

NATIONAL OILWELL VARCO INC  
Form 10-Q  
October 28, 2016

**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, 2016**

**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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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 21, 2016 the registrant had 377,683,622 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)**

|   | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|---|-------------------------------|------------------------------|
| <b>ASSETS</b>   |                               |                              |
| Current assets:   |                               |                              |
| Cash and cash equivalents                                   | \$ 1,510                      | \$ 2,080                     |
| Receivables, net  | 1,808                         | 2,926                        |
| Inventories, net  | 4,161                         | 4,678                        |
| Costs in excess of billings                                 | 765                           | 1,250                        |
| Prepaid and other current assets                            | 467                           | 491                          |
| Total current assets  | 8,711                         | 11,425                       |
| Property, plant and equipment, net                          | 3,261                         | 3,124                        |
| Deferred income taxes                                       | 135                           | 130                          |
| Goodwill  | 6,015                         | 6,980                        |
| Intangibles, net  | 3,626                         | 3,849                        |
| Investment in unconsolidated affiliates                     | 311                           | 327                          |
| Other assets  | 135                           | 135                          |
| Total assets  | \$ 22,194                     | \$ 25,970                    |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>                  |                               |                              |
| Current liabilities:  |                               |                              |
| Accounts payable  | \$ 396                        | \$ 623                       |
| Accrued liabilities   | 1,628                         | 2,284                        |
| Billings in excess of costs                                 | 550                           | 785                          |
| Current portion of long-term debt and short-term borrowings | 6                             | 2                            |
| Accrued income taxes  | 35                            | 264                          |
| Total current liabilities                                   | 2,615                         | 3,958                        |
| Long-term debt  | 3,210                         | 3,907                        |
| Deferred income taxes                                       | 1,155                         | 1,362                        |
| Other liabilities   | 326                           | 283                          |
| Total liabilities   | 7,306                         | 9,510                        |
| Commitments and contingencies                               |                               |                              |
| Stockholders' equity:                                       | 4                             | 4                            |

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Common stock - par value \$.01; 1 billion shares authorized; 377,674,480 and 375,764,794 shares issued and outstanding at September 30, 2016 and December 31, 2015

|  |           |           |
|--|-----------|-----------|
| Additional paid-in capital                 | 8,079     | 8,005     |
| Accumulated other comprehensive loss       | (1,283)   | (1,553)   |
| Retained earnings                          | 8,018     | 9,927     |
| Total Company stockholders' equity         | 14,818    | 16,383    |
| Noncontrolling interests                   | 70        | 77        |
| Total stockholders' equity                 | 14,888    | 16,460    |
| Total liabilities and stockholders' equity | \$ 22,194 | \$ 25,970 |

See notes to unaudited consolidated financial statements.

**NATIONAL OILWELL VARCO, INC.**

**CONSOLIDATED STATEMENTS OF INCOME (LOSS) (UNAUDITED)**

**(In millions, except per share data)**

|  | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|--|---------------------------|-------------|--------------------------|-------------|
|  | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|  | <b>2016</b>               | <b>2015</b> | <b>2016</b>              | <b>2015</b> |
| Revenue  | \$ 1,646                  | \$ 3,306    | \$ 5,559                 | \$ 12,035   |
| Cost of revenue  | 1,567                     | 2,634       | 5,201                    | 9,360       |
| Gross profit   | 79                        | 672         | 358                      | 2,675       |
| Selling, general and administrative                        | 293                       | 383         | 1,031                    | 1,378       |
| Goodwill and intangible asset impairment                   | 972                       | 55          | 972                      | 55          |
| Operating profit (loss)                                    | (1,186)                   | 234         | (1,645)                  | 1,242       |
| Interest and financial costs                               | (25)                      | (24)        | (80)                     | (76)        |
| Interest income  | 3                         | 2           | 11                       | 9           |
| Equity income (loss) in unconsolidated affiliates          | (6)                       |             | (19)                     | 16          |
| Other income (expense), net                                | (30)                      | (20)        | (85)                     | (106)       |
| Income (loss) before income taxes                          | (1,244)                   | 192         | (1,818)                  | 1,085       |
| Provision for income taxes                                 | 120                       | 36          | (119)                    | 330         |
| Net income (loss)  | (1,364)                   | 156         | (1,699)                  | 755         |
| Net income (loss) attributable to noncontrolling interests | (2)                       | 1           | (1)                      | 1           |
| Net income (loss) attributable to Company                  | \$ (1,362)                | \$ 155      | \$ (1,698)               | \$ 754      |
| Net income (loss) attributable to Company per share:       |                           |             |                          |             |
| Basic  | \$ (3.62)                 | \$ 0.41     | \$ (4.53)                | \$ 1.92     |
| Diluted  | \$ (3.62)                 | \$ 0.41     | \$ (4.53)                | \$ 1.92     |
| Cash dividends per share                                   | \$ 0.05                   | \$ 0.46     | \$ 0.56                  | \$ 1.38     |
| Weighted average shares outstanding:                       |                           |             |                          |             |
| Basic  | 376                       | 380         | 375                      | 392         |
| Diluted  | 376                       | 381         | 375                      | 393         |

See notes to unaudited consolidated financial statements.

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**NATIONAL OILWELL VARCO, INC.**
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)****(In millions)**

|   | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|---|---------------------------|-------------|--------------------------|-------------|
|   | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|   | <b>2016</b>               | <b>2015</b> | <b>2016</b>              | <b>2015</b> |
| Net income (loss)   | \$ (1,364)                | \$ 156      | \$ (1,699)               | \$ 755      |
| Currency translation adjustments                                    | (18)                      | (339)       | 79                       | (650)       |
| Changes in derivative financial instruments, net of tax             | 60                        | (19)        | 191                      | 7           |
| Comprehensive income (loss)   | (1,322)                   | (202)       | (1,429)                  | 112         |
| Comprehensive income (loss) attributable to noncontrolling interest | (2)                       | 1           | (1)                      | 1           |
| Comprehensive income (loss) attributable to Company                 | \$ (1,320)                | \$ (203)    | \$ (1,428)               | \$ 111      |

See notes to unaudited consolidated financial statements.

**NATIONAL OILWELL VARCO, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

(In millions)

|   | <b>Nine Months Ended<br/>September 30,</b> |                |
|---|--|----------------|
|   | <b>2016</b>                                | <b>2015</b>    |
| <b>Cash flows from operating activities:</b>  |  |                |
| Net income (loss)   | \$ (1,699)                                 | \$ 755         |
| <b>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</b> |  |                |
| Depreciation and amortization   | 529  | 564            |
| Deferred income taxes   | (216)                                      | (122)          |
| Equity (income) loss in unconsolidated affiliates   | 19   | (16)           |
| Dividend from unconsolidated affiliate  | 6  | 34             |
| Goodwill and intangible asset impairment  | 972  | 55             |
| Other, net  | 281  | 236            |
| <b>Change in operating assets and liabilities, net of acquisitions:</b>                         |  |                |
| Receivables   | 1,089                                      | 1,045          |
| Inventories   | 430  | (6)            |
| Costs in excess of billings   | 485  | 209            |
| Prepaid and other current assets  | 31   | 73             |
| Accounts payable  | (230)                                      | (460)          |
| Accrued liabilities   | (664)                                      | (716)          |
| Billings in excess of costs   | (235)                                      | (595)          |
| Income taxes payable  | (229)                                      | (318)          |
| Other assets/liabilities, net   | 238  | (20)           |
| <b>Net cash provided by operating activities</b>  | <b>807</b>                                 | <b>718</b>     |
| <b>Cash flows from investing activities:</b>  |  |                |
| Purchases of property, plant and equipment  | (221)                                      | (332)          |
| Business acquisitions, net of cash acquired   | (60)                                       | (70)           |
| Other   | 4  | 24             |
| <b>Net cash used in investing activities</b>  | <b>(277)</b>                               | <b>(378)</b>   |
| <b>Cash flows from financing activities:</b>  |  |                |
| Borrowings against lines of credit and other debt   | 3,972                                      | 9,184          |
| Payments against lines of credit and other debt   | (4,869)                                    | (8,369)        |
| Cash dividends paid   | (211)                                      | (537)          |
| Share repurchases   |  | (2,221)        |
| Proceeds from stock options exercised   | 2  | 6              |
| Other   | (10)                                       | (2)            |
| <b>Net cash used in financing activities</b>  | <b>(1,116)</b>                             | <b>(1,939)</b> |
| Effect of exchange rates on cash  | 16   | (91)           |

|  |          |          |
|--|----------|----------|
| Decrease in cash and cash equivalents          | (570)    | (1,690)  |
| Cash and cash equivalents, beginning of period | 2,080    | 3,536    |
| Cash and cash equivalents, end of period       | \$ 1,510 | \$ 1,846 |

Supplemental disclosures of cash flow information:

Cash payments during the period for:

|              |        |        |
|--------------|--------|--------|
| Interest     | \$ 56  | \$ 57  |
| Income taxes | \$ 173 | \$ 760 |

See notes to unaudited consolidated financial statements.



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**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 our 2015 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 2016 presentation. The results of operations for the three and nine months ended September 30, 2016 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):

|                                       | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|---------------------------------------|-------------------------------|------------------------------|
| Raw materials and supplies            | \$ 1,045                      | \$ 1,069                     |
| Work in process                       | 698                           | 632                          |
| Finished goods and purchased products | 2,418                         | 2,977                        |
| Total                                 | \$ 4,161                      | \$ 4,678                     |

### 3. Accrued Liabilities

Accrued liabilities consist of (in millions):

|  | September 30,<br>2016 | December 31,<br>2015 |
|--|-----------------------|----------------------|
| Customer prepayments and billings              | \$ 306                | \$ 426               |
| Vendor costs                                   | 280                   | 449                  |
| Compensation                                   | 195                   | 241                  |
| Warranty                                       | 190                   | 244                  |
| Taxes (non-income)                             | 148                   | 175                  |
| Insurance                                      | 94                    | 113                  |
| Commissions                                    | 57                    | 73                   |
| Fair value of derivative financial instruments | 43                    | 261                  |
| Interest                                       | 29                    | 8                    |
| Other  | 286                   | 294                  |
| <b>Total</b>                                   | <b>\$ 1,628</b>       | <b>\$ 2,284</b>      |

#### *Service and Product Warranties*

The Company provides service and warranty policies on certain of its products. The Company accrues liabilities under service and warranty policies based upon specific claims and a review of historical warranty and service 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 carrying amount of service and product warranties are as follows (in millions):

|  |               |
|--|---------------|
| Balance at December 31, 2015                         | \$ 244        |
| Net provisions for warranties issued during the year | 39            |
| Amounts incurred                                     | (94)          |
| Currency translation adjustments and other           | 1             |
| <b>Balance at September 30, 2016</b>                 | <b>\$ 190</b> |

### 4. Costs and Estimated Earnings on Uncompleted Contracts

Costs and estimated earnings on uncompleted contracts consist of (in millions):

|   | September 30,<br>2016 | December 31,<br>2015 |
|---|-----------------------|----------------------|
| Costs incurred on uncompleted contracts | \$ 8,133              | \$ 9,082             |

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|   |        |          |
|---|--------|----------|
| Estimated earnings  | 3,862  | 4,080    |
|   | 11,995 | 13,162   |
| Less: Billings to date  | 11,780 | 12,697   |
|   | \$ 215 | \$ 465   |
| Costs and estimated earnings in excess of billings on uncompleted contracts | \$ 765 | \$ 1,250 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | (550)  | (785)    |
|   | \$ 215 | \$ 465   |

**5. Accumulated Other Comprehensive Income (Loss)**

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

|  | <b>Currency<br/>Translation<br/>Adjustments</b> | <b>Derivative<br/>Financial<br/>Instruments,<br/>Net of<br/>Tax</b> | <b>Defined<br/>Benefit<br/>Plans,<br/>Net of Tax</b> | <b>Total</b> |
|--|---|---|--|--------------|
| Balance at December 31, 2015   | \$ (1,279)                                      | \$ (205)  | \$ (69)  | \$ (1,553)   |
| Accumulated other comprehensive income<br>(loss) before reclassifications  | 79  | 71  |  | 150          |
| Amounts reclassified from accumulated other<br>comprehensive income (loss) |   | 120   |  | 120          |
| Balance at September 30, 2016  | \$ (1,200)                                      | \$ (14)   | \$ (69)  | \$ (1,283)   |

