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NOV - Q3 2013 National Oilwell Varco Earnings Conference Call

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OVERVIEW:

Co. reported 3Q13 revenues of $5.7b and fully diluted EPS of $1.49. 3Q13 net income, excluding certain items, was $573m or $1.34 per fully diluted share.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Welcome to the third-quarter financial results earnings call. My name is Paulette and I will be your operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session. Please note that this conference is being recorded. I will now turn the call over to Loren Singletary, Vice President of Investor and Industry Relations. Please go ahead.

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

Thank you, Paulette and welcome, everyone to the National Oilwell Varco third-quarter earnings conference call. Joining me today is Pete Miller, Chairman and Chief Executive Officer; Clay Williams, President and Chief Operating Officer; and Jeremy Thigpen, Senior Vice President and Chief Financial Officer.

Before we begin this discussion of National Oilwell Varco's financial results for its third quarter ended September 30, 2013, please note that some of the statements we make during this call may contain forecasts, projections, and estimates, including but not limited comments about our outlook for the Company's business. These are forward-looking statements within the meaning of the Federal Securities Laws based on limited information as of today, which is subject to change. They are subject to risk and uncertainties and actual results may differ materially. No one should assume that these forward-looking statements remain valid later in the quarter or later in the year.

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

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

Thank you, Loren and good morning, everyone. Earlier today National Oilwell Varco announced third-quarter 2013 earnings of $1.49 per share on revenues of $5.7 billion. Included in this number were pretax transaction charges of $10 million and a pretax gain of $102 million from a litigation settlement. Netting these out provided a net income of $573 million or $1.34 per fully diluted share. Jeremy will provide more color on these results later in the call.

Additionally, we reported new capital equipment orders for the quarter of $3.31 billion, resulting in a quarter ending record capital equipment backlog of $15.15 billion. This reflects a continued preference for the industry-leading high-technology products provided by National Oilwell Varco. New orders for the year have surpassed $9.5 billion. I would like to thank all of our employees worldwide for their continued dedication to excellence as we serve the oil and gas industry. I will come back later in the call to add some color on our operations but at this time we'll turn the call over to Clay.

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

Thank you, Pete and good morning. We've long discussed four big trends that we expect to continue to shape National Oilwell Varco's destiny over the next decade. One, the build-out of a fleet of floating drilling rigs to explore and develop deepwater frontiers, opened by technology developments of the past 20 years. Two, the blossoming of floating production systems, which we expect to produce most deepwater discoveries. Three, the replacement of old jackup rigs with better safer new jackup rigs. And four, the steady progression of unconventional shale technologies into new onshore plays overseas, which will continue to drive steady retooling of land rigs and spur demand for other oilfield technologies.

This morning I'd like to update you on what we see within each of these four, how they drove our third-quarter results and how they are shaping our strategies. Demand for floating rigs has remained high, underpinned by, we believe, strong driller economics on these investments, good day rates, low-cost rigs, quick delivery, and available financing. We sold another 6 deepwater drilling packages into new build projects during the third quarter, bringing our total for the year to 22.

Strong floater demand contributed to Rig Technology's third-quarter capital equipment orders of $3.3 billion, our second-highest level ever. Our year-to-date orders totaled $9.5 billion through three quarters. And we're not done.

We expect fourth-quarter orders to be good maybe great, but down a little from Q3's grand performance. There are many new potential projects under discussion but we know the holidays may interfere with contract signings and sometimes we just run out of calendar. Nevertheless, Q4 is off to a solid start and should wrap up an extraordinary year for orders.

We recognize offshore rig orders are cyclical, exhibiting periods of diminished demand from time to time, but we expect deepwater orders to remain good more years than not for the next several. The reason for this is that we see the opening of deepwater provinces by new technology as presenting an unprecedented opportunity to the oil and gas industry, one that requires the unique sophisticated drilling tools National Oilwell Varco and our shipyard partners provide. The engine driving this demand, the possibility of monetizing billions of barrels of oil beneath the world's deepest oceans, is powerful. Technology has literally opened up two-thirds of the planet to oil and gas exploration, which requires a substantial fleet of floating drilling rigs.

This leads me to the second major trend. Once oil companies discover deepwater hydrocarbons they will produce these, and we believe floating production systems will emerge as a preferred method in most deepwater basins. Over the past few years we've invested in unique products required for floating production systems, including flexible risers, turret mooring systems, specialized deck machinery, pumps, sand handling and production equipment, and composite piping solutions. Category-leading products, superb project management skills, and close shipyard relationships position NOV extraordinarily well to emerge as a preferred supplier of floating production solutions.

FPSO construction projects have historically had a pretty bad record. Most, in fact nearly all, are late and over budget. Our strategy is to bring configurable designs and modern manufacturing techniques to this industry, analogous to what we have done successfully in the drilling rig construction world. We're making steady progress.

Many projects began to translate into orders this year. In fact, our APL turret mooring business expects to post record orders this year. Project margins are rising modestly as we work to standardize component designs to reduce engineering and commercial risk.

Additionally, we will mark the start up of our new Flexibles plant in Brazil this quarter, which will lead our NKT Flexibles business to new records in the future. While it will take time to develop, we believe that FPSOs will create the next major growth leg for National Oilwell Varco.

The third trend affecting National Oilwell Varco, jackup rig demand, has been white-hot lately, as operators seek to replace aging fleets, 54% of the marketed jackup fleet is more than 30 years old, and as NOCs in Mexico, Saudi Arabia, and elsewhere seek to ramp shallow water production to offset onshore production declines. In the third quarter we sold 13 jackup packages, bringing our total so far this year to 42 jackups. We expect the fourth-quarter demand will remain very strong as well to complete a truly brilliant year for jackup demand. Generally we see strong demand looking to establish yards in Singapore, but Chinese yards are pursuing projects aggressively, including offering attractive financing, and entrepreneurs are signing up with them.

