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NOV - Q1 2014 National Oilwell Varco Earnings Conference Call

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OVERVIEW:

Co. reported 1Q14 revenue of $5.8b, fully diluted EPS of $1.37 and fully diluted EPS, excluding $19m in pre-tax transaction charges, of $1.40.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Welcome to the first-quarter financial results earnings call. My name is Adriana, and I will be your operator for today's call.

(Operator Instructions)

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

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

Thank you, Adriana, and welcome, everyone, to the National Oilwell Varco first-quarter 2014 earnings conference call. With me today is Clay Williams, President and Chief Executive Officer 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 first quarter ended March 31, 2014, please note that some of the statements we make during this call may contain forecast, projections, estimates, including, but not limited to, comments about our outlook for the Company's business. These are forward-looking statements within the meaning of the Federal Securities Laws based on limited information as of today, which is subject to change. They are subject to risk and uncertainties, and actual results may differ materially.

No one should assume that these forward-looking statements remain valid later in the quarter or later in the year. I refer you to the latest forms 10-K and 10-Q National Oilwell Varco has on file with the Securities and Exchange Commission for a more detailed discussion of the major risk factors affecting our Business. Further information regarding these, as well as supplemental financial and operating information, may be found within our press release, on our website at www.nov.com, or in our filings with the SEC. Later on this call, we will answer your questions, which we ask you to limit to two in order to permit more participation.

Let me turn the call over to Clay.

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

Thank you, Loren, and good morning, everyone. Earlier today, National Oilwell Varco announced that it earned $1.37 per fully diluted share; and excluding transaction-related charges, $1.40 per fully diluted share for its first quarter of 2014. Earnings improved 9% from the first quarter of 2013, but declined 10% sequentially from our strong fourth-quarter results in 2013, excluding charges from all quarters.

Revenues were $5.8 billion in the quarter, up 9% from the prior year, and down 6% sequentially. Generally, our largest two segments saw a surge in product shipments late last year, which did not repeat in the first quarter, leading to slightly lower sequential results, as we expected. Overall, the Company made steady progress on several fronts through the first quarter, including moving closer to the spin-out of our distribution services group, which we will speak to more in a moment.

We were very pleased with another strong quarter for orders for drilling capital equipment. Rig technology posted over $2.3 billion in orders, which exceeded our revenue out of backlog by about 5%. This led to a record $16.3-billion backlog for rig technology.

Offshore demand remained very strong. We won drilling equipment packages for 3 floaters and 17 jack-up newbuilds during the first quarter. Land demand also increased materially, mostly internationally, and we are encouraged by rising demand for drilling, work-over and well-stimulation equipment for the resurgent US land market.

Our $2.3 billion of first-quarter orders for rig technology were comprised of $1.2 billion, or 52%, for packages for newbuild offshore rigs. We expect the second quarter to continue to be strong for offshore newbuild demand as well; but we expect demand for new offshore rigs to slow during the second half of the year, as offshore day rates have come under pressure. We do expect to win some offshore newbuilds orders in the second half, as our shipyard partners are continuing to quote to entrepreneurs targeting specific markets in Latin America and the North Sea, along with a few established drillers considering rigs for specific purposes like 20K.

The 48% balance of first-quarter orders included land rigs, work-over rigs, pressure-pumping equipment, FPSO equipment, and assorted individual components for various rigs and vessels. This other half of our order stream is carrying good momentum into 2014, and we expect it to partly offset offshore newbuild declines later in the year. Specifically, we are now seeing North American drillers resume buying equipment, while we continue to sell land rigs into the Middle East, Russia, and Latin America.

Drillers the world over continue to retool the land-rig fleet to newer, more modern levels of capability. While orders for AC power quick-move electronic control land rigs ebb and flow a bit, the direction is clear. These are the workhorses that make our industry steadily safer and more efficient, and enable profitable unconventional resource production; and land drilling contractors appear to be increasingly convinced of their superior economic returns.

We are also encouraged by recent orders for stimulation and pressure-pumping equipment in North America. Frac spreads continue to be pushed harder, pumping larger fracs into more stages at higher pressures, and many are now being run at 24 hours a day, consuming these fleets at a faster pace. Our book-to-bill for pressure pumping, coiled tubing, and wireline products all handily exceeded 1 in the first quarter. Demand for floating production products, [kit for] FPSOs and flexible pipe mainly, dipped this quarter, but we believe this is simply a function of timing, and that FPSO demand will increase as we move through the year, given our strong bidding activity.

To summarize our order outlook for the remainder of 2014, we believe the second quarter will be in the range of 1 to 1 book-to-bill, and that the third and fourth quarters will gradually drift down, leaving us with an ending backlog probably in the low-teens, but probably our second-highest year-ending backlog ever. Backlogs at or near record levels throughout most of the year should continue to drive strong financial performance for the next several quarters.

Our long-term outlook continues to be very robust. We have previously cited four major trends driving our prospects: one, the buildout of a fleet of deepwater rigs; two, the buildout of floating production systems to produce deepwater discoveries; three, the retooling and replacement of the jack-up fleet; and four, the continued proliferation of unconventional shale technologies driving demand for a wide variety of NOV equipment, products and services.

In our view, the energy needs of the 21st Century will be satisfied by a combination of growing production from: one, deepwater frontiers, which had gone from effectively zero to about 9% of worldwide oil production in 20 years; and two, unconventional shale technologies, which have gone from effectively zero to about 3% of worldwide liquids production in six years. Although these two incremental sources of oil today comprise only one in eight barrels of supply, most of the other seven barrels are from conventional fields found in prior eras, which will decline. And, with most of the easy oil already discovered, future conventional sources will continue to become increasingly challenging to find.