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

|                 | <b>Three Months Ended September 30,</b>         |   |                                      |   |   |                                      | <b>Total</b> |
|-----------------|---|---|--------------------------------------|---|---|--------------------------------------|--------------|
|                 | <b>2016</b>                                     |   |                                      | <b>2015</b>                                     |   |                                      |              |
|                 | <b>Currency<br/>Translation<br/>Adjustments</b> | <b>Derivative<br/>Financial<br/>Instruments</b> | <b>Defined<br/>Benefit<br/>Plans</b> | <b>Currency<br/>Translation<br/>Adjustments</b> | <b>Derivative<br/>Financial<br/>Instruments</b> | <b>Defined<br/>Benefit<br/>Plans</b> |              |
| Revenue         | \$  | \$  | \$                                   | \$  | \$  | (10)                                 | \$ (10)      |
| Cost of revenue |   | 48  |                                      | 48  |   | 82                                   | 82           |
| Tax effect      |   | (12)  |                                      | (12)  |   | (21)                                 | (21)         |
|                 | \$  | \$  | 36                                   | \$  | \$  | 51                                   | \$ 51        |

|                 | <b>Nine Months Ended September 30,</b>          |   |                                      |   |   |                                      | <b>Total</b> |
|-----------------|---|---|--------------------------------------|---|---|--------------------------------------|--------------|
|                 | <b>2016</b>                                     |   |                                      | <b>2015</b>                                     |   |                                      |              |
|                 | <b>Currency<br/>Translation<br/>Adjustments</b> | <b>Derivative<br/>Financial<br/>Instruments</b> | <b>Defined<br/>Benefit<br/>Plans</b> | <b>Currency<br/>Translation<br/>Adjustments</b> | <b>Derivative<br/>Financial<br/>Instruments</b> | <b>Defined<br/>Benefit<br/>Plans</b> |              |
| Revenue         | \$  | \$  | (3)                                  | \$  | \$  | (11)                                 | \$ (11)      |
| Cost of revenue |   | 170   |                                      | 170   |   | 234                                  | 234          |
| Tax effect      |   | (47)  |                                      | (47)  |   | (65)                                 | (65)         |
|                 | \$  | \$  | 120                                  | \$  | \$  | 158                                  | \$ 158       |

The Company's reporting currency is the U.S. dollar. A majority of the Company's international entities in which there is a substantial investment have the local currency as 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 months ended September 30, 2016, a majority of these local currencies weakened against the U.S. dollar resulting in net other comprehensive loss of \$18 million, upon the translation from local currencies to the U.S. dollar. For the nine months ended September 30, 2016, a majority of these local currencies strengthened against the U.S. dollar resulting in net other comprehensive income of \$79 million, upon the translation from local currencies to the U.S. dollar. For the three and nine months ended September 30, 2015, a majority of these local currencies weakened against the U.S. dollar resulting in net other comprehensive loss of \$339 million and \$650 million, respectively, upon the translation from local currencies to the U.S. dollar.

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 to which they are designed to 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 for 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 or prior periods. The accumulated effect was other comprehensive income of \$60 million (net of tax of \$20 million) and \$191 million (net of tax of \$72 million) for the three and nine months ended September 30, 2016, respectively. The accumulated effect was other comprehensive loss of \$19 million (net of tax of \$5 million) and income of \$7 million (net of tax of \$8 million) for the three and nine months ended September 30, 2015, respectively.

## 6. Business Segments

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

|  | Three Months Ended<br>September 30, |                 | Nine Months Ended<br>September 30, |                  |
|--|-------------------------------------|-----------------|------------------------------------|------------------|
|  | 2016                                | 2015            | 2016                               | 2015             |
| <b>Revenue:</b>                        |                                     |                 |                                    |                  |
| Rig Systems                            | \$ 470                              | \$ 1,496        | \$ 1,960                           | \$ 5,949         |
| Rig Aftermarket                        | 322                                 | 570             | 1,077                              | 1,946            |
| Wellbore Technologies                  | 526                                 | 834             | 1,668                              | 2,961            |
| Completion & Production Solutions      | 543                                 | 798             | 1,639                              | 2,619            |
| Eliminations                           | (215)                               | (392)           | (785)                              | (1,440)          |
| <b>Total revenue</b>                   | <b>\$ 1,646</b>                     | <b>\$ 3,306</b> | <b>\$ 5,559</b>                    | <b>\$ 12,035</b> |
| <b>Operating profit (loss):</b>        |                                     |                 |                                    |                  |
| Rig Systems                            | \$ (962)                            | \$ 278          | \$ (888)                           | \$ 1,176         |
| Rig Aftermarket                        | 72                                  | 157             | 203                                | 514              |
| Wellbore Technologies                  | (94)                                | (2)             | (331)                              | 141              |
| Completion & Production Solutions      | (61)                                | 10              | (132)                              | 183              |
| Eliminations and corporate costs       | (141)                               | (209)           | (497)                              | (772)            |
| <b>Total operating profit (loss)</b>   | <b>\$ (1,186)</b>                   | <b>\$ 234</b>   | <b>\$ (1,645)</b>                  | <b>\$ 1,242</b>  |
| <b>Operating profit (loss)%:</b>       |                                     |                 |                                    |                  |
| Rig Systems                            | (204.7%)                            | 18.6%           | (45.3%)                            | 19.8%            |
| Rig Aftermarket                        | 22.4%                               | 27.5%           | 18.8%                              | 26.4%            |
| Wellbore Technologies                  | (17.9%)                             | (0.2%)          | (19.8%)                            | 4.8%             |
| Completion & Production Solutions      | (11.2%)                             | 1.3%            | (8.1%)                             | 7.0%             |
| <b>Total operating profit (loss) %</b> | <b>(72.1%)</b>                      | <b>7.1%</b>     | <b>(29.6%)</b>                     | <b>10.3%</b>     |

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 four reporting segments that are eliminated in consolidation. Intercompany transactions within each reporting segment are eliminated within each reporting segment.

Included in operating profit (loss) are other items primarily related to goodwill and intangible asset impairments; costs associated with Voluntary Early Retirement Plans ( VERP ) established by the Company during the first quarters of 2016 and 2015; and certain costs related to severance and facility closures. As of September 30, 2016, the Company had approximately \$72 million accrued for the VERP postretirement medical benefits. Other items by segment are as follows (in millions):

|                     | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |      |
|---------------------|-------------------------------------|------|------------------------------------|------|
|                     | 2016                                | 2015 | 2016                               | 2015 |
| <b>Other items:</b> |                                     |      |                                    |      |

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|                                   |          |        |          |        |
|-----------------------------------|----------|--------|----------|--------|
| Rig Systems                       | \$ 994   | \$ 22  | \$ 1,069 | \$ 65  |
| Rig Aftermarket                   | 3        | 1      | 16       | 11     |
| Wellbore Technologies             | 24       | 29     | 112      | 83     |
| Completion & Production Solutions | 51       | 60     | 123      | 92     |
| Eliminations and corporate costs  | 6        |        | 16       |        |
| Total other items                 | \$ 1,078 | \$ 112 | \$ 1,336 | \$ 251 |

**7. Debt**

Debt consists of (in millions):

|  | September 30,<br>2016 | December 31,<br>2015 |
|--|-----------------------|----------------------|
| \$500 million in Senior Notes, interest at 1.35% payable semiannually, principal due on December 1, 2017 | \$ 499                | \$ 498               |
| \$1.4 billion in Senior Notes, interest at 2.60% payable semiannually, principal due on December 1, 2022 | 1,390                 | 1,389                |
| \$1.1 billion in Senior Notes, interest at 3.95% payable semiannually, principal due on December 1, 2042 | 1,087                 | 1,087                |
| Commercial paper   |                       | 890                  |
| Other  | 240                   | 45                   |
| <b>Total debt</b>  | <b>3,216</b>          | <b>3,909</b>         |
| Less current portion   | 6                     | 2                    |
| <b>Long-term debt</b>  | <b>\$ 3,210</b>       | <b>\$ 3,907</b>      |

On January 1, 2016, the Company adopted Accounting Standards Update No. 2015-03 Simplifying the Presentation of Debt Issuance Costs. This update requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. We have applied the change retrospectively for prior period balances of unamortized debt issuance costs, resulting in a \$21 million reduction in other assets and long-term debt on our consolidated balance sheet as of December 31, 2015. The table above now presents our debt liability net of the related debt discount and debt issuance costs.

The Company has a \$4.5 billion, five-year credit facility which expires September 28, 2018. The Company also has a commercial paper program under which borrowings are classified as long-term since the program is supported by the \$4.5 billion, five-year credit facility. At September 30, 2016, there were no commercial paper borrowings, and there were no outstanding letters of credit issued under the credit facility, resulting in \$4,500 million of funds available under this credit facility. Interest under this multicurrency facility is based upon LIBOR, NIBOR or EURIBOR 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, 2016, the Company was in compliance with a debt-to-capitalization ratio of 17.8%.

The Company had \$1,227 million of outstanding letters of credit at September 30, 2016 that are under various bilateral letter of credit facilities. Letters of credit are issued as bid bonds, advanced payment bonds and performance bonds.

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, 2016 and December 31, 2015, the fair value of the Company's unsecured Senior Notes approximated \$2,725 million and \$2,551 million, respectively. At September 30, 2016 and December 31, 2015, the carrying value of the Company's unsecured Senior Notes approximated \$2,976 million and \$2,974 million, respectively. The carrying value of the Company's variable rate borrowings approximates



fair value.

**8. Tax**

The effective tax rate for the three and nine months ended September 30, 2016 was (9.6)% and 6.5%, respectively, compared to 18.8% and 30.4% for the same periods in 2015. Impairment of goodwill not deductible for tax purposes, lower tax rates on losses incurred in foreign jurisdictions, and an increase in valuation allowance on deferred taxes, which, when applied to losses generated during the nine-month period resulted in a lower effective tax rate than the U.S. statutory rate. Included in the increase in valuation allowance is \$213 million recorded against excess foreign tax credits that are not expected to be realized before expiration. The lower effective tax rate was partially offset by benefits from foreign dividends net of foreign tax credits.

The difference between the effective tax rate reflected in the provision for income taxes and the U.S. federal statutory rate of 35% was as follows (in millions):

|   | <b>Three Months Ended</b>     |              | <b>Nine Months Ended</b>      |               |
|---|-------------------------------|--------------|-------------------------------|---------------|
|   | <b>September 30,<br/>2016</b> | <b>2015</b>  | <b>September 30,<br/>2016</b> | <b>2015</b>   |
| Federal income tax at U.S. federal statutory rate | \$ (436)                      | \$ 67        | \$ (637)                      | \$ 380        |
| Foreign income tax rate differential              | 38                            | (30)         | 14                            | (117)         |
| Nondeductible expenses                            | 2                             |              | 23                            | 17            |
| Foreign dividends, net of foreign tax credits     | (28)                          | (1)          | (47)                          | 14            |
| Tax impact of foreign exchange                    | 9                             | (4)          | 2                             | (22)          |
| Change in valuation allowance                     | 238                           |              | 259                           |               |
| Goodwill impairment                               | 273                           |              | 273                           |               |
| Tax rate change on temporary differences          | (2)                           | 1            | (5)                           | (2)           |
| Change in tax reserves                            | 39                            | (2)          | 19                            | 67            |
| Other   | (13)                          | 5            | (20)                          | (7)           |
| <b>Provision for income taxes</b>                 | <b>\$ 120</b>                 | <b>\$ 36</b> | <b>\$ (119)</b>               | <b>\$ 330</b> |

The balance of unrecognized tax benefits at September 30, 2016 was \$66 million. The Company does not anticipate its total unrecognized tax benefits at September 30, 2016 to significantly change due to the settlement of audits or the expiration of statutes of limitation within 12 months of this reporting date.

For the three and nine months ended September 30, 2016, the Company is utilizing 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; consequently, the actual effective rate for the interim period is being reported. The discrete-period method is applied when the application of the estimated annual effective tax rate is impractical because it is not possible to reliably estimate the annual effective tax rate.

For the three and nine months ended September 30, 2015, the Company utilized the estimated annual effective tax rate method in computing its interim tax provisions. The relationship between pre-tax accounting income and income tax for these periods allowed the Company to estimate the annual effective tax rate to be applied to year-to-date income in those periods.

On January 1, 2016, the Company adopted Accounting Standard Update No. 2015-17, Balance Sheet Classification of Deferred Taxes on a retrospective basis. Rather than classify deferred tax assets and liabilities as current and non-current, this update requires that deferred tax assets and liabilities be classified as non-current in the Consolidated Balance Sheet. Adoption of this standard resulted in a reclassification of our current deferred tax assets and liabilities

to non-current deferred tax assets and liabilities in our Consolidated Balance Sheet. Prior periods have been retrospectively adjusted. At December 31, 2015, \$376 million of current deferred tax assets have been reclassified to non-current deferred tax liabilities, \$358 million of non-current deferred tax assets have been reclassified to non-current deferred tax liabilities, and \$291 million of current deferred tax liabilities have been reclassified to non-current deferred tax liabilities.

