1998:

Three Stories

1998 ANNUAL REPORT

NATIONAL OILWELL

Our New Logo

NATIONAL OILWELL

National Oilwell, one of the most recognized names in the industry, launched a new worldmark in 1998. Its solid, rectangular-shaped "NOI" shows the integrity and strength of the organization, while the multi-shaded red sphere depicts movement, energy and global presence.

Over the last two years, we have achieved dynamic growth by combining with other well-known industry leaders — Dreco, Ross Hill and Griffith to name a few. These acquisitions brought similarly recognizable names into the National Oilwell family — names long associated with technology, quality service and product reliability. Our stakeholders will continue to see these valued industry technologies and services — now supported by the new worldmark — illustrating the financial strength, breadth of product offering and global reach offered by National Oilwell.

The National Oilwell worldmark is a symbol of the company, its beliefs and its people, products and services. Our vision is that this worldmark will become synonymous with value creation and integrity.

Selected Financial Data

(In thousands of U.S. dollars, except per share amounts)	Year Ended December 31, 1998	1997[2]	1996[3]	Year Ended August 31,[1] 1995	1994
Operating Data:					
Revenues	$ 1,172,013	$ 1,005,572	$ 761,816	$ 86,875	$ 79,663
Operating income (loss)[4]	121,106	87,239	27,499	10,059	(9,253)
Income (loss) before taxes and extraordinary loss[5]	109,313	82,482	16,718	12,196	(6,709)
Income (loss) before extraordinary loss[5]	68,927	51,281	10,147	7,789	(6,682)
Net income (loss)	68,927	50,658	6,147	7,789	(6,682)
Income (loss) per share before extraordinary loss[5]					
Basic	1.31	1.00	0.25	0.69	(0.59)
Diluted	1.30	0.99	0.25	0.68	(0.59)
Net income (loss) per share					
Basic	1.31	0.99	0.15	0.69	(0.59)
Diluted	1.30	0.98	0.15	0.68	(0.59)
Other Data:					
Depreciation and amortization	19,179	14,744	8,775	4,558	4,926
Capital expenditures	27,845	32,605	15,166	6,435	5,932
Balance Sheet Data:					
Working capital	346,410	252,137	168,897	32,992	18,292
Total assets	817,993	567,511	352,518	72,355	69,323
Long-term debt, less current maturities	205,637	61,565	39,136	1,987	1,440
Stockholders' equity	386,803	277,688	169,016	48,957	38,690

(1) Data for the two years ended August 31, 1995 reflect the operations of Dreco only, as the operations of National Oilwell were acquired from a predecessor partnership as of January 1, 1996 and, in accordance with generally accepted accounting principles, cannot be combined prior to that date.

(2) In order to conform Dreco's fiscal year end to match National Oilwell's year end, the results of operations for the month of June 1997 have been included directly in stockholders' equity. Dreco's revenues and net income were $13.4 million and $0.9 million for the month.

(3) In order to conform Dreco's August 31 fiscal year end to a period within 93 days of National Oilwell's December 31 year end, the results of operations for the period from September 1, 1995 through November 30, 1995 have been included directly in stockholders' equity. Dreco's revenues and net income were $33.4 million and $3.2 million for such period.

(4) In December 1998, National Oilwell recorded a $16,400,000 charge related to personnel reductions and facility closures and a $5,600,000 charge related to the writedown to the lower of cost or market of certain tubular inventories. In September 1997, National Oilwell recorded a $10,660,000 charge related to merger expenses incurred in connection with the combination with Dreco. In October 1996, National Oilwell recorded $16,611,000 in charges related to the cancellation of management agreements and expenses related to special incentive plans that terminated upon the occurrence of the initial public offering of its common stock.

(5) National Oilwell recorded extraordinary losses in September 1997 of $623,000 (net of $376,000 income tax benefit) and in October 1996 of $4,000,000 (net of $2,400,000 income tax benefit) due to the write-offs of deferred debt issuance costs.

Corporate Profile

National Oilwell is a worldwide leader in the design, manufacture and sale of machinery, equipment and downhole tools used in oil and gas drilling and production, as well as in the distribution to the oil and gas industry of maintenance, repair and operating products.

The Company manufactures and assembles drilling machinery, including drawworks, mud pumps, power swivels, SCR systems, traveling equipment and rotary tables, as well as masts, derricks and substructures. National Oilwell also designs and manufactures drilling motors and specialized drilling tools for rent and sale. Many of the Company's products are designed specifically for applications in offshore, deep land, extended reach and performance drilling.

National Oilwell provides distribution services through its network of approximately 125 distribution service centers located in the United States, Canada and near major drilling and production activity worldwide. The Company also offers outsourcing and alliance arrangements that include comprehensive procurement, inventory management and logistics support.

Fellow Stockholders

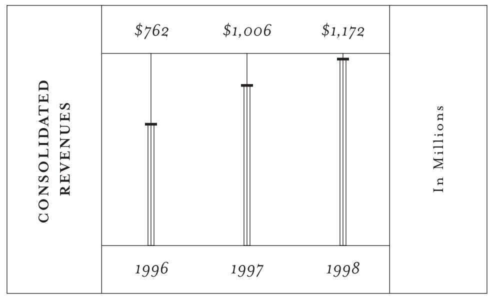
Whether you hold only National Oilwell stock or also invest in our peers, I'm sure by now you are painfully aware of the depressed market environment faced by the oil service industry. Domestic drilling activity is at the lowest level on record and oil prices continue to languish at levels that do not justify increased exploration and production spending. We can't predict when the price of this essential commodity will rebound, but we can manage our business to make a reasonable return in these conditions and position ourselves to produce exceptional results in a balanced supply and demand market. Recovery will occur; it is the timing that is uncertain. Our current focus, therefore, is upon sizing our business for the current level of activity while maintaining our fundamental capabilities. In the short-term, our commitment is to reduce our operating costs, generate cash from our balance sheet and significantly reduce our debt. This will position us to provide for future strategic acquisitions and to emerge from this downturn in a stronger position relative to our peers. We believe the actions we have taken will ensure that we are successful in this effort. Our longer-term commitment to create value by becoming an integral part of our customers' strategy remains unchanged. Let me share with you the ways in which we have delivered on both these commitments in 1998 and our plans to continue throughout 1999.

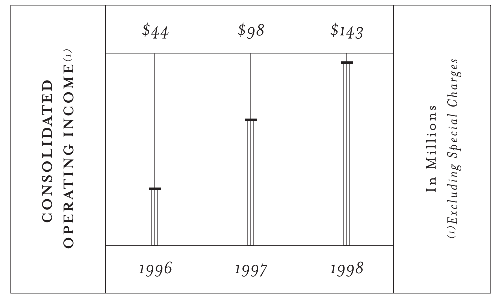
1998 Results. Fueled by oil prices in the $16–26 per barrel range, drilling activity was high during 1997 and the beginning of 1998. Many customers placed orders for equipment to be delivered in 1998, resulting in National Oilwell achieving record consolidated results. Revenues of $1.2 billion increased 17% from the prior year, while operating income of $143 million, excluding special charges, grew by 46%. Operating income margins increased from 9.7% in 1997 to 12.2% in 1998. Our Products and Technology Group achieved a 124% increase in operating profit on revenue growth of 80%. Our Distribution Services and Downhole Products Groups, however, were affected much earlier by the worldwide decrease in the demand for oil and the resultant deterioration in hydrocarbon pricing. These groups reported year-over-year revenue reductions of 20% and 11%. The Company's backlog for capital equipment, which began the year at $270 million, totaled $77 million at the end of 1998.

Long-Term Strategy. Throughout the course of the year, we continued to pursue our long-term strategy of enhancing our market positions and focusing on customer economics.

During 1998, five new companies were integrated into the National Oilwell fold.

- *May 1998.* Aberdeen-based Specialty Tools Ltd. and Versatech International Ltd. of Calgary, designers and manufacturers of downhole coiled tubing products.
- *May 1998.* Phoenix Energy Products, Inc., a manufacturer of multiple product lines that are complementary to those of National Oilwell, including drilling and completion expendable products and solids control equipment, as well as downhole equipment. This acquisition





was financed primarily through the issuance of $150 million in unsecured seven-year senior notes which have a coupon interest rate of 6.875%.

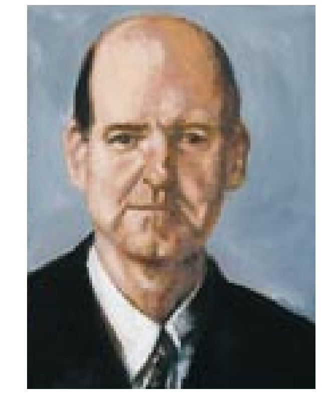
- *July 1998.* Roberds-Johnson Industries, Inc., a manufacturer of equipment used on deepwater drilling rigs, including modular packages for production facilities, small platform drilling rig packages, mud tank and engine packages and other fabricated equipment. Roberds also has a full rig-up facility with employees experienced in the engineering and construction of conventional land drilling rigs.
- *December 1998.* DOSCO, a major Canadian oilfield distribution business, which we are combining with our existing Canadian distribution business. With thirteen overlapping locations, this combination consolidates the Canadian market and enhances our offering of inventory procurement and supply chain management services.

We also continued to deliver new drilling technologies, designed to lower the cost required to produce attractive returns from exploration and production, and made substantial capital investments in information technologies that will enable the process changes that create value for us and our customers.

New products that increase performance and reduce downtime in offshore, deepwater and deep land drilling were introduced, while others are under development.

- *Active Heave Compensating Drawworks.* As more fully described on page 11 of this annual report, this drawworks is the first offering of a cooperative venture between National Oilwell and Hitec A.S.A. of Norway. This technological advance in the design of drawworks allows for faster and safer drilling operations, as well as reduced maintenance and downtime for offshore rigs.
- *The National Oilwell 7500 PSI Hydrodynamic System.* This new wash pipe packing system dramatically extends the period between packing failures in higher pressure drilling applications. In a recent high pressure field test, the new system ran for 180 hours before replacement was required, versus 40 hours using conventional wash pipe and packing.

