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NOV - Q2 2014 National Oilwell Varco Earnings Conference Call

EVENT DATE/TIME: JULY 29, 2014 / 1:00PM GMT

OVERVIEW:

NOV reported 2Q14 consolidated revenues from continuing operations of $5.3b, fully diluted EPS attributable to Co. for all operations of $1.44 and fully diluted EPS from continuing operations of $1.42.

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PRESENTATION

Operator

Welcome to the Second-Quarter Financial Results Earnings Call. My name is Shannon, and I will be your operator for today's call.

(Operator Instructions)

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

Loren Singletary - *National Oilwell Varco Inc - VP of IR & Industry Relations*

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

Before we begin this discussion of National Oilwell Varco's financial results for its second quarter ended June 30, 2014, please note that some of the statements we make during this call may contain forecasts, projections and estimates, including but not limited to, comments about our outlook for the Company's business. These are forward-looking statements within the meaning of the Federal Securities Laws, based on limited information as of today, which is subject to change.

They are subject to risks and uncertainties, and actual results may differ materially. No one should assume that these forward-looking statements remain valid later in the quarter, or later in the year.

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

Now let me turn this call over to Clay.

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

Thank you, Loren.

This morning, we announced that National Oilwell Varco earned $1.42 per fully diluted share from continuing operations, and $1.44 per share attributable to the Company for all operations in its second-quarter ended June 30, 2014. Consolidated revenues from continuing operations were $5.3 billion, up 7% sequentially, and up 12% year-over-year. Operating profit from continuing operations, excluding transaction costs, was $945 million or 18% of sales.

EBITDA from continuing operations, excluding non-recurring items, was $1.141 billion or 21.7% of sales. The second quarter included $31 million pretax or $0.05 share after-tax in transaction related charges, mostly due to the spinout of our Distribution NOW business, which we completed during the second-quarter. Adding these back, our earnings were $1.47 per fully diluted share from continuing operations.

Continuing earnings, excluding non-recurring items of $1.47, are consistent with what we have reported in the past. And on this basis for all periods, second-quarter earnings were up 14% sequentially and up 19% from the second-quarter last year.

We've seen many changes at National Oilwell Varco this quarter, including our spinout of our Distribution NOW business. This morning, we will be just detailing our results along new business segments, with new disclosures following our reorganization during the second-quarter.

Among these is our reporting of certain amortization expenses of purchased intangible assets. These were $91 million pretax or $0.14 per share after-tax for the second-quarter of 2014. Excluding these, and excluding discontinued operations and non-recurring items, second-quarter 2014 operating non-GAAP earnings per fully diluted share were $1.61 up 13% sequentially and up 16% year-over-year on the same basis for all quarters.

We offer the supplemental non-GAAP disclosure to lend more transparency to our cash flow generating capability per share. And Jeremy will speak to this more in a few moments.

Overall, on either basis of presentation, we are pleased with double-digit earnings growth for our shareholders for the second-quarter, which reflect skillful execution of projects and backlog, and improving market conditions across North America and other parts of the world. In particular, we are seeing the major North American shale plays growing.

Domestic E&P wellhead cash flows are rising with increasing production and strong commodity prices. And producers are choosing to plow back more of their cash into new shale drilling. While activity gains were partly offset by seasonal break up in Canada, our outlook for Canada is strengthening for the second half.

Activity is leading to rising demand for frac equipment, coil tubing units, and for new build land rigs required to maximize shale drilling efficiency, adding to continued strong land rig demand overseas, particularly in Latin America and the Middle East.

Offshore demand held up well through the second quarter. But as we discussed last quarter, we expect the second half of 2014 to be more challenging.

We see the market for new floating rigs softening for at least the next few quarters, due to lower day rates pressured by new uncontracted capacity coming into the market. Nevertheless, we still see some floater demand through this period for special capabilities required for the Arctic, for high pressure 20,000 psi prospects, for the North Sea mid-water market, and for well intervention and construction activity.

And with very few floaters scheduled to be delivered in 2017, we could see opportunistic investors, whether traditional drilling contractors or entrepreneurs, decide to place orders at some point in 2015. So with respect to rig systems capital orders, we expect a decline for new build floaters, but some level of demand for these special floating rigs continuing.

We see steady demand for jack-ups, at least for the second half of 2014. And we see a pronounced increase in demand for land rigs for the next several quarters. But land rigs and jack-ups will not fully offset falling floater demand.

Importantly, analysis of NOV's financial results in rig building through the past decade demonstrates that earnings and cash flow can and do remain strong through cyclical order downturns. Over the next several quarters, we expect the following factors to underpin solid revenue and earnings performance within our Rig Systems segment.

One, our record backlog with approximately 180 offshore new builds underway today. Two, equipment demand associated with five-year special periodic surveys of offshore rigs, which we see tripling between now and 2017. Three, general equipment upgrade demand around offshore rig for float capacity and BOPs. And four, rising backlog for land rigs and land equipment.

We expect these to buffer Rig Systems segment revenues from the volatility in deep-water new build orders. Offshore rig new build projects, floaters and jack-ups, accounted for approximately $1.4 billion or 27% of NOV's consolidated second-quarter revenues, all within the Rig Systems segment.

That segment also generated almost $1 billion from the sale of land rig new builds, and replacement and upgrade components for both land and offshore drilling rigs. Again, our backlog should help sustain results for the former for the next several quarters, while rising demand should strengthen the latter for the next several quarters.

During the second-quarter, the Rig Systems segment won orders totaling $2.3 billion, up 8% from the first quarter and its book-to-bill was 110%, lifting backlog to a record level of $15.4 billion for the segment. Backlog for rig systems is up 2% since year-end 2013, and up 41% since year-end 2012. Offshore new build orders included five floaters and two jack-ups during the second-quarter.