As economic growth steadily drives oil demand, we believe that growing production from: one, deepwater technology, which opened up vast horizontal expanses of the planet to production; and two, shale technology, which opened up vast vertical sections of the stratigraphic column to production, will supply this demand, both oil and NGLs, in greater and greater proportion through the 21st Century.

Since the earliest days of the oil industry, companies have battled ferociously to emerge as the lowest marginal cost source, or at least not be the highest marginal cost source of the last incremental barrel. The high-cost barrel is the most disadvantaged position on this battlefield. When economic cycles diminish demand, as they do from time to time, oil prices drop, and the highest marginal cost position suffers the most. Darwinian market forces continually test the resolve of high marginal cost producers. The battle lines constantly ebb and flow, as various combinations of innovation and geology lead winners to relative advantage, and sometimes brief periods of respite from harsh market forces, at least until their fields decline, or some other competitor finds better rocks and technology.

NOV is a unique supplier of critical components to the combatants on this battlefield. We understand that our success rests on the success of our customers, meaning: lowering their marginal cost per barrel, either capital or lifting cost or both. Both major new sources of incremental oil supply, deepwater and unconventionals, require new toolkits, specialized deepwater rigs, floating production systems, subsea production systems, Tier 1 AC land rigs, drilling motors, premium drill pipe bits and hydrologic stimulation tools.

Our products win demand in the marketplace by conferring lower costs and higher value to their users. That's why we must continue to invest in promising technologies and ideas. Unconventionals, in particular, are unique in the rate in which they consume iron. Long horizontal laterals wear out fixed cutter bits, downhole motors, and premium drill pipe far faster than vertical drilling, and they require specialty tools NOV provides, such as fluid hammers and agitators.

Similarly, high-pressure, massive 24-hour frac jobs wear out frac cleats and associated consumables like fluid ends, liners and pistons, far faster than stimulation jobs of yesterday. NOV is unique in our leading supply position into both of these major trends; and the trends themselves are unique in that they are more consumptive of specialized equipment as compared to sources of supply of yesterday. We saw good evidence in the first quarter that the industry has largely burned through its excess inventory of pressure-pumping consumables, and we believe new capital orders are not far behind.

History teaches us that new innovations constantly change this battlefield, sometimes in surprising ways. Who among us would've predicted that the US would enjoy such a revival, becoming, once again, the fastest-growing producer of oil, from marginally productive shales, no less. Pad drilling, downspacing, new rig technologies and bigger frac jobs have enabled shale producers to steadily improve their marginal cost positions, and further improvements are to be expected.

Likewise, while deepwater producers have struggled lately with project execution challenges and rising costs, these are certain to be remedied by time and innovation. The deepwater drilling space faces start-up challenges, which we believe are transient. A lot of new deepwater rigs have been launched recently with new crews, and these are operating under tighter operational requirements post-Macondo. Crews will certainly get more experienced and more efficient over time.

At NOV, we are helping by opening new technical training colleges to train both our own, as well as our customers', personnel. We supply simulators to let drillers practice safe, efficient operations offline. We are investing heavily to ramp aftermarket spares and service capacity in proportion to our growing installed base to improve uptime, and we are preparing for further challenges the industry will face as the new rig fleet undergoes five-year SPS surveys.

A couple of years ago, NOV deployed capital into floating production technologies used to produce deepwater fields, recognizing that FPSO construction projects are notoriously problematic to deliver on time, on budget. A recent industry study cited a sampling of nine FPSOs, which cost, on average, 38% more than budget, and were delivered an average of 14 months late.

We believe our success in transforming the deepwater rig fabrication supply chain, and our experience working with shipyards, uniquely positions NOV to undertake the challenge of driving cost and risk down for these complex projects. We further believe the recent introspection of deepwater producers signals their explicit recognition of the structural shortcomings of the status quo. NOV aspires to be an advocate of change because we think we can pioneer a better way.

Participants in both camps, shales and deepwater, are smart and adaptive; and the world needs oil supply from both camps to offset the relentless drum beat of production declines. Within this battle, NOV's mission is to offer new and better ways of doing things to lower the marginal cost of barrels, to improve economic returns of our customers' projects, to reduce environmental impact, and to improve the safety and efficiency of operations. To this end, we announced our plans to reorganize our Business along more customer-centric axes, concurrent with the spin-out of our new DistributionNOW company. Our new organization will enable us to focus more tightly on specific customer initiatives.

Beginning in the second quarter, we will begin reporting our results in four new segments. First, our new rig systems segment, which will primarily support offshore and land drillers, will consist of land and offshore rig equipment, offshore packages, complete land rigs, replacement and upgrade rig capital components. We believe that the industry's need to build out a new deepwater infrastructure, replace an aging jack-up fleet, and upgrade a global land rig fleet, will create tremendous growth opportunities for this segment.

Second, our new rig aftermarket segment, which will be closely tied to our rig system segment, will separately report sales of spare parts, repair services, training and other sales opportunities, focused on the maintenance of our substantial install base of drilling rigs worldwide. These two segments will jointly supply and maintain sophisticated modern drilling tools.