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## 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 was increased during the second quarter of 2016 to 69.4 million. The Plan is now 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, 2016, 31,772,300 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 24, 2016, the Company granted 3,672,411 stock options with a fair value of \$6.44 per share and an exercise price of \$28.24 per share; 1,732,095 shares of restricted stock and restricted stock units with a fair value of \$28.24 per share; performance share awards to senior management employees with potential payouts varying from zero to 341,780 shares; and 4,618,400 SARs with an exercise price of \$28.24 and a fair value of \$6.44 per SAR. The stock options vest over a three-year period from the grant date while the restricted stock and restricted stock units vest on the third anniversary of the date of grant. 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 index for the three-year performance period. The SARs are cash-settled awards and vest over a three-year period from the grant date. Upon exercise of the SARs, the employee is entitled to receive cash payment for the appreciation in the value of our common stock over the exercise price. We account for the cash-settled SARs as liability awards, which require the awards to be revalued at each reporting period.

On May 18, 2016, the Company granted 44,520 restricted stock awards with a fair value of \$31.45 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 was \$28 million and \$78 million for the three and nine months ended September 30, 2016, respectively, and \$21 million and \$83 million for the three and nine months ended September 30, 2015, respectively. Included in stock-based compensation for the nine months ended September 30, 2016 and 2015 is \$5 million and \$18 million, respectively, related to the Voluntary Early Retirement Plan established by the Company in the first quarter of each year. The total income tax benefit recognized in the Consolidated Statements of Income (Loss) for all stock-based compensation arrangements under the Plan was \$5 million and \$17 million for the three and nine months ended September 30, 2016, respectively, and \$7 million and \$20 million for the three and nine months ended September 30 2015, respectively.

## 10. Derivative Financial Instruments

ASC Topic 815, *Derivatives and Hedging* requires a company to recognize all of its derivative instruments as either assets or liabilities in the Consolidated Balance Sheet at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation.

The Company is exposed to certain risks relating to its ongoing business operations. The primary risk managed by using derivative instruments is 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 recognized nonfunctional 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 its exposure to changes in interest rates on anticipated long-term debt issuances.

At September 30, 2016, the Company has determined that the fair value of its derivative financial instruments representing assets of \$51 million and liabilities of \$43 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, 2016, the net fair value of the Company's foreign currency forward contracts totaled a net asset of \$8 million.

At September 30, 2016, the Company did not have any interest rate swaps 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. We do 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 nonfunctional 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 during the current period.

For the three and nine months ended September 30, 2016, the Company recognized losses of \$2 million and \$19 million, respectively, 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, 2016, there were \$17 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 additional losses due to the de-designation of existing hedge contracts.

The Company had the following outstanding foreign currency forward contracts that were entered into to hedge nonfunctional currency cash flows from forecasted revenues and expenses (in millions):

| Foreign Currency       | Currency Denomination |                      |
|------------------------|-----------------------|----------------------|
|                        | September 30,<br>2016 | December 31,<br>2015 |
| Norwegian Krone        | NOK 6,433             | NOK 9,655            |
| Euro                   | EUR 186               | EUR 78               |
| U.S. Dollar            | USD 155               | USD 321              |
| Danish Krone           | DKK 37                | DKK 57               |
| Singapore Dollar       | SGD 8                 | SGD 14               |
| British Pound Sterling | GBP 1                 | GBP 4                |
| Canadian Dollar        | CAD                   | CAD 2                |

*Non-designated Hedging Strategy*

The Company enters into forward exchange contracts to hedge certain nonfunctional 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 nonfunctional 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., nonfunctional currency monetary accounts) is recognized in other income (expense), net in current earnings.

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

| Foreign Currency       | Currency Denomination |                      |
|------------------------|-----------------------|----------------------|
|                        | September 30,<br>2016 | December 31,<br>2015 |
| Russian Ruble          | RUB 1,956             | RUB 2,164            |
| Norwegian Krone        | NOK 1,311             | NOK 2,265            |
| U.S. Dollar            | USD 536               | USD 515              |
| Euro                   | EUR 273               | EUR 371              |
| Danish Krone           | DKK 108               | DKK 153              |
| British Pound Sterling | GBP 15                | GBP 11               |
| Canadian Dollar        | CAD 11                | CAD 7                |
| Singapore Dollar       | SGD 1                 | SGD 5                |

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, 2016 | December 31, 2015 |                        | September 30, 2016 | December 31, 2015 |
| <b>Derivatives designated as hedging instruments under ASC Topic 815</b>           |                                  |                    |                   |                        |                    |                   |
| Foreign exchange contracts   | Prepaid and other current assets | \$ 28              | \$ 5              | Accrued liabilities    | \$ 27              | \$ 212            |
| Foreign exchange contracts   | Other Assets                     |                    |                   | Other liabilities      |                    | 25                |
| <b>Total derivatives designated as hedging instruments under ASC Topic 815</b>     |                                  | \$ 28              | \$ 5              |                        | \$ 27              | \$ 237            |
| <b>Derivatives not designated as hedging instruments under ASC Topic 815</b>       |                                  |                    |                   |                        |                    |                   |
| Foreign exchange contracts   | Prepaid and other current assets | \$ 23              | \$ 21             | Accrued liabilities    | \$ 16              | \$ 49             |
| Foreign exchange contracts   | Other Assets                     |                    |                   | Other Liabilities      |                    |                   |
| <b>Total derivatives not designated as hedging instruments under ASC Topic 815</b> |                                  | \$ 23              | \$ 21             |                        | \$ 16              | \$ 49             |
| <b>Total derivatives</b>   |                                  | \$ 51              | \$ 26             |                        | \$ 43              | \$ 286            |

**The Effect of Derivative Instruments on the Consolidated Statements of Income**  
(\$ in millions)

|  | Amount of Gain (Loss) Recognized in OCI or Derivative | Location of Gain (Loss) Reclassified from Accumulated OCI into Income | Amount of Gain (Loss) Reclassified from Accumulated OCI into Income | Location of Gain (Loss) Recognized in Income on Derivative | Amount of   |
|--|---|---|---|--|---|
|  |   |   |   |  | Gain (Loss) Recognized in Income on Derivative  |
| Derivatives in ASC Topic 815 Cash Flow Hedging Relationships | Derivative (Effective Portion) (a)                    | Income (Effective Portion)  | Accumulated OCI into Income (Effective Portion)                     | Excluded from Effectiveness Testing)                       | Amount of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount) |
|  | Nine Months Ended September 30,                       |   | Nine Months Ended September 30,                                     |  | Excluded from Effectiveness Testing) (b) Nine Months Ended September 30,                  |
|  |   |   |   |  |   |



|                            | 2016      | 2015         |                 | 2016         | 2015         |                             | 2016        | 2015        |
|----------------------------|-----------|--------------|-----------------|--------------|--------------|-----------------------------|-------------|-------------|
|                            |           |              | Revenue         | 3            | 11           | Cost of revenue             | (19)        | (27)        |
| Foreign exchange contracts | 96        | (196)        | Cost of revenue | (151)        | (207)        | Other income (expense), net | 3           | 1           |
| <b>Total</b>               | <b>96</b> | <b>(196)</b> |                 | <b>(148)</b> | <b>(196)</b> |                             | <b>(16)</b> | <b>(26)</b> |

| Derivatives Not Designated as<br>Hedging Instruments under<br>ASC Topic 815 | Location of Gain (Loss)<br>Recognized in Income<br>on Derivative | Amount of Gain (Loss)<br>Recognized in Income on<br>Derivative<br>Nine<br>Months<br>Ended<br>September 30,<br>2016 2015 |
|---|--|---|
| Foreign exchange contracts  | Other income (expense), net                                      | (84)  |
| <b>Total</b>  |  | <b>(84)</b>   |

- (a) The Company expects that \$20 million of the accumulated other comprehensive income (loss) will be reclassified into earnings within the next twelve months with an offset by gains from the underlying transactions resulting in no impact to earnings or cash flow.
- (b) The amount of gain (loss) recognized in income represents \$(19) million and \$(27) million related to the ineffective portion of the hedging relationships for each of the nine months ended September 30, 2016 and 2015, respectively, and \$3 million and \$1 million related to the amount excluded from the assessment of the hedge effectiveness for the nine months ended September 30, 2016 and 2015, 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):

|   | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|---|---------------------------|-------------|--------------------------|-------------|
|   | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|   | <b>2016</b>               | <b>2015</b> | <b>2016</b>              | <b>2015</b> |
| <b>Numerator:</b>   |                           |             |                          |             |
| Net income (loss) attributable to Company                                 | \$ (1,362)                | \$ 155      | \$ (1,698)               | \$ 754      |
| <b>Denominator:</b>   |                           |             |                          |             |
| Basic weighted average common shares outstanding                          | 376                       | 380         | 375                      | 392         |
| Dilutive effect of employee stock options and other unvested stock awards |                           | 1           |                          | 1           |
| Diluted outstanding shares  | 376                       | 381         | 375                      | 393         |
| <b>Net income (loss) attributable to Company per share:</b>               |                           |             |                          |             |
| Basic   | \$ (3.62)                 | \$ 0.41     | \$ (4.53)                | \$ 1.92     |
| Diluted   | \$ (3.62)                 | \$ 0.41     | \$ (4.53)                | \$ 1.92     |
| Cash dividends per share  | \$ 0.05                   | \$ 0.46     | \$ 0.56                  | \$ 1.38     |

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 attributable to Company allocated to these participating securities was immaterial for the three and nine months ended September 30, 2016 and therefore not excluded from net income attributable to Company per share calculation.

The Company had stock options outstanding that were anti-dilutive totaling 14 million for each of the three and nine months ended September 30, 2016, and 15 million and 14 million shares for each of the three and nine months ended September 30, 2015, respectively.

**12. Cash Dividends**

On August 18, 2016, the Company's Board of Directors approved a cash dividend of \$0.05 per share. The cash dividend was paid on September 30, 2016, to each stockholder of record on September 16, 2016. Cash dividends were \$19 million and \$211 million for the three and nine months ended September 30, 2016, and \$174 million and \$537 million for the three and nine months ended September 30, 2015, respectively. 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. Goodwill Impairment

The steep worldwide oil and gas industry downturn that started in 2014 stabilized somewhat during the third quarter of 2016, though at very low levels of activity. Operators have improved their cost structures and achieved operational efficiencies, reducing the industry's marginal cost of supply, primarily in the North American land market. While some improvements in offshore operations have been made, many deepwater projects will not be able to achieve an economically competitive cost structure under the current commodity pricing outlook. As a result, the market shift from offshore drilling to land drilling in North America intensified. Announced cancellations of major offshore projects during the quarter, releases of contracted offshore rigs, the number of idle offshore rigs and the number of current newbuilds still to be completed and enter the market all indicate a large over-supply of offshore equipment that will take years to absorb, even as offshore drilling activity recovers. During the third quarter, these factors indicated a more prolonged downturn associated with newbuild offshore drilling rigs, and we reduced our forecast accordingly, which indicated a goodwill impairment in the Rig Offshore reporting unit was possible.

Generally Accepted Accounting Principles require the company test goodwill and other indefinite-lived intangible assets for impairment at least annually or more frequently whenever events or circumstances occur indicating that those assets might be impaired.

The first step of the impairment analysis is to compare the reporting unit's carrying value to the respective fair value. Fair value of the reporting unit is determined in accordance with ASC Topic 820 Fair Value Measurements and Disclosures using significant unobservable inputs, or level 3 in the fair value hierarchy. These inputs are based on internal management estimates, forecasts and judgments, using discounted cash flow.

The discounted cash flow is based on management's forecast of operating performance for the reporting unit. The two main assumptions used in measuring goodwill impairment, which bear the risk of change and could impact the Company's goodwill impairment analysis, include the cash flow from operations from each reporting unit and its weighted average cost of capital. The starting point for each of the reporting unit's cash flow from operations is the detailed annual plan or updated forecast. Cash flows beyond the updated forecasted operating plans were estimated using a terminal value calculation, which incorporated historical and forecasted financial cyclical trends for each reporting unit and considered long-term earnings growth rates. The financial and credit market volatility directly impacts our fair value measurement through our weighted average cost of capital that we use to determine our discount rate. During times of volatility, significant judgment must be applied to determine whether credit changes are a short-term or long-term trend.