The fourth major trend driving our fortunes at National Oilwell Varco is the proliferation of technologies enabling unconventional shale production. Shale technologies, or more accurately, unconventional technologies because these are techniques being applied to enhanced production from all sorts of rocks, are positive for virtually everything NOV does and sells. Profitable unconventional developments require new modern rigs capable of drilling horizontally.

Specialized premium drill pipe, which must be coded and carefully inspected, mud motors and bits are all needed to drill horizontally. Frac fleets, flowline equipment, frac heads, coiled tubing, and coiled tubing units are all needed to hydraulically stimulate unconventional reservoirs. Composite tubing and coated and thoroughly inspected OCTG is required to transport and produce fluids, drill cuttings, and water and waste management technologies are applied to minimize environmental impact. NOV is the leading provider of almost all of the major hardware and technology required for unconventional shale success.

And as we survey our products and services in this realm, we see two unconventional production markets at different stages of evolution. First, North America, the birthplace of unconventional shale technologies, appears to be evolving most rapidly towards a more industrial efficiency-based approach. Rig productivity and well cost management are top of mind for E&P customers, and while much that NOV does enhances and enables such efficiencies, this isn't 100% good news for us or our oilfield service peers. By that I mean the E&P customers are focusing on supply chain management, reprice, for their drilling programs.

A few years ago, dozens of speculative shale plays were being probed. Today these are coalescing down to a handful of the most profitable. So even a flat rig count environment the most active basins steadily become more competitive as oilfield service companies reposition their assets and buy their way into the game in this handful through discounting, and the least active basins become more competitive as companies get desperate and discount to win dwindling work.

The winning strategy in this knife fight must therefore focus on adding value, i.e., reducing well costs, increasing productivity, enhancing efficiency. NOV seeks to provide differentiated products and services that do just that, and our unique positioning enables us to drive value for our customers throughout the oilfield food chain. Much that we make is consumed at a steady rate by rigs and frac fleets operating 24/7 near redline RPM's in these plays.

Our outlook for North America in 2014 is cautiously positive given the strong oil driven wellhead cash flows to E&P companies, and the relatively low re-investment rates of the past year. If oil remains near $100, we believe we'll see more spending in 2014 and NOV is well-positioned to enjoy an activity uptick in North America. This thesis should be helped by a large inventory of drill sites across North America with minimal geologic risk and steadily rising takeaway capacity which tends to enhance producer cash flow at the wellhead.

The second major shale market encompasses basically the rest of the world, outside North America. Here is where infrastructure is less developed. We view this market as considerably less evolved with tremendous potential and work to be done that will likely span a generation. It is not coincidental that the shale revolution was born on the continent with two-thirds of the world's working rigs and the highest level of geologic understanding.

Shale plays, unconventional plays are by definition marginally economic, requiring established efficient oil services infrastructure capable of birthing a well, the cost of which is marginally exceeded by the value of the hydrocarbons produced from it, at some reasonable expected commodity price.

Carrying the unconventional shale style of play built on finely tuned well construction costs into regions with less developed oilfield infrastructure, we'll predictably encounter headwinds and delays, after all it took the industry here in Texas a couple of decades to figure it out. I would submit that one of the most interesting economic opportunities in this scenario would be for a company that actually builds out oilfield services infrastructure, a company like NOV.

Hunger for infrastructure for new modern rigs and drill pipe and downhole tools helped fuel our third-quarter orders and results. Land rig sales jumped with more than two dozen sold in the quarter, almost all overseas and most going into more sophisticated horizontal drilling applications, employing unconventional techniques. In particular we saw strong demand from Latin America where Mexico is seeking to add new modern land rigs and where Argentina has lifted duties on rig imports for the next several months. The Middle East, Russia, and the Far East also saw strong demand for land rigs.

Our overseas expansion projects continued to strengthen our capabilities as we make strategic investments in manufacturing and service infrastructure and promising international markets. NOV is uniquely positioned to provide the tools required to bring the shale revolution to these new areas, an opportunity that we remain extremely excited about. The evolution of the vast international shale market will shape NOV's fortunes for decades.

Last quarter we talked about some of the delivery challenges we face in our Rig Technology segment. We are making good progress against these and saw margins improve slightly, but we continue to wrestle with very high volumes moving through our system and with record levels of installation and commissioning activity in shipyards. Strong orders continue to load up our manufacturing plants, filling up the capacity we've been adding aggressively, which requires we continue to outsource more and to spend a little more than we'd like to expedite equipment. As a consequence we foresee challenges continuing but expect steady progress quarter by quarter.

We've also made progress on pricing and commercial terms on new projects flowing into the backlog, although it will be a while before consolidated segment margins reflect this. Notably, we continue to face a very soft market for pressure pumping equipment in North America, and rising FPSO product sales are somewhat dilutive to the segment's EBIT margin. Reviewing our progress I am again reminded of how very fortunate we are to have such talented professionals at work executing our business.

Our Rig Technology segment by itself will generate over $11 billion in revenues this year at EBIT margins north of 20%. This is nearly double the size of all of NOV when we first emerged in 2005 and would rank midway through last year's Fortune 500 list, with far better than average profitability of most public companies. This accomplishment would not be possible without an extraordinarily talented team, and we are grateful for the tremendous results that they and all NOV employees produce; many, many thanks to all of you. Now I'm going to turn it over to Jeremy for a more detailed review of the third quarter.

