

NATIONAL OILWELL VARCO INC
Form 10-Q
October 26, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934
FOR THE QUARTERLY PERIOD ENDED September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934
Commission File Number 1-12317

NATIONAL OILWELL VARCO, INC.

(Exact name of registrant as specified in its charter)

Delaware 76-0475815
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

7909 Parkwood Circle Drive

Houston, Texas

77036-6565

(Address of principal executive offices)

(713) 346-7500

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer	Non-accelerated filer
Smaller reporting company	Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of October 19, 2018 the registrant had 383,366,548 shares of common stock, par value \$0.01 per share, outstanding.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

NATIONAL OILWELL VARCO, INC.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In millions, except share data)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,293	\$ 1,437
Receivables, net	2,005	2,015
Inventories, net	3,177	3,003
Contract assets	483	495
Prepaid and other current assets	263	267
Total current assets	7,221	7,217
Property, plant and equipment, net	2,813	3,002
Deferred income taxes	13	13
Goodwill	6,339	6,227
Intangibles, net	3,072	3,301
Investment in unconsolidated affiliates	304	309
Other assets	131	137
Total assets	\$ 19,893	\$ 20,206
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 675	\$ 510
Accrued liabilities	1,023	1,238
Contract liabilities	570	519
Current portion of long-term debt and short-term borrowings	8	6
Accrued income taxes	—	81
Total current liabilities	2,276	2,354
Long-term debt	2,706	2,706
Deferred income taxes	672	677
Other liabilities	263	309
Total liabilities	5,917	6,046
Commitments and contingencies		
Stockholders' equity:		
Common stock - par value \$.01; 1 billion shares authorized; 383,345,734 and		
380,104,970 shares issued and outstanding at September 30, 2018 and		
December 31, 2017	4	4

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Additional paid-in capital	8,361	8,234
Accumulated other comprehensive loss	(1,328)	(1,110)
Retained earnings	6,869	6,966
Total Company stockholders' equity	13,906	14,094
Noncontrolling interests	70	66
Total stockholders' equity	13,976	14,160
Total liabilities and stockholders' equity	\$ 19,893	\$ 20,206

See notes to unaudited consolidated financial statements.

NATIONAL OILWELL VARCO, INC.

CONSOLIDATED STATEMENTS OF INCOME (LOSS) (UNAUDITED)

(In millions, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue	\$2,154	\$1,835	\$6,055	\$5,335
Cost of revenue	1,761	1,550	5,020	4,610
Gross profit	393	285	1,035	725
Selling, general and administrative	320	292	911	891
Operating profit (loss)	73	(7)	124	(166)
Interest and financial costs	(24)	(26)	(71)	(77)
Interest income	6	11	18	19
Equity loss in unconsolidated affiliates	(2)	(2)	(1)	(4)
Other income (expense), net	(20)	(16)	(70)	(36)
Income (loss) before income taxes	33	(40)	—	(264)
Provision (benefit) for income taxes	29	(13)	37	(43)
Net income (loss)	4	(27)	(37)	(221)
Net income (loss) attributable to noncontrolling interests	3	(1)	6	2
Net income (loss) attributable to Company	\$1	\$(26)	\$(43)	\$(223)
Net income (loss) attributable to Company per share:				
Basic	\$0.00	\$(0.07)	\$(0.11)	\$(0.59)
Diluted	\$0.00	\$(0.07)	\$(0.11)	\$(0.59)
Cash dividends per share				
	\$0.05	\$0.05	\$0.15	\$0.15
Weighted average shares outstanding:				
Basic	379	377	378	377
Diluted	383	377	378	377

See notes to unaudited consolidated financial statements.

NATIONAL OILWELL VARCO, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

(In millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income (loss)	\$4	\$(27)	\$(37)	\$(221)
Currency translation adjustments	(32)	124	(219)	290
Changes in derivative financial instruments, net of tax	2	25	1	53
Comprehensive income (loss)	(26)	122	(255)	122
Comprehensive income (loss) attributable to noncontrolling interest	3	(1)	6	2
Comprehensive income (loss) attributable to Company	\$(29)	\$123	\$(261)	\$120

See notes to unaudited consolidated financial statements.

NATIONAL OILWELL VARCO, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In millions)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net loss	\$(37)	\$(221)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	519	523
Deferred income taxes	15	16
Equity loss in unconsolidated affiliates	1	4
Other, net	129	141
Change in operating assets and liabilities, net of acquisitions:		
Receivables	37	13
Inventories	(193)	103
Contract assets	12	147
Prepaid and other current assets	3	95
Accounts payable	152	36
Accrued liabilities	(239)	(50)
Contract liabilities	50	(152)
Income taxes payable	(81)	(72)
Other assets/liabilities, net	(68)	(72)
Net cash provided by operating activities	300	511
Cash flows from investing activities:		
Purchases of property, plant and equipment	(173)	(127)
Business acquisitions, net of cash acquired	(280)	(85)
Other	61	28
Net cash used in investing activities	(392)	(184)
Cash flows from financing activities:		
Payments against lines of credit and other debt	(6)	(4)
Cash dividends paid	(57)	(57)
Activity under stock incentive plans	51	11
Other	—	(2)
Net cash used in financing activities	(12)	(52)
Effect of exchange rates on cash	(40)	39
Increase (decrease) in cash and cash equivalents	(144)	314
Cash and cash equivalents, beginning of period	1,437	1,408
Cash and cash equivalents, end of period	\$1,293	\$1,722
Supplemental disclosures of cash flow information:		

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Cash payments during the period for:

Interest	\$48	\$51
Income taxes	\$61	\$130

See notes to unaudited consolidated financial statements.

NATIONAL OILWELL VARCO, INC.

Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

The preparation of financial statements in conformity with generally accepted accounting principles (“GAAP”) in the United States requires management to make estimates and assumptions that affect reported and contingent amounts of assets and liabilities as of the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The accompanying unaudited consolidated financial statements of National Oilwell Varco, Inc. (“NOV” or the “Company”) present information in accordance with GAAP in the United States for interim financial information and the instructions to Form 10-Q and applicable rules of Regulation S-X. They do not include all information or footnotes required by GAAP in the United States for complete consolidated financial statements and should be read in conjunction with the Company’s 2017 Annual Report on Form 10-K.

In our opinion, the consolidated financial statements include all adjustments, which are of a normal recurring nature unless otherwise disclosed, necessary for a fair presentation of the results for the interim periods. Certain reclassifications have been made to the prior year financial statements in order for them to conform with the current presentation. The results of operations for the three and nine months ended September 30, 2018 are not necessarily indicative of the results to be expected for the full year.

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, receivables, and payables approximated fair value because of the relatively short maturity of these instruments. Cash equivalents include only those investments having a maturity date of three months or less at the time of purchase. See Note 7 for the fair value of long-term debt and Note 10 for the fair value of derivative financial instruments.

2. Inventories, net

Inventories consist of (in millions):

	September 30, 2018	December 31, 2017
Raw materials and supplies	\$ 627	\$ 656
Work in process	600	513
Finished goods and purchased products	1,950	1,834
Total	\$ 3,177	\$ 3,003

3. Accrued Liabilities

Accrued liabilities consist of (in millions):

	September 30, 2018	December 31, 2017
Compensation	\$ 281	\$ 345
Vendor costs	128	150
Warranty	114	135
Taxes (non-income)	103	152
Insurance	61	74
Commissions	38	58
Interest	27	7
Fair value of derivatives	13	8
Other	258	309
Total	\$ 1,023	\$ 1,238

Warranties

The Company provides warranties on certain of its products and services. The Company accrues warranty liability based upon specific claims and a review of historical claim experience in accordance with Accounting Standards Codification (“ASC”) Topic 450 “Contingencies”. Adjustments are made to accruals as claim data and historical experience change. In addition, the Company incurs discretionary costs to service its products in connection with product performance issues and accrues for them when they are encountered.