Third, our new well-bore technologies segment will report products and services NOV provides which enhance drilling performance and reduce the environmental impact of drilling operations. This group will include bits, reamers, downhole drilling motors, premium drill pipe, solids control and waste management technologies, drilling fluids, tubular inspection and tubular coating services, drilling instrumentation and dynamic drilling systems.

Fourth, and finally, our new completions and production solutions segment will report sales of well-stimulation equipment and consumables, as well as composite flow-line products, flexible subsea pipe, conductor pipe, pumps and artificial lift products, and floating production solutions. We will also include certain non-oilfield industrial products within this segment.

Within the next few weeks, we plan to publicly announce our historical financial results for the preceding five years within this new segment framework on a pro-forma basis. This is designed to lend our investors long-term perspectives into NOV post the spin-out of our distribution services group. We will also change how we report backlog, including recasting our historical backlog through this historical period to conform to our new segments. I believe the new segment structure will lend greater transparency to the trends affecting our Business, and enable the investing public to better see our execution of our strategic plans. We also believe this new structure will highlight the diverse portfolio of products, equipment and services NOV delivers.

Finally, with regards to the spin-out of DistributionNOW, or NOW, Inc., we re-filed our Form 10 last week, and believe we are nearing the completion of the spin-out, which we hope to effect in late May. The new company, which will initially be debt free, has security commitment for $750 million revolving line of credit. We would encourage our investors to review our filings for this exciting new company, including its risk factors, which are available on our website at www.NOV.com. As a stand-alone company, DistributionNOW will be uniquely positioned to prosecute supply chain services initiatives and selective acquisitions from a focused public company platform to better serve its global upstream and mid-stream customer base.

I'm excited about the opportunities for this organization under the able leadership of CEO, Robert Workman; CFO, Dan Molinaro; Chief Accounting Officer, Dave Cherechinsky; and General Counsel, Raymond Chang. It will also have an outstanding Executive Chairman, a guy named Pete Miller, who has a pretty good track record of building successful companies. Pete will step down as Executive Chairman of NOV at the time of the spin, so I want to take this opportunity to say thank you to an extraordinary business leader, mentor and friend. Very, very few CEOs have achieved Pete's remarkable track record of success; and Pete, we are grateful to you for your vision for this Organization and for the industry we serve. So, on behalf of our 65,000 employees, congratulations and thank you, and very best wishes to you and all of our friends within DistributionNOW.

At this point, let me turn it to Jeremy to provide more color on our first-quarter results.

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

Thanks, Clay. As Clay already mentioned, National Oil Varco generated earnings of $1.37 per fully diluted share in its first quarter of 2014 on $5.8 billion in revenues. Excluding $19 million in pre-tax transaction charges, first-quarter 2014 earnings were $1.40 per fully diluted share, down $0.16 per share, or 10%, from the fourth quarter of 2013, but up $0.11 per share, or 9%, from the first quarter of 2013. Sales of $5.8 billion declined 6% sequentially, but on a year-over-year basis, revenues were up 9%, despite the fact that the worldwide rig count only increased 2% over the same time period.

Excluding transaction charges from all periods, operating profit for the quarter was $880 million, down 10% sequentially, but up 8% from the first quarter of last year. Operating margins on this basis were 15.2% for the first quarter of 2014, compared to 15.8% for the fourth quarter of 2013, and 15.4% for the first quarter of last year. Sequentially, decremental leverage on the 6% decline in revenues was 24%. On a year-over-year basis, operating profit [flow through or leverage] was 14% on the 9% increase in revenue.

Now, let's turn to our segment operating results. The rig technology segment generated revenues of $3 billion in the first quarter, down 9% sequentially, with, as expected, almost the entire shortfall being driven by reductions in revenues from our land rig and well-stimulation equipment businesses, which both benefited from large project shipments in the fourth quarter that did not recur in the first quarter. Compared to the first quarter of 2013, rig tech revenues were up almost 15%, as capacity additions enabled us to convert 12% more revenue out of backlog, as our ever and growing installed base, coupled with our recent investments in our aftermarket infrastructure, enabled us to generate 25% more in aftermarket sales, and as our floating production and subsea flexible strategies have produced strong year-over-year gains.

Operating profit for the segment was $635 million and operating margins were 21.1%, which were flat with the prior quarter, despite the 9% decline in revenue. While pleased with this result, we continue to face the same margin challenges that we've discussed in the past, which include: working through lower-price backlog; more aggressive delivery schedules from our shipyard customers; new drill floor layouts, coupled with new installation and commissioning personnel; unfavorable product mix; and continued investments in long-term strategic growth initiatives and capacity expansions that are not yet fully operational, such as the flexibles plant in Brazil. Still, we are confident that we are moving in the right direction on all fronts, and I'd just like to take a moment to address each.

Regarding lower-price backlog: Beginning in the second quarter of last year, we assumed a more assertive position on orders for offshore equipment components and complete packages. And while I would describe the improvement as modest, we are already seeing the impact of this change manifest itself in higher-margin backlog and a more favorable shift in customer financing. On the aggressive delivery schedules: Over the past couple of years, we've added manufacturing capacity to relieve some of the stress on our supply chain; and over that same time frame, we have significantly increased our installation and commissioning work force. As we become more comfortable and efficient with this new capacity, and as our new I&C teams come up the learning curve on these new drill floor layouts, we will realize efficiency gains.

With respect to product mix: As we move through 2014 and into 2015, we should begin to see a more favorable product mix, as demand returns for pressure-pumping equipment and coiled tubing units, and even more importantly, we continue to see mid-teens percentage growth in our aftermarket revenues. While these gains will partially be offset by continued growth in our floating production business, as well as the conversion of Brazilian backlog, we are still confident that the net result will be positive.