Our new Rig Aftermarket segment is closely related to the Rig Systems segment operationally, and serves to support the growing installed base of NOV drilling equipment operating in the field. The segment grew 5% sequentially, and 17% year-over-year in the second quarter, consistent with its annual growth results for the past several years.

It is high-margin and highly strategic to our offering in the drilling equipment space. That's why we continue to invest heavily in facilities and skilled personnel, to ensure that NOV continues to provide the high level of aftermarket support our customers expect. It provides clear differentiation to premium NOV drilling technology, and we foresee a bright future as our installed base of rigs continues to expand.

Our new Wellbore Technologies segment provides critical products and services designed to improve drilling performance. Drill bits, drill pipe, including IntelliServ wire drill pipe, tubular inspection and coding, drilling motors and reamers, solids control, waste management, drilling fluids, drilling optimization and instrumentation services provided by the group all serve to improve efficiency, safety, and environmental impact of drilling operations.

Although this segment is levered to drilling activity, it posted 13% sequential growth, despite the second-quarter global rig count decline arising from the Canadian breakup. Year-over-year, Wellbore Technologies segment second-quarter sales were up 18%.

Finally, our new Completion & Production Solutions segment provides equipment to complete and produce wells, along with some sales into certain industrial markets. This group engineers and manufactures equipment into hydraulic fracture stimulation operations, wireline and coiled tubing technologies, composite piping solutions, and critical technologies such as turret mooring systems and flexible pipe to support deep-water field developments.

The group posted 12% sequential revenue growth, and 7% year-over-year growth. Orders for the Completion & Production Solutions segment were extraordinarily strong; $1.1 billion for the second-quarter, more than double first-quarter orders, and representing a book-to-bill of 186%.

Growth was across the board. Floating production system components and subsea flexible pipe won some very large second-quarter orders, which we don't expect to repeat in the third quarter. But strong second-quarter frac and stimulation equipment demand appears to be continuing to build as we enter the third quarter.

Second quarter ending backlog for Completion & Production Solutions was a record $2.1 billion, up 31% from year-end 2013, and up 60% from year-end 2012. Jeremy will provide more color on markets and operations in just a moment.

As I mentioned earlier, NOV's second-quarter marked the successful spinout of Distribution NOW, which as of June 1st, is a stand-alone independent company trading under the symbol DNOW on the New York Stock Exchange.

Market reception to this exciting new company has been outstanding, owing to DNOW's leadership and growth plans, and we are pleased that the move has unlocked significant value for our shareholders. I'd like to thank the employees of both Companies for your hard work to help make this happen.

Our second-quarter results include two months of our distribution services business as a discontinued operation. Concurrent with the spinout, we reorganized our business into the four reporting sections I detailed earlier organized around customers.

In June, we released pro forma historical financial results going back five years by quarter on this new segment framework, to enable you to update your models and trend the data to better assess how we are performing. We are also disclosing depreciation and amortization expenses by segment to enable investors to compare our EBITDA margins to our peers.

I am pleased to congratulate the new operating heads of our segments on their new responsibilities. Joe Rovig is leading our rig systems and rig aftermarket segments. Mike Matta is heading our new Wellbore Technologies segment, and Kirk Shelton is leading the Completion & Production Solutions segment.

I'm grateful for the extraordinary team that we have in place. And I want to thank all of our hard-working employees and business leaders for continuing to support the critical needs of our customers through our busy second quarter.

Each new segment is presently engaged in a strategic review of its businesses, against a backdrop of the four major trends we see providing opportunity to our organization over the next several years. Namely, one, the buildout of the deep-water rig fleet, two, the buildout of infrastructure to support the development of deep-water oil and gas fields, three, the retooling of the worldwide jack-up fleet, and finally, four, the continued growth and proliferation of unconventional shale technologies worldwide.

I've explained many times before, how we see these shaping the global energy equation and NOV's fortunes for decades to come.

Our strategic goal is to determine how we will deploy resources to enhance NOV's competitive advantage, and financial returns within these trends. As we answer these questions this summer, we will be quantifying specific personnel facilities and capital needs to execute our strategic plans to grow organically, and to enhance our business through selective acquisitions.

On the topic of acquisitions, we have closed five small transactions so far this year for about $110 million in aggregate at less than 6 times trailing EBITDA, and less than 5 times current EBITDA run rates. We are pursuing a number of conversations around smaller transactions now, generally focused on finding excellent buys that fit our strategy, strengthen our franchises, and offer strong returns on capital employed.

This takes tremendous diligence. Even though we are almost always a strategic buyer, meaning that we have access to efficiencies and cost savings that financial buyers usually don't, we are nevertheless frequently outbid. Rather than chase expensive deals ever higher, we will sort through many potential targets to focus on rifle-shot singles and doubles with disciplined returns demanded of the acquisitions we execute.

NOV will also continue to focus on organic growth. Research and development and better technologies and products, tight management around costs, investments in more efficient production and operational excellence, expansion investments into new regions and aftermarket support, all of which will translate into more organic growth. Disciplined investment in both acquisition opportunities and organic growth opportunities will enhance our future financial performance.

Turning to our balance sheet and record of cash generation. We are also exploring other ways to enhance shareholder value, by optimizing our balance sheet and capital structure. Like many multi-nationals, we had challenges around repatriating cash from overseas and we are exploring ways to either put this excess capital to work or return it to shareholders.

We announced a 77% increase in our regular dividend during the second quarter and believe, as we reassess our organic growth capital needs through our strategic planning process, we can then turn to look at ways to return more capital to our shareholders. NOV has a strong record of cash generation, and reasonable expectations of strong future cash generation mean that we should have capacity to return more capital to shareholders in the future. Finally, we look forward to sharing our detailed strategic plans with investors in November.