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

Thanks, Clay. National Oilwell Varco generated earnings of $1.49 per fully diluted share in its third quarter 2013 on $5.7 billion in revenues. Excluding $10 million in pretax transaction charges and $102 million in pretax gains resulting from the settlement of an outstanding legal claim, third-quarter 2013 earnings were $1.34 per fully diluted share, up $0.01 per share from the second quarter 2013, and down $0.18 per share or 12% from the third quarter of 2012.

Sales of $5.7 billion improved 2% sequentially, largely driven by resumption of activity in Canada post-breakup, and grew 7% year-over-year, despite a 3% year-over-year reduction in the number of drilling rigs worldwide. Excluding transaction charges from all periods and the gains resulting from the outstanding legal claim in the third quarter of 2013, operating profit for the quarter was $853 million, up 3% sequentially and down 10% from the third quarter of last year. Operating margins on this basis were 15% for the third quarter 2013, compared to 14.7% for the second quarter of 2013 and 17.8% for the third quarter of last year. Sequentially, operating profit flow-through or leverage was 31%.

Now let's turn to our segment operating results. The Rig Technology segment generated revenues of $2.8 billion in the third quarter, flat sequentially and up 12% compared to the third quarter of 2012. Operating profit for the segment was $606 million and operating margins were 21.3%, up 60 basis points from the prior quarter.

On the Q2 conference call, we expected Rig Tech revenues to decrease in a low single-digit percentage range as continued declines in the sale of intervention and stimulation equipment, and somewhat lower project revenues, would more than offset continued growth in our aftermarket business. While as expected revenues for intervention and simulation equipment declined an additional 13% sequentially. However, our Q3 Rig Tech revenues were slightly improved from Q2 as revenues out of backlog, which were flat at $2.1 billion, and individual component sales, both outperformed our expectations.

And albeit at a slightly slower pace, which was simply a function of timing, our aftermarket business continued to grow to a new quarterly record of $627 million, which represented 22% of total Rig Tech revenues in the quarter. Needless to say we're excited by the fact that our aftermarket business continues to grow, both in total dollars and as a percentage of our total Rig Tech revenues.

Turning to Rig Tech margins, we were pleased to see the 60 basis points sequential uplift as we successfully avoided some but not all of the cost overruns that impacted us in Q1 and Q2. Still, we continue to face the same three challenges that we detailed in the Q2 conference call, including one, the stress on our supply chain; two, product mix with continuing declines in our North American land related businesses; and three, the incremental expense associated with numerous strategic growth initiatives and capacity expansions. However, with each passing quarter we've become increasingly more confident that we're taking the appropriate steps in each area to further expand our already industry-leading margins.

From a supply-chain standpoint everyone is working hard to bring our new manufacturing capacity online, which will ultimately lead to operational efficiencies. However, it's important to remember that we are continuing to secure orders at a very rapid pace. As Clay mentioned this year alone we have already secured 22 floaters and 42 jackups.

It's also important to remember that the lead time for jackups is 6 to 8 months shorter than the lead time for floaters, which applies additional pressure on our plants. Still with our new capacity and our skilled and dedicated team of employees, we have complete confidence that we are up for the challenge.

From a product mix standpoint we do not expect to see any near-term meaningful orders for new frac spreads, coiled tubing units, or land rigs in the North American market. But we know that our customers are utilizing and therefore consuming their existing equipment, and will ultimately need to return to us for repairs or to order complete replacements.

From an expense standpoint, many of our large strategic growth initiatives and capacity expansions are nearing completion, which will help to alleviate some of our recent margin pressures. But we still have some large projects that have yet to conclude, including the new flexible pipe manufacturing facility in Brazil, a new riser manufacturing facility in Brazil, and a new rig building facility in Russia that will all carry over into 2014. Additionally, we will likely add to our footprint in the Kingdom of Saudi Arabia, as the outlook for that market remains very positive and local content requirements are ever-increasing.

And while not previously referenced as one of our three challenges to expanding margins, the new contractual terms that we implemented in Q2 for our offshore equipment, components, and packages will over time help us to expand margins as revenues from this new higher-priced backlog begin to start flowing out later next year. Overall we are clearly moving in the right direction but it will take some time to return our margins to the 24% level that we've established as our target for this segment.

Now let's transition to the Q3 capital equipment orders and our resulting backlog. As evidenced by the $3.3 billion in new orders, industry demand for floaters and jackups remains very strong. And our customers continue to recognize National Oilwell Varco for our industry-leading technology, our proven track record of delivering projects on time, and our unmatched abilities to support our equipment globally.

For the quarter we booked 5 drillships, 1 semi, and 13 jackups. Of the 6 floaters that we booked in Q3, we secured the subsea BOP stacks on 4, plus 2 spare stacks, and of the 13 total jackups that we booked in Q3, we secured 5 of the stacks. In addition to the strong orders offshore, we were awarded a number of international land rig packages, both drilling and workover, destined for Mexico, Argentina, the UAE, Indonesia, and Australia.

Rounding out the order intake story, we secured a number of sizable orders for our NKT products, including flowline and riser, reconfirming our belief that we're still on pace to book roughly $1 billion in Flexibles and new floating production equipment for the year. All of these new orders were partly offset by revenues out of backlog of almost $2.1 billion, resulting in a book-to-bill of almost 1.6 times, and another record quarter ending backlog of $15.2 billion, which was up 9% from Q2 which by the way was the previous record, and up 30% year-over-year. Of the total backlog approximately 92% is offshore and 94% is destined for international markets. We expect a little over $2 billion to flow out of backlog in Q4.

Looking into the fourth quarter of 2013 we expect orders for new offshore drilling equipment packages and floating production equipment to remain strong and we hope to see continued demand for new land drilling rigs in Latin America and the Middle East and perhaps some workover rigs in Russia.