The changes in the warranty provision are as follows (in millions):

Balance at December 31, 2017	\$135
Net provisions for warranties issued during the year	27
Amounts incurred	(48)
Balance at September 30, 2018	\$114

4. Accumulated Other Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss) are as follows (in millions):

	Currency Translation Adjustments	Derivative Financial Instruments, Net of Tax	Defined Benefit Plans, Net of Tax	Total
Balance at December 31, 2017	\$ (1,104)	\$ 7	\$ (13)	\$(1,110)
Accumulated other comprehensive				
income (loss) before reclassifications	(225)	3	—	(222)
Amounts reclassified from accumulated				
other comprehensive income (loss)	6	(2)	—	4
Balance at September 30, 2018	\$ (1,323)	\$ 8	\$ (13)	\$(1,328)

The components of amounts reclassified from accumulated other comprehensive income (loss) are as follows (in millions):

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	Three Months Ended September 30, 2018				2017			
	Currency		Defined		Currency		Defined	
	Translation		Benefit		Translation		Benefit	
	Adjustments	Plans	Plans	Total	Adjustments	Plans	Total	
Revenue	\$—	\$ 1	\$ —	\$ 1	\$—	\$ (2)	\$ —	\$ (2)
Cost of revenue	—	2	—	2	—	4	—	4
Other income (expense), net	6	—	—	6	—	—	—	—
Tax effect	—	(1)	—	(1)	—	(1)	—	(1)
	\$6	\$ 2	\$ —	\$ 8	\$—	\$ 1	\$ —	\$ 1

	Nine Months Ended September 30, 2018				2017			
	Currency		Defined		Currency		Defined	
	Translation		Benefit		Translation		Benefit	
	Adjustments	Plans	Plans	Total	Adjustments	Plans	Total	
Revenue	\$—	\$ —	\$ —	\$ —	\$—	\$ (6)	\$ —	\$ (6)
Cost of revenue	—	(3)	—	(3)	—	8	—	8
Other income (expense), net	6	—	—	6	—	—	—	—
Tax effect	—	1	—	1	—	1	—	1
	\$6	\$ (2)	\$ —	\$ 4	\$—	\$ 3	\$ —	\$ 3

The Company's reporting currency is the U.S. dollar. For a majority of the Company's international entities in which there is a substantial investment, the local currency is their functional currency. As a result, currency translation adjustments resulting from the

process of translating the entities' financial statements into the reporting currency are reported in other comprehensive income or loss in accordance with ASC Topic 830 "Foreign Currency Matters" ("ASC Topic 830"). For the three and nine months ended September 30, 2018, a majority of these local currencies weakened against the U.S. dollar resulting in net other comprehensive losses of \$32 million and \$219 million, respectively, upon the translation from local currencies to the U.S. dollar. For the three and nine months ended September 30, 2017, a majority of these local currencies strengthened against the U.S. dollar resulting in net other comprehensive income of \$124 million and \$290 million, respectively, upon the translation from local currencies to the U.S. Due to the sale of a non-core industrial business, \$6 million of currency translation losses were reclassified from accumulated other comprehensive income (loss) into other income (expense), net in the Consolidated Statements of Income for the three and nine months ended September 30, 2018.

The effect of changes in the fair values of derivatives designated as cash flow hedges are accumulated in other comprehensive income or loss, net of tax, until the underlying transactions they hedge are realized. The movement in other comprehensive income or loss from period to period will be the result of the combination of changes in fair value of open derivatives and the outflow of other comprehensive income or loss related to cumulative changes in the fair value of derivatives that have settled in the current period. The accumulated effect was other comprehensive income of \$2 million (net of tax of \$0) and \$1 million (net of tax of \$0) for the three and nine months ended September 30, 2018, respectively. The accumulated effect was other comprehensive income of \$25 million (net of tax of \$8 million) and \$53 million (net of tax of \$15 million) for the three and nine months ended September 30, 2017, respectively.

5. Business Segments

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

	Three Months Ended September 30, 2018		September 30, 2017		Nine Months Ended September 30, 2018		September 30, 2017	
Revenue:								
Wellbore Technologies	\$847	\$693	\$2,351	\$1,862				
Completion & Production Solutions	735	682	2,143	1,982				
Rig Technologies	637	510	1,771	1,638				
Eliminations	(65)	(50)	(210)	(147)				
Total revenue	\$2,154	\$1,835	\$6,055	\$5,335				
Operating profit (loss):								
Wellbore Technologies	\$40	—	\$90	\$(81)				
Completion & Production Solutions	46	44	102	79				
Rig Technologies	58	18	138	37				
Eliminations and corporate costs	(71)	(69)	(206)	(201)				
Total operating profit (loss)	\$73	\$(7)	\$124	\$(166)				
Operating profit (loss)%:								
Wellbore Technologies	4.7 %	0.0 %	3.8 %	(4.4 %)				
Completion & Production Solutions	6.3 %	6.5 %	4.8 %	4.0 %				
Rig Technologies	9.1 %	3.5 %	7.8 %	2.3 %				
Total operating profit (loss)%	3.4 %	(0.4 %)	2.0 %	(3.1 %)				

Sales from one segment to another generally are priced at estimated equivalent commercial selling prices; however, segments originating an external sale are credited with the full profit to the Company. Eliminations include intercompany transactions conducted between the three reporting segments that are eliminated in consolidation. Intrasegment transactions are eliminated within each segment.

Included in operating profit (loss) are other items primarily related to costs associated with severance, facility closures, and credits for the reversals of certain accruals.

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6. Revenue Recognition

The Company's products and services are sold based upon purchase orders or other contracts with customers that include fixed or determinable prices and do not generally include right of return or other significant post-delivery obligations. The majority of our revenue streams record revenue at a point in time when a performance obligation has been satisfied by transferring control of promised goods or services to the customer. Revenue is recognized net of any taxes collected from customers, which are subsequently remitted to governmental authorities.

Payment terms and conditions vary by contract type. The Company's contracts are structured to align milestone billings with progress and revenue recognition, so generally do not include a financing component. We have elected to apply the practical expedient that does not require an adjustment for a financing component if, at contract inception, the period between when we transfer the promised goods or service to the customer and when the customer pays for the goods or service is one year or less.

The Company elects to treat shipping and handling costs as costs to fulfill a performance obligation instead of as a separate performance obligation. We recognize the cost for shipping and handling when incurred, generally when control over the products has transferred to the customer, as an expense in cost of sales.

Our contracts with customers often include promises to transfer multiple products and services. Determining whether products and services are considered distinct performance obligations that should be accounted for separately, versus together, may require significant judgment. We consider the degree of customization, integration and interdependency of the related products and services when assessing distinctness.

Judgment is also required to determine the stand-alone selling price ("SSP") for each distinct performance obligation. To determine the SSP, the Company uses the price at which the products and services would be sold separately to the customer. We also review past sales transactions to confirm that invoice prices for each distinct performance obligation reasonably approximate SSP and that there are no significant deviations. A discount, when provided, is also allocated based on the relative SSP of the various products and services.

