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 incorporation or organization)	(I.R.S. Employer 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

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:		

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):

	Three Months Ended September 30,							
	2018				2017			
	Currency Translation Adjustments	Derivative Financial Instruments	Defined Benefit Plans	Total	Currency Translation Adjustments	Derivative Financial Instruments	Defined Benefit 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 Translation Adjustments	Derivative Financial Instruments	Defined Benefit Plans	Total	Currency Translation Adjustments	Derivative Financial Instruments	Defined Benefit 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,		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)
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.

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.

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 gua