With that, let me turn it over to our Chief Financial Officer to give you more color on the second-quarter operating results. Jeremy?

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

Thanks, Clay.

Before we begin on our discussion of the quarterly operating results, let me take a quick moment to explain the change that we have made to the calculation of our adjusted EPS. From this point forward, our adjusted EPS metric will exclude the impact of the amortization of purchased intangible assets as well as discontinued operations and non-recurring items, as we always have.

Going forward, we will be referring to these adjusted earnings-per-share results as operating non-GAAP earnings-per-share. Here's why we're doing it.

Since amortization expense of purchased intangible assets is a non-cash period expense, we believe that this supplemental adjustment will help investors to more clearly understand how NOV's earnings-per-share relate to our periodic cash flow per share. Purchased intangible assets arise from the allocation of the purchase price of acquisitions, in excess of the fair market value of working capital and fixed assets of acquired businesses.

Amortization of these differs from depreciation, another non-cash periodic charge, and that depreciation expense reflects consumption of hard assets which must eventually be replaced used to produce periodic results, whereas amortization of purchased intangibles reflects the initial startup costs of acquisition capital.

Obviously, we will continue to report GAAP earnings, and continue to provide a reconciliation between GAAP and our new operating non-GAAP earnings metric, which you can see on the last page of our Second-Quarter 2014 Earnings Release. We intend this to be a supplemental disclosure, not a replacement for GAAP earnings-per-share, but rather to provide the investing public additional insight into the periodic cash results of our operations on a per-share basis.

Now, let's discuss the quarterly results. Since Clay already thoroughly covered the consolidated results, I would just like to offer one comment before transitioning into the results of our new segments.

Given the additional time and energy associated with the spinoff of our distribution business, and the reorganization of our remaining businesses, delivering a quarter with 7% growth and 35% flow-through on a sequential basis and 12% growth and 30% flow- through on a year-over-year basis, is quite an accomplishment.

So, I would just like to say thank you to each member of the NOV family for your unwaivering commitment, your focus, and your hard work throughout this past quarter. Your efforts and contributions are noticed and appreciated. So thank you very much.

Now, let's turn to the operating results of our newly formed segments. The Rig Systems Segment generated revenues of $2.4 billion in the second quarter, up 5% sequentially, driven largely by a significant increase in land-related sales which, before eliminations, accounted for approximately 22% of segment revenues. That's up 18% -- from 18% in the first-quarter of 2014, and up from 15% in the second-quarter of 2013.

Compared to the second-quarter of 2013, Rig Systems revenues were up 14%. As, one, heightened demand for new high spec land rigs, primarily in the US, Latin America, and the Middle East resulted in incremental year-over-year sales in complete rigs, as well as critical components such as top drives, VOPs, and pipe handling equipment. And two, recent capacity additions have enabled us to convert 14% more revenue out of our backlog for both land and offshore projects.

Operating profit for the segment was $501 million, and operating margins were 21.1%, which represented a 110 basis-point improvement over the previous quarter, and a 220 basis-point improvement over the prior year. EBITDA for the segment was $523 million, or 22% of sales.

As we move into the third quarter, we believe that Rig Systems revenue should remain relatively flat, and that operating margins could remain in the 20% to 21% range. As we look at Rig Systems margins for the balance of the year and then throughout 2015, we see a number of puts and takes which could result in some modest margin expansion as we move through next year. On the plus side, the price increases that we pushed through in 2013 have resulted in improving margins in our Rig Systems backlog.

Additionally, in time, we believe that we will start to recognize some efficiency gains from the new capacity that we added last year. However, some of the benefit associated with price increases and operational efficiencies will be offset by a growing percentage of Brazil- and China-related work, which we expect to be challenging. Naturally, we will continue to aggressively pursue opportunities to improve our already industry-leading equipment margins, but we believe that margins for the Rig Systems segment in the second half of 2014 will look very similar to the margins that we delivered in the first half of the year.

Now, let's transition to the capital equipment orders for our Rig Systems segment. As Clay already stated, for the quarter, we booked four drillships, one semi, and two jack-ups as well as some other packages and discrete components, including lifting and handling equipment, jacking systems, bare VOP stacks, and other equipment upgrades.

In addition to the strong orders offshore, we continue to see heightened demand for complete new land rigs, as well as land equipment packages and components for the US, Latin America, and Middle East markets.

Of the $2.3 billion in new Rig Systems orders, 59% was driven by new build construction for jack-ups, semis, and drillships, while sales of land rigs, land rig components, and replacement upgrade components to support existing offshore rigs accounted for the 41% balance from new bookings.

This $2.3 billion of new orders in the quarter was mostly offset by revenues out of backlog of $2.1 billion, resulting in a book to bill of 1.1 times. And another record quarter-ending backlog of $15.4 billion for the segment. Of this total backlog, approximately 93% is offshore, and 94% is destined for international markets.

Looking into the third quarter of 2014, we believe that orders for new floaters will be limited. However, we could see solid orders for jack-ups, as a number of opportunities slipped from the second quarter.

We also believe that demand should remain strong for individual offshore components, as well as complete land rigs, land equipment packages, and individual land components. Overall, we expect a healthy quarter for orders. However, as we stated on the previous conference call, for the Rig Systems segment, we do not at this time expect to achieve a one-to-one book-to-bill in the third quarter.

The Rig Aftermarket segment posted revenues of $785 million in the second quarter of 2014, up 5% sequentially and up 17% over the second-quarter of 2013, as our large and growing installed base of equipment, combined with the investments that we've made in additional personnel, training, global warehousing and service infrastructure, and inventory have resulted in mid-teens percentage growth for the past few years.

