

National Oilwell Varco, Inc.

Analyst Day 2014

Building Leadership the NOV Way

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Tom McGee is Vice President, Corporate Development for NOV, where he manages acquisition, investment and partnership activities. Tom has prior experience in investment banking, management consulting and international energy corporate development.

Oilfield is a fun place. We get to go to a lot of places. We occasionally go to dangerous places. Standing between a group of people in the oilfield and an open bar might be the most dangerous place I've ever been. I'm going to try to be fast. I recognize I'm wrapping this up.

I want to talk to you about building leadership and how we build leadership through investment. First, I think you'll hear a lot about this over the course. You've heard it today. You'll hear it again tomorrow. We're leaders in everything we do. We look for fragmented markets where we can combine products and technologies into leadership position. We can gain a competitive advantage. We look to sustain that competitive advantage, and we think that generates results for your shareholder base.

I'm going to start with results because I know a lot of people have questions on the M&A side, how do we measure how we do? At the very highest level -- and we'll get more granular from here. At the highest level, we're looking at cash flow per share. That's a unit someone owns when they own NOV. Our cash flow per share when you look at -- this is a post-merger look, post National and Varco, from 2006-2013, it has gone up three times. That is substantial in excess of any industry metric that you can put up there. We are growing much faster than the market and we're growing cash. Cash is what matters to us, and we'll talk about that more in a minute.

I'm going to take a more granular approach and start by saying, I know a lot of you thinking well, Rig Systems had a great run during that time and it did. It's not just Rig Systems. Now these are -- for competitive reasons, kind of disguised, but we're going to show you some of our business units. If you go back to 2006 and look at the business units that existed then and use revenue and you guys know our margin profile and have a pretty good understanding what that looks like, so you can back into that.

Look at what the business units have done in terms of growth from 2006-2013. This is ultimately how we measure the success of our investments. It is a system. A business unit is a system functioning together. It's a business that's running. It's growing organically. We're investing in transactions to grow that business and it's working. When we look at this, we look at it on an annual basis during annual plan, during mid-year plan. To the extent, we can isolate and measure something more specific and actual, actually we do it and we do look backs. At the highest level, if it's working, this is what we look at.

Getting into returns and I do want to talk a little bit about returns. I know a lot of people have questions about that. As we said before, it is difficult to isolate and measure returns when you're building a system and it makes it a little more complicated than a discrete financial investment. That said, if you look back at our DCF models and look at what we expect and look at what the result has been, we see a median kind of cash return of about 17.5%. We see a capital weighted average cash return in the 12% to 14% range. I think we're comfortable with the results we've generated. As we've said before to this community, when you take those returns and talk about a little more detail and kind of talk about different types of transactions, we have larger more transformative transactions. Those are generally going to be slightly lower return. And what I mean by that is low-to-mid double-digit cash returns.

When you get into what we do every day and the vast majority of the deals we do, no one knows about it. We're under the radar. There are smaller transactions. There are negotiated transactions. We'll talk more about that. When we get into our run-of-the-mill transactions, you're talking about mid-to-high 20% type cash returns, those are frequent. We even have some larger deals like Ameron, the public company we bought, fiberglass pipe business a couple of years ago. Ho Chang in Korea when we built out our rig fabrication capability in Korea. We do have some larger capital outlays that fall into that really nice sweet spot of returns.

We do a lot of little deals. We'll talk more about these in a minute as well. These are companies we can buy at attractive multiples and we



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can frequently double or triple the business in fairly short order. We see returns on some of those smaller transactions well in excess of 20%. That gives you a range of how we look at returns and how we measure our success. I don't mean to imply that we're batting 1,000, we're not. We have been very successful in the aggregate and to the extent, we can measure something specifically.

Now stepping back into who we are and what we do. Acquisitions are in our DNA. Acquisitions built this company. I think Clay lead it off by talking about this. I mean it's who we are, it's what we do. It's a competitive advantage for us. Right now, we're buying 10 to 15 companies a year and we'll talk about the types of deals we do in a lot more detail, but it's just -- it's something that we do on a regular basis and we're good at it.

What makes us good at it? I think this is important because we view it as competitive advantage. Clay started this off by talking about our private equity roots, talking about the transactional nature of who we are and how we are constantly looking at a portfolio, trying to improve it, trying to invest to grow and trying to make sure that we're doing the right deal from a financial perspective. That's important.