While we do not yet know if we will see a fourth consecutive quarter of new orders above $3 billion, we have enjoyed a very strong start to the quarter, and we're in the middle of some very encouraging and constructive discussions that could soon materialize into new orders. However, as you all well know timing is everything. If we do not receive the signed contract and the down payment by December 31 we will not book it in this quarter.

As of now we're planning for Rig Technology revenues to increase in the mid-single-digit percentage range, as continued declines in the sale of intervention and stimulation equipment will be more than offset by an increase in land related revenue associated with our Q3 bookings, higher offshore project related revenues as we help the shipyards to get back on schedule and continued growth in our aftermarket business. And although we realized some slight improvements in Q3, we remain cautious about Q4 margins, sticking to our previous guidance of 20% to 21%, as Q4 is expected to be the busiest quarter for installation and commissioning work in the history of NOV.

Transitioning to Petroleum Services and Supplies, this segment posted revenues of $1.8 billion, up 3% sequentially and up 5% year-over-year. Operating profit improved 7% sequentially to $324 million, and operating margins were 17.9%, up 50 basis points from the second quarter of 2013. On the Q2 call we guided for revenues in this segment to improve in the low- to mid-single-digit percentage range, primarily driven by increasing activity in Canada as it rebounded from breakup.

We also forecasted margins to remain relatively flat as many of our groups were or are still actively integrating acquisitions that were consummated late last year or earlier this year. Well as it turned out our revenue guidance was spot on, however, the source of revenue was somewhat surprising. As expected Canada was the primary driver of the improvement, but we were pleased to finally experience some growth in the US market, which posted an 8% sequential gain. From a margin perspective, the quarter played out a little better than expected as well, with 33% leverage or flow-through on the 3% sequential increase in revenue.

As we enter the fourth quarter of 2013 we believe Petroleum Services and Supplies segment sales will improve in the low- to mid-single-digit percentage range, as Canadian drilling activity reaches its seasonal highs, and we benefit from some end of year project sales into international markets. We believe that growth in these regions will be partially offset by a US market that typically slows during the holiday season. Still since we've right sized our businesses in this segment, we expect margins to move modestly higher on the incremental revenue.

The Distribution and Transmission segment posted revenues of $1.3 billion, up almost 4% sequentially and up 2% compared to Q3 of last year. Operating profit dollars improved 10% sequentially to $78 million and were flat as compared to Q3 of 2012, and operating margins improved 30 basis points from Q2 to 5.8%.

Like PS&S, we forecasted revenue within the Distribution and Transmission segment to improve in the low- to mid-single-digit percentage range, again primarily driven by increasing activity in Canada. This occurred as expected; however, we were very pleased to see continued growth in our international operations, which posted a 13% sequential improvement on top of the 9% gain that we posted from Q1 to Q2.

We also suggested that segment margins would likely remain fairly flat; however, the incremental volume helped margins to expand in Q3 to 5.8%. Looking into the fourth quarter of 2013, we expect Distribution and Transmission group revenues to decline in the low-single-digit percentage range, as increasing activity in Canada will be more than offset by reductions in the US, where the holiday season will result in fewer billing days in the quarter. As a result of the slightly lower revenues, we will likely experience some margin erosion as well in Q4.

On the topic of Distribution, I'd like to briefly cover two important and exciting topics. First, the integration of Wilson and CE Franklin is progressing exceptionally well, with facility consolidations and ERP implementations proceeding as planned. Second, on September 24, we announced the Company's Board of Directors had authorized Management to explore a plan to spinoff NOV's Distribution business from the remainder of the Company, creating two standalone publicly traded corporations. As Pete mentioned in the press release we believe the Company's Distribution business now has the size and scale to operate as a standalone world class distribution company.

And as a stand-alone entity we believe the Distribution will be better positioned for future growth because one, it can more aggressively pursue opportunities outside of the upstream oil and gas space; two, it will not be competing for capital with higher-margin, higher return businesses within NOV; and three, the separation will remove any conflicts that currently exist between Distribution and NOV's manufacturing competitors -- which will open up opportunities to sell products to NOV's competitors and to market those competitors products through its distribution network.

In addition to being a great opportunity for the Distribution business, we also believe that the proposed spin will help to highlight the remaining portion of NOV as a technology and manufacturing Company that is focused on designing, manufacturing, delivering, and then inspecting, servicing, and supporting the most advanced, robust, and reliable equipment in the industry. Needless to say we're excited by the opportunities for both businesses. If approved we would expect to close the transaction in the second quarter of 2014.

Now let's turn to National Oilwell Varco's consolidated third-quarter 2013 income statement. Gross margins improved 20 basis points sequentially to 23.8%, SG&A increased $8 million sequentially, but as a percentage of revenue SG&A remained unchanged from Q2 at 8.8%. Transaction costs primarily related to the Robbins and Myers acquisition totaled $10 million in the quarter, which were more than offset by $102 million gain associated with the settlement of some outstanding litigation.

Interest expense in the quarter declined $4 million sequentially to $26 million, largely attributable to the launching of our commercial paper program. Due to our strong financial condition, a favorable market outlook, our leading market position, and a track record of solid execution, we were able to secure top ratings for both Moody's and Standard and Poor's, which enabled us to meaningfully reduce our already low borrowing costs through the conversion of existing bank debt to commercial paper.

Equity income in our Voest-Alpine JV was $13 million, down $2 million sequentially as the plant was temporarily shut down for its annually scheduled maintenance. We expect equity income for the JV to decline even further in Q4 as demand for drill pipe, and therefore green tube, in the US will continue to be somewhat muted. Other expense for the quarter was $15 million, which represented a $28 million delta sequentially, but is more consistent with historical trends.