Our commitment to being the leading provider of supply chain management services and to lowering the total cost of ownership for our customers led to the investment of $7 million in 1998 for the implementation of redesigned processes, hardware, software and training. We will invest an additional $11 million toward this goal



Joel V. Staff

in 1999. At the core of this implementation is a business application system developed by SAP, which will enable us to significantly increase information processing efficiency and respond more rapidly to changing market conditions.

Short-Term Strategy. We began taking the steps necessary to ensure our position in the marketplace early in 1998. Capital expenditures totaling $28 million for the year were $5 million below 1997 levels, as capital expenditures that did not have compelling economic justification were canceled or deferred. Decisions were made and implemented to reduce personnel to appropriate levels and to permanently close and sell certain facilities. A special charge of $22 million was taken in the fourth quarter in respect of these reductions and to write down the value of certain inventory.

Thus, we enter 1999 structured to ensure continued customer support and the maintenance of our market leading installed base of capital equipment. We will aggressively manage our balance sheet and focus on cash generation and debt reduction, leaving us poised to capitalize on opportunities that arise and to deliver our longer-term strategy of value creation economics. I am proud to share with you three stories included in this year's annual report illustrating ways in which the employees of National Oilwell successfully pursued this strategy in 1998. These stories are a testament to our employees' creativity, innovation and dedication. As the industry recovers, all stakeholders will be the beneficiaries of their commitment.

I end this letter in tribute to James T. Dresher, who passed away on February 28, 1999. Jim served as a director of the Company since January 1996 and also as a member of the audit committee and Chairman of the compensation committee. He was a dedicated and valued member of the board, and the directors, management and employees of National Oilwell would like to express our great respect and gratitude for his service. He will be missed.

Sincerely,

Joel V. Staff
Chairman, President and Chief Executive Officer
March 1999

Alliance

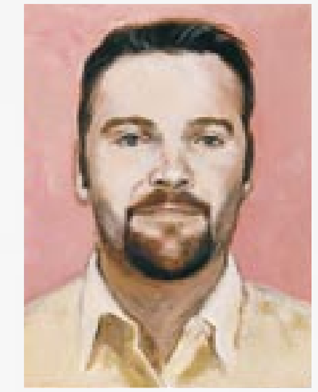
The Deutag International/National Oilwell Story

In 1997 Deutag International, a leading worldwide drilling contractor, began looking at the issue of supply chain management as a means of driving down repair and maintenance costs, improving delivery time and reducing the time spent in procurement and logistics. Their goal was to develop an alliance partnership with a provider who would manage their supply chain, operate their warehouses and help reduce their net capital employed. Deutag wanted to free up their personnel for higher value added activities, and ultimately increase their profit. By reducing repair and maintenance costs, increasing return on net capital employed, raising the level of customer satisfaction and improving drilling efficiency, Deutag would be better positioned to attract additional customers in the international arena.

National Oilwell was selected as Deutag's alliance partner based on its best overall knowledge of supply chain management, existing presence in key international areas and willingness to do business wherever Deutag International operates. The initial agreement provided for National Oilwell to be the single source provider of materials to the Deutag rigs

National Oilwell was selected as the single source provider of materials to Deutag International drilling rigs in key international areas based on its best overall knowledge of supply chain management. The alliance agreement has been expanded to include Deutag's platform operations in Scotland.

"This alliance eliminates duplicative procurement and logistics efforts and allows each partner to spend more time focusing on their respective core competencies."



Jeremy Thigpen
Alliance Coordinator

in Algeria, Nigeria, Venezuela, Thailand, Bangladesh, Oman and Azerbaijan. Together, Deutag and National Oilwell established benchmarks against which the success of the partnership would be measured, including reductions in the total costs of materials supplied and capital employed. Financial gains or losses measured against these benchmarks are shared between the partners.

For National Oilwell, this partnering opportunity is an effective strategy for adding value. It has tremendous potential to reduce transaction costs across the business interface, allowing partners to eliminate duplicative procurement and logistics efforts, and permit each to spend more time focusing on their respective core competencies. By working with Deutag in support of its drilling operations, National Oilwell gained a partner doing business in a number of regions, improving our capacity for additional global expansion. This relationship also provides us with the opportunity to be the preferred provider of other services to Deutag, such as the maintenance of rigs, upgrading of equipment and the consolidation of "in country" inventories across its many customers. Our internal estimates indicate that a drilling rig operating internationally may carry as much as $3 million in inventory to support the rig. In a country with a number of contractors and several drilling rigs, these inventories may be duplicative and unnecessarily high, reducing the return on capital for all

DEUTAG INTERNATIONAL

the affected operations. By streamlining the supply chain, reducing the time between the identification of a need and its fulfillment and consolidating inventories among several drilling contractors operating in a geographic area, National Oilwell can reduce total inventory required to support any given rig, freeing up scarce working capital for deployment elsewhere and improving the return on capital employed of all the affected drilling contractors.

To date, National Oilwell and Deutag have implemented the supply chain concept in all of the locations included in the initial agreement except Algeria, which will follow in April 1999. Both partners have recognized operational and financial successes as compared to the historical benchmark performance models. Aside from the financial results, the most reported and obvious improvement at the various Deutag operational sites is found in the National Oilwell software reporting tools which provide the Deutag area personnel with real-time visibility and budgetary control by rig.

Through this alliance partnership, National Oilwell and Deutag are striving to identify and implement innovative solutions to achieve a best-in-class performance through continuous modification and improvement of the process. The partners have displayed their confidence in the continued success of this relationship by expanding the alliance to include Deutag's platform operations in Scotland.

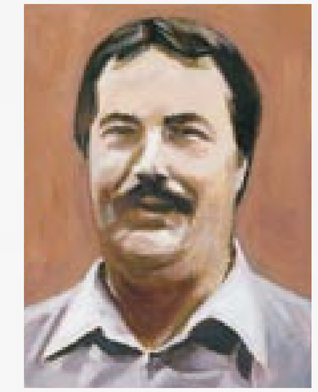
Active Heave Compensating Drawworks

Now and again, a new product sets sail with the ability to dramatically impact drilling efficiency. Such was the case on October 4, 1998, when the *Deepwater Pathfinder*, a drillship commissioned and owned by Conoco and R&B Falcon, left Koje, South Korea on her maiden voyage. This ultra deepwater dynamically positioned drillship is designed to drill in up to 10,000 feet of water, primarily in the Gulf of Mexico, where she is currently stationed. The *Deepwater Pathfinder*, outfitted for efficient drilling operations, includes the premier installation of the Active Heave Compensating Drawworks.

The Active Heave Compensating Drawworks marks the first jointly designed product of a cooperative venture between National Oilwell and Hitec ASA. Hitec, based in Norway, is a leading supplier of highly advanced systems and solutions for the oil and gas industry. Its leading-edge automation and remote control technologies are applied in oil and gas drilling, offshore oil and gas production and transport, and remote operated subsea construction and maintenance. In August 1998, the two companies announced a cooperative agreement under which joint engineering expertise and product knowledge would be used to enhance current

The Deepwater Pathfinder, an ultra deepwater drillship outfitted for efficient drilling operations, includes the premier installation of the Active Heave Compensating Drawworks. This new drawworks system allows for faster and safer drilling operations, reduced maintenance and an extended drilling window.

"The Active Heave Compensating Drawworks *offers* significant benefits to our customers *over traditional drawworks systems."*



Tim Watson
Chief Engineer

product offerings and provide new products to the oil and gas industry. The combination of National Oilwell's manufacturing expertise and worldwide marketing platform with Hitec's state-of-the-art drilling technologies delivers compelling economic and operational benefits to our customers, as evidenced by the Active Heave Compensating Drawworks.

This new drawworks system, which combines traditional drawworks and compensating systems into a single machine with AC motors and drives managed by an advanced control system, directly addresses the wave action and other motion challenges faced by drillship and semi-submersible drilling rig operators. It offers significant benefits to customers over traditional passive compensation systems, which ultimately result in improved drilling safety and efficiency. The technological and economic advantages of this drawworks span the life cycle of the product. Improved drilling control through accurate motion compensation allows the operator to continue drilling through more extreme weather conditions than conventional systems. This extended operational window reduces downtime in the drilling curve, thereby reducing the cost of drilling. Fewer moving parts than the traditional system make the Active Heave Compensating Drawworks more reliable and easier to maintain. A vessel's motion characteristics are improved through less bit load variation. With the need for a heavy crown-mounted passive heave compensator eliminated, a floating drilling rig's total weight is reduced and its center of gravity is lowered. Reduced equipment weight permits higher variable deck loads, enabling more supplies to be carried on board which, in turn, decreases the frequency of resupplying the vessel. Operating costs are reduced by improved wire-rope life and load-working range. Most importantly, however, drilling operations are made safer, with two sets of motors, gears, brakes and critical parts of the control system for back-up. By integrating the National Oilwell-Hitec system into the design of new vessels, operators can expect not only more efficient operations and a longer drilling window, but lower capital costs and improved vessel dynamics. Likewise, these benefits can be recognized by drilling contractors and their customers when retrofitted to existing drillships and semi-submersibles. To date, ten orders have been placed for the Active Heave Compensating Drawworks.

This product and the cooperative agreement with Hitec are outstanding examples of our commitment to create value by becoming an integral part of our customers' strategies. Many exciting opportunities are possible through the companies' joint efforts. National Oilwell now offers Hitec's Cyberbase drilling control systems with its line of conventional drawworks. This is a powerful alliance, with a vision toward complete automation of the rig floor.