Based on the Company's step one impairment analysis, as of July 1, 2016 the Rig Offshore reporting unit had a calculated fair value below its carrying value, and required a step two analysis, which compares the implied fair value of goodwill of a reporting unit to the carrying value of goodwill for the reporting unit. The implied fair value of goodwill is determined by deducting the fair value of a reporting unit's identifiable assets and liabilities from the fair value of that reporting unit as a whole. Consistent with the step one analysis, fair value of the assets and liabilities was determined in accordance with ASC Topic 820. Based on the step two analysis performed for the Rig Offshore reporting unit, the Company recorded a \$972 million write-down of goodwill during the third quarter. As a result of the goodwill impairment and a reduction in working capital, total assets for Rig Systems were \$3.7 billion at September 30, 2016.

Also, to achieve higher efficiencies and reduce costs, the Company combined the operations of the Rig Offshore and Rig Land reporting units during the third quarter of 2016. Generally accepted accounting principles require the Company to test the value of goodwill assets for impairment before and after combining reporting units. As a result we also tested Rig Land before the combination as well as the combined reporting unit, Rig Systems, as of July 1, 2016 for goodwill impairment, in accordance with accounting guidance ASC Topic No. 350, Intangibles Goodwill and Other .

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Based on the Company's step one impairment analysis, the calculated fair value of the Rig Land reporting unit was substantially in excess of its carrying value. Additionally, the goodwill impairment analysis performed subsequent to the combination of the two reporting units into the Rig Systems reporting unit, concluded that the calculated fair value of the Rig Systems reporting unit was substantially in excess of its carrying value. We also considered whether impairment indicators existed that would suggest the goodwill of our other reporting units was more likely than not impaired and concluded there were none. While the outlook for offshore new-builds has declined sharply, higher activity levels in land drilling will benefit our other businesses.

At September 30, 2016, the Company has approximately \$6 billion of goodwill, which is identified by segment as follows (in millions):

|  | <b>Rig Systems</b> | <b>Rig<br/>Aftermarket</b> | <b>Wellbore<br/>Technologies</b> | <b>Completion &amp;<br/>Production<br/>Solutions</b> | <b>Total</b> |
|--|--------------------|----------------------------|----------------------------------|--|--------------|
| Gross value before accumulated impairment    | \$ 1,232           | \$ 877                     | \$ 4,359                         | \$ 1,997   | \$ 8,465     |
| Accumulated impairment                       |                    |                            | (1,485)                          |  | (1,485)      |
| Balance at December 31, 2015                 | \$ 1,232           | \$ 877                     | \$ 2,874                         | \$ 1,997   | \$ 6,980     |
| Goodwill acquired and adjusted during period | 1                  |                            | (7)                              |  | (6)          |
| Impairment                                   | (972)              |                            |                                  |  | (972)        |
| Currency translation adjustments and other   |                    |                            | 4                                | 9  | 13           |
| Balance at September 30, 2016                | \$ 261             | \$ 877                     | \$ 2,871                         | \$ 2,006   | \$ 6,015     |

## 14. Commitments and Contingencies

In 2008, we received U.S. federal grand jury subpoenas and subsequent inquiries from U.S. governmental agencies requesting records related to our compliance with U.S. export trade laws and regulations. We have cooperated fully with agents from the U.S. Department of Justice, the Department of Commerce Bureau of Industry and Security, the United States Department of Treasury, Office of Foreign Assets Control, and U.S. Immigration and Customs Enforcement in responding to the inquiries. We have also cooperated with an informal inquiry from the Securities and Exchange Commission in connection with the inquiries previously made by the aforementioned federal agencies. We have conducted our own internal review of this matter. At the conclusion of our internal review in the fourth quarter of 2009, we identified possible areas of concern and discussed these areas of concern with the relevant agencies. We are currently negotiating a potential resolution with the agencies involved related to these matters. We currently anticipate that any administrative fine or penalty agreed to as part of a resolution would be within established accruals, and would not have a material effect on our financial position or results of operations. To the extent a resolution is not negotiated, we cannot predict the timing or effect that any resulting government actions may have on our financial position or results of operations.

In addition, we are involved in various other claims, internal investigations, regulatory agency audits and pending or threatened legal actions involving a variety of matters. As of September 30, 2016, the Company recorded an immaterial amount for contingent liabilities representing all contingencies believed to be probable. 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 cases referred to above, will not materially affect our financial position, cash flow or results of operations. As it relates to the cases referred to above we currently anticipate that any administrative fine or penalty agreed to as part of a resolution would be within established accruals, and would not have a material effect on our financial position or results of operations. To the extent a resolution is not negotiated as anticipated, we cannot predict the timing or effect that any resulting government actions may have on 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.

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. 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 hereunder may not result in additional, presently unquantifiable, costs or liabilities to us.

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 may 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. For example, the on-going, publicly disclosed investigations in Brazil have adversely impacted our shipyard customers, their customers, entities providing financing for our shipyard customers and/or entities in the supply chain. The investigations in Brazil have led to, and are expected to continue to lead to, delays in deliveries to our shipyard customers in Brazil, along with temporary suspension of performance under our supply contracts, and have resulted in cancellations and could result in further attempted cancellation or other breaches of our contracts by our shipyard customers.

In other jurisdictions, our shipyard customers' customers in some instances have, and may in the future, sought suspension, delay or cancellation of the contracts or payment due between our shipyard customers and their

customers. To the extent our shipyard customers and their customers become engaged in disputes or litigation related to any such suspensions, delays or cancellations, we may also become involved, either directly or indirectly, in such disputes or litigation, as we enforce the terms of our contracts with our shipyard customers. Further, customers in other markets may seek delay or suspension of deliveries, extending delivery into future periods, or may attempt cancellations. While we manage deliveries and collection of payment to achieve milestone payments that mitigate our financial risk, such delays, suspensions, attempted cancellations, breaches of contract or other similar circumstances, could adversely affect our operating results, collections of accounts receivable and financial condition and could reduce our backlog.

## 15. Recently Issued Accounting Standards

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 is currently assessing the impact of the adoption of ASU No. 2016-15 on its consolidated financial position and results of operations.

In March 2016, the FASB issued Accounting Standard Update No. 2016-09 *Improvements to Employee Share-Based Payment Accounting* (ASU 2016-09). This update requires that entities record all of the tax effects related to share-based payments at settlement (or expiration) through the income statement. ASU No. 2016-09 is effective for fiscal years beginning after December 15, 2016, and for interim periods within those fiscal years. The Company will adopt ASU No. 2016-09 on January 1, 2017.

In February 2016, the FASB issued Accounting Standard Update No. 2016-02 *Leases* (ASU No. 2016-02), which supersedes the lease requirements in Accounting Standard Codification 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. ASU No. 2016-02 is effective for fiscal years beginning after December 15, 2018, and for interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of ASU No. 2016-02 on its consolidated financial position and results of operations.

In November 2015, the FASB issued Accounting Standard Update No. 2015-17 *Balance Sheet Classification of Deferred Taxes* (ASU 2015-17). This update requires companies to classify all deferred tax assets and liabilities as non-current on its consolidated financial position. The Company has early adopted ASU 2015-17 on a retrospective basis, resulting in a reclassification of current deferred tax assets and liabilities to non-current deferred tax assets and liabilities. The ASU adoption is effective January 1, 2016, and prior periods have been retrospectively adjusted. See Note 8 for further information on the presentation of deferred taxes.

In April 2015, the FASB issued Accounting Standard Update No. 2015-03 *Simplifying the Presentation of Debt Issuance Costs* (ASU 2015-03) to simplify the presentation of debt issuance costs. This update requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts, as opposed to historical presentation as an asset on the balance sheet. ASU No. 2015-03 is effective for fiscal years beginning after December 15, 2015, and for interim periods within those fiscal years. The Company adopted this update on January 1, 2016, and has applied the change retrospectively to prior periods for unamortized debt issuance costs. See Note 7 for further information on the presentation of debt issuance costs.

In August 2014, the FASB issued Accounting Standard Update No. 2014-15 *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern* (ASU No. 2014-15), which amends FASB Accounting Standards Codification 205 *Presentation of Financial Statements*. This update requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. ASU No. 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. The Company is currently assessing the impact of the adoption of ASU No. 2014-15 on its consolidated financial position and results of operations.

In May 2014, the FASB issued Accounting Standard Update No. 2014-09 *Revenue from Contracts with Customers* (ASU



No. 2014-09), which supersedes the revenue recognition requirements in Accounting Standard Codification Topic No. 605 Revenue

Recognition and most industry-specific guidance. This update requires that entities recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. ASU No. 2014-09 is effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of ASU No. 2014-09 on its consolidated financial position and results of operations.

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

### *Introduction*

National Oilwell Varco, Inc. (the Company) is a worldwide leader in the design, manufacture and sale of equipment and components used in oil and gas drilling, completion and production operations, and the provision of oilfield services to the upstream oil and gas industry.

Unless indicated otherwise, results of operations data are presented in accordance with accounting principles generally accepted in the United States (GAAP). In an effort to provide investors with additional information regarding our results of operations, certain non-GAAP financial measures, including operating profit excluding other items, operating profit percentage excluding other items and operating (non-GAAP) earnings per share, are provided. 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.

### *Rig Systems*

The Company's Rig Systems segment makes and supports the capital equipment and integrated systems needed to drill oil and gas wells on land and offshore. 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 in Rig Systems include: substructures, derricks, and masts; cranes; 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; and rig instrumentation and control systems.

Rig Systems 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.

To achieve higher efficiencies and reduce costs in the current market, the Company combined the Rig Offshore and Rig Land reporting units during the third quarter of 2016. See Note 13.

### *Rig Aftermarket*

The Company's Rig Aftermarket segment provides comprehensive aftermarket products and services to support land and offshore rigs, and drilling rig components manufactured by the Company's Rig Systems segment.

The segment provides spare parts, repair, and rentals as well as technical support, field service and first well support, field engineering, and customer training through a network of aftermarket service and repair facilities strategically located in major areas of drilling operations.

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

### *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 sells equipment and technologies needed for hydraulic fracture stimulation, including

pressure pumping trucks, blenders, sanders, hydration units, injection units, flowline, manifolds, wellheads and completion tools; well intervention, including coiled tubing units, coiled tubing, and wireline units and tools; 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.

### **Critical Accounting Policies and Estimates**

In our annual report on Form 10-K for the year ended December 31, 2015, 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 under long-term construction contracts; 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; service and product 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.

#### *Goodwill Impairment*

To achieve higher efficiencies and reduce costs, the Company combined the Rig Offshore and Rig Land reporting units during the third quarter of 2016. Generally accepted accounting principles require the Company to test the value of goodwill assets for impairment before and after combining reporting units. Also during the third quarter, a shift to land drilling indicated a more prolonged downturn associated with newbuild offshore drilling rigs, and we reduced our forecast accordingly. Our updated forecast for the Rig Offshore reporting unit indicated an impairment was possible. We tested each of the two reporting units as of July 1, 2016 for goodwill impairment, before and after combining them, in accordance with accounting guidance ASC Topic No. 350, *Intangibles - Goodwill and Other*.

Based on the Company's step one impairment analysis, the calculated fair value of the Rig Land reporting unit was substantially in excess of its carrying value. The Rig Offshore reporting unit had a calculated fair value below its carrying value, and required a step two analysis in accordance with ASC Topic 820. Based on the step two analysis performed for the Rig Offshore reporting unit, the Company recorded a \$972 million write-down of goodwill during the third quarter. We performed the goodwill impairment analysis subsequent to the combination of the two reporting units into the Rig Systems reporting unit and concluded that the calculated fair value of the Rig Systems reporting unit was substantially in excess of its carrying value.

## EXECUTIVE SUMMARY

For its third quarter ended September 30, 2016, the Company had a \$1,362 million net loss, or \$3.62 per fully diluted share, on \$1.6 billion in revenue. Compared to the second quarter of 2016, revenue decreased \$78 million or 5% and net loss decreased \$1.1 billion or 528%. Compared to the third quarter of 2015, revenue decreased \$1.7 billion or 50%, and net income decreased \$1.5 billion or 979%.

Excluding other items from all periods, operating loss was \$108 million or (6.6)% of sales in the third quarter of 2016, compared to operating loss of \$153 million or (8.9)% of sales in the second quarter of 2016, and operating profit of \$346 million or 10.5% of sales in the third quarter of 2015.