We may provide other credits or incentives, which are accounted for as variable consideration when determining the transaction price. These credits or incentives are estimated at contract inception and recognized only to the extent that it is probable that a significant reversal of any incremental revenue will not occur. The estimates are updated each reporting period as additional information becomes available.

For revenue that is not recognized at a point in time, the Company follows accounting guidance for revenue recognized over time, as follows:

Revenue Recognition under Long-term Construction Contracts

The Company uses the over-time method to account for certain long-term construction contracts in the Completion & Production Solutions and Rig Technologies segments. These long-term construction contracts include the following characteristics:

- the contracts include custom designs for customer-specific applications;
- the structural design is unique and requires significant engineering efforts; and
- the Company has an enforceable right to payment for performance completed to date, including a reasonable profit.

Because of control transferring over time, revenue is recognized based on the extent of progress towards completion of the performance obligation. We generally use the cost-to-cost (input) measure of progress for our contracts because it best depicts the transfer of assets to the customer which occurs as we incur costs. Under the cost-to-cost measure of progress, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total

estimated costs at completion of the performance obligation. Revenues, including estimated fees or profits, are recorded proportionally as costs are incurred. These costs include labor, materials, subcontractors' costs, and other direct costs. If estimates of total costs to be incurred on a performance obligation exceed total estimates of revenue to be earned, a provision for the entire loss on the performance obligation is recognized in the period the loss is determined.

Our long-term construction contracts generally include a significant service of integrating a complex set of tasks and components into a single project or capability, so are accounted for as one performance obligation.

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Estimating total revenue and cost at completion of long-term construction contracts is complex, subject to many variables and requires significant judgment. It is common for our long-term contracts to contain late delivery fees, work performance guarantees, and other provisions that can either increase or decrease the transaction price. We estimate variable consideration as the most likely amount we expect to receive. We include variable consideration in the estimated transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur, or when the uncertainty associated with the variable consideration is resolved. Our estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based on an assessment of our anticipated performance and historical, current and forecasted information that is reasonably available to us. Net revenue recognized from performance obligations satisfied in previous periods was \$56 million for the nine months ended September 30, 2018 primarily due to change orders.

Service and Repair Work

For service contracts, we generally use the output method to measure progress due to the manner in which the customer receives and derives value from the services provided. For repair contracts, we generally use the cost-to-cost measure of progress because it best depicts the transfer of assets to the customer.

Remaining Performance Obligations

Remaining performance obligations represents the transaction price of firm orders for all revenue streams for which work has not been performed on contracts with an original expected duration of one year or more. We do not disclose the remaining performance obligations of royalty contracts, service contracts for which there is a right to invoice, and short-term contracts that are expected to have a duration of one year or less.

As of September 30, 2018, the aggregate amount of the transaction price allocated to remaining performance obligations was \$2,147 million. The Company expects to recognize approximately \$408 million in revenue for the remaining performance obligations in 2018 and \$1,739 million in 2019 and thereafter.

Costs to Obtain and Fulfill a Contract

We recognize an asset for the incremental costs of obtaining a contract, such as sales commissions, with a customer when we expect the benefit of those costs to be longer than one year. Costs to fulfill a contract, such as set-up and mobilization costs, are also capitalized when we expect to recover those costs. These contract costs are deferred and amortized over the period of contract performance. Total capitalized costs to obtain and fulfill a contract and the related amortization were immaterial during the periods presented and are included in other current and long-term assets on our consolidated balance sheets. We apply the practical expedient to expense costs as incurred for costs to obtain a contract with a customer when the amortization period would have been one year or less.

Disaggregation of Revenue

The following tables disaggregate our revenue by destinations, as we believe it best depicts how the nature, amount, timing and uncertainty of our revenue and cash flows are affected by economic factors. In the tables below, North America includes only the U.S. and Canada. (in millions):

Three Months Ended September 30,
2018

Completion

2017

Completion

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	Wellbore & Production Rig Technologies				Total	Wellbore & Production Rig Technologies				Total
	Solutions	Technologies	Eliminations			Solutions	Technologies	Eliminations		
North America	\$469	\$ 343	\$ 189	\$ —	\$1,001	\$377	\$ 282	\$ 139	\$ —	\$798
International	362	372	419	—	1,153	305	384	348	—	1,037
Eliminations	16	20	29	(65)	—	11	16	23	(50)	—
	\$847	\$ 735	\$ 637	\$ (65)	\$2,154	\$693	\$ 682	\$ 510	\$ (50)	\$1,835
Land	\$707	\$ 521	\$ 206	\$ —	\$1,434	\$553	\$ 468	\$ 174	\$ —	\$1,195
Offshore	124	194	402	—	720	129	198	313	—	640
Eliminations	16	20	29	(65)	—	11	16	23	(50)	—
	\$847	\$ 735	\$ 637	\$ (65)	\$2,154	\$693	\$ 682	\$ 510	\$ (50)	\$1,835

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	Nine Months Ended September 30, 2018					2017				
	Wellbore Technology	Completion & Production Substitutions	Rig Technology	Eliminations	Total	Wellbore Technology	Completion & Production Substitutions	Rig Technology	Eliminations	Total
North America	\$1,333	\$ 977	\$ 467	\$ —	\$2,777	\$1,024	\$ 780	\$ 399	\$ —	\$2,203
International	970	1,104	1,204	—	3,278	802	1,162	1,168	—	3,132
Eliminations	48	62	100	(210)	—	36	40	71	(147)	—
	\$2,351	\$ 2,143	\$ 1,771	\$ (210)	\$6,055	\$1,862	\$ 1,982	\$ 1,638	\$ (147)	\$5,335
Land	\$1,950	\$ 1,476	\$ 586	\$ —	\$4,012	\$1,479	\$ 1,281	\$ 508	\$ —	\$3,268
Offshore	353	605	1,085	—	2,043	347	661	1,059	—	2,067
Eliminations	48	62	100	(210)	—	36	40	71	(147)	—
	\$2,351	\$ 2,143	\$ 1,771	\$ (210)	\$6,055	\$1,862	\$ 1,982	\$ 1,638	\$ (147)	\$5,335

Contract Assets and Liabilities

Contract assets include unbilled amounts resulting from sales under long-term contracts when the cost-to-cost method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer, and right to payment is not only subject to the passage of time. There were no impairment losses recorded on contract assets for the periods ending September 30, 2018 or 2017.

Contract liabilities consist of advance payments, billings in excess of revenue recognized and deferred revenue. For the balance at December 31, 2017, we reclassified \$240 million of advance payments and deferred revenue from accrued liabilities to contract liabilities to conform with the 2018 presentation.

The changes in the carrying amount of contract assets and contract liabilities are as follows (in millions):

Contract Assets	
Balance at December 31, 2017	\$495
Additions and Milestone Billings	(606)
Revenue Recognized	637
Currency translation adjustments and other	(43)
Balance at September 30, 2018	\$483

Contract Liabilities	
Balance at December 31, 2017	\$519
Additions	856
Revenue Recognized	(676)
Currency translation adjustments and other	(129)
Balance at September 30, 2018	\$570

7. Debt

Debt consists of (in millions):

	September 30, 2018	December 31, 2017
\$1.4 billion in Senior Notes, interest at 2.60% payable semiannually, principal due on December 1, 2022	\$ 1,394	\$ 1,392
\$1.1 billion in Senior Notes, interest at 3.95% payable semiannually, principal due on December 1, 2042	1,088	1,088
Other	232	232
Total debt	2,714	2,712
Less current portion	8	6
Long-term debt	\$ 2,706	\$ 2,706

The Company has a \$3.0 billion, five-year unsecured revolving credit facility, which expires on June 27, 2022. The Company has the right to increase the aggregate commitments under this agreement to an aggregate amount of up to \$4.0 billion upon the consent of only those lenders holding any such increase. Interest under the multicurrency facility is based upon LIBOR, NIBOR or CDOR plus 1.125% subject to a ratings-based grid or the U.S. prime rate. The credit facility contains a financial covenant regarding maximum debt-to-capitalization ratio of 60%. As of September 30, 2018, the Company was in compliance with a debt-to-capitalization ratio of 16.3%.