The Delta Revolution

The Distribution Strategy Vision 2000 Team was established by National Oilwell in 1997 with a charter to develop initiatives that would deliver a dynamic global Distribution Services business in the coming decade. As this team reviewed the current state of the business and interviewed customers, vendors and best-in-class service providers, it was evident that this could only be accomplished by transforming our supply chain management capabilities and significantly changing the way we do business. Thus, in 1998, a major initiative was launched which centered around implementing business process improvements that would culminate in supply chain optimization, and the *Delta Revolution Team* was born.

Armed with National Oilwell's commitment to make the necessary investments in the systems, people and training required to deliver this initiative, the *Delta Revolution Team's* first order of business was the selection of a business application system. The selection criteria demanded a real-time, global system providing common data base management and capable of directly interfacing with our customers and vendors. SAP R/3 was chosen as the system

The Delta Revolution Team is responsible for identifying and implementing business process improvements that will culminate in supply chain optimization. Delivery of these improvements will minimize our customers' transaction costs, reduce their procurement costs, optimize their product selections and lower their investments.

"Information technology and process redesign create

efficiencies and gainsharing

for our customers, our vendors

best designed to significantly increase our information processing efficiency and fully integrate our business operations. Equally critical in the choice was the fact that this system provides a proven, effective platform for electronic commerce. Implementation of the system is well underway, with the Tubular Division successfully going live on January 1st and the entire Distribution Group to be live before the end of the year.

The Delta Revolution Team is also responsible for the identification of innovative business practices that will improve the procurement process and reduce transaction costs. One such tool identified by the team and currently being implemented by National Oilwell to drive process changes and efficiencies into the entire supply chain is Activity Based Cost Management (ABCM). ABCM is a non-traditional method of cost accounting that traces expenses to their appropriate activities and shows how these activities support customers, vendors and products. Application of ABCM results in more accurate measurements of efficiency and profitability within each of these areas. This ability to identify and favorably impact cost drivers allows us to provide gainsharing opportunities with existing and potential strategic alliance partners.

In developing its action plan, the *Delta Revolution Team* worked from a future vantage point, identifying specific improvements that would emerge with the successful delivery of

opportunities

and National Oilwell."

Rosalinda Schulli
Delta Revolution
Team Member

its commitment. Among others, the anticipated improvements include: a 50% reduction in supply chain costs for National Oilwell's top twenty customers; a significant reduction in National Oilwell's vendor base; a greater than two-fold improvement in inventory turns; and 90% electronic transactions with our top customers.

The realization of this exciting initiative is a strategic supplier network for the future. Global procurement and the application of world class materials requirement planning will ensure our customer base with consistency and control across the supply chain, ultimately reducing their inventory investment. Skill and service levels will be consistent worldwide and available around the clock. Boundaries between National Oilwell, our vendors and our customers will become invisible as we work together to create opportunities for increased profitability.

The employees of National Oilwell are dedicated to fulfilling the goals established by the *Delta Revolution Team*. The vision has been clearly defined and communicated, the investment in financial and human capital has been made, and National Oilwell's future as the leading provider of enhanced supply chain services is secure.

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Management's Discussion & Analysis of Financial Condition and Results of Operations

Introduction

National Oilwell is a worldwide leader in the design, manufacture and sale of machinery and equipment and in the distribution of maintenance, repair and operating products used in oil and gas drilling and production. National Oilwell's revenues are directly related to the level of worldwide oil and gas drilling and production activities and the profitability and cash flow of oil and gas companies and drilling contractors, which in turn are affected by current and anticipated prices of oil and gas. Beginning in late 1997, current and near term expectations for oil prices declined due to concerns about excess production, less demand from Asia due to an economic slowdown and warmer than average weather in many parts of the United States. The resulting lower demand for products and services is expected to have a negative impact on National Oilwell's 1999 operating results.

Results of Operations

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

	Year Ended December 31, 1998	1997	1996
Revenues:			
Products and Technology	$ 668.1	$ 371.8	$ 266.5
Downhole Products	61.8	69.0	28.6
Distribution Services	508.6	630.9	518.7
Eliminations	(66.5)	(66.1)	(52.0)
Total	$ 1,172.0	$ 1,005.6	$ 761.8
Operating Income:			
Products and Technology	$ 119.6	$ 53.4	$ 25.9
Downhole Products	17.0	25.6	8.9
Distribution Services	7.5	27.6	17.5
Corporate	(6.6)	(8.7)	(8.2)
	137.5	97.9	44.1
Special Charge	16.4	10.7	16.6
Total	$ 121.1	$ 87.2	$ 27.5

Products and Technology

The Products and Technology segment designs and manufactures a large line of proprietary products, including drawworks, mud pumps, power swivels, electrical control systems and reciprocating pumps, as well as complete land drilling and well servicing rigs and structural components such as masts, derricks and substructures. A substantial installed base of these products results in a recurring replacement parts and maintenance business. Sales of new capital equipment can result in large fluctuations in volume between periods depending on the size and timing of the shipment of orders. This segment also provides drilling pump expendable products for maintenance of National Oilwell's and other manufacturers' equipment. As noted above, low oil prices are expected to have a negative impact on operating results in 1999.

Revenues for the Products and Technology segment increased by $296.3 million over 1997 primarily due to increased sales of major capital equipment and drilling spares. Specifically, the sale of complete rig packages, mud pumps, cranes and SCR equipment were substantially greater than the prior year. Revenues generated by acquisitions completed in 1998 totaled approximately $48 million during the year.

Operating income increased by $66.2 million in 1998 compared to the prior year due principally to the increased sales volume. Operating income as a percentage of revenues increased due to higher prices and manufacturing and operating cost efficiencies resulting from the higher volumes. Various acquisitions completed in 1998 contributed $2.6 million in operating profit during the year.

Revenues during 1997 increased $105.3 million over 1996 primarily due to increased demand for drilling capital equipment and spare parts as well as fluid end expendable parts. Acquisitions in 1997 other than Dreco accounted for $26.6 million of the increase. Operating income for this segment increased by $27.5 million when compared to the prior year with 1997 acquisitions other than Dreco accounting for $5.0 million of this incremental income and the remainder due to the higher activity levels.

Backlog of the Products and Technology capital products was $77 million at December 31, 1998 compared to $270 million at December 31, 1997 and $38 million at December 31, 1996. Substantially all of the current backlog is expected to be shipped by June 30, 1999.

Downhole Products

National Oilwell designs and manufactures drilling motors and specialized drilling tools for rent and sale. Rentals generally involve products that are not economical for a customer to own or maintain because of the broad range of equipment required for the diverse hole sizes and depths encountered in drilling for oil and gas. Sales generally involve products that require infrequent service, are disposable or are sold in countries where National Oilwell does not provide repair and maintenance services.

Downhole Products revenues decreased by $7.2 million (10%) in 1998 when compared to 1997, due primarily to lower motor sales and rentals, particularly in Canada. Operating income decreased $8.6 million in 1998 compared to the prior year. This decrease in operating income was a result of reduced margins due to the volume reduction and an increase in overhead spending caused by the addition of two minor acquisitions.

Revenues in 1997 increased $40.4 million over 1996 due to a general increase in market activity plus the inclusion of Vector Oil Tool revenues, a 1997 acquisition, of $24.6 million. Operating income in 1997 exceeded the prior year by $16.7 million with Vector accounting for $14.7 million of the increase.

Distribution Services

Distribution Services revenues result primarily from the sale of maintenance, repair and operating supplies from the Company's network of distribution service centers and from the sale of well casing and production tubing. These products are purchased from numerous manufacturers and vendors, including the Company's Products and Technology segment.

Distribution Services revenues during 1998 fell short of the comparable 1997 period by $122.3 million. This 19% decrease reflects the reduced demand for tubular and general rig operating supplies precipitated by the significant decrease in oil prices. North American revenues were off approximately 20%, with tubular revenues roughly two-thirds of the level achieved in 1997. Operating income in 1998 was approximately $20 million below 1997, due to reduced margins from the decline in revenues partially offset by reduced operating expenses, and the recording of a $5.6 million charge related to the writedown to lower of cost or market of certain tubular inventories.

Distribution Services revenues in 1997 exceeded 1996 by $112.2 million. This 22% increase reflects the increased spending levels of the Company's alliance partners and other customers. Incremental sales of maintenance, repair and operating supplies ($34.2 million), tubular products ($58.0 million), drilling spares ($8.1 million) and fluid end expendable parts and related pumps ($8.0 million) accounted for the majority of this increase. Operating income in 1997 exceeded the prior year by $10.1 million (58%) as an increase in operating expenses offset part of the incremental margin.

Corporate

Corporate charges represent the unallocated portion of centralized and executive management costs. While corporate charges in 1997 were comparable to 1996, these costs decreased substantially in 1998 due to the elimination of duplicate corporate costs that existed prior to the combination with Dreco.

Special Charges

During the fourth quarter of 1998, the Company recorded a special charge of $16.4 million ($10.4 million after tax, or $0.20 per share) related to operational changes resulting from the depressed market for the oil and gas industry. The components of the special charge are as follows (in millions):

Asset impairments	$ 5.4
Severance	5.6
Facility closures and exit costs	5.4
	$ 16.4

The cash and non-cash elements of the charge approximate $11.0 million and $5.4 million, respectively. Breakdown of the charge by business segment is:

Products and Technology	$ 11.1
Downhole Products	1.4
Distribution Services	3.0
Corporate	.9
	$ 16.4

The asset impairment losses of $5.4 million consists primarily of the shutdown of four North American manufacturing facilities. Assets related to these non-productive facilities which are not in service totaling $10.0 million have been reclassified on the balance sheet to property held for sale and have been written down to their estimated fair value, less cost of disposal. Severance costs of $5.6 million relate to the involuntary termination of approximately 200 employees, most of which are located in North America. Facility closure costs of $5.4 million consists principally of lease cancellation and facility exit costs. Substantially all of the actions associated with this charge will be fully implemented before the end of the first quarter of 1999.

During 1997, National Oilwell recorded a $10.7 million charge ($8.1 million after tax) related to various professional fees and integration costs incurred in connection with the combination with Dreco.