Industrial insight, we'll talk about that more in a minute or two and how we use industrial insight as a competitive advantage part of this process. But the last two to me are really what matters. That's kind of a good background, but we're the most experienced acquirer, that matters. We're integration experts, that matters. Those are the two things that I think really set us apart. When you've done over 200 transactions and we'll talk about this in more detail too, you've seen just about everything you can see. We've seen every problem. We fixed almost every problem. We're integration experts. We'll talk about why that matters too, but this is where people live and die in M&As with integration and making sure you get that right.

First, we're going to go back in history. This is an old slide. This isn't pretty like the rest of the ones you've seen, and it's not just because I'm lazy. This actually goes back to when we were talking about the fact the rigs are old. I won't belabor the point, you get it, but this was the type of analysis we were doing back before we started making investments. This walks back -- all the way back to 1996 and you think about -- and by the way, I know I'm stealing some of Joe Rovig's thunder on this, but I'll buy him a drink at the open bar to make up for it later. You will see a lot more about this in our rig presentation tomorrow. I'm going to walk through it fairly quickly.

The point is we had some form of insight. Rigs are old. We had data to support it. We did a lot of analysis, and we invested aggressively behind it to make sure we are ready to capitalize on it over the course of the decade. We started just by the Top Drive, selling some kind of discrete components. You start building out of the discrete components. Start thinking, while there are other things that you sell along with the Top Drive, we've got a derrick, we've got some cranes, we started adding some additional land rig capability. We've got solids control, mud pumps step into the Hitec and IRI acquisition. The Hydralift acquisition in Norway truly helped our project management expertise. I want to focus on Hydralift for just one second, because I'm going to come back to this concept.

Backlog after we bought Hydrarig, backlog for Hydrarig went to zero. I don't think anyone would dispute the success of what we've done in that market today. It's important to remember that there was a time when we were investing years ahead of the trend and that's what ultimately paid off for us. Anyway with the National/Varco merger, you guys know what happened. We started with the pieces; we ended with a complete land rig package; we ended with a competitive advantage in the end. We had a market-leading product with a single control system that we are able to turn into a package. That's what we mean when we talk about building leadership, the NOV way. You start with fragmented industries, attractive industry structures, possibility technology leadership, you buy a few products. Examples of this that aren't rig related; APL, turret makers for the FPSOs; NKT, flexible pipe maker on the offshore production environment. We'll talk more about that. Additive deals, you then get into where you start to add pieces together whether it's small technologies for downhole where they need another technology to be able to complete the drill string or it's a new rig technology. You start to add pieces together, you get into a more transformative stage where you are able to put a package together, start working with your customers, deliver them value results in competitive advantage and value to us.

Finally, you get to the point where you partner with your customer, and that's where rig is today, and I think Joe will talk a lot about that. I want to set up this framework so when you see the other business units, Wellbore and Completion and Production, we are investing to do the same thing in those businesses. We're investing in the same way we did in rig, and they are starting to evolve and there are different stages. We have different businesses at different stages, but they're evolving towards the same state where a customer can call you and tell you the challenges they are facing in the Marcellus and you design a rig to meet those challenges. That's where we want to be.

Let's talk about competitive advantage because we talk about investing for competitive advantage and saying, we want to maintain competitive advantage. What does that mean? Let's try to give you some more specific examples and Clay touched on this as well. I mean market leadership is the key. It makes it a low risk purchase. If you're thinking about getting your pipe inspected and side passed by Tuboscope, take it across the street, save a buck a joint and there's the twist-off in the well and you've got a problem, that person is



probably going to lose their job, who made a decision to save a buck by taking it across the street from someone you knew was going to do it right and he was the market leader. That's market leadership. First mover advantage, we just opened a plant fairly recently, spoolable fiberglass pipe plant. This is big stuff. It's really expensive to ship.

We have a protected geography around that plant. We were aggressive. We saw an opportunity with the balance sheet to do it. We've built the plant and we expanded and we're going to have that market and that's what is first-mover advantage. There are times where you can create advantage just by being willing to move into a market and establish a presence.