The Company has a commercial paper program under which borrowings are classified as long-term since the program is supported by the \$3.0 billion, five-year credit facility. At September 30, 2018, there were no commercial paper borrowings, and there were no outstanding letters of credit issued under the credit facility, resulting in \$3.0 billion of funds available under this credit facility.

The Company had \$471 million of outstanding letters of credit at September 30, 2018, primarily in the U.S. and Norway, that are under various bilateral letter of credit facilities. Letters of credit are issued as bid bonds, advanced payment bonds and performance bonds.

At September 30, 2018 and December 31, 2017, the fair value of the Company's unsecured Senior Notes approximated \$2,287 million and \$2,346 million, respectively. The fair value of the Company's debt is estimated using Level 2 inputs in the fair value hierarchy and is based on quoted prices for those or similar instruments. At September 30, 2018 and December 31, 2017, the carrying value of the Company's unsecured Senior Notes approximated \$2,482 million and \$2,480 million, respectively.

8. Income Taxes

The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. The Act reduced the U.S. federal corporate tax rate from 35% to 21%, effective January 1, 2018. At September 30, 2018 and December 31, 2017, we had not completed our accounting for the tax effects of enactment of the Act; however, in certain cases, as described below,

we made reasonable estimates of the effects and recorded provisional amounts. We will continue to make and refine our calculations as additional analysis is completed. We have not recorded any significant changes in 2018. We recognized an income tax benefit of \$242 million in the year ended December 31, 2017 associated with the revaluation of our net deferred tax liability. Our provisional estimate of the one-time transition tax resulted in no additional tax expense. Our provisional estimate on Global Intangible Low Taxed Income (“GILTI”), Foreign Derived Intangible Income (“FDII”), Base Erosion and Anti-Abuse Tax (“BEAT”), and IRC Section 163(j) interest limitation do not impact our effective tax rate for the three and nine months ended September 30, 2018. The accounting for the tax effects of the Act will be finalized in the fourth quarter of 2018 as permitted by the U.S. Securities and Exchange Commission’s SAB No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act.

The provision (benefit) for income taxes for the three and nine months ended September 30, 2018 were \$29 million and \$37 million, respectively, compared to (\$13 million) and (\$43 million) for the same periods in 2017. The Company established valuation allowances on deferred tax assets for losses and tax credits generated in each period which resulted in a corresponding tax charge. The change in tax provision (benefit) from 2017 to 2018 was also impacted by the decrease in the U.S. federal corporate tax rate from 35% in 2017 to 21% in 2018.

The balance of unrecognized tax benefits at September 30, 2018 was \$92 million. The settlement of a foreign jurisdiction audit resulted in a decrease in uncertain tax positions during the year.

For the three and nine months ended September 30, 2018, the Company utilized the discrete-period method to compute its interim tax provision due to significant variations in the relationship between income tax expense and pre-tax accounting income or loss. For the three and nine months ended September 30, 2017, the Company estimated and recorded tax based on a full year effective tax rate.

9. Stock-Based Compensation

The Company has a stock-based compensation plan known as the National Oilwell Varco, Inc. Long-Term Incentive Plan (the "Plan"). The Plan provides for the granting of stock options, performance-based share awards, restricted stock, phantom shares, stock payments and stock appreciation rights ("SARs"). The number of shares authorized under the Plan is 69.4 million. The Plan is subject to a fungible ratio concept, such that the issuance of stock options and SARs reduces the number of available shares under the Plan on a 1-for-1 basis, and the issuance of other awards reduces the number of available shares under the Plan on a 3-for-1 basis. At September 30, 2018, 10,253,618 shares remain available for future grants under the Plan, all of which are available for grants of stock options, performance-based share awards, restricted stock awards, phantom shares, stock payments and SARs.

On February 28, 2018, the Company granted 1,610,599 stock options with a fair value of \$10.01 per share and an exercise price of \$35.09 per share; 2,391,933 shares of restricted stock and restricted stock units with a fair value of \$35.09 per share; performance share awards to senior management employees with potential payouts varying from zero to 449,532 shares; and 14,228 SARs. The stock options vest over a three-year period from the grant date. The restricted stock and restricted stock units vest in three equal annual installments commencing on the first anniversary of the grant date. The performance share awards can be earned based on performance against established goals over a three-year performance period. The performance share awards are based entirely on a TSR (total shareholder return) goal. Performance against the TSR goal is determined by comparing the performance of the Company's TSR with the TSR performance of the members of the OSX (Oil Service Sector) index for the three-year performance period.

The Company's other stock-based compensation plan, known as the National Oilwell Varco, Inc. 2018 Long-Term Incentive Plan (the "2018 Plan"), was approved by shareholders on May 11, 2018. The 2018 Plan provides for the granting of stock options, restricted stock, restricted stock units, performance awards, phantom shares, stock appreciation rights, stock payments and substitute awards. The number of shares authorized under the 2018 Plan is 17.8 million. The 2018 Plan is also subject to a fungible ratio concept, such that the issuance of stock options and SARs reduces the number of available shares under the 2015 Plan on a 1-for-1 basis, and the issuance of other awards reduces the number of available shares under the 2018 Plan on a 2.5-for-1 basis. At September 30, 2018, 17,709,906 shares remain available for future grants under the 2018 Plan. On May 11, 2018, the Company granted 35,432 restricted stock awards under the 2018 Plan with a fair value of \$40.65 per share. The awards were granted to non-employee members of the board of directors and vest on the first anniversary of the grant date.

Total stock-based compensation for all stock-based compensation arrangements under the Plan and the 2018 Plan was \$30 million and \$88 million for the three and nine months ended September 30, 2018, respectively, and \$33 million and \$85 million for the three and nine months ended September 30, 2017, respectively. The total income tax benefit recognized in the Consolidated Statements of Income (Loss) for all stock-based compensation arrangements under the

Plan and the 2018 Plan was \$6 million and \$12 million for the three and nine months ended September 30, 2018, respectively, and \$9 million and \$18 million for the three and nine months ended September 30, 2017, respectively.

10. Derivative Financial Instruments

The Company uses derivative instruments to manage foreign currency exchange rate risk. Forward contracts against various foreign currencies are entered into to manage the foreign currency exchange rate risk on forecasted revenues and expenses denominated in currencies other than the functional currency of the operating unit (cash flow hedge). In addition, the Company will enter into non-designated forward contracts against various foreign currencies to manage the foreign currency exchange rate risk on non-functional-currency monetary accounts (non-designated hedge).

The Company records all derivative financial instruments at their fair value in its Consolidated Balance Sheet. Except for certain non-designated hedges discussed below, all derivative financial instruments that the Company holds are designated as cash flow hedges

and are highly effective in offsetting movements in the underlying risks. Such arrangements typically have terms between 2 and 24 months, but may have longer terms depending on the underlying cash flows being hedged, typically related to the projects in our backlog. The Company may also use interest rate contracts to mitigate exposure to changes in interest rates on anticipated long-term debt issuances.