And finally, when talking about long-term strategic growth initiatives, the flexibles plant in Brazil, which is the single largest CapEx project in the history of NOV, has finally started commercial production, and will begin generating revenue sometime in the second quarter. So, as stated on the

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fourth-quarter conference call, we believe that we are taking the actions required to expand margins in the old rig tech segment, as we move through 2014 and 2015; but again, it will be a slow process.

Now, let's transition to the capital equipment orders for the first quarter of 2014 and our resulting backlog. As Clay already stated, for the quarter, we booked 2 semi's and 1 drill ship, as well as 17 jack-up packages. And we were pleased to once again win a majority of BOP work within these packages.

In addition to the strong orders offshore, we were especially pleased and encouraged to see continuing demand for new land rigs in the Latin America and Middle East markets, and particularly pleased to see strengthening demand for new land rigs in the US. In the quarter, we booked several complete land rigs for each of those three markets, as well as multiple equipment packages for other newbuilds. We also secured orders for new coiled tubing units destined for international markets, and we are starting to see some demand for new pressure-pumping equipment in the US and Canada, which is obviously very welcomed.

All of these new orders, which totaled $2.3 billion in the quarter, were mostly offset by revenues out of backlog of $2.2 billion, resulting in a book to bill of just over 1 times, and another record quarter-ending backlog of $16.3 billion. Of the total backlog, approximately 90% -- 92% is offshore and 94% is destined for international markets. So, overall, the quarter for rig technology turned out almost exactly as expected, with revenue declining in the high single-digit percentage range, margins flat, and a book to bill slightly above 1 times.

Looking into the second quarter of 2014, we expect orders for new offshore drilling equipment packages and land rig equipment packages to remain fairly steady. And while it might not happen in the second quarter, we believe that we could soon benefit from a resurgence in orders for well-stimulation equipment in the US. We also believe that we could see a higher volume of orders for our floating- and subsea-related production equipment.

Overall, we think that the total order intake in the second quarter is going to once again approach 1-to-1 book to bill. And while this will certainly be an odd quarter as we transition to our new organizational structure and reporting segments, I can tell you that I think that the revenues for the old rig tech segment on an apples-to-apples basis could improve in the mid-single-digit percentage range sequentially, and that margins would likely continue to be challenged to expand, but might see a slight uptick on the incremental revenue.

The petroleum services and supplies segment posted revenue of $1.8 billion, down 7% sequentially, but up 8 -- up 5% from the previous year. Sequentially, the decline in segment revenues was driven exclusively by the non-recurrence of some large year-end projects that were shipped in the fourth quarter of 2013. On a year-over-year basis, we benefited from both a full quarter of Robbins & Myers, and the fact that our customers had finally worked through the excess inventory that they carried into 2013.

Operating profit for the quarter was $326 million, or 18.2% of sales, down 80 basis points sequentially, and essentially flat, down 10 basis points, year over year. On a sequential basis, the decremental flow-through was just under 30%, which is fairly consistent with the historical performance of this segment.

As with rig technology, the quarter for the PS&S segment turned out almost exactly as expected, with revenue declining in the mid-single-digit percentage range and margins contracting on the volume. As we enter the second quarter of 2014, we believe that revenues for most of the products and services in our old petroleum services and supplies segment could improve in the mid-single-digit percentage range, as seasonal declines in Canadian drilling activity should be more than offset by strength in the US market and continued growth in our international businesses.

In the US, demand for our downhole technologies, including bits, downhole motors and agitators is clearly on the rise, as is demand for fluid-end expendables for both drilling and well-service applications. We are also starting to see incremental demand for coiled tubing, composite pipe, and even 4-inch and 5-inch drill pipe into the US land market, which is very encouraging. And while we expect margins to expand with the incremental volume, we believe that our flow-through on the incremental revenue could be somewhat challenged as we battle a few different issues, including: ERP implementations in multiple businesses; underabsorbed facilities and underutilized assets in Canada due to breakup; slightly unfavorable product mix; and some continued pricing pressures on certain products.

The distribution and transmission segment posted revenues of $1.3 billion, up 2% sequentially, and up 4% compared to the first quarter of 2013. The majority of the sequential growth for this segment was driven by a strengthening US market, but the segment also enjoyed strong project sales in the Middle East. On the $1.3 billion in revenue, D&T generated $68 million in operating profit for a 5.3% operating margin, which represented a 50-basis-point improvement from the fourth quarter of 2013, or 29% flow-through or leverage on a 2% increase in revenue. On a year-over-year basis, operating margins were flat.

For distribution and transmission, the quarter actually turned out a little better than expected. While we expected the low single-digit percentage growth, we were pleasantly surprised by the expansion in margin. With the implementation of SAP across the Enterprise and the work associated with the spin, we felt that margins would be challenged. But as a direct result of the focus, hard work and dedication of the entire D&T team, they have once again managed to overcome distractions and challenges to produce a solid result.

Looking into the second quarter of 2014, under our old segment reporting, we would expect distribution and transmission group revenues to remain relatively flat, as the seasonal reduction in Canadian drilling activity, as well as the absence of the large Middle East projects, should be offset by strengthening US markets. And we think that margins could contract slightly sequentially, as we fully expect to both complete the rollout of SAP and finalize the spin, both of which have the potential to be somewhat distracting and disruptive.