During 1996, National Oilwell incurred certain one-time expenses in connection with its initial public offering of common stock, as follows: (i) a management services agreement was terminated at a cost of $4.4 million ($2.8 million after tax) and (ii) expenses and payout under National Oilwell's Value Appreciation Plans, which resulted in National Oilwell recording an expense of $12.2 million ($7.6 million after tax). The Value Appreciation Plans required the issuance of 681,852 shares of common stock and payment of $6.4 million in cash.

Interest Expense

Interest expense increased during 1998 when compared to the prior year due to the incurrence of debt to finance the Phoenix acquisition. Interest expense in 1997 was substantially lower than 1996 due to lower amounts of debt outstanding and lower interest rates under the new credit facilities.

Income Taxes

National Oilwell is subject to U.S. federal, state and foreign taxes and recorded a combined tax rate of 37% in 1998, 38% in 1997 and 39% in 1996. National Oilwell has net operating tax loss carryforwards in the United States that could reduce future tax expense by up to $6.8 million. Additional loss carryforwards in Europe generally would reduce goodwill if realized in the future. Due to the uncertainty of future utilization, all of the potential benefits described above have been fully reserved. During 1998, National Oilwell realized a tax benefit of $2.6 million from its U.S. carryforwards, but closure of certain operations may significantly reduce future realization. National Oilwell's combined tax rate in 1998 would have been 39% if these carryforwards were excluded.

Extraordinary Losses

In the third quarter of 1997, National Oilwell replaced its existing credit facility and recorded a charge of $1.0 million ($0.6 million after tax) due to the write-off of deferred debt costs. In the fourth quarter of 1996, the credit facility established in connection with the acquisition of the Company was replaced, resulting in the write-off of $6.4 million ($4.0 million after tax) in deferred debt costs.

Liquidity and Capital Resources

At December 31, 1998, National Oilwell had working capital of $346.4 million, an increase of $94.3 million from December 31, 1997. Significant components of National Oilwell's assets are accounts receivable and inventories. Accounts receivable, including unbilled revenues, increased by $57.3 million and inventories increased $38.5 million during 1998. Decreases in accounts payable of $16.4 million and customer prepayments of $12.3 million were offset by an increase in other accrued liabilities of $28.2 million.

Total capital expenditures were $27.8 million during 1998, $32.6 million in 1997 and $15.2 million in 1996. Additions and enhancements to the downhole rental tool fleet and information management and inventory control systems represent a large portion of these capital expenditures. Capital expenditures are expected to decline to approximately $20-22 million in 1999, which will include approximately $7 million necessary to complete the installation of a new information system for the Distribution Services group. National Oilwell believes it has sufficient existing manufacturing capacity to meet currently anticipated demand through 1999 for its products and services.

On September 25, 1997, National Oilwell entered into a new five-year unsecured $125 million revolving credit facility. The credit facility is available for acquisitions and general corporate purposes. The credit facility provides for interest at prime or LIBOR plus 0.625%, subject to adjustment based on National Oilwell's Capitalization Ratio, as defined. The credit facility contains financial covenants and ratios regarding minimum tangible net worth, maximum debt to capital and minimum interest coverage.

National Oilwell believes that cash generated from operations and amounts available under the credit facility will be sufficient to fund operations, working capital needs, capital expenditure requirements and financing obligations. National Oilwell also believes any significant increase in capital expenditures caused by any need to increase manufacturing capacity can be funded from operations or through debt financing.

National Oilwell intends to pursue acquisition candidates, but the timing, size or success of any acquisition effort and the related potential capital commitments cannot be predicted. National Oilwell expects to fund future cash acquisitions primarily with cash flow from operations and borrowings, including the unborrowed portion of the credit facility or new debt issuances, but may also issue additional equity either directly or in connection with acquisitions. There can be no assurance that acquisition funds will be available at terms acceptable to National Oilwell.

Inflation has not had a significant impact on National Oilwell's operating results or financial condition in recent years.

Year 2000

The year 2000 issue is the result of computer programs having been written using two digits rather than four to define the applicable year. Any computer programs that have date-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or miscalculations causing disruptions of operations, including, among other things, a temporary inability to process transactions, send invoices, or engage in similar normal business activities.

In 1997, the Company's Distribution Services segment decided to replace its main business system in order to significantly improve our supply chain capabilities. The new system installation is expected to be complete in the third quarter of 1999 and will be Year 2000 compliant. In addition, the Company continues to identify, evaluate and implement modifications to its other business systems in order to achieve year 2000 date conversion compliance. The total cost of the year 2000 readiness is estimated at $1.0 million, of which approximately half has been spent. The Year 2000 review covers internal computer systems and process control systems, as well as embedded systems in products delivered. In addition, the Company has initiated formal communication with its significant suppliers, customers and business partners to determine the extent to which we are vulnerable to any failure of these third parties to remedy their own Year 2000 issues. Third party vendors of hardware and packaged software have also been contacted about their products' compliance status. While the ability of third parties with whom the Company transacts business to address adequately their year 2000 issue is outside its control, the Company will evaluate the need to change sources as necessary.

Management believes that with installation of new systems, conversion to new software and modifications to existing software, the year 2000 issue will pose no significant operational problems for National Oilwell. The Company expects to complete all new installations, conversions and necessary systems modifications and conversions by September 30, 1999. Accordingly, the Company does not have a contingency plan with respect to the year 2000 issue. There can be no assurance, however, that the Company will be able to install and maintain year 2000 compliant software and should this occur, operational difficulties could result. In such circumstances, delays in financial processes could occur, but neither these nor any product-related problems are expected to have an adverse effect on the Company's financial position.

The costs of the project and the dates on which the Company believes it will complete its Year 2000 project are based on management's best estimates. These estimates were derived using numerous assumptions of future events, including continued availability of resources, third party's Year 2000 status and plans and other factors. However, there can be no assurance that these estimates will be achieved and actual results could differ materially from those anticipated. Specific factors that might cause such material differences include the availability and cost of personnel, the ability to identify and correct all Year 2000 impacted areas, timely and effective action by third parties, the ability to implement interfaces between Year 2000-ready systems and those systems not being replaced, and other similar uncertainties.

Market Risk Disclosure

The Company is subject to market risk exposure related to changes in interest rates on its credit facility which is comprised of revolving credit notes in the United States and Canada. A portion of the borrowings are denominated in Canadian funds which could expose the Company to market risk with exchange rate movements, although such is mitigated by the Company's substantial operations in Canada. These instruments carry interest at a pre-agreed upon percentage point spread from either the prime interest rate or LIBOR. Under its credit facility, the Company may, at its option, fix the interest rate for certain borrowings based on a spread over LIBOR for 30 days to 6 months. At December 31, 1998, the Company had $55.6 million outstanding under its credit facility. Based on this balance, an immediate change of one percent in the interest rate would cause a change in interest expense of approximately $0.6 million on an annual basis. The Company's objective in maintaining variable rate borrowings is the flexibility obtained regarding early repayment without penalties and lower overall cost as compared with fixed-rate borrowings.

Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board issued Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. The Company expects to adopt the new Statement effective January 1, 2000. The Statement will require the Company to recognize all derivatives on the balance sheet at fair value. The Company does not anticipate that the adoption of this Statement will have a significant effect on its results of operations or financial position.

In April 1998, the AICPA issued SOP 98-5, Reporting the Costs of Start-up Activities. The SOP is effective for fiscal years beginning after December 15, 1998, which requires that the costs associated with such activities be expensed as incurred. The adoption of the new statement will not have a significant effect on earnings or the financial position of the Company.

Forward-Looking Statements

This document, other than historical financial information, contains forward-looking statements that involve risks and uncertainties. Such statements relate to National Oilwell's sales of capital equipment, backlog, capacity, liquidity and capital resources, plans for acquisitions and any related financings and the impact of Year 2000. Given these uncertainties, current or prospective investors are cautioned not to place undue reliance on any such forward-looking statements. National Oilwell disclaims any obligation or intent to update any such factors or forward-looking statements to reflect future events or developments.

Although National Oilwell believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from National Oilwell's expectations are disclosed in, but not limited to, the matters described in "Risk Factors" in National Oilwell's annual report on Form 10-K.

Report of Independent Auditors

To the Stockholders and Board of Directors
National-Oilwell, Inc.

We have audited the accompanying consolidated balance sheets of National-Oilwell, Inc., as of December 31, 1998 and 1997, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit, in 1996, the financial statements of Dreco Energy Services, Ltd., a wholly-owned subsidiary, which statements reflect total revenues of $113,195,000 for the year ended November 30, 1996. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to data included for Dreco Energy Services, Ltd., is based solely on the report of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of National-Oilwell, Inc., at December 31, 1998 and 1997, and the consolidated results of its operations and its cash flows for each of the years then ended, in conformity with generally accepted accounting principles.

Ernst & Young LLP

Houston, Texas
February 3, 1999

To the Directors of
Dreco Energy Services Ltd.

We have audited the consolidated balance sheet of Dreco Energy Services Ltd. as at November 30, 1996 and the consolidated statements of operations, shareholders' equity and cash flows for the twelve months ended November 30, 1996. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the company as at November 30, 1996 and the consolidated results of its operations and its cash flows for the twelve months then ended in accordance with generally accepted accounting principles in the United States.