At September 30, 2018, the Company has determined that the fair value of its derivative financial instruments representing assets of \$18 million and liabilities of \$16 million (primarily currency related derivatives) are determined using level 2 inputs (inputs other than quoted prices in active markets for identical assets and liabilities that are observable either directly or indirectly for substantially the full term of the asset or liability) in the fair value hierarchy as the fair value is based on publicly available foreign exchange and interest rates at each financial reporting date. At September 30, 2018, the net fair value of the Company's foreign currency forward contracts totaled a net asset of \$2 million.

At September 30, 2018, the Company did not have any interest rate contracts and its financial instruments do not contain any credit-risk-related or other contingent features that could cause accelerated payments when the Company's financial instruments are in net liability positions. The Company does not use derivative financial instruments for trading or speculative purposes.

Cash Flow Hedging Strategy

To protect against the volatility of forecasted foreign currency cash flows resulting from forecasted revenues and expenses, the Company has instituted a cash flow hedging program. The Company hedges portions of its forecasted revenues and expenses denominated in non-functional currencies with forward contracts. When the U.S. dollar strengthens or weakens against the foreign currencies, the change in present value of future foreign currency revenues and expenses is offset by changes in the fair value of the forward contracts designated as hedges.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is subject to a particular currency risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income (loss) and reclassified into earnings in the same line item associated with the forecasted transaction and in the same period or periods during which the hedged transaction affects earnings (e.g., in "revenues" when the hedged transactions are cash flows associated with forecasted revenues). The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any (i.e., the ineffective portion), or hedge components excluded from the assessment of effectiveness, is recognized in the Consolidated Statements of Income (Loss) during the current period.

For the nine months ended September 30, 2018, the Company recognized a gain of \$2 million as a result of the discontinuance of certain cash flow hedges when it became probable that the original forecasted transactions would not occur by the end of the originally specified time period. At September 30, 2018, there were \$10 million in pre-tax losses recorded in accumulated other comprehensive income (loss). Significant changes in forecasted operating levels or delays in large capital construction projects, whereby certain hedged transactions associated with these projects are no longer probable of occurring by the end of the originally specified time period, could result in losses or gains due to the de-designation of existing hedge contracts.

The Company had the following outstanding foreign currency forward contracts to hedge non-functional currency cash flows from forecasted revenues and expenses (in millions):

Foreign Currency	Currency Denomination			
		September 30, 2018		December 31, 2017
Norwegian Krone	NOK	3,875	NOK	4,013
Japanese Yen	JPY	326	JPY	982
U.S. Dollar	USD	111	USD	163
Euro	EUR	82	EUR	120
Danish Krone	DKK	19	DKK	30
British Pound Sterling	GBP	9	GBP	11
Canadian Dollar	CAD	1	CAD	—

Non-designated Hedging Strategy

The Company enters into foreign currency forward contracts to hedge certain non-functional currency monetary accounts. The purpose of the Company's foreign currency hedging activities is to protect the Company from risk that the eventual U.S. dollar

equivalent cash flows from the non-functional currency monetary accounts will be adversely affected by changes in the exchange rates.

For derivative instruments that are non-designated, the gain or loss on the derivative instrument subject to the hedged risk (i.e., non-functional currency monetary accounts) is recognized in the Consolidated Statements of Income (Loss).

The Company had the following outstanding foreign currency forward contracts that hedge the fair value of non-functional currency monetary accounts (in millions):

Foreign Currency	Currency Denomination				
		September 30, 2018		December 31, 2017	
Norwegian Krone	NOK	1,708		NOK	1,734
Russian Ruble	RUB	1,329		RUB	2,699
U.S. Dollar	USD	539		USD	463
Mexican Peso	MXN	285		MXN	—
South African Rand	ZAR	176		ZAR	150
Euro	EUR	122		EUR	99
Danish Krone	DKK	15		DKK	15
British Pound Sterling	GBP	8		GBP	3
Canadian Dollar	CAD	1		CAD	—

The Company has the following gross fair values of its derivative instruments and their balance sheet classifications:

	Asset Derivatives		Liability Derivatives			
	Balance Sheet Location	Fair Value		Balance Sheet Location	Fair Value	
		September 30, 2018	December 31, 2017		September 30, 2018	December 31, 2017
Derivatives designated as hedging instruments under ASC Topic 815						
	Prepaid and other current assets	\$ 8	\$ 13	Accrued liabilities	\$ 5	\$ 3
	Other Assets	3	8	Other liabilities	2	2
Total derivatives designated as hedging instruments		\$ 11	\$ 21		\$ 7	\$ 5

under ASC Topic 815

Derivatives not designated

as hedging instruments

under ASC Topic 815

Prepaid and other current

Foreign exchange contracts	assets	\$4	\$ 10	Accrued liabilities	\$8	\$ 5
Foreign exchange contracts	Other Assets	3	2	Other Liabilities	1	1

Total derivatives not

designated as hedging

instruments under ASC

Topic 815		\$7	\$ 12		\$9	\$ 6
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Total derivatives		\$18	\$ 33		\$16	\$ 11
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The Effect of Derivative Instruments on the Consolidated Statements of Income (\$ in millions)

Derivatives in	Amount of		Location of	Amount of	Location of Gain (Loss)	Amount of
	Gain	(Loss)	Gain (Loss)	Gain (Loss)	Recognized in Income on	Gain (Loss) Recognized in Income on
ASC Topic 815	Recognized	in	Reclassified	Reclassified	Derivative (Ineffective	Derivative
Cash Flow Hedging	OCI on	OCI on	from Accumulated	from Accumulated	Portion and Amount	(Ineffective
Relationships	Derivative	Derivative	Income (Effective	Income (Effective	Excluded from	Portion and
	Portion) (a)	Portion) (b)	Portion)	Portion)	Effectiveness Testing)	Amount
	Nine	Nine				Excluded
	Months	Months				from
	Ended	Ended				Effectiveness
	September	September				Testing) (b)
	30,	30,				
	2018	2017				
			Revenue	— 6	Cost of revenue	1 10
Foreign exchange			Cost of			
contracts	4	67	revenue	2 (18)	Other income(expense), net	(5) 4
Total	4	67		2 (12)		(4) 14

Derivatives Not Designated as	Location of	Amount of
	Gain (Loss)	Gain (Loss)
Hedging Instruments under	Recognized in Income	Recognized
ASC Topic 815	in Income	in Income
	on	on
	Derivative	Derivative
	Nine	Nine
	Months	Months
	Ended	Ended
	September	September
	30,	30,
	2018	2017
Foreign exchange contracts	Other income (expense), net	(11) 65
Total		(11) 65

(a) The Company expects that \$8 million of the accumulated other comprehensive income (loss) will be reclassified into earnings within the next twelve months with an offset by losses from the underlying transactions resulting in no impact to earnings or cash flow.

(b) The amount of gain (loss) recognized in income includes \$1 million and \$10 million related to the ineffective portion of the hedging relationships for the nine months ended September 30, 2018 and 2017, respectively, and \$(5) million and \$4 million related to the amount excluded from the assessment of the hedge effectiveness for the nine months ended September 30, 2018 and 2017, respectively.