While on the topic of the spin, I'd like to provide a brief update on some of the organizational changes that are currently underway within National Oilwell Varco, before moving on to discuss some of the remaining income statement and balance sheet items. As previously mentioned, we hope to consummate the spinoff of our distribution business in late May.

Shortly following the spin, we will be filing two separate 8-Ks. The first 8-K will be related to the discontinued operations of the distribution business. The second will include five years of historical financial statements for the new reporting segments, and will include the first quarter of 2014 financial statements. A few weeks following the second 8-K, we will plan to file a revised 10-K for NOV remainCo's 2013, and a revised 10-Q for NOV's remainCo for the first quarter of 2014.

While the spinoff of our distribution business and the subsequent restructuring have required a great deal of work, the entire Organization is excited about the realignment of our businesses into rig systems, rig aftermarket, well-bore technologies, and completion and production solutions. With these new segments, we believe that we will be much easier to understand and access, which should benefit all of National Oilwell Varco's stakeholders.

For suppliers and customers, the new segments will make it easier to navigate our Organizations to find the people, products, services and support that they require. For employees, the new segment should help each employee to more easily and obviously connect his or her specific job to the overriding objectives of NOV, which we expect to lead to improved awareness and engagement.

For investors, the new segment should provide more visibility to more of the market-leading products and services that we provide, while also giving more clarity to the way in which we participate in each of the markets that we support. It should also help investors to better understand the interrelatedness of our various businesses, and the value that this brings to our customers and to National Oilwell Varco.

In addition to being much easier to understand and access, we also believe that the reorganization will ultimately help drive improved operational and financial performance. While we've always done a good job of working across businesses and segments to both recognize efficiencies where possible, and to offer complete and integrated solutions to our customers, we believe that the realignment of our businesses will, in time, better enable us to drive incremental improvements in both areas.

Now, let's turn to National Oilwell Varco's consolidated first-quarter 2014 income statement. Gross margins only declined 10 basis points sequentially to 24.2%, despite a 6% reduction in revenues. SG&A declined $7 million sequentially, and represented 9% of Q1 revenues. Transaction costs, primarily related to the Robbins & Myers acquisition, and the distribution spinoff, totaled $19 million in the quarter. Interest expense declined $1 million sequentially to $26 million, and interest income was flat at $4 million.

Equity income in our Voest-Alpine JV was $14.5 million, which was consistent with the previous quarter. However, in the quarter, we booked a $4-million loss attributable to a pair of joint ventures that we acquired with the Ameron transaction. For the second quarter, we do not expect to incur such losses from the Ameron JVs, but we do expect for equity income from the Voest-Alpine JV to decline slightly.

Other expense for the quarter was zero, which represented a $17-million delta sequentially, as we benefited from favorable movements in currencies, and we also recognized a gain on the sale of assets. The effective tax rate for the second quarter was 30.6%, which was higher than the 29.2% rate that we posted in the fourth quarter of 2013, but it is more consistent with historical trends. Unallocated expenses and eliminations on our supplemental segment schedule was $149 million in the first quarter, down $1 million sequentially.

Depreciation and amortization was $195 million, down $5 million from the fourth quarter. And EBITDA, excluding transaction charges, was $1.1 billion, or 18.9% of sales.

Turning to the balance sheet, National Oilwell Varco's March 31, 2014, balance sheet employed working capital, excluding cash and debt, of $6.4 billion, up $115 million from the previous quarter, but down $582 million from the previous year. In the quarter, inventory increased $56 million, or 1%, as all of our PS&S businesses modestly added to their inventories to support heightening demand in the US market.

Accounts receivable increased $414 million, or 8% sequentially, despite the sequential decline in revenue. This build can be directly tied to our distribution business, where the implementation of SAP has led to some slight delays in our collections process, and our rig technologies segment where we had some payment delays from some of our larger, more established customers. In short, the growth is simply an issue of timing. Fortunately, a large portion of this growth was offset by continued improvements in customer financing, where pre-payments and milestone invoicing on major projects outpaced costs incurred by $379 million.

In addition to the increase in working capital, we spent $132 million on capital expenditures, made cash tax payments of $301 million, paid dividends totaling $111 million, and cut bonus checks based on 2013 performance. As a result, the Company generated free cash flow of $252 million in the first quarter, resulting in a quarter-ending cash balance of $3.7 billion, and a net cash position of $539 million. Of the $3.7 billion in cash, 12% of the balance was in the US at March 31.

Now, let me turn it back to Clay.

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

Thank you, Jeremy.

Before we open it up for questions, I want to say thank you to all of our employees out there. We have a lot of terrific employees around the globe who have been working very, very hard to effect the spin of our distribution services business, which we are very excited about, as well as take care of all of our good customers around the globe. And just want to say, once again, how grateful Jeremy, Loren and I are for the hard work that you do.

That completes the prepared remarks this morning; so, at this point, we are prepared to open it up for questions. Adriana?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Kurt Hallead from RBC Capital Markets.

Kurt Hallead - *RBC Capital Markets - Analyst*

Thanks for all that color and detail. Much appreciated. One follow-up I would have, or point of clarity I would ask for, would the your views on backlog ending the year.

Your comment, I think, was in the low teens and, once again, just wanted to understand the semantics or definition of low teens. The way I would think about low teens would be $12 billion or $13 billion.

$1 billion, that would appear to me to be way too slow, predicated on the other commentary about slightly declining order book as the year goes on. If you provide a little more clarity on that, that would be very, very helpful. Thanks.