Coopers & Lybrand
Chartered Accountants

Edmonton, Alberta
October 21, 1997

Consolidated Balance Sheets

(In thousands, except share data)	*December 31, 1998*	*December 31, 1997*
Assets		
Current assets:		
Cash and cash equivalents	$ 11,440	$ 19,824
Receivables, less allowance of $4,718 and $4,056	281,312	192,470
Unbilled revenues	–	31,521
Inventories	241,987	203,520
Deferred taxes	16,489	9,839
Prepaid and other current assets	6,533	6,424
Total current assets	557,761	463,598
Property, plant and equipment, net	91,756	74,282
Deferred taxes	6,757	4,919
Goodwill	145,696	24,233
Property held for sale	9,981	–
Other assets	6,042	479
	$ 817,993	$ 567,511
Liabilities and stockholders' equity		
Current liabilities:		
Current portion of long-term debt	$ 7,447	$ 1,340
Accounts payable	118,579	134,955
Customer prepayments	25,392	37,688
Accrued compensation	7,237	12,957
Other accrued liabilities	52,696	24,521
Total current liabilities	211,351	211,461
Long-term debt	205,637	61,565
Deferred taxes	4,097	2,675
Other liabilities	10,105	14,122
Total liabilities	431,190	289,823
Commitments and contingencies		
Stockholders' equity:		
Common stock – par value $.01; 55,996,785 and 51,655,782 shares issued and outstanding at December 31, 1998 and December 31, 1997	561	517
Additional paid-in capital	248,198	207,954
Accumulated other comprehensive income	(13,827)	(7,074)
Retained earnings	151,871	76,291
	386,803	277,688
	$ 817,993	$ 567,511

The accompanying notes are an integral part of these statements.

Consolidated Statements of Operations

(In thousands, except per share data)	Year Ended December 31, 1998	1997	1996
Revenues	$ 1,172,013	$ 1,005,572	$ 761,816
Cost of revenues	898,995	799,367	639,433
Gross profit	273,018	206,205	122,383
Selling, general and administrative	135,479	108,306	78,273
Special charge	16,433	10,660	16,611
Operating income	121,106	87,239	27,499
Interest and financial costs	(12,530)	(6,196)	(12,241)
Interest income	1,025	1,524	1,301
Other income (expense), net	(288)	(85)	159
Income before income taxes and extraordinary loss	109,313	82,482	16,718
Provision for income taxes	40,386	31,201	6,571
Net income before extraordinary loss	68,927	51,281	10,147
Extraordinary loss, net of tax benefit	–	623	4,000
Net income	$ 68,927	$ 50,658	$ 6,147
Net income per share:			
Basic			
Net income before extraordinary loss	$ 1.31	$ 1.00	$ 0.25
Extraordinary loss	–	(0.01)	(0.10)
Net income	$ 1.31	$ 0.99	$ 0.15
Net income per share:			
Diluted			
Net income before extraordinary loss	$ 1.30	$ 0.99	$ 0.25
Extraordinary loss	–	(0.01)	(0.10)
Net income	$ 1.30	$ 0.98	$ 0.15
Weighted average shares outstanding:			
Basic	52,780	51,124	40,018
Diluted	52,962	51,956	40,553

The accompanying notes are an integral part of these statements.

Consolidated Statements of Cash Flows

(In thousands)	Year Ended December 31, 1998	1997	1996
Cash flow from operating activities:			
Net income	$ 68,927	$ 50,658	$ 6,147
Adjustments to reconcile net income to net cash provided (used) by operating activities:			
Depreciation and amortization	19,179	14,744	8,775
Provision for losses on receivables	610	730	526
Provision for deferred income taxes	(4,092)	(3,121)	(2,433)
Gain on sale of assets	(2,337)	(2,973)	(2,727)
Foreign currency transaction (gain) loss	(103)	602	(157)
Special charge	16,433	10,660	16,611
Extraordinary loss	–	999	6,400
Changes in assets and liabilities, net of acquisitions:			
Receivables	(46,507)	(60,815)	(25,682)
Unbilled revenues	31,521	(17,641)	(8,151)
Inventories	15,667	(64,978)	(2,410)
Prepaid and other current assets	4,048	1,864	(889)
Accounts payable	(42,521)	45,083	5,555
Other assets/liabilities, net	(23,325)	23,339	(8,177)
Net cash provided (used) by operating activities	37,500	(849)	(6,612)
Cash flow from investing activities:			
Purchases of property, plant and equipment	(27,845)	(32,605)	(15,166)
Proceeds from sale of assets	9,866	4,415	3,995
Businesses acquired, net of cash	(130,867)	(19,253)	–
Partnership acquired, net of cash	–	–	(106,248)
Other	–	248	(350)
Net cash used by investing activities	(148,846)	(47,195)	(117,769)
Cash flow from financing activities:			
Borrowings (payments) on line of credit	(6,005)	57,677	(89,259)
Retirement of long-term debt	(40,855)	(41,359)	–
Net proceeds from issuance of long-term debt	148,937	–	–
Proceeds from issuance of common stock	–	37,240	107,947
Proceeds from stock options exercised	1,002	6,546	341
Proceeds from debt related to acquisition of Company	–	–	103,378
Other	104	–	5,125
Net cash provided (used) by financing activities	103,183	60,104	127,532
Effect of exchange rate losses on cash	(221)	(4,097)	(180)
Increase (decrease) in cash and equivalents	(8,384)	7,963	2,971
Cash and cash equivalents, beginning of year	19,824	13,611	16,266
Change in cash to conform fiscal year end	–	(1,750)	(5,626)
Cash and cash equivalents, end of year	$ 11,440	$ 19,824	$ 13,611

The accompanying notes are an integral part of these statements.

Consolidated Statements of Stockholders' Equity

(In thousands, except share data)	*Common Stock*	*Additional Paid-in Capital*	*Accumulated Other Comprehensive Income*	*Retained Earnings*	*Total*
Beginning Balance	$ 56	$ 40,138	$ (3,730)	$ 15,439	$ 51,903
Net income				6,147	6,147
Currency translation adjustments			1,428		1,428
Comprehensive income					7,575
Stock options exercised		341			341
Issuance of 17,857,698 shares	179	107,497			107,676
Tax benefit of options exercised		1,521			1,521
Balance at December 31, 1996	235	149,497	(2,302)	21,586	169,016
Net income				50,658	50,658
Currency translation adjustments			(4,772)		(4,772)
Comprehensive income					45,886
Stock options exercised	5	6,546			6,551
Issuance of 1,053,000 shares	10	37,225			37,235
Stock issued for acquisitions	8	10,984		3,130	14,122
Two-for-one stock split	259	(259)			–
Change in subsidiary's year end				917	917
Tax benefit of options exercised		3,961			3,961
Balance at December 31, 1997	517	207,954	(7,074)	76,291	277,688
Net income				68,927	68,927
Currency translation adjustments			(6,929)		(6,929)
Unrealized losses on available-for-sale securities			(473)		(473)
Comprehensive income					61,525
Stock options exercised		1,002			1,002
Stock issued for acquisitions	44	39,138	649	6,653	46,484
Tax benefit of options exercised		104			104
Balance at December 31, 1998	$ 561	$ 248,198	$ (13,827)	$ 151,871	$ 386,803

The accompanying notes are an integral part of these statements.

Notes to Consolidated Financial Statements

NOTE 1 ORGANIZATION AND BASIS OF PRESENTATION

Information concerning common stock and per share data has been restated on an equivalent share basis and assumes the exchange of all Exchangeable Shares issued in connection with the combination with Dreco Energy Services Ltd., as described below. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect reported and contingent amounts of assets and liabilities as of the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Effective January 1, 1996, National-Oilwell, Inc. acquired National-Oilwell, a general partnership. The transaction was accounted for under the purchase method of accounting.

Effective September 25, 1997, National Oilwell completed a combination with Dreco Energy Services Ltd. The combination was accounted for as a pooling-of-interests and the consolidated financial statements of National Oilwell and Dreco have been combined with all prior periods restated. As a result of the combination, each Dreco Class "A" common share outstanding was converted into .9159 of a Dreco Exchangeable Share and approximately 14.4 million Exchangeable Shares were issued. Each Exchangeable Share is intended to have substantially identical economic and legal rights as, and will ultimately be exchanged on a one-for-one basis for, a share of National Oilwell common stock. As of December 31, 1998, approximately 82% of the Exchangeable Shares had been converted into National Oilwell common stock.

Other Acquisitions

On December 2, 1996, Dreco acquired 100% of the issued and outstanding shares of Vector Oil Tool Ltd. for consideration of 778,000 Dreco common shares and cash consideration of $1.5 million. This business involves the manufacture, sale, rental and service of downhole motors and other products. The transaction was accounted for using the purchase method, is reflected in the 1997 financial statements due to the combination of differing balance sheet dates as discussed above and did not have a material effect on National Oilwell's consolidated financial statements.

On April 25, 1997, National Oilwell purchased the drilling controls business of Ross Hill Controls and its affiliate, Hill Graham Controls Limited, for $19.2 million in cash. This business involves the manufacture, sale and service of electrical control systems used in conjunction with drilling operations. The transaction was accounted for under the purchase method of accounting and did not have a material effect on National Oilwell's consolidated financial statements.

On May 15, 1997, National Oilwell acquired by merger 100% of the common stock of PEP, Inc., a manufacturer of petroleum expendable pump products. The Company issued 800,000 shares of common stock pursuant to the transaction which was recorded in accordance with the pooling-of-interests method of accounting. The transaction did not have a material effect on National Oilwell's historical consolidated financial statements and financial statements prior to April 1, 1997 were not restated.

On May 29, 1998, National Oilwell acquired all of the capital stock of Phoenix Energy Products Holdings, Inc. for approximately $115 million in a business combination which was accounted for under the purchase method of accounting. Phoenix manufactures and sells multiple product lines that are complementary to those of National Oilwell. The acquisition of the stock and the repayment of approximately $41 million in Phoenix debt were financed primarily through the issuance of $150 million in unsecured seven year senior notes. The excess of the purchase price over the book value of the net assets was approximately $106 million. Assuming the acquisition had occurred at the beginning of each period presented, pro forma summary results of operations would have been as follows:

	1998	1997
Revenues	$ 1,205,472	$ 1,088,003
Income before extraordinary item	68,170	55,609
Net income	68,170	54,986
Net income per share:		
Basic		
Income before extraordinary item	$ 1.29	$ 1.09
Net income	1.29	1.08
Diluted		
Income before extraordinary item	$ 1.29	$ 1.07
Net income	1.29	1.06

The unaudited pro forma summary is not necessarily indicative of results of operations that would have occurred had the purchase been made at the beginning of the year or of future results of operations of the combined businesses.