During the third quarter of 2016, second quarter of 2016, and third quarter of 2015, pre-tax other items included in operating profit (loss) were \$1,078 million, \$117 million and \$112 million, respectively. Excluding other items from all periods, third quarter 2016 operating (non-GAAP) losses were \$(0.34) per fully diluted share, compared to losses of \$(0.30) per fully diluted share in the second quarter of 2016 and earnings of \$0.61 per fully diluted share in the third quarter of 2015.

### Oil & Gas Equipment and Services Market

Over the past decade, technological advancements in the oilfield equipment and service space unlocked production from formations that were previously deemed uneconomic, especially in North America. From 2004 to 2014 global oil and liquids supply increased dramatically from U.S. unconventional resources, deep-water (defined as water depths greater than 400 feet) resources and from other sources. The advances in technology combined with relatively high commodity prices caused by growing demand enabled and sustained an increase in global drilling activity. In recent years, global supply started to catch up to demand, and in the latter 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, the first signs of an oversupply-related imbalance appeared and prices began to decline. Unlike previous cycles, when the Organization of the Petroleum Exporting Countries (OPEC) curtailed production levels to defend pricing, certain members of OPEC increased production in an effort to increase market share and financially stress higher cost producers, most notably those operating in the North American shale market. As a result, the price of oil declined significantly during early 2015, remained depressed throughout the year, and underwent another major reduction toward the end of 2015. In early 2016, the market witnessed oil trading in the high \$20 per barrel range, a price range not seen since 2003.

In response to rapidly deteriorating market conditions, operators adjusted accordingly by acutely reducing both operating and capital expenditures. Orders for our equipment and services slowed and rig counts declined rapidly with active drilling rig counts hitting 70 year lows during the second quarter of 2016. As a result of the sharp cutback in activity, production began to decline in certain areas of the world and commodity prices began to rebound as oil markets begin the process of re-balancing.

### Segment Performance

The Rig Systems segment generated \$470 million in revenue and \$962 million in operating loss or (204.7)% of sales in the third quarter of 2016. Compared to the prior quarter, revenue decreased \$94 million or 17%, and operating profit decreased \$969 million. Compared to the third quarter of 2015, segment revenue decreased \$1.0 billion or 69%, and operating profit decreased \$1.2 billion or 446%. Third quarter 2016 revenue out of backlog for the Rig Systems segment decreased 18% sequentially and 72% year-over-year on fewer shipments and postponed delivery dates of some offshore projects. During the third quarter of 2016, the segment received \$185 million in new orders, composed primarily of a complete land rig package. Backlog for capital equipment orders for the Rig Systems segment at September 30, 2016 was \$2.8 billion.

The Rig Aftermarket segment generated \$322 million in revenue and \$72 million in operating profit or 22.4% of sales in the third quarter of 2016. Compared to the prior quarter, revenue decreased \$42 million or 12%, and operating profit increased \$10 million or 16%. Compared to the third quarter of 2015, segment revenue decreased \$248 million or 44%, and operating profit decreased \$85 million or 54%. Revenue decreased year-over-year as drilling contractors reduced spending and depleted existing spares inventories rather than purchase new, and deferred repair and maintenance work on their rig fleets when possible.

The Wellbore Technologies segment generated \$526 million in revenue and a \$94 million operating loss, or (17.9)% of sales, for the third quarter of 2016. Compared to the prior quarter, revenue increased \$15 million or 3%, and operating loss decreased \$52 million or 36%. Compared to the third quarter of 2015, revenue decreased \$308 million or 37%, and operating loss increased \$92 million. The declines from prior year were driven by lower levels of worldwide drilling activity, which required and consumed less of the segment's services and product offerings.

The Completion & Production Solutions segment generated \$543 million in revenue and \$61 million in operating loss or (11.2)% of sales during the third quarter of 2016. Compared to the prior quarter, revenue increased \$5 million or 1%, and operating loss increased \$28 million or 85%. Compared to the third quarter of 2015, revenue decreased \$255 million or 32%, and operating profit decreased \$71 million or 710%. Revenue and operating profit decreased year-over-year on lower levels of worldwide activity and pricing pressures. Backlog for capital equipment orders for the Completion & Production Solutions segment at September 30, 2016 was \$812 million.

## Outlook

The persistent supply and demand imbalance has led to low commodity prices and significantly reduced activity by exploration and production companies. The reduced activity has created an oversupply of service capacity and capital equipment, resulting in increasingly challenging prospects for many of our customers in the form of reduced volumes and pricing pressures. Consequently, we are cautious in our outlook for the remainder of 2016, and anticipate that our customers will minimize capital expenditures until they see the early signs of a recovery in commodity prices and overall activity levels. We also expect them to continue to minimize parts purchases and postpone maintenance using existing stocks of spares and cannibalizing idle equipment whenever possible.

In the current environment, contractors are hesitant to invest in older equipment which can be far less productive and competitive. As a result, we anticipate that the industry will retire a significant portion of the current base of capital equipment during this cyclical downturn, which could result in newbuild orders when commodity prices recover and activity increases. While U.S. activity levels have increased off of historical lows, a meaningful increase in global drilling activity is not expected in 2016 as commodity prices remain low. As a result, our near-term outlook remains cautious and visibility beyond 2016 remains limited as the duration of the current market downturn is uncertain.

We expect the slope and timing of revenue decline, stabilization and recovery will be different across our four business segments. Likewise, our global customer base includes national oil companies, international oil companies, onshore and offshore drilling contractors and others whose strategies and reactions to low commodity prices vary. Our Completion & Production Solutions segment is expected to see an increase in activity when decisions are made to complete and produce the inventory of already drilled wells. Our Wellbore Technologies and Rig Aftermarket segments are expected to see stronger recovery as drilling of new wells increases, while orders for newbuild rigs in our Rig Systems segment may come later in the cycle.

We will continue to focus on cost control, sizing our operations to anticipated levels of activity, while continuing to advance our longer term strategic goals. The Company has a history of implementing cost-control measures and downsizing in response to depressed market conditions and has a track record of executing strategic acquisitions and developing new products and technologies. The Company remains optimistic regarding longer-term market fundamentals as existing oil and gas fields continue to deplete, global demand continues to grow and new sources of oil and gas will require sophisticated technology that the Company provides.

## 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 2016 and 2015, and the second quarter of 2016 include the following:

|  | 3Q16*    | 3Q15*    | 2Q16*    | %<br>3Q16<br>3Q15 | %<br>3Q16<br>2Q16 |
|--|----------|----------|----------|-------------------|-------------------|
| <b>Active Drilling Rigs:</b>                             |          |          |          |                   |                   |
| U.S.   | 479      | 865      | 421      | (44.6%)           | 13.8%             |
| Canada   | 122      | 191      | 49       | (36.1%)           | 149.0%            |
| International  | 936      | 1,132    | 943      | (17.3%)           | (0.7%)            |
| Worldwide  | 1,537    | 2,188    | 1,413    | (29.8%)           | 8.8%              |
| <b>West Texas Intermediate Crude Prices (per barrel)</b> | \$ 44.85 | \$ 46.50 | \$ 45.41 | (3.5%)            | (1.2%)            |
| <b>Natural Gas Prices (\$/mmbtu)</b>                     | \$ 2.85  | \$ 2.74  | \$ 2.13  | 4.0%              | 33.8%             |

\* 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, 2016, on a quarterly basis:

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



The worldwide quarterly average rig count increased 8.8% (from 1,413 to 1,537), and the U.S. increased 13.8% (from 421 to 479), in the third quarter of 2016 compared to the second quarter of 2016. The average per barrel price of West Texas Intermediate Crude Oil decreased 1.2% (from \$45.41 per barrel to \$44.85 per barrel) and natural gas prices increased 33.8% (from \$2.13 per mmbtu to \$2.85 per mmbtu) in the third quarter of 2016 compared to the second quarter of 2016.

U.S. rig activity at October 21, 2016 was 553 rigs, increasing 15% compared to the third quarter of 2016 average of 479 rigs. The price for West Texas Intermediate Crude Oil was at \$50.85 per barrel at October 21, 2016, increasing 13% from the third quarter of 2016 average. The price for natural gas was at \$2.99 per mmbtu at October 21, 2016, increasing 5% from the third quarter of 2016 average.

## Results of Operations

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

|  | Three Months Ended<br>September 30, |                 | Nine Months Ended<br>September 30, |                  |
|--|-------------------------------------|-----------------|------------------------------------|------------------|
|  | 2016                                | 2015            | 2016                               | 2015             |
| <b>Revenue:</b>                        |                                     |                 |                                    |                  |
| Rig Systems                            | \$ 470                              | \$ 1,496        | \$ 1,960                           | \$ 5,949         |
| Rig Aftermarket                        | 322                                 | 570             | 1,077                              | 1,946            |
| Wellbore Technologies                  | 526                                 | 834             | 1,668                              | 2,961            |
| Completion & Production Solutions      | 543                                 | 798             | 1,639                              | 2,619            |
| Eliminations                           | (215)                               | (392)           | (785)                              | (1,440)          |
| <b>Total revenue</b>                   | <b>\$ 1,646</b>                     | <b>\$ 3,306</b> | <b>\$ 5,559</b>                    | <b>\$ 12,035</b> |
| <b>Operating profit (loss):</b>        |                                     |                 |                                    |                  |
| Rig Systems                            | \$ (962)                            | \$ 278          | \$ (888)                           | \$ 1,176         |
| Rig Aftermarket                        | 72                                  | 157             | 203                                | 514              |
| Wellbore Technologies                  | (94)                                | (2)             | (331)                              | 141              |
| Completion & Production Solutions      | (61)                                | 10              | (132)                              | 183              |
| Eliminations and corporate costs       | (141)                               | (209)           | (497)                              | (772)            |
| <b>Total operating profit (loss)</b>   | <b>\$ (1,186)</b>                   | <b>\$ 234</b>   | <b>\$ (1,645)</b>                  | <b>\$ 1,242</b>  |
| <b>Operating profit (loss)%:</b>       |                                     |                 |                                    |                  |
| Rig Systems                            | (204.7%)                            | 18.6%           | (45.3%)                            | 19.8%            |
| Rig Aftermarket                        | 22.4%                               | 27.5%           | 18.8%                              | 26.4%            |
| Wellbore Technologies                  | (17.9%)                             | (0.2%)          | (19.8%)                            | 4.8%             |
| Completion & Production Solutions      | (11.2%)                             | 1.3%            | (8.1%)                             | 7.0%             |
| <b>Total operating profit (loss) %</b> | <b>(72.1%)</b>                      | <b>7.1%</b>     | <b>(29.6%)</b>                     | <b>10.3%</b>     |

### Rig Systems

Three and nine months ended September 30, 2016 and 2015. Revenue from Rig Systems was \$470 million for the three months ended September 30, 2016, compared to \$1,496 million for the three months ended September 30, 2015, a decrease of \$1,026 million or 69%. For the nine months ended September 30, 2016, revenue from Rig Systems was \$1,960 million compared to \$5,949 million for the nine months ending September 30, 2015, a decrease of \$3,989 million or 67%.

Operating loss from Rig Systems was \$962 million for the three months ended September 30, 2016 compared to operating profit of \$278 million for the three months ended September 30, 2015, a decrease of \$1,240 million or 446%. Operating profit (loss) percentage decreased to (204.7)% for the three months ended September 30, 2016, from 18.6% in the three months ended September 30, 2015. For the nine months ended September 30, 2016, operating loss from Rig Systems was \$888 million compared to operating profit of \$1,176 million for the nine months ending September 30, 2015, a decrease of \$2,064 million or 176%. Operating profit (loss) percentage decreased to (45.3)% for the nine months ended September 30, 2016, from 19.8% in the nine months ended September 30, 2015. Operating profit percentage decreased as the segment's through-put fell in its manufacturing facilities as the Company worked down its backlog and recorded a \$972 million goodwill impairment charge. See Note 13.

The Rig Systems segment monitors its capital equipment backlog to plan its business. New orders are added to backlog only when the Company receives a firm written order for major drilling rig components or a signed contract related to a construction project. In light of the vote by the shareholders of SETE Brasil Participacoes SA to authorize Sete to file for bankruptcy, and a further decline in drilling activity during the first half of the year to record lows and the resulting effect on certain other customers, the Company removed \$2.1 billion of orders from its backlog in the first quarter of 2016. Some of the contracts for these orders remain in place and are enforceable. If these customers obtain funding to continue their projects, the Company will pursue resumption of construction and update the backlog accordingly. The capital equipment backlog was \$2.8 billion at September 30, 2016, a decrease of \$5.2 billion, or 65%, from backlog of \$8.0 billion at September 30, 2015. Numerous factors may affect the timing of revenue out of backlog. Considering these factors, the Company reasonably expects approximately \$300 million of revenue out of backlog for the remainder of 2016 and approximately \$2.5 billion of revenue out of backlog in 2017 and thereafter. At September 30, 2016, approximately 81% of the capital equipment backlog was for offshore products and approximately 82% of the capital equipment backlog was destined for international markets.