11. Net Income (Loss) Attributable to Company Per Share

The following table sets forth the computation of weighted average basic and diluted shares outstanding (in millions, except per share data):

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Numerator:				
Net income (loss) attributable to Company	\$1	\$(26)	\$(43)	\$(223)
Denominator:				
Basic—weighted average common shares outstanding	379	377	378	377
Dilutive effect of employee stock options and other unvested stock awards	4	—	—	—
Diluted outstanding shares	383	377	378	377
Net income (loss) attributable to Company per share:				
Basic	\$0.00	\$(0.07)	\$(0.11)	\$(0.59)
Diluted	\$0.00	\$(0.07)	\$(0.11)	\$(0.59)
Cash dividends per share	\$0.05	\$0.05	\$0.15	\$0.15

ASC Topic 260, "Earnings Per Share" requires companies with unvested participating securities to utilize a two-class method for the computation of net income attributable to Company per share. The two-class method requires a portion of net income attributable to Company to be allocated to participating securities, which are unvested awards of share-based payments with non-forfeitable rights to receive dividends or dividend equivalents, if declared. Net income (loss) attributable to Company allocated to these participating securities was immaterial for the three and nine months ended September 30, 2018 and 2017 and therefore not excluded from net income attributable to Company per share calculation.

The Company had stock options outstanding that were anti-dilutive totaling 11 million shares and 17 million shares for each of the three and nine months ended September 30, 2018, and 17 million shares and 13 million shares for each of the three and nine months ended September 30, 2017, respectively.

12. Cash Dividends

On August 16, 2018, the Company's Board of Directors approved a cash dividend of \$0.05 per share. The cash dividend was paid on September 28, 2018, to each stockholder of record on September 14, 2018. Cash dividends were \$19 million and \$57 million for the three and nine months ended September 30, 2018, respectively, and \$19 million and \$57 million for the three and nine months ended September 30, 2017. The declaration and payment of future dividends is at the discretion of the Company's Board of Directors and will be dependent upon the Company's results of operations, financial condition, capital requirements and other factors deemed relevant by the Company's Board of Directors.

13. Commitments and Contingencies

Our business is affected both directly and indirectly by governmental laws and regulations relating to the oilfield service industry in general, as well as by environmental and safety regulations that specifically apply to our business. Our business is also subject to trade regulations that may restrict or prohibit trade with certain countries, companies and/or individuals, for example, trade sanctions applicable, to Russia, Syria and Iran. Although we have not incurred material costs in connection with our compliance with such laws, there can be no assurance that other developments, such as new environmental laws, regulations and enforcement policies may not result in additional, presently unquantifiable, costs or liabilities to us. We are also subject to increasing local content and localization requirements in various jurisdictions, as well as increasing trade tariffs, retaliatory tariffs and other trade controversies, all of which could result in material negative impacts to our business.

The Company is involved, from time to time, in internal and regulatory investigations, regulatory agency audits and pending or threatened legal actions, arbitration and litigation involving a variety of matters. In many instances, the Company maintains insurance that covers claims arising from risks associated with the business activities of the Company, including claims for injuries to third parties and third parties' property, e.g., premises liability, product liability and other such claims. The Company carries substantial insurance to cover such risks above a self-insured retention. The Company believes, and the Company's experience has been that such insurance has been sufficient to cover such risks. See Item 1A. Risk Factors. If, however, such insurance was inapplicable or insufficient to cover such losses, there could be material negative impacts to our business.

The Company is also a party to claims, threatened and actual litigation, governmental regulatory proceedings and private arbitration arising from ordinary day to day business activities, in which parties assert claims against the Company for a broad spectrum of potential liabilities, including: individual employment law claims, collective actions under federal employment laws, intellectual property claims, e.g., alleged patent infringement, and/or misappropriation of trade secrets, premises liability claims, personal injuries arising from allegedly defective products, alleged breach of warranty, improper payments under anti-corruption and anti-bribery laws and other commercial claims seeking recovery for alleged actual or exemplary damages. In currently pending litigation and arbitrations, adverse parties have asserted damages in material amounts for which they seek recovery from the Company. Due to

the inherent risks and uncertainty of litigation, an unexpected adverse result may occur from time to time. For many such contingent claims, the Company's insurance coverage is inapplicable or an exclusion to coverage may apply. In such instances, settlement or other resolution of such contingent claims could have a material financial or reputational impact on the Company.

As of September 30, 2018, the Company recorded reserves in an amount believed to be sufficient for contingent liabilities representing all contingencies believed to be probable to cover such liabilities. The Company has also assessed the potential for additional losses above the amounts accrued as well as potential losses for matters that are not probable but are reasonably possible. The total potential loss on these matters cannot be determined; however, in our opinion, any ultimate liability, to the extent not otherwise provided for and except for the specific cases referred to above, will not materially affect our financial position, cash flow or results of operations. These estimated liabilities are based on the Company's assessment of the nature of these matters, their progress toward resolution, the advice of legal counsel and outside experts as well as management's intention and experience.

Further, in some instances, direct or indirect consumers of our products and services, entities providing financing for purchases of our products and services or members of the supply chain for our products and services have become involved in governmental investigations, internal investigations, political or other enforcement matters. In such circumstances, such investigations may adversely impact the ability of consumers of our products, entities providing financial support to such consumers or entities in the supply chain to timely perform their business plans or to timely perform under agreements with us. We may also become involved in these investigations, at substantial cost to the Company.

14. New Accounting Pronouncements Recently Adopted Accounting Standards

In March 2017, the FASB issued Accounting Standard Update No. 2017-07 “Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost” (ASU 2017-07). This update requires that an employer report the service cost component in the same line item as other compensation costs and separately from other components of net benefit cost. ASU 2017-07 is effective for fiscal periods beginning after December 15, 2017, and for interim periods within those fiscal years. The Company adopted this update on January 1, 2018 with no material impact.

In August 2016, the FASB issued Accounting Standard Update No. 2016-15 “Classification of Certain Cash Receipts and Cash Payments” (ASU 2016-15). This update amends Accounting Standard Codification Topic No. 230 “Statement of Cash Flows” and provides guidance and clarification on presentation of certain cash flow issues. ASU No. 2016-15 is effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. The Company adopted this update on January 1, 2018 with no material impact.

In May 2014, the FASB issued Accounting Standard Update No. 2014-09, “Revenue from Contracts with Customers” (ASU 2014-09), which supersedes the revenue recognition requirements in FASB ASC Topic 605, “Revenue Recognition,” and most industry-specific guidance. This ASU proscribes a five-step model for determining when and how revenue is recognized. Under the model, an entity will recognize revenue to depict the transfer of goods or services to a customer at an amount reflecting the consideration it expects to receive in exchange for those goods or services.

ASU 2014-09 is effective for fiscal periods beginning after December 15, 2017. The Company adopted this update on January 1, 2018, using the modified retrospective approach, in which an immaterial cumulative effect adjustment was made to retained earnings. The adoption of ASU 2014-09 did not have a material impact on the Company’s consolidated financial position, results of operations, equity or cash flows as of the adoption date or for the nine months ended September 30, 2018. See Note 6 for additional details of the Company’s revenue recognition policies.

Recently Issued Accounting Standards

In August 2017, the FASB issued Accounting Standard Update No. 2017-12 “Derivatives and Hedging – Targeted Improvements to Accounting for Hedging Activities” (ASU 2017-12). This update improves the financial reporting of hedging relationships and simplifies the application of the hedge accounting guidance. ASU 2017-12 is effective for fiscal periods beginning after December 15, 2018, and for interim periods within those fiscal years. Early adoption is permitted in any interim period after issuance of ASU 2017-12. The Company is currently assessing the impact of the adoption of ASU No. 2017-12 on its consolidated financial position and results of operations.