The seller of Phoenix is an affiliate of First Reserve Corporation, which is the beneficial owner of 22.9% of National Oilwell's common stock. Two directors of National Oilwell are affiliated with First Reserve.

On July 21, 1998, National Oilwell purchased 100% of the capital stock of Roberds-Johnson Industries, Inc., a manufacturer of a broad range of drilling equipment, in exchange for 1.35 million shares of National Oilwell common stock. This transaction was accounted for under the pooling-of-interests method of accounting. The Company's financial statements prior to July 1, 1998 have not been restated since the transaction did not have a material effect on National Oilwell's consolidated historical financial statements.

On December 16, 1998, National Oilwell purchased the business of DOSCO, a major Canadian oilfield distribution business, for 3 million shares of National Oilwell common stock and a note for approximately U.S. $6.5 million. This transaction was accounted for under the purchase method of accounting. DOSCO has been combined with the National Oilwell's existing Canadian distribution business. Pro-forma information has not been provided as such amounts are not material.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of National Oilwell and its subsidiaries, all of which are wholly owned. All significant intercompany transactions and balances have been eliminated in consolidation.

Fair Value of Financial Instruments

Financial instruments consist primarily of cash and cash equivalents, receivables, payables and debt instruments. Cash equivalents include only those investments having a maturity of three months or less at the time of purchase. The carrying values of these financial instruments approximate their respective fair values.

Inventories

Inventories consist of oilfield products and oil country tubular goods, manufactured equipment, manufactured specialized drilling products and downhole motors and spare parts for manufactured equipment and drilling products. Inventories are stated at the lower of cost or market using the first-in, first-out or average cost methods.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Expenditures for major improvements which extend the lives of property and equipment are capitalized while minor replacements, maintenance and repairs are charged to operations as incurred. Disposals are removed at cost less accumulated depreciation with any resulting gain or loss reflected in operations. Depreciation is provided using the straight-line method or declining balance method over the estimated useful lives of individual items.

Intangible Assets

Deferred financing costs are amortized on a straight-line basis over the life of the related debt security and accumulated amortization was $205,000 and $24,000 at December 31, 1998 and 1997, respectively. Goodwill is amortized on a straight-line basis over its estimated life of 10–40 years. Accumulated amortization at December 31, 1998 and 1997 was $4,061,000 and $1,214,000.

Foreign Currency

The functional currency for National Oilwell's Canadian, United Kingdom, German and Australian operations is the local currency. The cumulative effects of translating the balance sheet accounts from the functional currency into the U.S. dollar at current exchange rates are included in cumulative foreign currency translation adjustments. The U.S. dollar is used as the functional currency for the Singapore and Venezuelan operations. Accordingly, certain assets are translated at historical exchange rates and all translation adjustments are included in income. For all operations, gains or losses from remeasuring foreign currency transactions into the functional currency are included in income.

Revenue Recognition

Revenue from the sale and rental of products and delivery of services is recognized upon passage of title, incurrance of rental charges or delivery of services to the customer. Revenue is recognized on certain significant contracts in the Products and Technology segment using the percentage of completion method based on the percentage of total costs incurred to total costs expected. Provision for estimated losses, if any, is made in the period such losses are estimable.

Income Taxes

Income taxes have been provided using the liability method in accordance with Financial Accounting Standards Board Statement No. 109, *Accounting for Income Taxes.*

Concentration of Credit Risk

National Oilwell grants credit to its customers, which operate primarily in the oil and gas industry. National Oilwell performs periodic credit evaluations of its customers' financial condition and generally does not require collateral, but may require letters of credit for certain international sales. Reserves are maintained for potential credit losses and such credit losses have historically been within management's expectations.

Stock-Based Compensation

National Oilwell uses the intrinsic value method in accounting for its stock-based employee compensation plans. Compensation costs for stock options would be recognized over the vesting period if options were granted with an exercise price below market on the date of grant.

Net Income Per Share

The following table sets forth the computation of weighted average basic and diluted shares outstanding (in thousands):

	Year Ended December 31, 1998	1997	1996
Denominator for basic earnings per share – weighted average shares	52,780	51,124	40,018
Effect of dilutive securities:			
Employee stock options	182	832	535
Denominator for diluted earnings per share – adjusted weighted average shares and assumed conversions	52,962	51,956	40,553

NOTE 3 INVENTORIES

Inventories consist of (in thousands):

	December 31, 1998	December 31, 1997
Raw materials and supplies	$ 24,304	$ 19,970
Work in progress	39,991	34,849
Finished goods and purchased products	177,692	148,701
Total	$ 241,987	$ 203,520

NOTE 4 STATEMENTS OF CASH FLOWS

The following information supplements the Consolidated Statements of Cash Flows (in thousands):

	December 31, 1998	1997	1996
Cash paid during the period for:			
Interest	$ 5,767	$ 6,904	$ 8,819
Income taxes	47,985	24,175	4,252

NOTE 5 PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of (in thousands):

	Estimated Useful Lives	December 31, 1998	December 31, 1997
Land and improvements	2–20 Years	$ 6,421	$ 6,823
Buildings and improvements	5–31 Years	26,221	22,760
Machinery and equipment	5–12 Years	48,767	31,254
Computer and office equipment	3–10 Years	35,021	15,104
Rental equipment	1–7 Years	29,217	36,982
		145,647	112,923
Less accumulated depreciation		(53,891)	(38,641)
		$ 91,756	$ 74,282

NOTE 6 LONG-TERM DEBT

Long-term debt consists of (in thousands):

	December 31, 1998	December 31, 1997
Revolving credit facilities	$ 55,637	$ 60,560
6⅞% senior notes	150,000	–
Other	7,447	2,345
	213,084	62,905
Less current portion	7,447	1,340
	$ 205,637	$ 61,565

On September 25, 1997, National Oilwell entered into a new five-year unsecured $125 million revolving credit facility that was used in part to repay amounts outstanding under the previous revolving credit facilities and other indebtedness. The credit facility is available for acquisitions and general corporate purposes and provides up to $50 million for letters of credit, of which $16 million were outstanding at December 31, 1998. The credit facility provides for interest at prime or LIBOR plus 0.625% (7.75% and 6.25% at December 31, 1998) subject to adjustment based on National Oilwell's Capitalization Ratio, as defined. The credit facility contains financial covenants and ratios regarding minimum tangible net worth, maximum debt to capital and minimum interest coverage.

National Oilwell also has additional credit facilities totaling $22.5 million used primarily for letters of credit, of which $3.1 million were outstanding at December 31, 1998.

In June 1998, National Oilwell sold $150 million of 6.875% unsecured senior notes due July 1, 2005. Interest is payable on January 1 and July 1 of each year.

NOTE 7 PENSION PLANS

National Oilwell and its consolidated subsidiaries have several pension plans covering substantially all of its employees. Defined-contribution pension plans cover most of the U.S. and Canadian employees and are based on years of service, a percentage of current earnings and matching of employee contributions. For the years ended December 31, 1998, 1997 and 1996, pension expense for defined-contribution plans was $3.7 million, $3.5 million and $2.3 million, and all funding is current.

One of National Oilwell's subsidiaries in the United Kingdom has a defined-benefit pension plan whose participants are primarily retired and terminated employees who are no longer accruing benefits. The pension plan assets are invested primarily in equity securities, United Kingdom government securities, overseas bonds and cash deposits. At December 31, 1998, the plan assets at fair market value were $43.5 million and the projected benefit obligation was $27.3 million.

NOTE 8 ACCUMULATED OTHER COMPREHENSIVE INCOME

The components of other comprehensive income are as follows:

	Currency Translation Adjustments	Unrealized Gains On Available-for-sale Securities	Total
Beginning Balance	$ (3,730)	$ –	$ (3,730)
Currency translation adjustments	1,428	–	1,428
Balance at December 31, 1996	(2,302)	–	(2,302)
Currency translation adjustments	(4,772)	–	(4,772)
Balance at December 31, 1997	(7,074)	–	(7,074)
Currency translation adjustments	(6,929)	–	(6,929)
Unrealized gains on available-for-sale securities	–	244	244
Deferred taxes relating to unrealized gains on available-for-sale securities	–	(68)	(68)
Balance at December 31, 1998	$ (14,003)	$ 176	$ (13,827)

NOTE 9 COMMITMENTS AND CONTINGENCIES

National Oilwell leases land, buildings and storage facilities, vehicles and data processing equipment under operating leases extending through various dates up to the year 2004. Rent expense for the years ended December 31, 1998, 1997 and 1996 was $10.3 million, $9.0 million and $10.5 million. National Oilwell's minimum rental commitments for operating leases at December 31, 1998, excluding future payments applicable to facilities to be closed as part of the 1998 Special Charge, were as follows: 1999 - $5.7 million; 2000 - $3.4 million; 2001 - $1.1 million; 2002 - $0.3 million; 2003 - $0.3 million; thereafter - $0.3 million.

National Oilwell is involved in various claims, regulatory agency audits and pending or threatened legal actions involving a variety of matters. The total liability on these matters at December 31, 1998 cannot be determined; however, in the opinion of management, any ultimate liability, to the extent not otherwise provided for, should not materially affect the financial position, liquidity or results of operations of National Oilwell.

National Oilwell's business is affected both directly and indirectly by governmental laws and regulations relating to the oilfield service industry in general, as well as by environmental and safety regulations that specifically apply to National Oilwell's business. Laws and regulations protecting the environment have generally become more expansive and stringent in recent years and National Oilwell believes the trend will continue. Although National Oilwell has not incurred material costs in connection with its compliance with such laws, there can be no assurance that other developments, such as stricter environmental laws, regulations and enforcement policies thereunder could not result in additional, presently unquantifiable costs or liabilities to National Oilwell.