Operating profit for the segment was $217 million for 27.6% of revenue, up 210 basis points sequentially, but down 60 basis points from the prior year due to slightly unfavorable mix. EBITDA for this segment was $224 million, or 28.5% of revenue.

As we move into the third quarter, we feel that aftermarket revenues could continue to improve in the low single-digit percentage range, maintaining that mid-teens percentage year-over-year growth trajectory. And, we believe that operating margins should continue to hold fairly steady in the third quarter, and for the foreseeable future.

However, I would like to take this opportunity to communicate that this business, due to product mix and the timing of service work and repairs, has a tendency to be somewhat lumpy. On an annual basis, I feel comfortable providing an outlook of mid-teens percent growth and fairly steady margins. However, there will undoubtedly be some swings from quarter-to-quarter, so please be prepared for some slight quarterly choppiness in the segment.

Despite these quarterly fluctuations, we are very excited about the exceptional growth profile and profitability of this segment of our business. And, we look forward to providing additional insight into this business in the coming quarters.

The Wellbore Technologies segment posted revenues of $1.4 billion, up 13% sequentially and up 18% for the second-quarter of last year. As previously stated, the Wellbore Technologies business is driven by activity. More rigs, drilling more wells and more footage require more solid control equipment, more fluids, more drill pipe, the inspection and coding of that drill pipe, more downhole drilling tools, more drill bits, and more rig monitoring and drilling optimization services.

As such, despite the seasonal decline in Canada, the continued strengthening of the US market coupled with the fact that our customers have clearly worked through the excess inventory that they carried into the first half of 2013, has led to outsized growth for this segment. On this $1.4 billion in revenue, the Wellbore Technologies segment generated $269 million in operating profit, or 18.6% of revenues which represented 110 basis-point improvement over the first quarter of 2014, or a 27% flow-through to leverage on the 13% increase in revenue.

On a year-over-year basis, operating margins improved 260 basis points, or a 33% flow-through to leverage on the 18% increase in revenue. EBITDA for this segment was 26.1%.

As you've undoubtedly noticed, this particular segment carries a fairly heavy load of depreciation and amortization expenses. Because one, the businesses in this segment have made significant investments in roofline and machinery to manufacture and service equipment and tools globally.

Two, three of these business have invested heavily in their respective rental fleets of downhole drilling tools, instrumentation tools, and solids control equipment, which account for a sizable percentage of their respective revenue streams. And three, we've made significant investments and game-changing acquisitions in this segment, including, but not limited to, Grant Prideco drillpipe, ReedHycalog drill bits, Robbins & Myers drilling motors, and Andergauge Downhole Technologies. All of which improved and expanded our product and service offering to our customers, and further strengthened our competitive position.

Looking into the third quarter of 2014, we believe that Wellbore Technologies' segment revenues could improve in the low to mid-single-digit percentage range if Canada comes out of breakup, and the US market continues to modestly improve, and our other key markets in aggregate remain relatively steady. And, while our actual results will always depend upon product, customer, and geographic mix, we believe on average that this segment should generate plus or minus 30% flow-through on each dollar of additional revenue.

The Completion & Production Solutions segment generated revenues of $1.1 billion, up 12% sequentially and up 7% year-over-year. On a sequential basis, the revenue growth was driven primarily by a strong delivery quarter out of our subsea businesses. And an improving market for our well intervention and stimulation equipment, including coil tubing units, coil tubing, pressure pumping equipment, well service pumps, fluid end expendables, and flowline.

On a year-over-year basis, substantial growth in both our floating production and subsea businesses, which were up 82% and 45% respectively, more than offset the year-over-year decline in sales for our stimulation equipment. Operating profit for the segment was $158 million or 14% of revenues, which was relatively flat with the first-quarter of 2014, and down 140 basis points from the second quarter of 2013.

As you probably surmised, the year-over-year decline was almost entirely attributable to product mix, with a lower percentage of higher margin stimulation equipment revenues, and a higher percentage of lower margin floating production and subsea revenues.

Of note, we're also continuing to incur high startup costs for our flexibles plant in Brazil, resulting in low leverage on higher sequential flexible pipe sales. But on that topic, we're pleased to report that we're nearing the finish line on this state-of-the-art facility, and hope to see improvements as we exit the year.

Second quarter EBITDA for the segment was 18.7%. While the delta between operating margins and EBITDA margins is not as pronounced as it is within the Wellbore Technologies segment, the Completion & Production Solutions segment also carries a fairly heavily D&A load, related to investments in roofline and machinery, as well as some fairly recent transformational acquisitions such as APL, NKT, Enerflow, and the pumps frac wellheads and frac manifolds from Robbins & Myers.

For the third quarter, we believe that revenues for our Completion & Production Solutions segment could improve in the mid- to high- single-digit percentage range, as we continue to see increasing demand for our well intervention and stimulation equipment as well as improved revenues for our floating production and subsea businesses. And for the quarter, depending on the overall mix, we could see a slight uptick in operating margins, as we benefit from increasing demand for our well stimulation equipment and associated consumables.

Now, let's transition to the capital equipment orders for our Completion & Production Solutions segment. During the quarter, the segment had very strong bookings of $1.1 billion, which was partially offset by almost $600 million in shipments out of backlog, resulting in a 1.8 times book-to-bill, and a quarter-ending record backlog of $2.1 billion for the segment.

Of the $1.1 billion in new orders, approximately 70% of the total was driven by production-related equipment, and 30% from our well intervention and stimulation equipment businesses. As we move into the third quarter, we believe that new orders for production equipment will slow substantially, owing to timing of projects.