The effective tax rate for the second quarter was 30.8% which was just slightly lower than Q2. Unallocated expenses and eliminations on our supplemental segment schedule was $155 million in the third quarter, that's up $19 million sequentially on higher volumes of inter-segment business. Depreciation and amortization was $191 million, up $1 million from the second quarter, and EBITDA excluding transaction charges and the gain from the legal settlement was $1 billion or 18.4% of sales.

Turning to the balance sheet, National Oilwell Varco's September 30, 2013 balance sheet employed working capital excluding cash and debt of $7.2 billion, that's down $78 million from the second quarter as we for the second consecutive quarter realized a slight sequential reduction in inventory. As importantly, we also experienced a turnaround in customer financing, which improved by $378 million sequentially as prepayments and milestone invoicing on major projects outpaced costs incurred.

Current and long-term debt net of cash was $1 billion at the end of quarter versus $1.8 billion at the end of the second quarter, with $3.7 billion in debt offset by $2.7 billion in cash. Of the $2.7 billion in cash only 11% of the balance was in the US at September 30.

Cash flow from operations was $1 billion for the third quarter, which was an all-time quarterly record, surpassing the old record of $912 million, which was in Q2 of 2011. During the quarter we paid down debt by $371 million, made cash tax payments of $218 million, made dividend payments totaling $111 million, and we spent $164 million in CapEx, bringing our year-to-date CapEx spending to $484 million. We expect CapEx spending to increase slightly in Q4 to finish the year just under $700 million in total. Now let me turn it back to Pete.

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

Thanks, Jeremy. And I think both Clay and Jeremy have really given you a very comprehensive overview of both our financials and our operational situation, so I'm just going to make a couple of real brief comments.

First, as you take a look at catalysts that I think are going to project out over the next two or three years, I'd keep my eye on a couple of international plays. I think number one will be Russia. I think the Russians are going to be very aggressively doing things the next few years. We have felt that way for a long time and the consequence of that is that we started building a plant over in Russia, and we're going to be prepared to be able to really take advantage of that as we move into the latter half of 2014 and the early part of 2015.

I think another area that's going to be very exciting and certainly should keep your eye on will be Mexico. You've had the change of laws down there. I think as we move into the rest of the year you'll have a constitutional amendment hopefully, and then you'll have the laws that will come out in the first quarter. I think that's going to really open up a tremendous area for a lot of the service companies, and in particular, National Oilwell Varco. So those are two areas I'd keep my eye on.

Third one for us and Clay mentioned it in his comments is China. I think as you take a look at China and especially at the aggressiveness of the shipyards over there, we are uniquely positioned to be able to take advantage of that and to help those shipyards and add the legitimacy that they need to be able to go out and increase the business. So I think that's going to be a very positive catalyst for us as we continue to move forward.

And then finally the old standby is Brazil. Brazil is very important to us today, but I think we're going to move into another plateau -- or not plateau, but another tier if you will which, is going to be the production of the FPSO and the Flexibles. As we bring our Flexible plant online, as we take a look at some of the different engineering ideas we have in FPSOs that Clay mentioned earlier, I think Brazil is going to be a very, very positive area for us.

So if I'm looking into the future I'm really keeping my eyes on those. I could go on. I could talk about the Middle East, I could talk about both coasts of Africa, but the point is there's going to be a lot of international catalysts out there I believe that are going to help drive our business over the next few years. So with those brief comments, Paulette, I'd like to open it up to questions that any of our listeners might have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jim Crandell, Cowen.

Jim Crandell - *Cowen Securities LLC - Analyst*

Great quarter. Great orders.

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

Thanks.

Jim Crandell - *Cowen Securities LLC - Analyst*

Pete, first question, could you talk to how the new Brazilian yards are progressing in terms of their building rigs and how this might affect the delivery of rig equipment packages from NOV?

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

Sure. Actually the Brazilian yards are we think moving along very, very well. We're in the process of doing a lot of different work down there today. We're basically talking about four different yards that we're involved with.

Jim, by definition the deliveries are going to be slower in Brazil. When you look at the Koreans, we're getting those rigs out much, much faster, but even the Koreans if you go back to the early part of this decade had a harder time. You've got to get out of that learning curve, and that's going to happen in these yards.

So the revenue that we actually have in backlog for these orders will have a much slower velocity coming out of backlog than we will have for instance for something coming out of one of the Korean or Singaporean yards. But overall, it's been very positive. We're seeing good things down there and progress is being made every day.

Jim Crandell - *Cowen Securities LLC - Analyst*

Okay. Good. Clay, a question for you. Can you talk about some of the cost reduction initiatives you've put through since you became COO? And can you also talk to how these new facilities coming on will impact Rig Tech margins?

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

You bet. Jim, we've had a lot of activity and a lot of progress in Rig Technology this past quarter, and really continuing through the year, specifically around adding capacity. A lot of those initiatives we launched a couple of years ago and they are designed to be able to let NOV meet the needs of our customers with all these orders flowing in. And so as you can imagine, they've been a little disruptive to our production schedule. Those are continuing.

Week by week, quarter by quarter, we're making progress, and as we get those set, we can expect to see benefits from them. Probably the main initiative underway right now in Rig Technology is to get through this first group of rigs. I think we talked about this a little bit on the last call, but the rigs that we're building today and the rigs that we're delivering now and through the next couple of quarters really are new designs, they're new rig floor layouts.

We are satisfying new class requirements in the post-Macondo era, ABS 2012, DNV, other class requirements. And so in a lot of ways rigs that we've built from 2005 to 2010, 2011 were different designs and we've lost a lot of the learning curve effects on those.