In March 2016, the FASB issued ASC Topic 842, “Leases” (ASC Topic 842), which supersedes the lease requirements in ASC Topic No. 840 “Leases” and most industry-specific guidance. This update increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing

key information about leasing arrangements. ASC Topic 842 is effective for fiscal years beginning after December 15, 2018, and for interim periods within those fiscal years.

The Company's internal team, assisted by a top-tier accounting and consulting firm, has implemented and is testing new software, processes, procedures and controls to correctly account for leases under the new requirements. We currently estimate implementing ASC Topic 842 in the first quarter of 2019 will gross-up the Company's balance sheet with additional assets and liabilities in the range of approximately \$500 to \$750 million. Implementing the new standard will not affect the Company's compliance with the debt-to-capitalization covenant of our \$3 billion revolving credit facility (see Note 7) because that agreement grandfathers the prior treatment of operating leases for purposes of the calculation.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

National Oilwell Varco, Inc. (the "Company") is a leading independent provider of equipment and technology to the upstream oil and gas industry. The Company designs, manufactures and services a comprehensive line of drilling and well servicing equipment; sells and rents drilling motors, specialized downhole tools, and rig instrumentation; performs inspection and internal coating of oilfield tubular products; provides drill cuttings separation, management and disposal systems and services; and provides expendables and spare parts used in conjunction with the Company's large installed base of equipment. The Company also manufactures coiled tubing and high-pressure fiberglass and composite tubing, and sells and rents advanced in-line inspection equipment to makers of oil country tubular goods. The Company has a long tradition of pioneering innovations which improve the cost-effectiveness, efficiency, safety, and environmental impact of oil and gas operations.

Unless indicated otherwise, results of operations are presented in accordance with accounting principles generally accepted in the United States ("GAAP"). Certain reclassifications have been made to the prior year financial statements in order for them to conform with the 2018 presentation. The Company discloses Adjusted EBITDA (defined as Operating Profit excluding Depreciation, Amortization and, when applicable, Other Items) in its periodic earnings press releases and other public disclosures to provide investors additional information about the results of ongoing operations. See Non-GAAP Financial Measures and Reconciliations in Results of Operations for an explanation of our use of non-GAAP financial measures and reconciliations to their corresponding measures calculated in accordance with GAAP.

Wellbore Technologies

The Company's Wellbore Technologies segment designs, manufactures, rents, and sells a variety of equipment and technologies used to perform drilling operations, and offers services that optimize their performance, including: solids control and waste management equipment and services; drilling fluids; portable power generation; premium drill pipe; wired pipe; drilling optimization and automation services; tubular inspection, repair and coating services; rope access inspection; instrumentation; measuring and monitoring; downhole and fishing tools; steerable technologies; hole openers; and drill bits.

Wellbore Technologies focuses on oil and gas companies and supports drilling contractors, oilfield service companies, and oilfield equipment rental companies. Demand for the segment's products and services depends on the level of oilfield drilling activity by oil and gas companies, drilling contractors, and oilfield service companies.

Completion & Production Solutions

The Company's Completion & Production Solutions segment integrates technologies for well completions and oil and gas production. The segment designs, manufactures, and services equipment and technologies needed for hydraulic fracture stimulation, including downhole multistage fracturing tools, pressure pumping trucks, blenders, sanders, hydration units, injection units, flowline, and manifolds; well intervention, including coiled tubing units, coiled tubing, and wireline units and tools; well construction, including premium connections and liner hangers; onshore production, including composite pipe, surface transfer and progressive cavity pumps, and artificial lift systems; and, offshore production, including floating production systems and subsea production technologies.

Completion & Production Solutions supports service companies and oil and gas companies. Demand for the segment's products depends on the level of oilfield completions and workover activity by oilfield service companies and drilling contractors, and capital spending plans by oil and gas companies and oilfield service companies.

Rig Technologies

The Company's Rig Technologies segment makes and supports the capital equipment and integrated systems needed to drill oil and gas wells on land and offshore as well as other marine-based markets, including offshore wind vessels. The segment designs, manufactures and sells land rigs, offshore drilling equipment packages, including installation and commissioning services, and drilling rig components that mechanize and automate the drilling process and rig functionality. Equipment and technologies the segment brings to customers include: substructures, derricks, and masts; cranes; jacking systems; pipe lifting, racking, rotating, and assembly systems; fluid transfer technologies, such as mud pumps; pressure control equipment, including blowout preventers; power transmission systems, including drives and generators; rig instrumentation and control systems; mooring, anchor, and deck handling machinery; and pipelay and construction systems. The segment also provides spare parts, repair, and rentals as well as comprehensive remote equipment monitoring, technical support, field service, and customer training through an extensive network of aftermarket service and repair facilities strategically located in major areas of drilling operations around the world.

Rig Technologies supports land and offshore drillers. Demand for the segment's products depends on drilling contractors' and oil and gas companies' capital spending plans, specifically capital expenditures on rig construction and refurbishment; and secondarily on the overall level of oilfield drilling activity, which drives demand for spare parts, service, and repair for the segment's large installed base of equipment.

Critical Accounting Policies and Estimates

In our annual report on Form 10-K for the year ended December 31, 2017, we identified our most critical accounting policies. In preparing the financial statements, we make assumptions, estimates and judgments that affect the amounts reported. We periodically evaluate our estimates and judgments that are most critical in nature which are related to revenue recognition (See Note 6); allowance for doubtful accounts; inventory reserves; impairment of long-lived assets (excluding goodwill and other indefinite-lived intangible assets); goodwill and other indefinite-lived intangible assets; purchase price allocation of acquisitions; warranties; and income taxes. Our estimates are based on historical experience and on our future expectations that we believe are reasonable. The combination of these factors forms the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results are likely to differ from our current estimates and those differences may be material.

EXECUTIVE SUMMARY

For the third quarter ended September 30, 2018, the Company generated net income of \$1 million, compared to net income of \$24 million in the second quarter of 2018 and a net loss of \$26 million in the third quarter of 2017.

Operating profit for the third quarter of 2018 was \$73 million, or 3.4 percent of sales, compared to operating profit of \$52 million in the second quarter of 2018 and an operating loss of \$7 million in the third quarter of 2017. Third quarter 2018 Adjusted EBITDA was \$245 million, compared to \$226 million in the second quarter of 2018 and \$167 million in the third quarter of 2017.

Oil & Gas Equipment and Services Market

Technological advancements in oilfield equipment and services unlocked production from previously uneconomic formations which, combined with high commodity demand and prices, enabled and sustained an increase in global drilling activity that dramatically grew oil supplies from 2004 to 2014. Global supply started to catch up to demand, and, in the second half of 2014, demand growth in areas such as Asia, Europe and the U.S. weakened while drilling activity remained strong and production continued to grow. As a result, inventories of crude and refined products increased, and the price of oil declined significantly during early 2015, remained depressed throughout the year and fell further toward the end of 2015. In early 2016, the market witnessed oil trading in the high \$20 per barrel range, prices not seen since 2003.

The Company aggressively sized its operations to the market and reduced annual expenses relating to salaries, wages, outside services, contractors, travel and entertainment by approximately \$3.0 billion, while continuing to invest in developing and acquiring new products, technologies and operations that advance the Company's longer term strategic goals. The Company believes that sharp spending reductions by customers has created pent up demand for its products and services and NOV is well positioned to cost-effectively ramp operations to capitalize on market improvements. The Company has successfully pivoted towards the industry's increased focus on onshore unconventional developments, while strategically maintaining a leading position in offshore equipment.