Scale economies, and this is something that gets thrown around a lot, so I want to talk about a couple of examples, very specific examples here, Ameron and Fiberspar, two transactions we've done with the fiberglass. When we did those transactions, we had a contract in hand that said, we can buy fiberglass cheaper than they're buying it and we'll talk about the power of having specific cost-savings opportunities like that when you do transactions. RBN, Robbins & Myers, same thing, power section spin, we knew we could save 2.5% on the cost of goods going into the power sections. We had a contract that said we could do that.

Just more of a generic comment, global expansion, when you're operating around the world and you're doing business, some of the places we do business in, having that infrastructure and having that support allows you to do deals that other people cannot do.

Installed base, we've got the largest installed base of coiled tubing units, wireline units, well service rigs, land rigs, jack-up, floaters, and turrets. This gives us tremendous staying power with our customers, it gives us unique industry insight and it means that we can continue to evolve to meet their challenges. That's a very powerful competitive advantage for us. Finally, this leads to growth in after-market, which you're going to hear a lot about tomorrow.

Talking about the M&A process, the most important point I can make is we got 61,000 people out there doing this. Everyone's wired to do this. It's not just a little team of people, who sit and field phone calls. This is a team effort, everyone in the world is out actively looking for opportunities. There is a creative tension our organization that's designed to help us process and evaluate opportunities. We've got people who run businesses, who we want to be unbelievably passionate and excited about the opportunity they bring forward and we need to close that transaction, they're going to own it, they're going to drive for success and they do succeed every time and we want them to be passionate.

We want a dispassionate process on the capital allocation side and so there's that creative tension, it's a positive working relationship. We have to make sure that we are good stewards of your capital and have people that are really fired up to put it to work. Boots on the ground bring us our transactions and this is hard to emphasize enough. I think there is a perception some people have as I just talk to even friends about how we do M&A. We don't wait for bankers to call. We field phone calls from people around the world, we get on a plane, we go to Brazil, we go to Korea, we go to Russia wherever it is, we respond to people who are on the ground working for NOV, who call and say I have someone that you need to talk to.

This is, I think, the way a lot of people do this. I mean on the buy side, we are represented by a banker under 5% of the time. Now, don't go back and tell your investment banking colleagues that please, although most of them already know it and complain about it. On the sell side, when we actually are buying a company, sometimes there's a representative representing their company, but still under half the time, a lot of our deals are negotiated and that's so important. It's important about building a relationship with those sellers, but also it leads to generally a better outcome.

A couple of examples, we bought a downhole company in Brazil a few years ago. Again, that's an opportunity that was brought to us by our operations. They called us. Said we got a great company down here, we think it would really help our market presence, we get a local manufacturing capability and we're able to better serve this market. We did that transaction, it was a one-on-one transaction. A few years ago, one group called up and said our vendor in Korea does fantastic work, we could do a lot with it, we think we can really grow the business, we think it will really help our customer base if we entered ourselves; again one-on-one negotiation.

Before the spin of DNOW, we had done deals for distribution in Kazakhstan and Russia. These things just aren't possible without the infrastructure we have around the world, those boots on the ground, which leads to the next point, which we are terrible at winning auctions and proud of it. This took me a while to get used to, when an investment bank calls up, it's running an auction process and tells you that someone's doubled your bid, like Tag Consulting, we have a CEO who gives you a high-five when he hears that, which reinforces some value discipline. We're not good at winning auctions and we like to get out and outwork people rather than wait for the phone to ring.

Finally, look this takes patience, it takes years, not months. So much of these deals or transactions are about building relationships and



whether it's with the public company or an entrepreneur, it can take years to develop a relationship for it's a consummated transaction.

To talk a little bit about valuation and you guys know how to value a business. I'm not going to tell you how to value business. I'm just going to make the point that operating cash flow less CapEx is value to us. Cash flow is what matters to us in the long run. We look at cash flow. I will take this point to say that we closed on one in seven or one in eight of every deal that we look at; so kind of rough ratio. A lot of it falls apart on value, because we maintain value discipline. It's very important.

I want to speak a little bit about landmines that we see -- that we avoid falling into with our process. First is synergies. I really don't know what synergies mean. I don't use the word, I don't let anyone use the word. In my experience, it means we're overpaying. You really break it down into two things, you have cost savings and you have revenue enhancements. To us, a cost saving, it's a hard schedule of cost savings. It is saying I have a contract that we talked about before, to buy fiberglass at 2% cheaper once I buy this company, it's a hard contractual range, but we don't believe in magic efficiency ones.