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

First, as you well know, our visibility into precision around orders is always limited, Kurt. But looking out into the second half of the year, we are coming off a March 31 balance of $16.3 billion.

If we fall short of the one-to-one book-to-bill for Q3 and Q4, that could drift down a little bit. It certainly would be expected to drift down a little bit. We would define low teens as anything south of $15 billion and right now, that's our outlook.

I will stress, though, that we are very encouraged to see land orders picking up, stimulation equipment picking up. We are encouraged for improvement in our FPSO orders later on in the year. There's a lot of moving pieces here, but we are just trying to provide a little more color.

I think [12 or 13] would be lower than we would expect at this point. I think you're probably looking at something in the $14 billion, $15 billion range.

Kurt Hallead - *RBC Capital Markets - Analyst*

Great. Thanks. Appreciate that. The follow-up I would have would be -- what's your take on the situation in Russia? There were sanctions, obviously, announced this morning. Might be a little bit too early for you to make that assessment, but it looks like Rosneft was one of the companies that was -- that sanctions were put on.

I know you have a facility that's being manufactured in Russia. Just trying to get a handle on how to risk assess that from that standpoint.

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

We do. We've been investing in Russia and are building a facility to actually rig up plant rigs in that country. That's obviously a quickly evolving situations there, so we've been watching it very, very closely.

We have lots of customers in Russia, including western companies that operate there. We will have to see what the sanction -- the specifics around the sanctions, in terms of the impact on our business. But we've been a supplier of equipment into the Russian market for many, many years and have a pretty diverse customer base there.

Kurt Hallead - *RBC Capital Markets - Analyst*

Thanks. Appreciate that.

Operator

Jim Crandell from Cowen.

Jim Crandell - *Cowen Securities LLC - Analyst*

First, I would just like to second your comments, Clay, that you made about Pete and the outstanding job he's done over the past dozen or so years as CEO. I have questions about the order outlook for three distinct areas, Clay, and I will just lay them out here and let you answer.

One is, FPSOs and if you expect a better order picture there and how quickly you see that segment improving. Secondly is Russia, particularly in light of you building this new plant, we might see in terms of an improvement in land rig orders there.

Then thirdly, well stimulation. If you could answer well stimulation in the context of how big was that last time, and how meaningful could that be to Nation in the next cycle?

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

You bet, Jim. Last year, with regards to FPSOs, we had over $1 billion in FPSO-related orders, primarily turret mooring systems for vessels, along with flexible pipe that plugs into those turret mooring systems. In addition to those two major products, we also sell a lot of composite piping systems into FPSO vessels.

Very strong year for orders and improving P&L results coming out of those orders, so we were very encouraged. As I mentioned in my prepared comments, Q1 orders for FPSOs dipped down a little bit, but we do think that's just a function of timing. We think both for flexible pipe is well as for vessels, Q2 and Q3 and looking much better, and so we are encouraged by that.

With regards to Russia, as I just mentioned, we are investing in another facility there. We have manufacturing operations for many years in Belarus, which primarily supplies the Russian market. A couple of years ago we opened another facility in Nizhnevartovsk.

So it's a market that has a lot of potential. There are something on the order of 800 rigs operating in Russia, and most of those are older technology. There's a growing recognition, I think amongst Russian oil companies for the need for new technology, much like their counterparts in North America and elsewhere around the globe.

Our idea is to expand our footprint in Russia, and in particular, our aftermarket support of that fleet. Under our current plans, that particular facility was slated to open up and start producing revenue probably the second part -- second quarter of 2015. Very encouraged about the progress on the plant, sanctions notwithstanding. Obviously, we are keeping a close eye on that, as I just mentioned.

Finally, the well intervention stimulation business, as we mentioned, we are very encouraged there. We saw orders slow way down through 2013.

We continue to deliver a backlog, and so the P&L for that business has been coming down. But last quarter, our Q4 2013 and then Q1, the quarter we just finished, we saw orders begin to tick up and are really encouraged for new capital equipment and also a lot of the consumables that we see in that business. That's what we are seeing across those landscapes, Jim.

Jim Crandell - *Cowen Securities LLC - Analyst*

Okay, and if I can just get a brief follow-up. On the -- on your FPSO answer, are you seeing any progress with the customers in order willingness, to try to order a standardized package?

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

I would prefer to use the term configurable package, Jim. What we're trying to do are standardized interfaces between modules, and make the vessels, overall, more configurable.

Yes, what we are running into at the senior level among many of our customers is this recognition that their prior projects haven't gone particularly well economically. It's a combination of vessels running over their original AFP amounts, plus delayed first oil because of late delivery of those projects.

Arguably, I think, the project can be challenged. So we are gaining an audience at the highest levels of a couple of the oil companies and are encouraged with a couple of specific, two in particular, specific projects we are bidding this concept into. We think there will be more to come.

It's very early days, and we know from our drilling rig transformation experience, changing the status quo in this industry is a long-term effort to generate success. But we do think we have a better way, and we actually think the recent concern that oil companies are expressing publicly about their economic returns around those projects provides a good backdrop to go in and have those kinds of conversations.

Jim Crandell - *Cowen Securities LLC - Analyst*

Thank you, Clay.

Operator

Marshall Adkins of Raymond James.

Marshall Adkins - *Raymond James & Associates - Analyst*

Clay, you guys have more than a pristine balance sheet, and you've got pretty substantial free cash flow. I will go ahead and asked the question I've been getting a lot. Any -- what's your latest in terms of thoughts of what we do with that cash here in the next year or two?