NOTE 10 COMMON STOCK

National Oilwell has authorized 75 million shares of $.01 par value common stock. National Oilwell also has authorized 10 million shares of $.01 par value preferred stock, none of which is issued or outstanding.

National Oilwell's stock plans collectively authorize the grant of restricted stock or options to purchase up to 5,832,606 shares of National Oilwell's common stock to officers, key employees, non-employee directors and other persons. Options granted generally vest over a 3-year period starting one year from the date of grant and generally expire 5 years from the date of grant. During 1996, prior to National Oilwell becoming a public company, 1,882,606 shares of restricted common stock were purchased by executive officers. These shares are subject to restrictions on transferability and are not entitled to receive cash dividends or distributions until such restrictions lapse. Restrictions lapse annually on 20% of these shares beginning on January 17, 1997 or in their entirety upon the occurrence of (i) a merger or consolidation of National Oilwell into another company, (ii) a sale of all or substantially all the assets of National Oilwell, or (iii) a sale of all the common stock of National Oilwell. Restrictions also lapse in their entirety upon a participant's disability, death or involuntary termination of employment without cause. During 1998 and 1997, 112,954 and 225,906 shares of restricted stock were repurchased by the Company pursuant to the original terms of the issuance. In accordance with the plan, these forfeited shares may be reawarded in the future.

Options outstanding at December 31, 1998 under the stock option plans have exercise prices between $5.62 and $28.81 per share, and expire at various dates from March 21, 2002 to January 13, 2007. The weighted average exercise price on the 904,511 outstanding options at December 31, 1998 is $21.74.

The following summarizes option activity:

	Weighted Average Share Price				
	Incentive Plans	Private Agreements	Incentive Plans	Private Agreements	Total Options
Options outstanding:					
Balance at December 31, 1996	$ 6.01	$ 7.03	663,114	201,498	864,612
Granted	17.95	21.84	447,142	119,062	566,204
Cancelled	14.90	–	(132,456)	–	(132,456)
Exercised	5.77	12.53	(439,208)	(320,560)	(759,768)
Balance at December 31, 1997	13.94	–	538,592	–	538,592
Granted	27.46		513,896	–	513,896
Cancelled	22.82		(44,020)	–	(44,020)
Exercised	9.60		(103,957)	–	(103,957)
Balance at December 31, 1998	21.74	–	904,511	–	904,511
Options exercisable:					
Balance at December 31, 1996	$ 5.72	$ 7.03	328,260	201,498	529,758
Became exercisable	5.96	21.84	167,055	119,062	286,117
Exercisable cancelled	5.62	–	(9,159)	–	(9,159)
Exercised	5.77	12.53	(439,208)	(320,560)	(759,768)
Balance at December 31, 1997	6.16	–	46,948	–	46,948
Became exercisable	13.74		178,249		178,249
Exercisable cancelled	22.32		(7,034)		(7,034)
Exercised	9.60		(103,957)		(103,957)
Balance at December 31, 1998	13.97	–	114,206	–	114,206

The weighted average fair value of options granted during 1998 was approximately $10.23 per share as determined using the Black-Scholes option-pricing model. Assuming that National Oilwell had accounted for its stock-based compensation using the alternative fair value method of accounting under FAS No. 123 and amortized the fair value to expense over the option's vesting period, net income and earnings per share would have been affected by $0.02 from the amounts reported. These pro forma results may not be indicative of future effects.

The Company evaluates annually the grant of options to eligible participants and on February 9, 1999, 1,233,889 options to purchase shares of common stock were granted at an exercise price of $10.13, the fair value of the common stock at that date.

In January 1996, National Oilwell established Value Appreciation Plans intended to reward participants for enhancing the value of National Oilwell's common stock. The company's initial public offering represented a triggering event under these plans, resulting in a one-time charge before taxes of $12.2 million ($7.6 million after tax). National Oilwell paid $2.9 million of this amount in cash at the time of the initial public offering and became obligated to pay an additional $3.5 million in cash in five annual installments beginning January 17, 1997. The balance of the obligation was payable by the issuance of common stock. As of December 31, 1997, 365,588 shares of common stock had been issued and another 316,264 shares of common stock were issued on or about January 17, 1999.

NOTE 11 INCOME TAXES

The domestic and foreign components of income before income taxes were as follows (in thousands):

	December 31, 1998	December 31, 1997	December 31, 1996
Domestic	$ 58,725	$ 47,436	$ 1,096
Foreign	50,588	35,046	15,622
	$ 109,313	$ 82,482	$ 16,718

The components of the provision for income taxes consisted of (in thousands):

	December 31, 1998	December 31, 1997	December 31, 1996
Current:			
Federal	$ 24,341	$ 17,428	$ 4,435
State	2,074	1,496	561
Foreign	18,063	15,398	4,008
	44,478	34,322	9,004
Deferred:			
Federal	$ (4,151)	$ (287)	$ (3,898)
State	(845)	(64)	(864)
Foreign	904	(2,770)	2,329
	(4,092)	(3,121)	(2,433)
	$ 40,386	$ 31,201	$ 6,571

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

	December 31, 1998	December 31, 1997	December 31, 1996
Federal income tax at statutory rate	$ 38,260	$ 28,869	$ 5,851
Foreign income tax rate differential	230	494	173
State income tax net of federal benefit	1,151	919	–
Tax benefit of foreign sales corporation	(2,547)	(990)	–
Nondeductible expenses	1,223	2,837	1,170
Incremental U.S. tax on foreign earnings	2,517	–	–
Unbenefited losses	2,903	209	–
Change in deferred tax valuation allowance	(2,765)	(1,617)	(462)
Other	(586)	480	(161)
	$ 40,386	$ 31,201	$ 6,571

Significant components of National Oilwell's deferred tax assets and liabilities were as follows (in thousands):

	December 31, 1998	December 31, 1997
Deferred tax assets:		
Accrued liabilities	$ 18,641	$ 14,055
Net operating loss carryforwards	13,521	16,096
Other	9,625	5,913
Total deferred tax assets	41,787	36,064
Valuation allowance for deferred tax assets	(18,541)	(21,306)
	23,246	14,758
Deferred tax liabilities:		
Tax over book depreciation	1,743	2,226
Other	2,354	449
Total deferred tax liabilities	4,097	2,675
Net deferred tax assets	$ 19,149	$ 12,083

In the United States, the Company has $19.9 million of net operating loss carryforwards as of December 31, 1998, which expire at various dates through 2009. These operating losses were acquired in the combination with Dreco and are associated with Dreco's U.S. subsidiary. As a result of share exchanges occurring since the combination resulting in a more than 50% aggregate change in the beneficial ownership of Dreco, the availability of these loss carryforwards to reduce future United States federal taxable income may have become subject to various limitations under Section 382 of the Internal Revenue Code of 1986, as amended. In addition, these net operating losses can only be used to offset separate company taxable income of Dreco's U.S. subsidiary. Since the ultimate realization of these net operating losses is uncertain, the related potential benefit of $6.8 million has been recorded with a full valuation allowance. Future income tax expense will be reduced if the Company ultimately realizes the benefit of these net operating losses.

Outside the United States, the Company has $19.8 million of net operating loss carryforwards as of December 31, 1998 that are available indefinitely. The related potential benefit available of $6.7 million has been recorded with a full valuation allowance. If the Company ultimately realizes the benefit of these net operating losses, $4.7 million would reduce goodwill and other intangible assets and $2.0 million would reduce income tax expense.

The deferred tax valuation allowance decreased $2.8 million and $1.6 million for the period ending December 31, 1998 and December 31, 1997, respectively, resulting from the realization of foreign net operating losses and investment tax credits that were previously deferred. National Oilwell's deferred tax assets are expected to be realized principally through future earnings.

Undistributed earnings of the Company's foreign subsidiaries amounted to $59.1 million and $44.4 million at December 31, 1998 and December 31, 1997. Those earnings are considered to be permanently reinvested and no provision for U.S. federal and state income taxes has been made. Distribution of these earnings in the form of dividends or otherwise would result in both U.S. federal taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable in various foreign countries. Determination of the amount of unrecognized deferred U.S. income tax liability is not practical; however, unrecognized foreign tax credit carryforwards would be available to reduce some portion of the U.S. liability. Withholding taxes of approximately $6.1 million would be payable upon remittance of all previously unremitted earnings at December 31, 1998.

NOTE 12 SPECIAL CHARGES

During the fourth quarter of 1998, the Company recorded a special charge of $16.4 million ($10.4 million after tax, or $0.20 per share) related to operational changes resulting from the depressed market for the oil and gas industry. The components of the special charge are as follows (in millions):

Asset impairments	$ 5.4
Severance	5.6
Facility closures and exit costs	5.4
	$ 16.4

The cash and non-cash elements of the charge approximate $11.0 million and $5.4 million, respectively. Breakdown of the charge by business segment is:

Products and Technology	$ 11.1
Downhole Products	1.4
Distribution Services	3.0
Corporate	.9
	$ 16.4

The asset impairment losses of $5.4 million consist primarily of the shutdown of four North American manufacturing facilities. Assets related to these non-productive facilities which are not in service totaling $10.0 million have been reclassified on the balance sheet to property held for sale and have been written down to their estimated fair value, less cost of disposal. Severance costs of $5.6 million relate to the involuntary termination of approximately 200 employees, most of which are located in North America. Facility closure costs of $5.4 million consists principally of lease cancellation and facility exit costs. Substantially all of the actions associated with this charge will be fully implemented before the end of the first quarter of 1999.

During 1997, National Oilwell recorded a $10.7 million charge ($8.1 million after tax) related to various professional fees and integration costs incurred in connection with the combination with Dreco.