The market downturn began to stabilize during the second half of 2016. Through 2017 and into the first nine months of 2018, drilling activity increased for North America land, stabilized in international land markets, and remained depressed offshore. Well completion work increased as the market recovered but then fell in September of 2018. The

average price of West Texas Intermediate Cushing Crude for the third quarter of 2018 was \$69.76 a barrel.

NOV's global customer base includes national oil companies, international oil companies, independent oil and gas companies, onshore and offshore drilling contractors and service companies and others whose strategies and reactions to low or volatile commodity prices vary. Likewise, the Company expects the timing and slope of revenue stabilization and recovery will be different across its operating regions and its three business segments. NOV's Wellbore Technologies segment and certain elements of its Completion & Production Solutions and Rig Technologies segments are realizing a faster recovery as drilling of new wells increases, while a strong recovery for certain of its more capital equipment-oriented businesses are expected to come later in the cycle.

Segment Performance

Wellbore Technologies

Wellbore Technologies generated revenues of \$847 million in the third quarter of 2018, an increase of seven percent from the second quarter of 2018 and an increase of 22 percent from the third quarter of 2017. The segment realized meaningful growth for the second consecutive quarter as revenue outpaced rig-count growth in the U.S. and international operations capitalized on an increasing number of opportunities associated with the emerging recovery in the Eastern Hemisphere. Operating leverage was limited to four percent mostly due to higher steel and labor costs, which outpaced the segment's price increases. Operating profit was \$40 million, or 4.7 percent of sales. Adjusted EBITDA increased two percent sequentially and 44 percent from the prior year to \$135 million, or 15.9 percent of sales.

Completion & Production Solutions

Completion & Production Solutions generated revenues of \$735 million in the third quarter of 2018, a decrease of \$3 million from the second quarter of 2018 and an increase of eight percent from the third quarter of 2017. Growing global demand for land production equipment was offset by offshore capital equipment businesses that have not yet bottomed and a pullback in demand for well-simulation equipment in North America. Operating profit was \$46 million or 6.3 percent of sales. Adjusted EBITDA increased five percent sequentially and two percent from the prior year to \$99 million, or 13.5 percent of sales.

Backlog for capital equipment orders for Completion & Production Solutions at September 30, 2018 was \$880 million. New orders booked during the quarter were \$372 million, representing a book-to-bill of 85 percent when compared to the \$439 million of orders shipped from backlog.

Rig Technologies

Rig Technologies generated revenues of \$637 million in the third quarter of 2018, a decrease of two percent from the second quarter of 2018 and an increase of 25 percent from the third quarter of 2017. Improving aftermarket sales and better progress on offshore projects did not fully offset lower land rig sales from inventory. Operating profit was \$58 million, or 9.1 percent of sales. Adjusted EBITDA decreased seven percent sequentially and increased 95 percent from the prior year to \$78 million, or 12.2 percent of sales.

At September 30, 2018, backlog for capital equipment orders for Rig Technologies was \$3.40 billion. New orders booked during the quarter totaled \$151 million, representing a book-to-bill of 59 percent when compared to the \$256 million of orders shipped from backlog.

Outlook

While North America land drilling has increased, working rig-counts remain well below prior cyclical highs. International land drilling, which had been slower to fall than North American activity, may have reached the bottom of its cycle during 2017, and is showing some signs of recovery. Offshore activity, which has longer project cycle times, showed leading indicators of renewed investment during Q3, and may improve into 2019. Near-term, the Company anticipates that land drilling customers will continue to increase spending on NOV's equipment and services and North American pressure pumping customers will proceed slower in the face of lower well stimulation day rates. The Company remains optimistic regarding longer-term market fundamentals as existing oil and gas fields continue to deplete and numerous major projects to replenish supply have been deferred or canceled while global demand continues to grow.

NOV expects unconventional resources will continue to gain a greater share of global production, and the Company will continue to enhance its unconventional resource focused products and technologies, including advanced, automated drilling rigs; premium drillpipe and directional drilling technologies; hydraulic fracture stimulation equipment; and multistage completion tools. NOV expects big data and predictive analytics to improve uptime and operating efficiency, and the Company remains at the forefront of applying this promising technology to oilfield drilling and completion equipment. NOV expects the oil and gas industry to adopt more efficient supply chain practices that the Company is pioneering to construct floating production facilities to produce the immense resources discovered offshore. The Company has used the recent downturn to vigorously advance these strategic initiatives and is encouraged by its progress.

Operating Environment Overview

The Company's results are dependent on, among other things, the level of worldwide oil and gas drilling, well remediation activity, the prices of crude oil and natural gas, capital spending by other oilfield service companies and drilling contractors, and worldwide oil and gas inventory levels. Key industry indicators for the third quarter of 2018 and 2017, and the second quarter of 2018 include the following:

	3Q18*	3Q17*	2Q18*	% 3Q18 3Q17	% 3Q18 2Q18
Active Drilling Rigs:					
U.S.	1,051	947	1,037	11.0 %	1.4 %
Canada	208	208	105	0.0 %	98.1 %
International	1,003	947	968	5.9 %	3.6 %
Worldwide	2,262	2,102	2,110	7.6 %	7.2 %
West Texas Intermediate					
Crude Prices (per barrel)	\$69.76	\$48.15	\$68.03	44.9 %	2.5 %
Natural Gas Prices (\$/mmbtu)	\$2.90	\$2.93	\$2.82	(1.0 %)	2.8 %

* Averages for the quarters indicated. See sources below.

The following table details the U.S., Canadian, and international rig activity and West Texas Intermediate Crude Oil prices for the past nine quarters ended September 30, 2018, on a quarterly basis:

Source: Rig count: Baker Hughes, Inc. (www.bakerhughes.com); West Texas Intermediate Crude Oil and Natural Gas Prices: Department of Energy, Energy Information Administration (www.eia.doe.gov).

The worldwide quarterly average rig count increased seven percent (from 2,110 to 2,262), and the U.S. increased one percent (from 1,037 to 1,051), in the third quarter of 2018 compared to the second quarter of 2018. The average per barrel price of West Texas Intermediate Crude Oil increased three percent (from \$68.03 per barrel to \$69.76 per barrel) and natural gas prices increased three percent (from \$2.82 per mmbtu to \$2.90 per mmbtu) in the third quarter of 2018 compared to the second quarter of 2018.

U.S. rig activity at October 19, 2018 was 1,067 rigs, increasing 2 percent compared to the third quarter of 2018 average of 1,051 rigs. The price for West Texas Intermediate Crude Oil was at \$69.12 per barrel at October 19, 2018, decreasing one percent from the third quarter of 2018 average. The price for natural gas was at \$3.25 per mmbtu at October 19, 2018, increasing 12 percent from the third quarter of 2018 average.

Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue:				
Wellbore Technologies	\$847	\$693	\$2,351	\$1,862
Completion & Production Solutions	735	682	2,143	1,982
Rig Technologies	637	510	1,771	1,638
Eliminations	(65)	(50)	(210)	(147)
Total revenue	\$2,154	\$1,835	\$6,055	\$5,335
Operating profit (loss):				
Wellbore Technologies	\$40	—	\$90	\$(81)
Completion & Production Solutions	46	44	102	79
Rig Technologies	58	18	138	37
Eliminations and corporate costs	(71)	(69)	(206)	(201)
Total operating profit (loss)	\$73	\$(7)	\$124	\$(166)