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

Marshall, historically, we have paid a dividend. We began paying a dividend in 2009, both a special and a regular. We doubled that dividend last year. I would tell you, in the past, our preferred method of returning cash to shareholders, and I think that's what you're talking to --

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Marshall Adkins - *Raymond James & Associates - Analyst*

Correct.

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

- - has been around the dividend. We agree, we have a very strong level of cash flow, and in our meetings with our board upcoming in May, we plan on discussing the level of dividend with them. As well as other alternatives, including share buybacks or some other use of cash.

We will see how that turns out. But I would say that we are looking hard at the meaningful increase in the dividend again in May.

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

The other things I would add to that, Marshall, we intentionally took a pause from acquisitions following the Robbins & Myers acquisition in February last year. We consummated about 20 deals in about a 16, 17 month span, and needed some time to digest what we'd acquired.

I'd say we've done that now. We've got good integration of work, we're just about done with the spin, which is consuming a lot of resources. But I think you will see us get a little more active in that market again.

Deals are looking pretty good right now. I'd say we have got a pretty full pipeline, most of them are smaller in nature. Most of them are internationally based, which is good since 88% of our cash at the end of the quarter is overseas.

We will continue to look there, as well. We still have a couple of fairly significant CapEx projects, including the Russian facility, we're doing some work in Saudi, certainly some work in Latin America, primarily Brazil, that will consume some cash.

Marshall Adkins - *Raymond James & Associates - Analyst*

Right, and the follow-up there, Jeremy, you mentioned you're putting in an ELP system and SAP. A lot of times that creates some short-term disruption as it's going in. Tell me how that's progressing and where you stand on all that?

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

We don't have a common ERP platform across of all of NOV. The distribution and transmission segment functioned on SAP prior to the acquisitions of Wilson and CE Franklin.

They're going through the conversion process now to upgrade their SAP platform and then bring over the Wilson and CE Franklin's businesses. That's going extremely well. Obviously, these are always somewhat disruptive, but we've had SAP in our business since 2000 I believe, maybe it was 1999.

So, we have got some strong subject matter experts around the world in that area. In some of our PS&S segments -- our current PS&S segments, it's not as if we are implementing a common ERP across that old segment. It's each individual business within the segment who are converting over to something a little more robust, now that we are far more global and much larger and more complex.

I don't expect any majors disruptions, Marshall. Certainly, there's going to be some little hiccups here and there, but I don't think it's going to be anything material.

Marshall Adkins - *Raymond James & Associates - Analyst*

Sounds good, guys. Thank you.

Operator

Brad Handler from Jefferies.

Brad Handler - *Jefferies & Company - Analyst*

I think you've outlined in some previous calls that your pace of delivery of offshore rigs is running right around the 50 plus mark, I guess it did last year, it is this year. It is into 2015, if I read it correctly.

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

That is correct.

Brad Handler - *Jefferies & Company - Analyst*

That's correct? Okay, good. Can you -- what you have done so far, what you are in the process of tying together in terms of workforce addition, capacity addition from a plant standpoint, is that enough? Or should we expect continued initiatives along that vein as you live with what choices you've made?

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

I think we are building up to a level of capacity that fits that level. If you look back, Brad, over the last couple of years, orders began flowing in earnest late 2011, 2012.

We rebuilt our backlog up to a new record levels here more recently. We began to experience supply chain challenges in the first components that go into rigs, which are typically mud pumps.

Then as we worked through those and gotten better at that, the next wave that we saw was rig floor equipment, derricks, finally BOPs last year were the source of some challenges, and then more lately it's been I&C. What you've seen is that as this -- as the pigs move through the snake, it's tracked the equipment that has had to be delivered into this extraordinarily high level of rigs that we are delivering.

Why we are so confident, we know where it's going to get a lot better is that piece by piece, we successfully challenged our supply chain issues and worked through those short term challenges as we ramped up our capacity. We are addressing that, and we feel like we are in the last phases of it.

A record level of installation commissioning work going on in shipyards right now to accommodate a level of rig deliveries, which is effectively double, our prior peak in 2008/2009, and dealing with shorter delivery times and the like, and we're making progress on it quarter by quarter. That's the progression of things.

The -- with regards to that last piece of the fabrication puzzle, the installation and commissioning. We now have six technical colleges around the globe, and are going to eight shortly to train our service technicians who both perform installation and commissioning work on new build rigs, as well as repair older rigs. It's a virtual skill set.

When we look out over the next four or five years, we see a tremendous number of offshore rigs having to come back in for their five-year surveys. This is a workforce that we are training to handle the I&C work on new orders, and we foresee a few years out.

Then, a portion of those would be redeployed into our next pressing challenge, which is to handle the flood of rigs coming back into shipyards to be -- see overhauls and upgrades of the equipment that's on those rigs. This is a workforce that we see a lot. We are going to keep them pretty busy for the next several years.

Brad Handler - *Jefferies & Company - Analyst*

Makes sense. (multiple speakers) Sure.

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

One thing to add to that would just be, as you look at capacity additions on a go forward, what I think you might see is more regionally specific capacity additions where you see places really strong and growing markets, say, in Saudi Arabia where they are pushing for more and more local content requirements. This has also obviously happened in Brazil and happening in Russia, you're seeing it in Argentina, it will be in Mexico. I think if you see capacity additions on a go forward, they will be smaller in scale, not nearly requiring the same level of CapEx and far less disruptive, but it will be to capture new and growing markets.