But, that new orders for coil tubing units and pressure pumping equipment should strengthen, resulting in a book-to-bill for the Completion & Production Solutions segment that could approach if not exceed one-to-one.

While on the topic of backlog and book-to-bill, it's important to note that only 53% of the segment's second quarter revenue came out of backlog, as the remaining portion of this business is selling quick-turn spare parts and consumables to support and/or enhance the equipment that we sell from this segment.

Now that we've walked through the new segments, let's turn to the remaining elements of National Oilwell Varco's consolidated second-quarter 2014 income statement. Gross margin improved 130 basis points sequentially, and 150 basis points year-over-year to 27.7%. SG&A increased $38 million sequentially, and $54 million year-over-year; however, as a percentage of revenue, it has remained relatively flat at 9.7%.

Non-recurring items, primarily related to the spinoff of the distribution business, totaled $32 million in the quarter. Interest expense increased $1 million sequentially to $27 million, and interest income increased $1 million to $5 million.

Equity income in our Voest-Alpine JV was strong at $23 million, as the JV experienced across-the-board increases in sales of green tube, OCTG, and line pipe. But, as is typically the case, we do expect a significant decline in equity income in the third-quarter, as the plant will be shut down for two weeks for routine maintenance.

Other expense for the quarter was $21 million versus zero in the first quarter. A you may remember, in the first quarter, we benefited from favorable movements in currencies and we also recognized a gain on the sale of fixed assets. By contrast, in the second-quarter, we incurred losses related to foreign exchange, slight losses on the sale of fixed assets, as well as higher bank fees.

The effective tax rate for the second quarter was 31.8%, which was higher than the 30.4% rate that we posted in the first quarter of 2014, as we recognized a much higher percentage of US generated income in the quarter. Given our belief that the US will continue to be a source of growth in the third-quarter, we expect an effective tax rate of 32% -- 33% for the balance of the year.

And finally, if you turn to the last supplemental schedule, you'll see that depreciation and amortization was $190 million, down $1 million from the first quarter. And EBITDA, excluding transaction charges, was $1.1 billion or 21.1% of sales.

Turning to the balance sheet, I'd like to start by highlighting a few key points in the quarter. Number one, we continue to see the results of our focus on working capital. Number two, we continued to strategically deploy capital into our business through acquisitions that complement our existing businesses, and through infrastructure investments to improve efficiencies, to shorten lead times, improve customer service, and enhance competitive advantage. And three, we provided our shareholders with a much larger dividend.

Our June 30, 2014, balance sheet employed working capital, excluding cash, of $5.2 billion, down $1.2 billion sequentially. Accounts receivable decreased $883 million or 17% sequentially, with the reduction being driven by a combination of the DNOW spinoff and strong collections by NOV businesses where accounts receivable from continuing operations were down $130 million, despite a $366 million sequential increase in revenue.

We also continue to realize improvements in customer financing where milestone invoicing on major projects outpaced costs incurred by $50 million. Inventory decreased $461 million or 8%, with an $844 million reduction associated with the distribution spin, being partly offset by a $383 million build in our continuing operations to execute a record backlog and to support heightening demand for our products in the US market.

Capital spending in the quarter was $175 million, due to several significant ongoing operational expansion efforts. Dividend payments were $198 million, representing an $87 million sequential increase. The remaining uses of cash included tax payments of $572 million, cash interest payments of $45 million, acquisitions of $100 million, and $253 million in cash went with Distribution NOW.

As a result, the Company generated free cash flow, as defined as operating cash flow less capital expenditures, from continuing operations of $610 million, which was a 69% increase sequentially. We ended the quarter with a cash balance of $3.9 billion, and a net cash position of $737 million. Of the $3.9 billion in cash, only 7% of the balance was in the US at June 30th.

Now, let me turn it back to Clay.

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

Thank you, Jeremy.

So to sum it up, this morning, we are pleased to report strong double-digit earnings growth plus sequential and year-over-year for our second-quarter. Record backlogs for both Rig Systems and Completion & Production Solutions, with both posting book-to-bill's north of one in the quarter.

A 77% increase in our regular dividend during the quarter. Completion of a $3.5 billion spinout to our shareholders of an exciting new public company. A whole bunch of new granular disclosure, and our path forward to develop and communicate our strategic plans.

So with that, Shannon, I think we're ready to open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jeff Tillery from Tudor, Pickering, & Holt.

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

Hello, good morning guys. As you think about the M&A program, could you give us color around businesses that were acquired, things that are interesting, where you see the best opportunities?

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

Yes Jeff. Generally, as I noted in my opening comments, we have a lot of conversations underway. They're generally with smaller companies. And I think I mentioned, we've closed five transactions year-to-date that I think are indicative of what that population looks like.

I would say the flavor of these is continued investment in our aftermarket support of the growing installed base of rig equipment. And so, a couple of these have to do with that strategic thrust. e have a lot going on in our tubular services world, and have seen great organic growth and acquisition growth in our capability to repair tubulars around the globe, and we're continuing to invest in that.

But the overarching theme here is generally, I think we're seeing smaller transactions, and believe that those offer better purchase economics. The bigger these deals become, the more attention they attract, and when that happens generally the price goes up, the multiples go up, and our returns go down. Looking forward, we'd really like to put more focus on those smaller transactions, and benefit from the higher economics they can bring to our operation.

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

Great. And then second question I had was just around Rig Systems. Obviously, with the segment recasting some of the benchmarks you've had historically have moved. But as you think about the medium to longer term margin goals, is that still in the low- to mid- 20%s? Is that how you think about a normalized margins for the Rig Systems segment?