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### *Rig Aftermarket*

*Three and nine months ended September 30, 2016 and 2015.* Revenue from Rig Aftermarket was \$322 million for the three months ended September 30, 2016, compared to \$570 million for the three months ended September 30, 2015, a decrease of \$248 million or 44%. For the nine months ended September 30, 2016, revenue from Rig Aftermarket was \$1,077 million compared to \$1,946 million for the nine months ending September 30, 2015, a decrease of \$869 million or 45%. This decrease was due to the overall decrease in drilling rigs and drilling activity with customers using existing inventories and components from idle and unused rigs rather than purchasing new.

Operating profit from Rig Aftermarket was \$72 million for the three months ended September 30, 2016 compared to \$157 million for the three months ended September 30, 2015, a decrease of \$85 million or 54%. Operating profit percentage decreased to 22.4% for the three months ended September 30, 2016, from 27.5% in the three months ended September 30, 2015. For the nine months ended September 30, 2016, operating profit from Rig Aftermarket was \$203 million compared to \$514 million for the nine months ending September 30, 2015, a decrease of \$311 million or 61%. Operating profit percentage decreased to 18.8% for the nine months ended September 30, 2016, from 26.4% in the nine months ended September 30, 2015. Operating profit percentage decreased due to lower volumes and pricing pressure.

### *Wellbore Technologies*

*Three and nine months ended September 30, 2016 and 2015.* Revenue from Wellbore Technologies was \$526 million for the three months ended September 30, 2016, compared to \$834 million for the three months ended September 30, 2015, a decrease of \$308 million or 37%. For the nine months ended September 30, 2016, revenue from Wellbore Technologies was \$1,668 million compared to \$2,961 million for the nine months ending September 30, 2015, a decrease of \$1,293 million or 44%. This decrease was due to the overall decrease in drilling activity.

Operating loss from Wellbore Technologies was \$94 million for the three months ended September 30, 2016 compared to \$2 million for the three months ended September 30, 2015, an increase of \$92 million. Operating loss percentage increased to (17.9)% for the three months ended September 30, 2016, from (0.2)% in the three months ended September 30, 2015. For the nine months ended September 30, 2016, operating loss from Wellbore Technologies was \$331 million compared to operating profit of \$141 million for the nine months ending September 30, 2015, a decrease of \$472 million or 335%. Operating profit (loss) percentage decreased to (19.8)% for the nine months ended September 30, 2016, from 4.8% in the nine months ended September 30, 2015. This decrease was due to lower volumes and pricing pressures resulting from an overall decrease in drilling activity.

### *Completion & Production Solutions*

*Three and nine months ended September 30, 2016 and 2015.* Revenue from Completion & Production Solutions was \$543 million for the three months ended September 30, 2016, compared to \$798 million for the three months ended September 30, 2015, a decrease of \$255 million or 32%. For the nine months ended September 30, 2016, revenue from Completion & Production Solutions was \$1,639 million compared to \$2,619 million for the nine months ending September 30, 2015, a decrease of \$980 million or 37%. This decrease was due to the overall decrease in market activity.

Operating loss from Completion & Production Solutions was \$61 million for the three months ended September 30, 2016 compared to operating profit of \$10 million for the three months ended September 30, 2015, a decrease of \$71 million or 710%. Operating profit (loss) percentage decreased to (11.2)% for the three months ended September 30, 2016, from 1.3% in the three months ended September 30, 2015. For the nine months ended September 30, 2016, operating loss from Completion & Production Solutions was \$132 million compared to operating profit of \$183 million for the nine months ending September 30, 2015, a decrease of \$315 million or 172%. Operating profit (loss)

percentage decreased to (8.1)% for the nine months ended September 30, 2016, from 7.0% in the nine months ended September 30, 2015. This decrease was due to an overall decrease in market activity and a shift in product mix as revenue decreased more in higher operating profit businesses such as pressure pumping and fiberglass pipe.

The Completion & Productions Solutions segment monitors its capital equipment backlog to plan its business. New orders are added to backlog only when the Company receives a firm written order for major completion and production components or a signed contract related to a construction project. The capital equipment backlog was \$812 million at September 30, 2016, a decrease of \$359 million, or 31% from backlog of \$1,171 million at September 30, 2015. Numerous factors may affect the timing of revenue out of backlog. Considering these factors, the Company reasonably expects approximately \$340 million of revenue out of backlog for the remainder of 2016 and approximately \$470 million of revenue out of backlog in 2017 and thereafter. At September 30, 2016, approximately 70% of the capital equipment backlog was for offshore products and approximately 89% of the capital equipment backlog was destined for international markets.

*Eliminations and corporate costs*

Eliminations and corporate costs were \$141 million and \$497 million for the three and nine months ended September 30, 2016, respectively, compared to \$209 million and \$772 million for the three and nine months ended September 30, 2015, respectively. This change is primarily due to the change in intersegment eliminations. 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 four reporting segments that are eliminated in consolidation. Intercompany transactions within each reporting segment are eliminated within each reporting segment.

*Voluntary Early Retirement Plans*

Also included in operating profit for the nine months ended September 30, 2015 and 2016, are certain other items primarily related to costs associated with Voluntary Early Retirement Plans ( VERP ) established by the Company during the first quarters of 2016 and 2015. In 2016 and 2015, VERP costs included \$45 million and \$58 million in severance, respectively, \$35 million and \$45 million in postretirement medical benefits, respectively, and \$5 million and \$18 million related to stock-based compensation, respectively.

*Other income (expense), net*

Other income (expense), net were expenses of \$30 million and \$85 million for the three and nine months ended September 30, 2016, respectively, compared to expenses of \$20 million and \$106 million for the three and nine months ended September 30, 2015, respectively. The change in expense was primarily due to the fluctuations in foreign currencies.

*Provision for income taxes*

The effective tax rate for the three and nine months ended September 30, 2016 was (9.6)% and 6.5%, respectively, compared to 18.8% and 30.4% for the same periods in 2015. Impairment of goodwill not deductible for tax purposes, lower tax rates on losses incurred in foreign jurisdictions, and an increase in valuation allowance on deferred taxes, which, when applied to losses generated during the nine-month period resulted in a lower effective tax rate than the U.S. statutory rate. Included in the increase in valuation allowance is \$213 million recorded against excess foreign tax credits that are not expected to be realized before expiration. The lower effective tax rate was partially offset by benefits from foreign dividends net of foreign tax credits.

*Non-GAAP Financial Measures and Reconciliations*

In an effort to provide investors with additional information regarding our results as determined by GAAP, we disclose various non-GAAP financial measures in our quarterly earnings press releases and other public disclosures. The non-GAAP financial measures we focus on herein are: (i) operating profit excluding other items, (ii) operating profit percentage excluding other items and (iii) operating (non-GAAP) earnings per share. Each of these financial measures excludes the impact of certain amounts as further identified below and have not been calculated in accordance with GAAP. A reconciliation of each of these non-GAAP financial measures to its most comparable GAAP financial measure is included below.

We use these non-GAAP financial measures internally to evaluate and manage the Company's operations because we believe it provides useful supplemental information regarding the Company's on-going economic performance. We have chosen to provide this information to investors to enable them to perform more meaningful comparisons of operating results and as a means to emphasize the results of on-going operations.

The following tables set forth the reconciliations of these non-GAAP financial measures to their most comparable GAAP financial measures (in millions, except per share data):

|   | Three Months Ended    |                  | Nine Months Ended |                       |                       |
|---|-----------------------|------------------|-------------------|-----------------------|-----------------------|
|   | September 30,<br>2016 | June 30,<br>2015 | June 30,<br>2016  | September 30,<br>2016 | September 30,<br>2015 |
| Reconciliation of operating profit (loss):    |                       |                  |                   |                       |                       |
| GAAP operating profit (loss)                  | \$ (1,186)            | \$ 234           | \$ (270)          | \$ (1,645)            | \$ 1,242              |
| Other items (1)(2):                           |                       |                  |                   |                       |                       |
| Rig Systems                                   | 994                   | 22               | 23                | 1,069                 | 65                    |
| Rig Aftermarket                               | 3                     | 1                | 5                 | 16                    | 11                    |
| Wellbore Technologies                         | 24                    | 29               | 50                | 112                   | 83                    |
| Completion & Production Solutions             | 51                    | 60               | 38                | 123                   | 92                    |
| Eliminations                                  | 6                     |                  | 1                 | 16                    |                       |
| Operating profit (loss) excluding other items | \$ (108)              | \$ 346           | \$ (153)          | \$ (309)              | \$ 1,493              |

|   | Three Months Ended    |                  | Nine Months Ended |                       |                       |
|---|-----------------------|------------------|-------------------|-----------------------|-----------------------|
|   | September 30,<br>2016 | June 30,<br>2015 | June 30,<br>2016  | September 30,<br>2016 | September 30,<br>2015 |
| Reconciliation of operating profit (loss) %:    |                       |                  |                   |                       |                       |
| GAAP operating profit (loss) %                  | (72.1%)               | 7.1%             | (15.7%)           | (29.6%)               | 10.3%                 |
| Other items %                                   | 65.5%                 | 3.4%             | 6.8%              | 24.0%                 | 2.1%                  |
| Operating profit (loss) % excluding other items | (6.6%)                | 10.5%            | (8.9%)            | (5.6%)                | 12.4%                 |

|  | Three Months Ended    |                  | Nine Months Ended |                       |                       |
|--|-----------------------|------------------|-------------------|-----------------------|-----------------------|
|  | September 30,<br>2016 | June 30,<br>2015 | June 30,<br>2016  | September 30,<br>2016 | September 30,<br>2015 |
| Reconciliation of diluted earnings (loss) per share: |                       |                  |                   |                       |                       |

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|   |           |         |           |           |         |
|---|-----------|---------|-----------|-----------|---------|
| GAAP earnings (loss) per share  | \$ (3.62) | \$ 0.41 | \$ (0.58) | \$ (4.53) | \$ 1.92 |
| Other items (2)   | 0.18      | 0.10    | 0.23      | 0.67      | 0.33    |
| Goodwill and other intangible asset write-downs<br>(1)(2)             | 2.51      | 0.10    |           | 2.51      | 0.09    |
| Fixed asset write-downs (Other income (expense),<br>net)              | 0.02      |         | 0.05      | 0.08      |         |
| Argentina/Venezuela asset write-down (Other<br>income (expense), net) |           |         |           |           | 0.02    |
| Tax items (Provision for income taxes)                                | 0.57      |         |           | 0.57      | 0.17    |
| Operating (non-GAAP) earnings (loss) per share                        | \$ (0.34) | \$ 0.61 | \$ (0.30) | \$ (0.70) | \$ 2.53 |

- (1) Included in operating profit are other items related to goodwill and intangible asset impairments.
- (2) Included in operating profit are other items related to costs associated with Voluntary Early Retirement Plans established by the Company during the first quarters of 2016 and 2015 and costs related to severance, facility closures, and other items. See Note 6. For the three and nine months ended September 30, 2016, other items included in operating profit were \$1,078 million and \$1,336 million, respectively. For the three and nine months ended September 30, 2015, other items included in operating profit were \$112 million and \$251 million, respectively. Other items included in operating profit for the three months ended June 30, 2016 totaled \$117 million.



## Liquidity and Capital Resources

### Overview

The Company assesses liquidity in terms of its ability to generate cash to fund operating, investing and financing activities. The Company remains in a strong financial position, with resources available to reinvest in existing businesses, strategic acquisitions and capital expenditures to meet short- and long-term objectives. The Company believes that cash on hand, cash generated from expected results of operations, amounts available under its credit facility and its commercial paper program will be sufficient to fund operations, anticipated working capital needs and other cash requirements such as capital expenditures, debt and interest payments and dividend payments for the foreseeable future.

At September 30, 2016, the Company had cash and cash equivalents of \$1,510 million and total debt of \$3,216 million. At December 31, 2015, cash and cash equivalents were \$2,080 million and total debt was \$3,909 million. As of September 30, 2016, approximately \$1,368 million of the \$1,510 million of cash and cash equivalents was held by our foreign subsidiaries, of which \$1,315 million would be subject to a 35% U.S. income tax rate, offset by any available foreign tax credits if repatriated. However, our current plans are to permanently reinvest these funds outside of the U.S. If opportunities to invest in the U.S. are greater than available cash balances that are not subject to income tax, rather than repatriating cash, the Company may choose to borrow against its revolving credit facility or utilize its commercial paper program.