So in terms of margin progression over the next several quarters, a lot will hinge upon getting the engineering completed on these new rig designs, actually getting them constructed in the shipyards, and getting them out the door. And as we make the second and third and fourth copies of those same rig designs, I think that's where you're really going to see the benefits flow through. It's really pretty much a repeat of what we saw in the 2006, 2007, 2008 era and so we're very confident of how this plays out.

Some other things we have underway, we're doing a lot to ease some of the congestion in some of our plants. So for example, we're moving some land BOP products for example out of our BOP plant and moving those to a different operation to free up more bandwidth within that plant to be able to handle the extraordinarily high volumes moving through there. We've got plans to also move our rubber components out of that particular plant as well. And so that's just one operation. I'd say across-the-board lots of things going on manufacturing wise to make our business more efficient.

Jim Crandell - *Cowen Securities LLC - Analyst*

Okay. Thank you. And one quick final one for you, Pete, you had a substantial increase in your dividend earlier this year. Can you review with us your current thinking about how you're viewing the dividend?

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

Jim, we doubled the dividend in May. And what we want to be able to do in this Company is continue to increase the dividend on a fairly systematic basis. We want to return money to our shareholders. We think the dividend is absolutely the best policy. We made a very significant jump in May.

But our Board is committed to continue to try to increase the dividend as we move forward, and I think you'll see that happen. Whether or not I tell you we'll double it, that's a little bit different. But at the end of the day we're going to continue to try to increase our dividend to return what we can to the shareholders in that regard.

Jim Crandell - *Cowen Securities LLC - Analyst*

Okay. Thanks very much.

Operator

Jeff Tillery, Tudor, Pickering.

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

Good morning. On the spinoff of the distribution business I think it makes a lot of sense strategically. I have gotten a fair number of questions, was this part of the plan all along in terms of scaling the business up? A little bit of confusion just around purchasing two of those businesses last year and then spinning them out so quickly, so just interested to hear your color around that.

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

No, Jeff, this is Loren. It was not the plan initially. What we really did there is we had the opportunity to consolidate from a strategic standpoint the upstream distribution business in North America and around the world. And once we started the integration process it became apparent that the stars had aligned. And that we had the critical mass to actually have a Company that, standalone, could be world-class in its own right.

And so that was really the genesis of why we did that. It was not because of the initial purchase of Wilson and CE Franklin, because those are targets that we'd looked at for many, many years. But to add value to our shareholders we think this is something that's going to be very important going forward, and just another way that we can return capital to our existing shareholders.

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

And then my second question is just on the PS&S consumables businesses here in North America, are you seeing anything change in order front there? Or do you think we're going through something structurally different in terms of the way your customers manage inventories?

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

I think it's probably more the latter there, Jeff. We are seeing the inventory overhang come down but it's not really changing customers' buying habits. As Clay mentioned in his remarks, our customers have consolidated into a handful of basins. All of our competitors who are supplying with similar products have consolidated in those basins as well, so our customers have ready access to supply.

And so what we're seeing now is they're being more efficient in the management of their supply chain, and they're only ordering products when they need them as opposed to ordering them for additional inventory. And so it's almost kind of a hand to mouth approach that we're seeing today, and until we see some more rigs, and spreading out into some more basins, it will probably be like that for the foreseeable future.

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

Yes. I think we overshot inventories a little bit a couple of years ago when the supply chain was very tight and deliveries were months out, our customers tended to double order and over order a little bit. When the rig count started creeping down, they took delivery on those inventories, and so we've ended up with this overhang that we're working through. I can't tell you when we're going to get through it, but we do know day by day they're chipping away at it.

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

It's going to be tough to calibrate if we are in a flattish rig count world. We're still consuming drillpipe, we're still using your products and services, and at some point we're going to see the increase in that without necessarily an associated increase in rig counts. I just didn't know if you guys are seeing anything turn yet.

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

I don't think we're seeing a turn yet. Q3 was promising, we did see an uptick in the US. Q4 we expect to tick down as I mentioned just really more the holiday season than anything.

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

A couple things, I think that head-faked us a little bit, but broadly speaking we don't see the turn just yet. So probably sometime hopefully in 2014.

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

Okay. Thank you very much.

Operator

Jud Bailey, ISI Group.

Jud Bailey - *ISI Group - Analyst*

A follow-up on the -- some of the comments Clay you made regarding some of the new design rigs that will be coming out of the yard here soon and getting those behind you. Could you give us a little more color? Are those going to be largely delivered in 2014, and be done by 2015? Or can you give us a little more color on the timing of those deliveries?

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

Yes. They're being delivered that's exactly right through 2014 and into 2015 these new class designs. The real benefit of all this work is that once you build that first rig you've got all the engineering done. You have all the lessons learned through the first copy of it. You apply those lessons, and this is what I think our team is extraordinarily good at is capturing those lessons and benefiting from them on the next copy. So it's the second and third copies that you really start to see the benefit.

That's exactly what we saw in 2008, 2009, 2010 as we get a deeper into that way we started seeing a lot of positives and a lot of efficiency gains. Those were in contrast candidly to issues and problems we faced earlier in that buildup when you're making the first copy. So that learning curve effect is well-established and we're looking forward to benefiting from it as we get into the back half of next year and into 2015.

Jud Bailey - *ISI Group - Analyst*

Okay. And then my follow-up would be my understanding is several contractors right now are for their next few new builds are actually looking at new designs or enhanced designs. Do you take a little bit different strategy in taking the next -- when looking at the next generation given some of the problems you've had, do you take any pricing strategy and whatnot?

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

We do. We try as best we can to factor all this in. But when you're building something for the first time you're always going to face some challenges that are a little bit unexpected. And I would stress we encourage our customers to stick with proven designs. It really I think reduces the cost and risk of their new build programs.