During 1996, National Oilwell incurred certain one-time expenses in connection with its initial public offering of common stock, as follows: (i) a management services agreement was terminated at a cost of $4.4 million ($2.8 million after tax) and (ii) expenses and payout under National Oilwell's Value Appreciation Plans, which resulted in National Oilwell recording an expense of $12.2 million ($7.6 million after tax). The Value Appreciation Plans required the issuance of 681,852 shares of common stock and payment of $6.4 million in cash.

NOTE 13 EXTRAORDINARY LOSSES

In the third quarter of 1997, the replacement of the previous credit facility resulted in the write-off of $1.0 million ($0.6 million after tax) in deferred financing costs related to the replaced agreement. In the fourth quarter of 1996, another credit facility was replaced, resulting in the write-off of $6.4 million ($4.0 million after tax) in deferred financing costs related to the replaced agreement.

NOTE 14 RELATED PARTY TRANSACTIONS

Prior to becoming a public company, National Oilwell entered into a five-year Management Services Agreement with National Oilwell's then largest stockholders, whereby National Oilwell would pay for senior management assistance and other services as agreed and pay fees in connection with each acquisition or disposition completed during a five-year period. After becoming a public company, this agreement was terminated pursuant to a Deferred Fee Agreement, which provides for cash payments of up to $4.4 million. As of December 31, 1998, cash payments aggregating $3.5 million have been made to Inverness/Phoenix LLC and First Reserve Corporation in connection with the Deferred Fee Agreement. Future payments totaling $900,000 will be made to Inverness/Phoenix LLC during 1999. In addition, National Oilwell paid transaction and management fees of $2.6 million to the Inverness/Phoenix LLC and $1.2 million to First Reserve Corporation in connection with the purchase of the company from a previous owner.

On May 29, 1998, National Oilwell acquired Phoenix Energy Products Holdings, Inc., an affiliate of First Reserve Corporation, as more fully described in note 1.

NOTE 15 BUSINESS SEGMENTS AND GEOGRAPHIC AREAS

National Oilwell's operations consist of three segments: Products and Technology, Downhole Products and Distribution Services. The Products and Technology segment designs and manufactures a variety of oilfield equipment for use in oil and gas drilling, completion and production activities. The Downhole Products segment designs and manufactures drilling motors and specialized drilling tools for rent and sale. The Distribution Services segment distributes an extensive line of oilfield supplies, oilfield equipment and tubular products. Intersegment sales and transfers are accounted for at commercial prices and are eliminated in consolidation. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies of the Company. The Company evaluates performance of each reportable segment based upon its operating income, excluding non-recurring items.

No single customer accounted for 10% or more of consolidated revenues during the three years ended December 31, 1998.

Summarized financial information is as follows (in thousands):

Business Segments:

	Products and Technology	Downhole Products	Distribution Services	Corporate/Eliminations[1]	Total
December 31, 1998					
Revenues from:					
Unaffiliated customers	$ 603,766	$ 59,636	$ 508,611	$ –	$ 1,172,013
Intersegment sales	64,301	2,119	–	(66,420)	–
Total revenues	668,067	61,755	508,611	(66,420)	1,172,013
Operating income (loss)	119,573	17,021	7,505[2]	(22,993)	121,106[2]
Capital expenditures	5,030	9,112	12,824	879	27,845
Depreciation and amortization	7,173	9,338	1,628	1,040	19,179
Identifiable assets	510,380	88,183	188,998	30,432	817,993
December 31, 1997					
Revenues from:					
Unaffiliated customers	$ 306,481	$ 68,192	$ 630,899	$ –	$ 1,005,572
Intersegment sales	65,360	820	–	(66,180)	–
Total revenues	371,841	69,012	630,899	(66,180)	1,005,572
Operating income (loss)	53,453	25,551	27,581	(19,346)	87,239
Capital expenditures	13,812	16,724	1,434	635	32,605
Depreciation and amortization	3,448	8,950	1,131	1,215	14,744
Identifiable assets	274,336	78,036	177,574	37,565	567,511
December 31, 1996					
Revenues from:					
Unaffiliated customers	$ 214,802	$ 28,329	$ 518,685	$ –	$ 761,816
Intersegment sales	51,732	275	–	(52,007)	–
Total revenues	266,534	28,604	518,685	(52,007)	761,816
Operating income (loss)	25,902	8,858	17,483	(24,744)	27,499
Capital expenditures	3,126	10,959	1,050	31	15,166
Depreciation and amortization	2,766	4,304	1,650	55	8,775
Identifiable assets	123,680	43,338	154,985	30,515	352,518

(1) *Operating loss of Corporate includes a special charge of $16,433 for 1998, $10,660 for 1997 and $16,611 for 1996.*
(2) *Includes a $5,600 charge related to the writedown to the lower of cost or market of certain tubular inventories.*

Geographic Areas:

	United States	Canada	United Kingdom	Other	Eliminations	Total
December 31, 1998						
Revenues from:						
Unaffiliated customers	$ 888,211	$ 196,493	$ 54,625	$ 32,684	$ –	$ 1,172,013
Interarea sales	58,112	34,912	4,056	1,044	(98,124)	–
Total revenues	946,323	231,405	58,681	33,728	(98,124)	1,172,013
Long-lived assets	451,217	306,847	36,321	23,608	–	817,993
December 31, 1997						
Revenues from:						
Unaffiliated customers	$ 733,905	$ 201,360	$ 38,223	$ 32,084	$ –	$ 1,005,572
Interarea sales	42,273	11,858	2,383	703	(57,217)	–
Total revenues	776,178	213,218	40,606	32,787	(57,217)	1,005,572
Long-lived assets	373,544	131,078	27,240	35,649	–	567,511
December 31, 1996						
Revenues from:						
Unaffiliated customers	$ 554,686	$ 146,067	$ 29,152	$ 31,911	$ –	$ 761,816
Interarea sales	34,252	10,028	1,912	504	(46,696)	–
Total revenues	588,938	156,095	31,064	32,415	(46,696)	761,816
Long-lived assets	228,881	66,129	21,632	35,876	–	352,518

NOTE 16 QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized quarterly results as restated to reflect the combination with Dreco were as follows (in thousands, except per share data which have been restated to comply with FAS 128):

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
Year Ended December 31, 1998					
Revenues	$ 301,852	$ 294,843	$ 306,457	$ 268,861	$ 1,172,013
Gross profit	64,792	72,808	75,747	59,671[1]	273,018[1]
Special charge	–	–	–	16,433	16,433
Income (loss) before taxes	33,546	38,097	34,005	3,665	109,313
Net income	21,137	23,811	21,579	2,400	68,927
Net income per diluted share	0.40	0.46	0.40	0.04	1.30
Year Ended December 31, 1997					
Revenues	$ 206,670	$ 234,090	$ 264,959	$ 299,853	$ 1,005,572
Gross profit	38,640	43,038	55,352	69,175	206,205
Special charge	–	–	10,660	–	10,660
Income (loss) before taxes	15,096	17,164	16,715	33,507	82,482
Net income before extraordinary loss	9,699	11,065	9,447	21,070	51,281
Net income	9,699	11,065	8,824	21,070	50,658
Net income per diluted share, before extraordinary loss	0.19	0.21	0.18	0.41	0.99
Net income per diluted share	0.19	0.21	0.17	0.41	0.98

(1) *Includes a $5,600 charge related to the writedown to the lower of cost or market of certain tubular inventories.*

Market for Registrant's Common Equity and Related Stockholder Matters

National Oilwell common stock is listed on the New York Stock Exchange (ticker symbol: NOI). The following table sets forth the stock price range during 1998 and 1997:

	1998		1997	
Quarter	High	Low	High	Low
First	$ 34.00	$ 23.88	$ 19.32	$ 14.00
Second	39.75	25.94	28.88	15.82
Third	29.13	7.75	37.50	25.07
Fourth	17.69	8.81	44.44	27.88

As of March 15, 1999, there were 435 holders of record of National Oilwell common stock. National Oilwell has never paid cash dividends, and none are anticipated during 1999.

Corporate Directory

Directors

Joel V. Staff
Chairman, President
and Chief Executive Officer

Howard I. Bull
Private Investor

James C. Comis III
Managing Director,
Inverness Management LLC

W. McComb Dunwoody
Managing Director,
Inverness Management LLC

William E. Macaulay
President and CEO,
First Reserve Corporation

Frederick W. Pheasey
Executive Vice President

Bruce M. Rothstein
Managing Director,
First Reserve Corporation

Executive Officers

Joel V. Staff
Chairman, President
and Chief Executive Officer

James J. Fasnacht
Vice President and Group President,
Distribution Services

Jerry N. Gauche
Vice President,
Organizational Effectiveness

Steven W. Krablin
Vice President and
Chief Financial Officer

Merrill A. Miller, Jr.
Vice President and Group President,
Products and Technology

Frederick W. Pheasey
Executive Vice President

Form 10-K

The annual report on Form 10-K, as filed with the Securities and Exchange Commission is available on our web site at: www.natoil.com. A copy may also be obtained without charge by contacting:

M. Gay Mather
Manager – Investor Relations
National-Oilwell, Inc.
10000 Richmond Avenue
4th Floor
Houston, Texas 77042
(713) 346-7500

Auditors

Ernst & Young LLP
Houston, Texas

Corporate Data

Exchange Listing

New York Stock Exchange
Symbol: NOI

Annual Meeting

National Oilwell will hold its annual meeting at the ITT Sheraton Luxury Collection Hotel at 1919 Briar Oaks Lane in Houston, Texas, May 19, 1999 at 11:00 a.m.

Stock Transfer Agent and Registrar

Communications concerning stock transfer requirements, lost certificates or changes of address should be directed to:

American Stock Transfer
and Trust Company
40 Wall Street, 46th Floor
New York, NY 10005

Communications concerning the exchange of Dreco Exchangeable Shares into National Oilwell Common Stock should be directed to:

Montreal Trust Company of
Canada Stock Transfer Services
Western Gas Tower
600, 530 8th Ave., S.W.
Calgary, Alberta T2P 3S8

Design: Savage Design Group, Inc., Houston, Texas

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