The Company's outstanding debt at September 30, 2016 was \$3,216 million and consisted of \$499 million in 1.35% Senior Notes, \$1,390 million in 2.60% Senior Notes, \$1,087 million in 3.95% Senior Notes, and other debt of \$240 million. The Company was in compliance with all covenants at September 30, 2016.

At September 30, 2016, there were no commercial paper borrowings supported by the \$4.5 billion credit facility and no outstanding letters of credit issued under the credit facility, resulting in \$4,500 million of funds available under this credit facility.

The Company had \$1,227 million of outstanding letters of credit at September 30, 2016 that are under various bilateral letter of credit facilities. Letters of credit are issued as bid bonds, advanced payment bonds and performance bonds.

The following table summarizes our net cash provided by (used in) continuing operating activities, continuing investing activities and continuing financing activities for the periods presented (in millions):

|   | <b>Nine Months Ended</b> |             |
|---|--------------------------|-------------|
|   | <b>September 30,</b>     |             |
|   | <b>2016</b>              | <b>2015</b> |
| Net cash provided by operating activities | \$ 807                   | \$ 718      |
| Net cash used in investing activities     | (277)                    | (378)       |
| Net cash used in financing activities     | (1,116)                  | (1,939)     |

### Operating Activities

For the first nine months of 2016, cash provided by operating activities was \$807 million compared to \$718 million in the same period of 2015. Before changes in operating assets and liabilities, net of acquisitions, cash was used by operations primarily through loss from operations of \$1,699 million plus non-cash charges of \$1,566 million, \$6 million in a dividend received from Voest-Alpine Tubulars, an unconsolidated affiliate, and \$19 million in equity loss

in unconsolidated affiliates.

Net changes in operating assets and liabilities, net of acquisitions, provided \$915 million of cash for the first nine months of 2016 compared to \$788 million used in the same period in 2015. The increase in cash provided in the first nine months of 2016 compared to the same period in 2015 was primarily due to declines in accounts receivable, inventory and costs in excess of billings, partially offset by declines in accounts payable, accrued liabilities and billings in excess of costs.

*Investing Activities*

For the first nine months of 2016, net cash used in investing activities was \$277 million compared to \$378 million for the same period of 2015. Net cash used in investing activities was primarily the result of capital expenditures and acquisition activity, both of which decreased in the first nine months of 2016 compared to the same period of 2015. The Company used \$221 million during the first nine months of 2016 for capital expenditures compared to \$332 million for the same period of 2015 and \$60 million for acquisitions in the first nine months of 2016 compared to \$70 million for the same period of 2015.

*Financing Activities*

For the first nine months of 2016, net cash used in financing activities was \$1,116 million compared to \$1,939 million for the same period of 2015. This decrease was primarily the result of \$897 million used to make payments on net commercial paper borrowings in 2016 compared to \$815 million of net commercial paper borrowings in 2015 used to purchase \$2,221 million (44.0 million shares) of the Company's outstanding common shares.

*Other*

The effect of the change in exchange rates on cash flows was an increase of \$16 million and a decrease of \$91 million for the first nine months of 2016 and 2015, respectively.

We believe that cash on hand, cash generated from operations, amounts available under our credit facility and through our commercial paper program, as well as from other sources of debt will be sufficient to fund operations, working capital needs, capital expenditure requirements, dividends and financing obligations.

We intend to pursue additional acquisition candidates, but the timing, size or success of any acquisition effort and the related potential capital commitments cannot be predicted. We continue to expect to fund future acquisitions primarily with cash on hand, cash flow from operations and borrowings, including the unborrowed portion of the credit facility, our commercial paper program or new debt issuances, but may also issue additional equity either directly or in connection with acquisitions. There can be no assurance that additional financing for acquisitions will be available at terms acceptable to us.

### Recently Issued Accounting Standards

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 is currently assessing the impact of the adoption of ASU No. 2016-15 on its consolidated financial position and results of operations.

In March 2016, the FASB issued Accounting Standard Update No. 2016-09 *Improvements to Employee Share-Based Payment Accounting* (ASU 2016-09). This update requires that entities record all of the tax effects related to share-based payments at settlement (or expiration) through the income statement. ASU No. 2016-09 is effective for fiscal years beginning after December 15, 2016, and for interim periods within those fiscal years. The Company will adopt ASU No. 2016-09 on January 1, 2017.

In February 2016, the FASB issued Accounting Standard Update No. 2016-02 *Leases* (ASU No. 2016-02), which supersedes the lease requirements in Accounting Standard Codification 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. ASU No. 2016-02 is effective for fiscal years beginning after December 15, 2018, and for interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of ASU No. 2016-02 on its consolidated financial position and results of operations.

In November 2015, the FASB issued Accounting Standard Update No. 2015-17 *Balance Sheet Classification of Deferred Taxes* (ASU 2015-17). This update requires companies to classify all deferred tax assets and liabilities as non-current on its consolidated financial position. The Company has early adopted ASU 2015-17 on a retrospective basis, resulting in a reclassification of current deferred tax assets and liabilities to non-current deferred tax assets and liabilities. The ASU adoption is effective January 1, 2016, and prior periods have been retrospectively adjusted. See Note 8 for further information on the presentation of deferred taxes.

In April 2015, the FASB issued Accounting Standard Update No. 2015-03 *Simplifying the Presentation of Debt Issuance Costs* (ASU 2015-03) to simplify the presentation of debt issuance costs. This update requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts, as opposed to historical presentation as an asset on the balance sheet. ASU No. 2015-03 is effective for fiscal years beginning after December 15, 2015, and for interim periods within those fiscal years. The Company adopted this update on January 1, 2016, and has applied the change retrospectively to prior periods for unamortized debt issuance costs. See Note 7 for further information on the presentation of debt issuance costs.

In August 2014, the FASB issued Accounting Standard Update No. 2014-15 *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern* (ASU No. 2014-15), which amends FASB Accounting Standards Codification 205 *Presentation of Financial Statements*. This update requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. ASU No. 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. The Company is currently assessing the impact of the adoption of ASU No. 2014-15 on its consolidated financial position and results of operations.

In May 2014, the FASB issued Accounting Standard Update No. 2014-09 *Revenue from Contracts with Customers* (ASU

No. 2014-09), which supersedes the revenue recognition requirements in Accounting Standard Codification Topic No. 605 Revenue Recognition and most industry-specific guidance. This update requires that entities recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. ASU No. 2014-09 is effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of ASU No. 2014-09 on its consolidated financial position and results of operations.

### **Forward-Looking Statements**

Some of the information in this document contains, or has incorporated by reference, forward-looking statements. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements typically are identified by use of terms such as may, expect, anticipate, estimate, and similar words, although some forward-looking statements are expressed differently. All statements herein regarding expected merger synergies are forward-looking statements. You should be aware that our actual results could differ materially from results anticipated in the forward-looking statements due to a number of factors, including but not limited to changes in oil and gas prices, customer demand for our products, difficulties encountered in integrating mergers and acquisitions, and worldwide economic activity. You should also consider carefully the statements under Risk Factors, as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015, which address additional factors that could cause our actual results to differ from those set forth in the forward-looking statements. Given these uncertainties, current or prospective investors are cautioned not to place undue reliance on any such forward-looking statements. We undertake no obligation to update any such factors or forward-looking statements to reflect future events or developments.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to changes in foreign currency exchange rates and interest rates. Additional information concerning each of these matters follows:

*Foreign Currency Exchange Rates*

We have extensive operations in foreign countries. The net assets and liabilities of these operations are exposed to changes in foreign currency exchange rates, although such fluctuations generally do not affect income since their functional currency is typically the local currency. These operations also have net assets and liabilities not denominated in the functional currency, which exposes us to changes in foreign currency exchange rates that impact income. We recorded a foreign exchange loss in our income statement of approximately \$10 million in the first nine months of 2016, compared to approximately \$41 million in foreign exchange loss in the same period of the prior year. The gains and losses are primarily due to exchange rate fluctuations related to monetary asset balances denominated in currencies other than the functional currency and adjustments to our hedged positions as a result of changes in foreign currency exchange rates. Currency exchange rate fluctuations may create losses in future periods to the extent we maintain net monetary assets and liabilities not denominated in the functional currency of the countries using the local currency as their functional currency.

Some of our revenues in foreign countries are denominated in U.S. dollars, and therefore, changes in foreign currency exchange rates impact our earnings to the extent that costs associated with those U.S. dollar revenues are denominated in the local currency. Similarly, some of our revenues are denominated in foreign currencies, but have associated U.S. dollar costs, which also give rise to foreign currency exchange rate exposure. In order to mitigate that risk, we may utilize foreign currency forward contracts to better match the currency of our revenues and associated costs. We do not use foreign currency forward contracts for trading or speculative purposes.

The following table details the Company's foreign currency forward contracts grouped by functional currency and their expected maturity periods (in millions, except contract rates):

| Functional Currency                              | As of September 30, 2016 |        |        | December 31,<br>2015 |
|--|--------------------------|--------|--------|----------------------|
|  | 2016                     | 2017   | Total  |                      |
| <b>CAD Buy USD/Sell CAD:</b>                     |                          |        |        |                      |
| Notional amount to buy (in Canadian dollars)     |                          |        |        | 10                   |
| Average USD to CAD contract rate                 |                          |        |        | 1.3759               |
| Fair Value at September 30, 2016 in U.S. dollars |                          |        |        |                      |
| <b>Sell USD/Buy CAD:</b>                         |                          |        |        |                      |
| Notional amount to sell (in Canadian dollars)    | 96                       |        | 96     | 136                  |
| Average USD to CAD contract rate                 | 1.3213                   |        | 1.3213 | 1.3554               |
| Fair Value at September 30, 2016 in U.S. dollars |                          |        |        | (2)                  |
| <b>EUR Buy USD/Sell EUR:</b>                     |                          |        |        |                      |
| Notional amount to buy (in Euros)                | 6                        |        | 6      | 11                   |
| Average USD to EUR contract rate                 | 0.8872                   | 0.8851 | 0.8870 | 0.8528               |
| Fair Value at September 30, 2016 in U.S. dollars |                          |        |        | 1                    |
| <b>Sell USD/Buy EUR:</b>                         |                          |        |        |                      |
| Notional amount to buy (in Euros)                | 88                       | 17     | 105    | 199                  |
| Average USD to EUR contract rate                 | 0.8842                   | 0.8735 | 0.8824 | 0.8953               |
| Fair Value at September 30, 2016 in U.S. dollars | (1)                      |        | (1)    | (5)                  |
| <b>KRW Sell USD/Buy KRW:</b>                     |                          |        |        |                      |
| Notional amount to buy (in South Korean won)     | 93,085                   |        | 93,085 | 23,613               |