Jud Bailey - *ISI Group - Analyst*

Okay. And then a question I think for Jeremy. Jeremy you may have mentioned it, but I may have missed it, do you have a revenue out of backlog number updated for 2014?

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

We didn't say it but it will look similar to 2013.

Jud Bailey - *ISI Group - Analyst*

Okay. Got it. All right. Thank you. I'll turn it back.

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

Thank you.

Operator

Brad Handler, Jefferies.

Brad Handler - *Jefferies & Company - Analyst*

I guess I was -- the last question was one I was going to ask as well, so maybe Jeremy you can fill it in a little bit, so the revenue out of backlog for 2014, sorry not looking at my notes -- has it been roughly $8 billion for 2014 and then how much would it be in 2015?

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

That's probably about right, Brad.

Brad Handler - *Jefferies & Company - Analyst*

Okay. Got it and then do you have a 2015 reference?

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

I don't think so yet.

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

2015 and beyond is I think in the $5 billion. $5 billion range.

Brad Handler - *Jefferies & Company - Analyst*

Right.

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

Based on what we have today.

Brad Handler - *Jefferies & Company - Analyst*

Okay. Okay. Maybe I have a multipart follow-up, but I think it's all kind of in the same context, and it's coming back to Rig Tech margins, we've had a conversation you've helped us in understanding your challenges and we appreciate that. The path to getting back to the 24% margin I would certainly appreciate if you -- does it happen at some point in 2014? Or what are the challenges to having that happen at some point in 2014?

And then maybe before I just turn it back to you, related to that is, it's easy for me to certainly understand some efficiencies and learning curve as you're describing them. It's also easy to understand capacity additions, and so some of the expediting costs go down, but it does sound like installation and commissioning challenges have been real as well. And I don't know how those are enhanced or how those costs come down if you're delivering a lot of rigs in 2014, but perhaps you could help describe why that also gets a little easier or cheaper or what have you.

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

That's a great question, Brad. Let me explain it. When we set up our initial plans to build a rig installation and commissioning on a drillship, we typically budget five to six months to accomplish that. What we find is delays, some of our own making many not. Some from our shipyard partners, but we're all building a new rig for the first time. So we typically launch those I&C projects late and into a project that may drift beyond its delivery deadline, and we're under a lot of pressure to speed up our I&C activity. So we get asked, can you guys shorten that up to four months or three months?

And to accomplish that, it costs us money. We go to -- we've taken the extraordinary step of going to 24 hour operations on certain things that we're doing on the I&C world. We're paying extra to expedite equipment and people and move resources around our system to try to get back on track on these projects or as close as we can there too, so that's costing us extra money. So this is all tied together and the installation commissioning is the last thing we do on a rig and so it shows up there as well.

But on that subject more broadly, I've touched on a number of the factors and I don't think these are new to anybody but probably worth delineating them all again. The new designs that we're building right now for the first time and the loss of the copy effect from the preceding cycle is an issue. Expansion in our plants has been an issue.

And the installation and commissioning efforts that are underway right now, Jeremy mentioned we're going to be at record levels of I&C here in the second half of this year and as we move into 2014 are all contributing to this. But I would say on all three fronts, we see this getting better. We get better as we progress through it. I would add to this, the resumption of land rig demand that we saw in the third quarter will help the segment's margins.

And the last factor is the fact that our aftermarket piece of Rig Technology in the third quarter, it grew but only by a couple of percent, so you didn't get sort of the positive impact on margin expansion out of aftermarket that you would otherwise expect. I would stress that that aftermarket is a transient thing, quarter to quarter. It's a timing thing and we are going to see that business continue to grow. We're very confident so that will help contribute to margin expansion.

However, some of the risks and headwinds that we face, first, we are glad to see rising demand for FPSO products, but those are a little bit dilutive to our EBIT margin. Second, as we mentioned, demand is down for pressure pumping equipment particularly for North America. So that business really has been at rock-bottom on orders.

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

And margins in that business are accretive to overall Rig Tech.

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

Yes. Thank you. And the third is the shortened deliveries that we have on these rigs means that we have a little less headroom and safety factor than we've had in the past. We've talked about this in the past too, we're making these offshore rigs faster and faster, and so to the extent we run into unexpected problems, the timeframe that we have to recover is much more limited, so that's a little bit of a risk.

And finally the fourth issue is in the third quarter, again we have very strong demand once again for jackup rigs, we sold 42 jackup rig packages. That's a little quicker turn capital and so we're putting more volume through our system, and so that makes our congestion issues a little more challenging. So those are the puts and takes going into our margin outlook overall.

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

And as to your first question around when do you get back to the 24% margins, I would expect as we get through Q1 of next year to see some slow steady progression in margins in the Rig Tech business, but I wouldn't expect to get to 24% next year. 2015 I think is more likely and if we can get some help as Clay said on the orders for pressure pumping equipment that we can ship and turn into revenue and margin, I think we can get there in 2015.

Brad Handler - *Jefferies & Company - Analyst*

Very helpful. Thorough explanation. I appreciate it and I'll turn it back. Thanks.

Operator

Stephen Gengaro, Sterne Agee.

Stephen Gengaro - *Sterne, Agee & Leach - Analyst*

Just wanted to hit on the PS&S business. Can you give us a sense there, I know you've had -- the US rig count's everybody's been expecting it to go higher more rapidly, but you're still at a very healthy level. How should we think about sort of the structure of the business right now and what you see from a demand perspective in 2014? Is it simply rig count intensity driven or is there an inventory issue that could help growth there?

