

DRIL-QUIP INC
Form 10-Q
May 07, 2010

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 MARCH 31, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 001-13439

DRIL-QUIP, INC.

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

74-2162088
(I.R.S. Employer Identification No.)

13550 HEMPSTEAD HIGHWAY

HOUSTON, TEXAS

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77040

(Address of principal executive offices)

(Zip Code)

(713) 939-7711

(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 regulations 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, or a non-accelerated filer. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

(Do not check if a smaller reporting company)

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

As of May 4, 2010, the number of shares outstanding of the registrant's common stock, par value \$.01 per share, was 39,813,335.

PART I FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

DRIL-QUIP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

| | December 31, 2009 | March 31, 2010 |
|--|----------------------|-------------------|
| | (In thousands) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 197,792 | \$ 217,419 |
| Trade receivables, net | 130,816 | 136,092 |
| Inventories, net | 251,357 | 241,319 |
| Deferred income taxes | 24,542 | 23,923 |
| Prepays and other current assets | 12,849 | 12,512 |
| Total current assets | 617,356 | 631,265 |
| Property, plant and equipment, net | 194,703 | 194,655 |
| Other assets | 5,187 | 10,102 |
| Total assets | \$ 817,246 | \$ 836,022 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 24,828 | \$ 27,461 |
| Current maturities of long-term debt | 723 | 678 |
| Accrued income taxes | 8,514 | 7,017 |
| Customer prepayments | 47,214 | 38,833 |
| Accrued compensation | 10,751 | 10,634 |
| Other accrued liabilities | 12,595 | 17,484 |
| Total current liabilities | 104,625 | 102,107 |
| Long-term debt | 316 | 134 |
| Deferred income taxes | 7,220 | 7,303 |
| Total liabilities | 112,161 | 109,544 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, 10,000,000 shares authorized at \$0.01 par value (none issued) | | |
| Common stock: | | |
| 50,000,000 shares authorized at \$0.01 par value, 39,658,524 and 39,799,710 shares issued and outstanding at | | |
| December 31, 2009 and March 31, 2010 | 396 | 398 |
| Additional paid-in capital | 129,528 | 134,932 |
| Retained earnings | 583,287 | 608,984 |
| Foreign currency translation adjustment | (8,126) | (17,836) |
| Total stockholders' equity | 705,085 | 726,478 |

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| | | |
|--|------------|------------|
| Total liabilities and stockholders' equity | \$ 817,246 | \$ 836,022 |
|--|------------|------------|

The accompanying notes are an integral part of these statements.

DRIL-QUIP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

| | Three months ended March 31, | |
|---|--|------------|
| | 2009 | 2010 |
| | (In thousands, except per share data) | |
| Revenues: | | |
| Products | \$ 105,136 | \$ 121,833 |
| Services | 22,386 | 20,700 |
| Total revenues | 127,522 | 142,533 |
| Cost and expenses: | | |
| Cost of sales: | | |
| Products | 59,952 | 69,392 |
| Services | 12,065 | 12,423 |
| Total cost of sales | 72,017 | 81,815 |
| Selling, general and administrative | 14,540 | 13,433 |
| Engineering and product development | 6,305 | 6,786 |
| Special item | | 5,901 |
| | 92,862 | 107,935 |
| Operating income | 34,660 | 34,598 |
| Interest income | 212 | 61 |
| Interest expense | (48) | (27) |
| Income before income taxes | 34,824 | 34,632 |
| Income tax provision | 10,153 | 8,935 |
| Net income | \$ 24,671 | \$ 25,697 |
| Earnings per common share: | | |
| Basic | \$ 0.63 | \$ 0.65 |
| Diluted | \$ 0.63 | \$ 0.64 |
| Weighted average common shares outstanding: | | |
| Basic | 39,023 | 39,728 |
| Diluted | 39,315 | 39,972 |

The accompanying notes are an integral part of these statements.

DRIL-QUIP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

| | Three months ended March 31, | |
|---|---------------------------------|------------|
| | 2009 | 2010 |
| | (In thousands) | |
| Operating activities | | |
| Net income | \$ 24,671 | \$ 25,697 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 4,162 | 4,884 |
| Stock-based compensation expense | 997 | 1,192 |
| Loss/(gain) on sale of equipment | 13 | (3) |
| Deferred income taxes | (1,379) | 635 |
| Changes in operating assets and liabilities: | | |
| Trade receivables, net | 16,799 | (8,304) |
| Inventories, net | (10,894) | 4,789 |
| Prepays and other assets | 2,769 | (4,831) |
| Excess tax benefits of stock option exercises | | (833) |
| Trade accounts payable and accrued expenses | 2,133 | (317) |
| Net cash provided by operating activities | 39,271 | 22,909 |
| Investing activities | | |
| Purchase of property, plant and equipment | (13,794) | (7,593) |
| Proceeds from sale of equipment | 195 | 481 |
| Net cash used in investing activities | (13,599) | (7,112) |
| Financing activities | | |
| Principal payments on long-term debt | (151) | (171) |
| Proceeds from exercise of stock options | | 3,717 |
| Excess tax benefits of stock option exercises | | 833 |
| Net cash provided by (used in) financing activities | (151) | 4,379 |
| Effect of exchange rate changes on cash activities | 70 | (549) |
| Increase in cash and cash equivalents | 25,591 | 19,627 |
| Cash and cash equivalents at beginning of period | 95,952 | 197,792 |
| Cash and cash equivalents at end of period | \$ 121,543 | \$ 217,419 |

The accompanying notes are an integral part of these statements.