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

Yes, I think low 20%s is probably more accurate for normalized margins. As you'll remember, part of our margin enhancement story was around growth in certain product lines that were accretive to overall -- the old rig tech margins. Those have now moved into the aftermarket segment, and of course the Completion & Production Solutions segment. So, I think low 20%s normalized margins is probably appropriate.

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

Thank you very much.

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

Thanks, Jeff.

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

Thanks.

Operator

Jim Wicklund from Credit Suisse.

Jim Wicklund - *Credit Suisse - Analyst*

Good morning, guys. You mentioned challenges and going forward in Brazil and China, and I know the flex pipe plant in Brazil is a little behind schedule in getting flowing operational. Can you talk to us a little bit about Brazil? What to expect? What's going on? What should we see over the next 12 months or so in Brazil?

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

The good news, so far so good in Brazil, Jim. We're working on about a half a dozen rigs currently. The first should be delivered in September of next year.

And so, we're getting well into this build out for NOV 21 Deepwater floaters for that market. All of our customers though are pressing ahead, and so I would say so far so good. To put it in perspective, it's building in terms of its contribution quarter-by-quarter.

So in the second-quarter, we did about $180 million in revenue within Rig Systems associated with that effort. And the challenges that we were referring to stem from a couple things. One is, is that we won that work if you'll recall back in the 2009, 2010 time period when pricing was under pressure.

Jim Wicklund - *Credit Suisse - Analyst*

Not as good as is it today, yes.

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

So the margins are good, but they're not great. And so the intrinsic margins in the work is a little lower than the rest of our backlog.

Number two, it's Brazil. We've been networking Brazil for 30 plus years. It's very challenging from a regulatory standpoint, from local content requirement standpoint, from a tax standpoint, from a foreign currency standpoint. So we're just being realistic about the incremental margins that will continue to flow from Brazil, as we get deeper and deeper into the program. But again, operationally, so far so good.

And to round out the picture, we're very excited about the expansion that we've had underway in Brazil to support both that new construction. As well as all of the rigs that we have at work in Brazil, supporting those on an ongoing basis, from an aftermarket standpoint. So these are sort of dual-purpose facilities.

And I think the middle of next year were going to open our new Riser manufacturing plant. We've got other expansion initiatives going on around Brazil. And so, it will continue to be a very, very important market for us.

On China, the other part of the comment, we've seen a lot of our offshore rig building work shift into Chinese shipyards. Predominantly with jack ups, although there's a few semi's coming together in Chinese yards as well. And what we know from experience, and to be clear, we've worked closely with Chinese shipyards quite a bit in the past, but we know from experience that sometimes those projects can be a little more challenging.

But, we're not losing a lot of sleep over the China shift. It's just again being realistic. We know that sometimes it's a little more challenging in those yards, vis-a-vis, the yards in Korea or the yard in Singapore.

Jim Wicklund - *Credit Suisse - Analyst*

That's not bad for Brazil, considering everybody else's issues there. My follow-up, if I could, the Completion & Production. Coil tubing. You mentioned coil tubing a couple times, demand fro coil tubings picking up.

That has been one segment that has lagged from an operating point of view in the US. Is your pickup in demand in coil tubing primarily international, or are we seeing the demand pickup in the US as well?

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

Most of the incremental is US and North America really. A lot of demand for components going into larger diameter coil tubing, so a lot of the coil tubing demand is around 2-inch, 2 3/8-inch, 2 5/8-inch diameters. And so real trailers and injectors heads going in to modify and upgrade actually older coil tubing units is a trend we've seen lately. But generally, a lot of orders are on the upswing and a lot more optimism about that market.

The international market has remained steady, or it didn't fall off the same way North America did. And so, we're seeing some resumed demand overseas as well. But it never plummeted the way North America did back in 2012, 2013.

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

Yes, in early 2013, we saw slight drop in demand internationally as some of the US-based customers were shipping excess shipment overseas to fulfill need. But in the back half of 2013, we started see more orders for new coil tubing units going into the international market. And it has been pretty steady.

Jim Wicklund - *Credit Suisse - Analyst*

That's encouraging across the board. Thank you very much, gentlemen.

Operator

Kurt Hallead from RBC Capital Markets.

Kurt Hallead - *RBC Capital Markets - Analyst*

Good morning. I just wanted to follow up. You talked about the prospects of looking at varying dynamics to return additional cash to shareholders. And one of the bottlenecks in that process had been the fact that you have only 37% of your existing cash in the US. So in that context, I just wonder if you could provide us with maybe some insights on how you may be able to accomplish some of those goals in terms of returning more cash to shareholders, and how serious of a consideration doing a levered recap might be?

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

So first, it's 7% of our cash in the US. Did you say 37%?

Kurt Hallead - *RBC Capital Markets - Analyst*

Sorry. I must have misheard what you said on the call. Thanks for clarifying that.

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

Only 7%. So we are essentially dividending out our US cash flow. So we're already pushing the envelope in the US. So, yes, internally, we are looking at different ways to get cash back to the US in a tax efficient manner. It is challenging, but we're certainly doing that. And to your next question --

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

Yes we -- so $3.5 billion plus cash overseas, some of the things we're looking presently are ways to repatriate that, and to improve the ability to repatriate US cash generated overseas. Which would give us more flexibility around either share buyback, or upping the dividend with that cash we have on our balance sheet. Or alternatively, looking for really good solid acquisitions overseas, or probably a combination of both is what we're looking at, Kurt.

Kurt Hallead - *RBC Capital Markets - Analyst*

So, it's a levered recap not necessarily at the forefront of your thoughts?

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

Not in the near term. And partly, I think I detailed the fact that our new segments, the new segment leaders are going through a deep dive on strategic reviews and strategic plans on their businesses this Summer.