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

I think we're cautiously optimistic is how I would describe it. We think producer cash flows have been pretty strong and so we think there's good financial resources to see an uptick in the rig count. As I mentioned in my comments, increasingly we've seen North America become more and more competitive, this inventory overhang issue has been out there, the fact that the industry is restructuring and coalescing into the handful of most profitable basins has created some headwinds.

But I would add this rig efficiency phenomenon that everyone has been talking about we believe ultimately will grow the pie. It's going to make some of the less economic basins now more attractive and more economic, and so with ample financial resources and growing opportunities perhaps in other basins, we think that's a pretty good backdrop to see expansion some time out there in 2014. We haven't seen it yet. But I think we're entering with a pretty good backdrop for 2014.

And I would also reiterate that the very intensive nature of drilling and completion operations in the major shale plays is consuming what NOV makes. And so we know day by day these inventories are being whittled away by day to day operations.

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

And I think if you look at PS&S you almost have to segment it by product types. Things like drillpipe and downhole tools, as long as well count is high which it has been, those products get consumed and they get consumed pretty quickly. So there was definitely an inventory overhang for both of those types of products, downhole tools and drillpipe. We'll work through that at some point in time next year and we'll start to see more demand for those products.

As you get into the more consumable type items like fluid and expendables, valve seats, liners, pistons, those are probably going to be consumed as customers need them as opposed to really building up inventory levels because there is ample supply out there. So it's going to be a bit of a mix between the products.

Stephen Gengaro - *Sterne, Agee & Leach - Analyst*

Okay. Thank you. And then as an unrelated follow-up, as we think about CapEx and we think about the tax rate for 2014, what's the impact of the spin? Does it change the tax rate much? Or the CapEx number?

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

I think it's too early to answer that right now. We're still working through the process ourselves and as we get closer to the finish line we'll come back with more information.

Stephen Gengaro - *Sterne, Agee & Leach - Analyst*

Okay. Thank you.

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

Thank you, Stephen.

Operator

Marshall Adkins, Raymond James.

Marshall Adkins - *Raymond James & Associates - Analyst*

We've heard from this season a few of the offshore drillers talk about rig equipment delays and this quarter we see your backlog burn slowing a little bit. Is there anything we should read into that, are lead times getting longer? Is there anything going on there or is it something else?

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

No. As we talked about on lots of calls we're pretty loaded up. $15.2 billion backlog and so we're having to be very careful about what we sign up to do on deliveries.

I think some of the issues you're talking about on some of the deliveries, again go back to this fact that we're building the first versions of rigs under new class standards with new rig floor layouts for all of us. And we've collectively faced some issues, but I would stress that NOV has moved heaven and earth to try to get those rigs back on schedule as best we can. And many we have, not all, but many. And so I think we're moving progressively towards -- up that learning curve and getting better and better at it, month by month.

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

And the other thing I'd add, Marshall just real quickly the backlog burn is pretty high level $2.1 billion, which was consistent with last quarter and just slightly below our peak at Q4, so we're getting better at delivering I think.

Marshall Adkins - *Raymond James & Associates - Analyst*

So don't read too much into it other than just the new rig design?

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

Well, that's about right.

Marshall Adkins - *Raymond James & Associates - Analyst*

Okay. Second question on the backlog, to stay on this subject, we've seen a pretty good ramp up this year in the jackups you're doing. I can't believe these numbers are right, but I had like 8 last year and 50-ish by the time we end this year, and deepwater rigs have gone from 24 last year to high 20s this year.

Where are we going to go next year? I'm just kind of trying to get my arms around how you're almost at 30 deepwater rigs, are you going to order another 30? It sounds like in your guidance for backlog, we fall off a little bit from that. Is that -- am I reading that correctly?

Clay Williams - *National Oilwell Varco, Inc. - President and COO*

Well, there's probably a little bit of conservatism baked in that but yes, our customers are pretty busy. They've ordered a lot of rigs. They have a lot of projects underway. Time will tell where we end up next year.

But I think bigger picture, and this is some of the -- part of the themes that I touched on in the opening comments where it's an enormous opportunity out there. And with high commodity prices, we're seeing a lot of oil companies and a lot of drillers avail themselves to these opportunities, and so we think again the backdrop, the fundamentals are very strong. Day rates are strong. Financing's available.

The shipyard infrastructure is offering hulls at very, very low cost. The risk around building these things is low. And so you're seeing drillers go after that opportunity and grow their businesses by investing in these assets.

And with regards to the jackups, there's still an awful lot -- over half of the marketed jackups are still more than 30 years old, and so there's a lot of rigs to build. On the floater side of things, you take all of the floaters that were in existence prior 2005 and you add all the floaters built since 2005, and you add all the floaters that are on order to be built, you're almost up to half of the rigs working in the state of Texas to go out and drill the rest of the two-thirds of the planet covered by deepwater, so we think that's again a huge opportunity.

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

And Marshall, I might add that this same sort of question was asked of us in 2007, it was asked of us in 2008. Probably it was asked in 2009. But I just can't remember. It was asked in Q4 of last year. And we continue to be very bullish on the need for the equipment and the rigs that we make for oil expiration and gas exploration in the rest of the world.

Marshall Adkins - *Raymond James & Associates - Analyst*

The difference this time is you also going to get a kick from the FPSO. Even if it does slow a little bit, that would be ramping up I would expect.

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

Absolutely. Absolutely as we tell people, these drillships aren't drilling for practice. They're drilling to discover oil and gas and the approved solution on that production is going to be the FPSO business.

Marshall Adkins - *Raymond James & Associates - Analyst*

Thanks, guys.

Operator

I will now turn the call back over to Pete Miller, Chairman and CEO, to close the call.

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

Thank you all very much. And we look forward to talking to you when we do our year-end results in February. Thank you very, very much.

Operator

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