NOV doesn't buy something, walk in and say okay, your margin is at 21%, now it's a 24%. That's not how business works, hard cost savings are what matters. When we're looking at transactions, we're factoring hard cost savings. Revenue enhancements, they better happen and they do happen. If you factor them in, you really haven't created any value first of all. Secondly, they are challenging and we approach those with a very sober perspective to make sure that we can deliver on that and we think that the way we value things needs to be the value of the asset itself.

Capital intensity, as you guys are well aware of, but I'd see we see a lot of people in the M&A environment underestimate capital intensity, underestimate the amount of CapEx needed to maintain a business. Cycles, we all know is a cyclical industry. Take this a step further and say we'd like to understand how companies behave during this cycle both up and down. A number one in an industry behaves very differently than the number three in terms of revenue progression and margin profile, that matters. We're valuing something obviously to say we run downside scenarios, of course we do, but that downside scenario isn't just market falls. It's how does this business react when the market falls, because those are again how market leadership reacts very differently than number three or number four.

Finally, it's value of the asset, not the cost of the funding. We demand a return from each asset that's commensurate with the risk of that asset, not just based on what we can finance something at. Due diligence is where experience really pays off. We are experts and we're proud to say that. You can't replicate the experience we have. We have an environmental guy, who's walked in excess of 1,000 facilities. When that person calls you and says you have a problem, you have a problem, you better listen. When you get a call and say you don't, you don't, you can't replicate that experience.

We have an HR and IT organization and I want you to ask, just as fun, go ask another company who does deals, ask how their HR and IT teams respond when they call them and tell them they're going to do a transaction. Ours thrive on it. They get excited. They get fired up. They get bored if we're not doing it. They call me and say we're bored, what can you give us, we need a challenge? You just can't replicate that and we're proud of that.

Practical experience matters. We know what matters and what doesn't. When we go into due diligence, we cut to the chase, because of the history, we don't need to check the box on things, we can look at something and understand whether it's a risk or not. We involve operations upfront. This is very important. It's a team effort. We don't believe in handoffs. We're not going to call up one of the guys and say, "Hey, we bought you this company, good luck with it." We have senior management from business units and financial management business unit is involved every step of the way when we do a transaction. It's very important to our success and it gets you ready for integration.

As I said before, we've seen everything in the diligence we've done and we're ready for it and we don't panic, we don't run, we evaluate the risk, we make a decision on whether it's appropriate or not for our shareholders. Which leads us to integration. This is where companies live and die by M&A. You've got to evolve operations up front, which I think helps, you evolve your corporate functions upfront, but take you through how we think about this, it might be a little bit different. Say your doing a large deal, pick a big transaction, big public company and you decide to start working on integration. You form a team of people at NOV and then you form a team of people at the company being acquired. I mean those people start meeting, they can't do very much and it's awkward because no one really knows what's going to happen and what you end up with is you end up with Republicans and Democrats arguing over what color to paint the trucks. We really just reject that form of integration. We think it's wrong. We think its conventional wisdom and we think it's wrong. Our approach is a lot -- in some respects, we wait on a deal like that until it's little bit closer to closing. When we are close to closing, we show up, we act very quickly, very decisively, set the organization and then let people get back to work.

Integration -- once an organization is set and people know where they stand, they get stuff done and they get back to taking care of the



customer. That's what matters. You cannot move fast enough and our experience prepares us for that. People don't panic. They show up a couple weeks, say let's roll up our sleeves, let's get it done. We've done it before, we'll do it again. That integration is just so important and of course we have the standard stuff you hear about. We have the standard textbook approach. We have a very long list of things that need to get done but the most important thing is you've got to move quickly, set the organization, let people know where they stand and let them get back to work; and that's how we succeed in integration.

Just wrapping up real quick. Why do we think we're successful? We've got passionate people that run businesses that are very excited about the opportunities we're looking at. We've have a dispassionate capital stewardship process. We cultivate that healthy tension on purpose. We've talked about industrial vision. You'll hear a lot about that tomorrow with the framework that we laid out for you today. Urgent integration and we measure everything we can and if that's -- we've talked to you about returns, it's also about measuring tasks and making sure that things don't fall through the cracks. That's to us, that's how we succeed in M&A. That's it.

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