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

(Multiple speakers) Primarily (inaudible) market support.

Brad Handler - *Jefferies & Company - Analyst*

Makes sense, makes sense. As a related follow-up, and maybe it is going to be certainly broader than just that part of rig tech or the legacy rig tech. But in general, what you've just described is leveraging what you have put into place, appreciating some smaller editions.

Obviously you have a lot of optimism around some improving mix over the course of time as some of the well stimulation equipment comes back. You get a little bit better pricing in backlog, as you described. All things are pointing to what you have described for us in the past, as an improving trend.

Is there any change to that thought, if we start to think about margins in rig tech over the course of the next couple of years, is there any acceleration to getting back to that mid-20s level, for example? Do see any signs that, that might, maybe because of the US land market, that, that might happen a little bit more quickly than you have suggested to us in the past?

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

It is certainly encouraging as we see other parts of the rig tech business pickup, and that will help us on that front. The plain driver here, though, is continuing to gain experience on these new rig floor layouts. We've talked in previous calls about new class specifications for the crop of deep-water rigs that have been ordered recently, new refloor layouts.

We negated some of the learning curve effects from the 2008 cycle. We know from history, across all of our businesses, once we are making the second copy and the fifth copy of the tenth copy of something, we always get better at it. Costs always come down, and we are moving into that phase for this new crop of rigs, too. I would say that the main engine, and then the other improvements in other parts of our business are additive to that.

Brad Handler - *Jefferies & Company - Analyst*

Great, okay, got it. Thanks, guys. Appreciate the color.

Operator

This will be the last question in our Q&A session. Michael LaMotte from Guggenheim.

Michael LaMotte - *Guggenheim Securities - Analyst*

Clay, did I hear the words share repurchases come from your -- come forth from those lips (laughter)?

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

Michael, to be fair, we've always considered share repurchases along with dividends, and we will continue to look at that. So, yes. Also, too, as a reminder, at Varco, prior to the merger, we had are share repurchase program, so we are very familiar with the math and the concept.

Michael LaMotte - *Guggenheim Securities - Analyst*

Yes.

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

But to be fair, we have a track record out paying a dividend, and our recent thinking around this subject with our board's counsel has been more along the lines of dividends.

Michael LaMotte - *Guggenheim Securities - Analyst*

Understood. Just wanted to make sure there wasn't a change there. I'm struck by looking at the rig tech business and thinking about how in an up cycle you are focused on making sure that your pricing is running ahead of your inflationary pressures so that you can grow margin.

When you are on the downside of working the rat through the snake, you are really focused on efficiency and delivery as the emphasis on margin. I'm wondering, as the volume scales back from 50 floaters a year delivery to something less than that, how do you manage the absorption issue, in terms of potential margin pressure?

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

Thank you. That's a great question. First point of clarification, when I say 50 rigs a year, that's jackups plus floaters.

Michael LaMotte - *Guggenheim Securities - Analyst*

Right.

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

But certainly, cyclicality and in our business is not news to us, and historically, this business has been up and down. We, I think, are very, very good at managing both the ups and downs.

The good news for us, again, is the fact that the five-year SPS cycle for these rigs kicks in earnest. In fact, in the year 2017, 2016, 2017, really ramps hard. Even if the new build infrastructure slows down, we are going to be very busy in the shipyards with rigs coming in a lot.

By the way, to provide further clarification around this, the vessels have to come in for hull inspections for insurance, for Coast Guard certificate purposes and the like, every five years. As part of that downtime in a shipyard, they will do a lot of work on the drilling equipment packages at the same time, because the opportunity cost of being out of service for month or two is so high.

That drives a lot of work for us in serving those rigs, repairing that equipment, replacing and frequently upgrading equipment as part of those rigs. We see our installed base driving very bright prospects over the next few years, and so that will do a lot to help keep our folks very busy. I think the aftermarket portion of our business does a lot to bring stability to an otherwise more cyclical business.

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

Another thought on that, Michael, is when we made the decision to add capacity in our rig tech segment, we were operating at three shifts, outsourcing way too much, expediting freight. We added the capacity with the hope that we could bring that down to a more balanced level of capacity in our plant, maybe two ships, not outsourcing as much, not expediting. Then we had a record level of orders last year.

We're still operating at three shifts. We've reduced our outsourcing certainly and certainly reduced the expediting of freight, but we're not at optimal levels at this point in time. So, a slight slowdown would not be the worst thing in the world from a margin standpoint and efficiency standpoint.

Michael LaMotte - *Guggenheim Securities - Analyst*

Okay, great. So, really two -- if I can summarize, just two real sources of leverage. One, the efficiency, Jeremy, and two, utilization doesn't fall off necessarily with the volume because of aftermarket coming back in.

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

Correct.

Michael LaMotte - *Guggenheim Securities - Analyst*

Thanks, guys.

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

Michael, [before we see that subject too], let me throw in that we are very optimistic about the land rig opportunity before us, and -- both in North America and elsewhere. This business shares a lot of resources between land and offshore, as well. So, this is a particular area of strategic focus going forward. The need to continue to upgrade the land rig fleet, and so I think that will help provide additional source of work going forward.

Michael LaMotte - *Guggenheim Securities - Analyst*

Great. Thanks, Clay.

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

I want to thank all of you for joining us this morning. We look forward to speaking to about our second quarter results in July when, as another reminder, we will be reporting along our new segment reporting lines. Thanks very much, and have a great week

Operator

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