DRIL-QUIP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Organization and Principles of Consolidation

Dril-Quip, Inc., a Delaware corporation (the Company or Dril-Quip), designs, manufactures, sells and services highly engineered offshore drilling and production equipment that is well suited for use in deepwater, harsh environment and severe service applications. The Company's principal products consist of subsea and surface wellheads, subsea and surface production trees, subsea control systems and manifolds, mudline hanger systems, specialty connectors and associated pipe, drilling and production riser systems, liner hangers, wellhead connectors and diverters. Dril-Quip's products are used by major integrated, large independent and foreign national oil and gas companies in offshore areas throughout the world. Dril-Quip also provides technical advisory assistance on an as-requested basis during installation of its products, as well as rework and reconditioning services for customer-owned Dril-Quip products. In addition, Dril-Quip's customers may rent or purchase running tools from the Company for use in the installation and retrieval of its products.

The Company's operations are organized into three geographic segments: Western Hemisphere (including North and South America; headquartered in Houston, Texas), Eastern Hemisphere (including Europe and Africa; headquartered in Aberdeen, Scotland) and Asia-Pacific (including the Pacific Rim, Southeast Asia, Australia, India and the Middle East; headquartered in Singapore). Each of these segments sells similar products and services and the Company has major manufacturing facilities in all three of its headquarter locations as well as Macae, Brazil.

The condensed consolidated financial statements included herein have been prepared by Dril-Quip and are unaudited, except for the balance sheet at December 31, 2009, which has been derived from the audited consolidated financial statements at that date. In the opinion of management, the unaudited condensed consolidated interim financial statements include all normal recurring adjustments necessary for a fair presentation of the financial position as of March 31, 2010, the results of operations for each of the three-month periods ended March 31, 2010 and 2009, and the cash flows for each of the three-month periods ended March 31, 2010 and 2009. Although management believes the unaudited interim related disclosures in these condensed consolidated financial statements are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in annual audited consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America under guidance from the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The results of operations and the cash flows for the three-month period ended March 31, 2010 are not necessarily indicative of the results to be expected for the full year. The condensed consolidated financial statements included herein should be read in conjunction with the consolidated audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

2. Significant Accounting Policies

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All material intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America under guidance from the ASC requires management to make estimates and

assumptions that affect reported amounts of assets and liabilities and disclosure of contingent 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. Some of the Company's more significant estimates are those affected by critical accounting policies for revenue recognition, inventories and contingent liabilities as discussed more fully in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

Cash and cash equivalents

Short-term investments that have a maturity of three months or less from the date of purchase are classified as cash equivalents. The Company invests excess cash in interest bearing accounts, money market mutual funds and funds which invest in U.S. Treasury obligations and repurchase agreements backed by U.S. Treasury obligations. The Company's investment objectives continue to be the preservation of capital and the maintenance of liquidity.

Inventories

Inventory costs are determined principally by the use of the first-in, first-out (FIFO) costing method and are stated at the lower of cost or market. Company manufactured inventory is valued principally using standard costs, which are calculated based upon direct costs incurred and overhead allocations. Inventory purchased from third party vendors is principally valued at the weighted average cost. Periodically, obsolescence reviews are performed on slow-moving inventories and reserves are established based on current assessments about future demands and market conditions. The inventory values have been reduced by a reserve for excess and obsolete inventories. Inventory reserves of \$24.2 million and \$23.7 million were recorded as of December 31, 2009 and March 31, 2010, respectively. If market conditions are less favorable than those projected by management, additional inventory reserves may be required.

Property, Plant and Equipment

Property, plant and equipment are carried at cost, with depreciation provided on a straight-line basis over their estimated useful lives.

Income Taxes

The Company accounts for income taxes using the asset and liability method. Current income taxes are provided on income reported for financial statement purposes, adjusted for transactions that do not enter into the computation of income taxes payable in the same year. Deferred tax assets and liabilities are measured using enacted tax rates for the expected future tax consequences of temporary differences between the carrying amounts and the tax basis of assets and liabilities. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Revenue Recognition

Product Revenue

The Company earns product revenues from two sources:

product revenues recognized under the percentage-of-completion method; and

product revenues from the sale of products that do not qualify for the percentage-of-completion method.

Revenues recognized under the percentage-of-completion method

The Company uses the percentage-of-completion method on long-term project contracts pursuant to ASC Topic 605-35, which provides guidance on accounting for the performance of contracts. Long-term project contracts have the following characteristics:

The contracts call for products which are designed to customer specifications;

The structural designs are unique and require significant engineering and manufacturing efforts generally requiring more than one year in duration;

The contracts contain specific terms as to milestones, progress billings and delivery dates; and

Product requirements cannot be filled directly from the Company's standard inventory.