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|   |        |        |        |
|---|--------|--------|--------|
| Average USD to KRW contract rate                    | 1,095  | 1,095  | 1,181  |
| Fair Value at September 30, 2016 in U.S. dollars    |        |        |        |
| <b>GBP Buy USD/Sell GBP:</b>                        |        |        |        |
| Notional amount to buy (in British Pounds Sterling) | 2      | 2      | 2      |
| Average USD to GBP contract rate                    | 0.7010 | 0.7010 | 0.6416 |
| Fair Value at September 30, 2016 in U.S. dollars    |        |        |        |
| <b>Sell USD/Buy GBP:</b>                            |        |        |        |
| Notional amount to buy (in British Pounds Sterling) | 195    | 195    | 170    |
| Average USD to GBP contract rate                    | 0.7650 | 0.7650 | 0.6613 |
| Fair Value at September 30, 2016 in U.S. dollars    | (2)    | (2)    | (5)    |



| Functional Currency                              | As of September 30, 2016 |        |        | December 31,<br>2015 |
|--|--------------------------|--------|--------|----------------------|
|  | 2016                     | 2017   | Total  |                      |
| <b>USD Buy CAD/Sell USD:</b>                     |                          |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 5                        |        | 5      | 7                    |
| Average CAD to USD contract rate                 | 0.7818                   |        | 0.7818 | 0.7635               |
| Fair Value at September 30, 2016 in U.S. dollars |                          |        |        |                      |
| <b>Buy DKK/Sell USD:</b>                         |                          |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 11                       | 4      | 15     | 24                   |
| Average DKK to USD contract rate                 | 0.1483                   | 0.1549 | 0.1500 | 0.1553               |
| Fair Value at September 30, 2016 in U.S. dollars |                          |        |        | (1)                  |
| <b>Buy EUR/Sell USD:</b>                         |                          |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 53                       | 61     | 114    | 278                  |
| Average EUR to USD contract rate                 | 1.1275                   | 1.1290 | 1.1283 | 1.1925               |
| Fair Value at September 30, 2016 in U.S. dollars |                          |        |        | (23)                 |
| <b>Buy GBP/Sell USD:</b>                         |                          |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 12                       | 1      | 13     | 20                   |
| Average GBP to USD contract rate                 | 1.4525                   | 1.3318 | 1.4437 | 1.5568               |
| Fair Value at September 30, 2016 in U.S. dollars | (1)                      |        | (1)    | (1)                  |
| <b>Buy NOK/Sell USD:</b>                         |                          |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 597                      | 311    | 908    | 1,501                |
| Average NOK to USD contract rate                 | 0.1275                   | 0.1245 | 0.1264 | 0.1353               |
| Fair Value at September 30, 2016 in U.S. dollars | (14)                     |        | (14)   | (239)                |
| <b>Buy SGD/Sell USD:</b>                         |                          |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 2                        | 4      | 6      | 12                   |
| Average SGD to USD contract rate                 | 0.7684                   | 0.7262 | 0.7370 | 0.7534               |
| Fair Value at September 30, 2016 in U.S. dollars |                          |        |        | (1)                  |
| <b>Sell CAD/Buy USD:</b>                         |                          |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 4                        |        | 4      |                      |
| Average CAD to USD contract rate                 | 0.7714                   |        | 0.7714 |                      |
| Fair Value at September 30, 2016 in U.S. dollars |                          |        |        |                      |
| <b>Sell DKK/Buy USD:</b>                         |                          |        |        |                      |
| Notional amount to buy (in U.S. dollars)         | 7                        |        | 7      | 8                    |
| Average DKK to USD contract rate                 | 0.1524                   |        | 0.1524 | 0.1510               |
| Fair Value at September 30, 2016 in U.S. dollars |                          |        |        |                      |
| <b>Sell EUR/Buy USD:</b>                         |                          |        |        |                      |
| Notional amount to sell (in U.S. dollars)        | 38                       | 18     | 56     | 89                   |
| Average EUR to USD contract rate                 | 1.1266                   | 1.1322 | 1.1284 | 1.1075               |
| Fair Value at September 30, 2016 in U.S. dollars |                          |        |        | 1                    |
| <b>Sell GBP/Buy USD:</b>                         |                          |        |        |                      |
| Notional amount to sell (in U.S. dollars)        | 9                        |        | 9      | 3                    |
| Average GBP to USD contract rate                 | 1.4109                   |        | 1.4109 | 1.4961               |
| Fair Value at September 30, 2016 in U.S. dollars | 1                        |        | 1      |                      |
| <b>Sell NOK/Buy USD:</b>                         |                          |        |        |                      |
| Notional amount to sell (in U.S. dollars)        | 52                       | 17     | 69     | 110                  |
| Average NOK to USD contract rate                 | 0.1226                   | 0.1186 | 0.1216 | 0.1321               |
| Fair Value at September 30, 2016 in U.S. dollars | (1)                      | (1)    | (2)    | 15                   |
| <b>Sell RUB/Buy USD:</b>                         |                          |        |        |                      |
| Notional amount to sell (in U.S. dollars)        | 30                       |        | 30     | 30                   |
| Average RUB to USD contract rate                 | 0.0153                   |        | 0.0153 | 0.0139               |
| Fair Value at September 30, 2016 in U.S. dollars |                          |        |        | 1                    |

**Sell SGD/Buy USD:**

|  |        |        |        |
|--|--------|--------|--------|
| Notional amount to sell (in U.S. dollars)        | 1      | 1      | 2      |
| Average SGD to USD contract rate                 | 0.7323 | 0.7323 | 0.7082 |
| Fair Value at September 30, 2016 in U.S. dollars |        |        |        |

| Functional Currency   | As of September 30, 2016 |           |          | December 31, |
|---|--------------------------|-----------|----------|--------------|
|   | 2016                     | 2017      | Total    | 2015         |
| <b>BRL Buy EUR/Sell BRL:</b>                                  |                          |           |          |              |
| Notional amount to sell (in U.S. dollars)                     | 66                       | 176       | 242      | 199          |
| Average EUR to BRL contract rate                              | 4.1542                   | 4.4752    | 4.3825   | 4.3679       |
| Fair Value at September 30, 2016 in U.S. dollars              | (2)                      | (5)       | (7)      | 1            |
| <b>Buy USD/Sell BRL:</b>                                      |                          |           |          |              |
| Notional amount to sell (in U.S. dollars)                     | 4                        | 26        | 30       |              |
| Average USD to BRL contract rate                              | 3.8229                   | 4.0278    | 3.9999   |              |
| Fair Value at September 30, 2016 in U.S. dollars              |                          | (1)       | (1)      |              |
| <b>Sell EUR/Buy BRL:</b>                                      |                          |           |          |              |
| Notional amount to sell (in U.S. dollars)                     | 187                      | 943       | 1,130    | 427          |
| Average EUR to BRL contract rate                              | 4.2892                   | 4.5304    | 4.4886   | 4.6985       |
| Fair Value at September 30, 2016 in U.S. dollars              | 7                        | 29        | 36       | 4            |
| <b>Sell USD/Buy BRL:</b>                                      |                          |           |          |              |
| Notional amount to sell (in U.S. dollars)                     | 4                        | 18        | 22       |              |
| Average USD to BRL contract rate                              | 3.6258                   | 3.6941    | 3.6820   |              |
| Fair Value at September 30, 2016 in U.S. dollars              |                          |           |          |              |
| <b>DKK Sell DKK/Buy USD:</b>                                  |                          |           |          |              |
| Notional amount to buy (in U.S. dollars)                      | 890                      |           | 890      | 1,396        |
| Average DKK to USD contract rate                              | 6.5485                   |           | 6.5485   | 6.5618       |
| Fair Value at September 30, 2016 in U.S. dollars              | (1)                      |           | (1)      | (8)          |
| <b>Other Currencies</b>                                       |                          |           |          |              |
| Fair Value at September 30, 2016 in U.S. dollars              |                          |           |          | 2            |
| <b>Total Fair Value at September 30, 2016 in U.S. dollars</b> | <b>(14)</b>              | <b>22</b> | <b>8</b> | <b>(260)</b> |

The Company had other financial market risk sensitive instruments denominated in foreign currencies for transactional exposures totaling \$6 million and translation exposures totaling \$264 million as of September 30, 2016 excluding trade receivables and payables, which approximate fair value. These market risk sensitive instruments consisted of cash balances and overdraft facilities. The Company estimates that a hypothetical 10% movement of all applicable foreign currency exchange rates on the transactional exposures financial market risk sensitive instruments could affect net income by \$1 million and the translational exposures financial market risk sensitive instruments could affect the future fair value by \$26 million.

The counterparties to forward contracts are major financial institutions. The credit ratings and concentration of risk of these financial institutions are monitored on a continuing basis. In the event that the counterparties fail to meet the terms of a foreign currency contract, our exposure is limited to the foreign currency rate differential.

#### *Interest Rate Risk*

At September 30, 2016, long term borrowings consisted of \$499 million in 1.35% Senior Notes, \$1,390 million in 2.60% Senior Notes and \$1,087 million in 3.95% Senior Notes. At September 30, 2016, there were no commercial paper borrowings and no outstanding letters of credit issued under the credit facility, resulting in \$4,500 million of funds available under this credit facility. Occasionally a portion of borrowings under our credit facility could be denominated in multiple currencies which could expose us to market risk with exchange rate movements. These instruments carry interest at a pre-agreed upon percentage point spread from either LIBOR, NIBOR or EURIBOR, or at the U.S. prime rate. Under our credit facility, we may, at our option, fix the interest rate for certain borrowings based on a spread over LIBOR, NIBOR or EURIBOR for 30 days to six months. Our objective is to maintain a

portion of our debt in variable rate borrowings for the flexibility obtained regarding early repayment without penalties and lower overall cost as compared with fixed-rate borrowings.

**Item 4. Controls and Procedures**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. The Company's disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed by the Company in the reports it files under the Exchange Act is accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures and is recorded, processed, summarized and reported within the time period specified in the rules and forms of the Securities and Exchange Commission. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this report at a reasonable assurance level.

There has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1A. Risk Factors**

As of the date of this filing, the Company and its operations continue to be subject to the risk factors previously disclosed in Part I, Item 1A Risk Factors in our 2015 Annual Report on Form 10-K.

**Item 4. Mine Safety Disclosures**

Information regarding mine safety and other regulatory actions at our mines is included in Exhibit 95 to this Form 10-Q.

**Item 6. Exhibits**

Reference is hereby made to the Exhibit Index commencing on page 40.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: October 28, 2016

*By: /s/ Scott K. Duff*

Scott K. Duff

Vice President, Corporate Controller & Chief Accounting

Officer (Duly Authorized Officer, Principal Accounting Officer)

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**INDEX TO EXHIBITS**

(a) Exhibits

- 3.1 Fifth Amended and Restated Certificate of Incorporation of National Oilwell Varco, Inc. (Exhibit 3.1) (1)
- 3.2 Amended and Restated By-laws of National Oilwell Varco, Inc. (Exhibit 3.1) (2)
- 10.1 Credit Agreement, dated as of September 28, 2012, among National Oilwell Varco, Inc., the financial institutions signatory thereto, including Wells Fargo Bank, N.A., in their capacities as Administrative Agent, Co-Lead Arranger and Joint Book Runner. (Exhibit 10.1) (3)
- 10.2 Amendment No. 2 to the Credit Agreement, dated as of September 28, 2012, among National Oilwell Varco, Inc., the financial institutions signatory thereto, including Wells Fargo Bank, N.A., as Administrative Agent, the other agents named therein, and the lenders parties thereto. (Exhibit 10.1) (4)
- 10.3 National Oilwell Varco Long-Term Incentive Plan, as amended and restated. (5)\*
- 10.4 Form of Employee Stock Option Agreement. (Exhibit 10.1) (6)
- 10.5 Form of Non-Employee Director Stock Option Agreement. (Exhibit 10.2) (6)
- 10.6 Form of Performance-Based Restricted Stock. (18 Month) Agreement (Exhibit 10.1) (7)
- 10.7 Form of Performance-Based Restricted Stock. (36 Month) Agreement (Exhibit 10.2) (7)
- 10.8 Form of Performance Award Agreement (Exhibit 10.1) (8)
- 10.9 Form of Executive Employment Agreement. (Exhibit 10.1) (9)
- 10.10 Form of Executive Severance Agreement. (Exhibit 10.2) (9)
- 10.11 Form of Employee Nonqualified Stock Option Grant Agreement (10)
- 10.12 Form of Restricted Stock Agreement (10)
- 10.13 Form of Performance Award Agreement (10)
- 31.1 Certification pursuant to Rule 13a-14a and Rule 15d-14(a) of the Securities and Exchange Act, as amended.
- 31.2 Certification pursuant to Rule 13a-14a and Rule 15d-14(a) of the Securities and Exchange Act, as amended.
- 32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 95 Mine Safety Information pursuant to section 1503 of the Dodd-Frank Act.
- 101 The following materials from our Quarterly Report on Form 10-Q for the period ended September 30, 2016 formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to the Consolidated Financial Statements, tagged as block text.

\* Compensatory plan or arrangement for management or others.

(1) Filed as an Exhibit to our Quarterly Report on Form 10-Q filed on August 5, 2011.

(2) Filed as an Exhibit to our Current Report on Form 8-K filed on August 17, 2011.



- (3) Filed as an Exhibit to our Current Report on Form 8-K filed on October 1, 2012
- (4) Filed as an Exhibit to our Current Report on Form 8-K filed on May 13, 2015.

- (5) Filed as Appendix I to our Proxy Statement filed on April 11, 2016.
- (6) Filed as an Exhibit to our Current Report on Form 8-K filed on February 23, 2006.
- (7) Filed as an Exhibit to our Current Report on Form 8-K filed on March 27, 2007.
- (8) Filed as an Exhibit to our Current Report on Form 8-K filed on March 27, 2013.
- (9) Filed as an Exhibit to our Current Report on Form 8-K filed on November 24, 2014.
- (10) Filed as an Exhibit to our Current Report on Form 8-K filed on February 26, 2016.

We hereby undertake, pursuant to Regulation S-K, Item 601(b), paragraph (4) (iii), to furnish to the U.S. Securities and Exchange Commission, upon request, all constituent instruments defining the rights of holders of our long-term debt not filed herewith.