And so, first things first is to get the strategic -- and we're not expecting major departures, but let's get settled on the strategic plans going forward and the capital needs around those. And then I think that will then lead us into a conversation later this year around new opportunities to return capital to shareholders.

Kurt Hallead - *RBC Capital Markets - Analyst*

Okay great, thanks. And then my follow-up question is just on the Rig Systems second half outlook on the order book. We can make our own guesses and assumptions. As we have in the past, you provided some general directional guidance of being -- having book-to-bill being under one.

There's a big range of that. So are we talking about an absolute plummet in orders in the back half of the year? Or more of a I'd say more of a gradual decline?

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

Kurt, over the last two quarters, we've provided a little more granularity into our order intake, and really broken out what was from new build construction for jack ups and floaters versus everything else. I wouldn't call everything else at baseline, because that fluctuates each quarter as well.

But it will give you some indication as to what we think future orders could look like in that space. And then we also provided some guidance that we think jack ups could continue to be strong in Q3, and fairly steady in Q4. So probably, back into a number that way.

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

They're not going to zero. So there's a lot of things cooking out there. Land rigs demand is ascending, and that's -- it's a small piece now but it's growing and growing quickly. And as Jeremy mentioned, we've had a lot of jack ups that pushed from Q2 to Q3, and so the outlook for the back of the year for jack ups at least is pretty good.

And then I would add too, I touched on a number of specific floating rig opportunities that are continuing to work out there around 20,000 psi capabilities, around Arctic capabilities. And so even in the floater space, it's not going to zero. So I'm not sure we can be a lot more quantitative than that, but directionally, that's where the three main groups are going.

Kurt Hallead - *RBC Capital Markets - Analyst*

I think that helps clarify. And then if I may, just sneak one more point in on your guidance relating to the Wellbore Technology group. You had a significant increase in revenue sequentially, as indicated at 13%, even with the breakup in Canada. And now, suggesting a more moderate sequential increase into the third quarter, even with the Canadian rebound.

Just trying to help connect the dots there. Because it appears to us, that rig activity, well activity is on the rise in the US. You get a rebound in Canada. So, just not quite sure why the sequential increase would be say more than half of what it was in the second quarter.

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

I think there's a possibility for that, Kurt. But really what we've seen in this segment historically, and really thinking back to our PS&S businesses. When activity starts to pick up and customers work through their inventories they kind of start to buy in bulk and add some inventory so that they're not compromised if activity continues to grow.

So we think there was a little bit of that going on in the second-quarter. And don't know if that will continue in the third, or if they just kind of go to replenishing inventories as they consume it at that point in time.

Kurt Hallead - *RBC Capital Markets - Analyst*

That's great color. Perfect. Thanks, guys.

Operator

Bill Sanchez from Howard Weil.

Bill Sanchez - *Howard Weil Incorporated - Analyst*

Thanks. Good morning. Clay or Jeremy, I was hoping perhaps maybe you could give us an outlook on two things. One, I know this is the second-quarter and now you've discussed the expectation book-to-bill in Rig Systems going below one. I'm just curious if you had any thoughts on the duration of how long you might see book-to-bill stay below that target. I is guess my first question.

As my follow-up, I got to believe the revenue capacity or that revenue efficiency continues to increase. I know, Jeremy, you were able to give us an expectation on after market growth year-over-year. Is there any thought as we look at 2014 and maybe even next year, what type of top line growth we could perhaps expect out of Rig Systems?

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

The first question, Bill, with regards to the duration of this downturn. We're not sure. We believed -- it's not a one quarter dip. We've got at least a few quarters, and it could extend beyond that overall.

Long-term, our outlook is still very, very bright. There's an awful lot of development drilling and expiration drilling that still needs to go on, and deep water basins that require floating rigs. So we think the fundamental demand is there, but a lot of capacity flowing into the market last year, this year, next year is giving rise to this.

I mentioned some of the special-purpose rigs that we're looking at. Another interesting set of conversations. We've go a couple of folks looking at 2017, 2018 not seeing any floater deliveries scheduled outside of Brazil. I'm thinking there may be opportunities to introduce -- to go ahead and sign up for new builds to try to hit that point in the market when very few new rigs are coming in. And so there's lots of conversations that are underway. So, our expectation is we're headed for a cyclical soft patch here. I'm not sure I have a lot of insight to offer around how long that may last. With regards to -- I'm sorry, your second question was top line growth for which segments?

Bill Sanchez - *Howard Weil Incorporated - Analyst*

For Rig Systems around capacity.

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

That, we had a lot of visibility into is with $15.4 billion of firm orders. And you do the math, that means we've got a couple of years of work ahead of us with rising prospects for land rigs. And so far, continued demand for jack ups as well for at least the next couple of quarters.

And so, I'm not prepared at this point to give you a number year-to-year, 2014 to 2015, what that might look like, but certainly orders will not be a negating item. As you correctly point out, we've been adding a lot of capacity throughout our infrastructure to deal with the record backlogs, a lot of challenges in the supply chain to deal with these record backlogs. And so, a lot of continued capacity coming online to handle this work.

To connect the dots there though, if the downturn in floater demand does stay down for a while, we're not overly concerned because we foresee a big pickup in special periodic surveys. Particularly as we move into 2017, and I think this is something I referenced in my comments as well. Every five years, all floating rigs need to come back to the shipyard for hull inspections and for drilling equipment to be inspected and recertified and get new certificates of compliance.

And when we look at the demographics of the birth years of the growing offshore fleet, what we see is that they're all starting to stack up in 2017 and 2018. So there's going to be a lot of work for us to do, even if it's not necessarily building as many new deep-water floaters as we have in the past.

