from international markets. We think that's going to continue well into the future, as shale plays take hold on other continents and international markets. So this is just another way to sort of strengthen what we do and make our combined operation more efficient and open up opportunities for us. So very excited about it, and hopefully we'll have it closed here in a few days.

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**Brian Uhlmer** - *Global Hunter Securities, LLC - Analyst*

So do you view it more as expansionary versus a consolidation type move?

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

Yes. I think it's going to create a lot of opportunities. As always is the case, there'll be some efficiencies that come out of this. We'll have a little bit more purchasing leverage, for instance, and economies of scale, but we're very, very pleased and anxious to get this done.

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

Brian, we always are looking for opportunities to add more arrows to our quiver, and I think this is a good example of that. While there's some duplicatative products, it really is additive to what we can put into the marketplace, and we're excited about the worldwide shales, and we think this plays very, very well to being able to support that.

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**Brian Uhlmer** - *Global Hunter Securities, LLC - Analyst*

Outstanding, and following up on that, on the coil tubing, since we're in the Well Servicing Segment. On the coil tubing units, the new mill is strictly tubing. How is the demand for tubing in itself, and is that -- or are we talking more international markets with that as well, aside from the massive growth that we see in the North America in '12?

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

Yes, both. We've seen strong demand in both, actually. North America demand for coil tubing's been very high, but a lot of other countries, in particular China and particularly the Middle East, have seen strong demand for coil tubing as well. So those two go together. They're complimentary products. As you know, we make both the units as well as the coil tubing itself, and we've been expanding our capacity in both. So this is teriffic technology. It's kind of the arthroscopic surgery of the oil fields. And let's you go in and do some things you cannot otherwise do in a well. So year by year, we just seem to tap into more and more demand.

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

Yes, and I'll say on a macro basis, Brian, really shales have brought the maturation of coil tubing and coil tubing units to the fore. I mean, the shales were really made for the coil tubing concept. I mean, you've talked about coil tubing for many years, and we have, and it's always had good opportunities, but the shales give it a whole other level of opportunity. I think we're excited about our expansion opportunities. Our coil tubing facility that makes coil tubing here in Houston, as Clay mentioned earlier, we are up to four or five lines out there. We're expanding up in Fort Worth with our hydro rig outfit. So we think this is really going to be a great business over the next four or five years.

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**Brian Uhlmer** - *Global Hunter Securities, LLC - Analyst*

The international side are still going to be, I guess what we'd term the [bow cues] and where you're more differentiated with the bigger units that are a little bit less competitive marketplace in terms of the new equipment, is that correct?

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

Yes, actually it is. I mean, I think you'll see a lot of international opportunity. I mean, we're actually selling some of the equipment into China today, because the Chinese need the best equipment possible and China's a wonderful shale play today.

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

Russia's another good market. We make equipment in Belarus to support that market and are expanding into Russia. So a lot of interest overseas.

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**Operator**

Marshall Adkins, Raymond James.

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**Marshall Adkins** - *Raymond James & Associates - Analyst*

You give us some pretty good detail, Clay, on the PS&S Division, why it was so strong, down hole tools, drill pipe, other pipe-related stuff. Notwithstanding the seasonal downturn coming up next quarter, can we get back to the robust margins we have right now in Q3 and 4, and help us understand kind of product lines we need to watch there going forward, either on the positive or negative side.

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

Yes, the short answer is yes. Q2 will have the seasonal impact from Canada, but Q3, barring a rig count meltdown in North America, and like everybody on the call we're anxiously watching the gas rig count in the US. We know that's going to come under pressure. The real question is how much the oil rigs replace that. Barring a meltdown across that scenario, yes, I think 22% margins are repeatable. The sector has done north of 23% and north of 24%. You go back to 2006, I think is when we got up in the 23% range, and in 2007 and 2008, on a pro forma basis pushed up into the mid-24% margins range. So we expected this segment to gradually move up into that range, given sustained high levels of activity and sustained pricing leverage, and it's outperformed in terms of getting there faster than we thought that it would.

So 22%, nearly 23% operating margin this quarter beat our expected timeframe, probably a year or so, and just speaks to the good execution that we have out there. We've done great acquisitions and had good execution of integration of those acquisitions within this segment. We've got good pricing leverage. I would say, though, Marshall, pricing leverage within Petroleum Services and Supplies appears to be flattening out. The rig count's kind of flattening out here as you go through this big migration in North America. And although we're getting a few price increases here and there, I would say by and large it feels like it's leveling across a lot of groups, and so we're going to watch that closely. We probably need another uptick on rigs working to get back to a little more pricing leverage. We feel pretty good the back half of the year ought to have some pretty stout margins in PS&S.

**Marshall Adkins** - *Raymond James & Associates - Analyst*

Any product lines we should watch over the next year, positive or negative?

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

Yes. The largest single piece of Petroleum Services and Supplies is our down hole tools business, which provides [reed hydrolock] bits, down hole drilling motors, and a variety of other equipment, jars and shock tools, and other things, and so that moves the needle more than most, and the sequential improvement that you saw from Q4 to Q1 was mostly driven by down hole tools. But as you know, there's a bunch of different products and services in there. The second-largest is our Well Site Services Group, which rents solids control equipment, and then Drill Pipe Products and Tuboscope are roughly tied for third. So I would characterize all those businesses, the common thread is they're all driven by rig count. So as rig count rises and falls, that's going to ultimately dictate the fortunes of those businesses, which will do a lot to drive the fortunes of the segment. So that's probably what we want to watch most closely, and then I'll also finish up by saying that it's mostly North American rig count where we get pricing leverage and we get good operating flow-throughs from those business. So that's kind of what drives those things,

**Marshall Adkins** - *Raymond James & Associates - Analyst*

Right. One last quick one for Pete. What Brent price should we get worried about on offshore new builds? I mean, how low would Brent have to fall before we start to get worried about new build orders?

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

Marshall, that's a great question. All I know is the answer I give you will be wrong, but let me work on it anyway. I think as you kind of take a look, everybody's looking out, when you're building these new builds rigs, you're making an assumption about something 2.5. 3 years down the pike. I mean, we're delivering those things. You start ordering it, takes you about six months to get your engineering done. Then you order it, we're delivering it. In two years your new sea trial's ready to rip. So the fact of the matter is, it really is the assumption on what the world economy's going to do, what the tightness on oil. I think if you started going much below $75, you would probably have people saying how long are we going to keep in this $75 range, and is this really something we want to be investing for in the long-term.

I think anything north of that makes all the sense of the world. South of that, you start getting into a more problematical area. Now having said that, that also means that if it goes down below that, then you have to make the assumption, how long is that going to last, because traditionally in this industry, just like with natural gas, we're rapidly self-correcting, and so if you stop drilling and people don't like the $75, it moves up, but really, the worldwide economy and the demand for that oil is really going to be the kicker on it. So we think it's probably in good shape right now, but if it went below that, you'd have to ask some questions.

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**Marshall Adkins** - *Raymond James & Associates - Analyst*

A lot of our margin for error between here and $75.

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

Absolutely, absolutely.

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**Operator**

I will now turn the call over to Mr. Pete Miller for closing remarks.

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

Thank you all. We appreciate you calling in, and we look forward to talking to you when we do our second quarter 2012 earnings call. Thank you very much.

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**Operator**

Thank you. This conference is available for playback at 888-843-7419, passcode 32074039. This concludes today's conference. Thank you for participating. You may now disconnect.

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