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

And specifically to your question, Bill, in terms of revenue conversion out of backlog. We had the big capacity -- the major capacity additions in 2012 an early 2013. We're now getting comfortable with those additions, and if you'll look, we've been running at between $2 billion and $2.2 billion in revenue out of backlog for the last couple of few. And I think that's probably a reasonable proxy for the future.

Bill Sanchez - *Howard Weil Incorporated - Analyst*

That's helpful, Jeremy. Just to quantify that, I appreciate it. If I could ask just one more, with regard to the amortization of the intangible assets. As we look through the press release, I was just trying to basically identify that back to a specific segment or segments, Jeremy. Is that concentrated in one particular area as we try to reconcile what maybe the --

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

It really shows up if you look at the difference between EBIT margins, EBITDA margins, you can see the disconnect really. And it's really in Wellbore Technologies primarily, but also in Completion & Production Solutions.

Bill Sanchez - *Howard Weil Incorporated - Analyst*

Okay.

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

A little bit in Rig.

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

But not as pronounced as it is in those two segments.

Bill Sanchez - *Howard Weil Incorporated - Analyst*

But as we look at the restated numbers, if apple -- at least the first quarter comparison, that's an apples-to-apples comparison as we think about the 2Q?

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

Correct.

Bill Sanchez - *Howard Weil Incorporated - Analyst*

Okay, great. Thank you all for the --

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

By the way, on that topic, we're going to continue to breakout -- it'll be running at about $0.14 a share. That's what it's -- I think we've got ten quarters going back historically on our [pare] sheet. So you can see it's $0.13, $0.14, $0.15 a share every quarter. So it's a pretty level load, and we will be disclosing that separately from our non-recurring transaction charges.

Bill Sanchez - *Howard Weil Incorporated - Analyst*

Great. I appreciate the time. I'll turn it back.

Operator

Waqar Syed from Goldman Sachs.

Waqar Syed - *Goldman Sachs - Analyst*

Thank you for taking my question. In terms of the five-year surveys, we've seen some offshore drillers defer or even cancel their five-year service waiting for better visibility in the market. Are you seeing that in your discussions with the offshore drillers? And how does that factor into your guidance on the aftermarket business for the coming years?

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

Waqar, I think they maybe defer that, but they need to do it before they go back to work. Because it's a statutory -- I think regulatory requirement. It's been required for decades, and it is the practice across the industry that every five years these come in.

We've been in the industry dialogue about how to make that more efficient. Because right now, we've been on a run rate of about 40 rigs a year going into the shipyards. And as I mentioned earlier, see that going up to 130 in 2017, and that's just based on NOV delivered kit.

And we're going to have to do something different to accommodate that. That's a tremendous amount of work. So we're exploring with the industry ideas to make that more efficient.

We've also reorganized internally to bring some of our project management expertise within Rig Systems to bear on these projects. The planning for these is critical. As you can imagine, taking a rig off day rate and putting in a shipyard to it accommodate the periodic survey has a high opportunity cost, because it's off day rate. So our customers want to get as much done all they can while that rig is in the shipyard.

And that can be made much more efficient and minimize opportunity cost if a lot of very tight planning goes into that project well in advance, and as long as we can get out to the rigs and survey that equipment. And so, our plan is to try to work with the industry to develop a better way that's more efficient, and enables them to get their rigs through and minimize opportunity costs associated with that requirement.

Waqar Syed - *Goldman Sachs - Analyst*

So just to understand, in your forecast, are you assuming any major regular time or so the older rates? Or you feel that every single rig that's due for its five-year service gets that done?

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

Well if rigs are not on contract at the time, I suppose they may be able to defer. I don't know that for sure. But nevertheless, there's a lot of new iron out there required by the Coast Guard to come in. So I think that's a fairly safe bet.

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

The other thing to point out too, is that we are in conversations with these customer a year in advance of their STF surveys. So we know if and when they're coming in, and what kind of upgrades they're going to require. So this is part of that challenge and streamlining this process that Clay was talking about. So, we know what's coming in.

Waqar Syed - *Goldman Sachs - Analyst*

Great. Now just one last on the Chinese shipyards regarding jack ups. Are you -- there is also a view that's being floated around by the offshore drillers, saying that many of the rigs that are being built the jack ups being built in Chinese shipyards may not actually get built. Are you hearing any cancellations there, or any concern on the part of the shipyards that the rigs may not get built?

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

No. I think what you're referring to, the Chinese generally were offering very attractive terms. For instance, 10% down, 90% at delivery. So the China is financing the build out of these rigs, and whether or not they're customer shows up and makes the final payment or not, we've got very strong contracts with our customers there.

So we're not concerned about this. We went through a massive downturn economically in 2009, and had a very small I think to 2% or 3%, 4% of our backlog where customers defaulted and the projects went away. So I think we've demonstrated before our contracts are pretty solid, and our expectation is that our customers in China are going to see those projects through.

And in many of these too, also they're not necessarily contracted now, you've got Pemex talking about picking up a dozen rigs next year, and another 20 or 30 a few years after that. A lot of interest out of the far east, out of India, so there's a lot of jackup interest out there. And then the final thing is, if you look at demographics of the jackup rig fleet, what you're seeing here is retooling rejuvenating that fleet in earnest, and that's the fundamental driver for demand for these rigs.

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

And to be clear, we're not offering that financing to our shipyard customers. In fact, we're getting paid as we go. So we stay cash positive, cash neutral at worst on these projects.

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

Yes, thank you, Jeremy. Important point.

Waqar Syed - *Goldman Sachs - Analyst*

Well thank you very much. Thanks, guys.

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

Well that wraps up our call. We appreciate everyone joining us, and look forward to speaking to you next quarter. Thanks very much.

Operator

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