For each project, the Company prepares a detailed analysis of estimated costs, profit margin, completion date and risk factors which include availability of material, production efficiencies and other factors that may impact the project. On a quarterly basis, management reviews the progress of each project, which may result in revisions of previous estimates, including revenue recognition. The Company calculates the percent complete and applies the percentage to determine the revenues earned and the appropriate portion of total estimated costs. Losses, if any, are recorded in full in the period they first become evident. Historically, the Company's estimates of total costs and costs to complete have approximated actual costs incurred to complete the project.

Under the percentage-of-completion method, billings do not always correlate directly to the revenue recognized. Based upon the terms of the specific contract, billings may be in excess of the revenue recognized, in which case the amounts are included in customer prepayments as a liability on the Condensed Consolidated Balance Sheets. Likewise, revenue recognized may exceed customer billings in which case the amounts are reported in trade receivables. Unbilled revenues are expected to be billed and collected within one year. At December 31, 2009 and March 31, 2010, receivables included \$24.8 million and \$22.6 million of unbilled receivables, respectively. During the quarter ended March 31, 2010, there were 16 projects representing approximately 16% of the Company's total revenue and approximately 19% of its product revenues that were accounted for using percentage-of-completion accounting as compared to 14 projects during the first quarter of 2009 which represented 21% of the Company's total revenues and 26% of its product revenues.

Revenues not recognized under the percentage-of-completion method

Revenues from the sale of inventory products, not accounted for under the percentage-of-completion method, are recorded at the time the manufacturing processes are complete and ownership is transferred to the customer.

Service revenue

The Company earns service revenues from three sources:

technical advisory assistance;

rental of running tools; and

rework and reconditioning of customer-owned Dril-Quip products.

The recognition of service revenue is the same for all products, including those accounted for under the percentage-of-completion method. The Company does not install products for its customers, but it provides technical advisory assistance. At the time of delivery of the product, the customer is not obligated to buy or rent

the Company's running tools and the Company is not obligated to perform any subsequent services relating to installation. Technical advisory assistance service revenue is recorded at the time the service is rendered. Service revenues associated with the rental of running and installation tools are recorded as earned. Rework and reconditioning service revenues are recorded when the refurbishment process is complete.

The Company normally negotiates contracts for products, including those accounted for under the percentage-of-completion method, and services separately. For all product sales, it is the customer's decision as to the timing of the product installation as well as whether Dril-Quip running tools will be purchased or rented. Furthermore, the customer is under no obligation to utilize the Company's technical advisory services. The customer may use a third party or their own personnel.

Foreign Currency

The financial statements of foreign subsidiaries are translated into U.S. dollars at period end exchange rates except for revenues and expenses, which are translated at average monthly rates. Translation adjustments are reflected as a separate component of stockholders' equity and have no effect on current earnings or cash flows.

Foreign currency exchange transactions are recorded using the exchange rate at the date of the settlement. Exchange gains (losses) are included in selling, general and administrative costs in the Condensed Consolidated Statements of Income.

Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and cash equivalents, receivables, payables, and debt instruments. The carrying values of these financial instruments approximate their respective fair values as they are either short-term in nature or carry interest rates that approximate market rates.

Concentration of Credit Risk

Financial instruments which subject the Company to concentrations of credit risk primarily include trade receivables. The Company grants credit to its customers, which operate primarily in the oil and gas industry. The Company performs periodic credit evaluations of its customers' financial condition and generally does not require collateral. The Company maintains reserves for potential losses, and such losses have historically been within management's expectations.

In addition, the Company invests excess cash in interest bearing accounts, money market mutual funds and funds which invest in obligations of the U.S. Treasury and repurchase agreements backed by U.S. Treasury obligations. Changes in the financial markets and interest rates could affect the interest earned on short-term investments.

Comprehensive Income

ASC Topic 220 establishes the standards for the reporting and display of comprehensive income and its components. The standard requires the Company to include unrealized gains or losses on foreign currency translation adjustments in other comprehensive income. Generally, gains are attributed to a weakening U.S. dollar and losses are the result of a strengthening U.S. dollar.

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The following table provides comprehensive income for the periods indicated:

| | Three months ended March 31, | |
|---|---------------------------------|------------------|
| | 2009 | 2010 |
| | (In thousands) | |
| Net income | \$ 24,671 | \$ 25,697 |
| Foreign currency translation adjustment | (1,568) | (9,710) |
| Comprehensive income | \$ 23,103 | \$ 15,987 |

Earnings Per Share

Basic earnings per common share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per common share is computed considering the dilutive effect of stock options using the treasury stock method.

In each relevant period, the net income used in the basic and dilutive earnings per share calculations is the same. The following table reconciles the number of common shares outstanding at March 31 of each year to the weighted average number of common shares outstanding and the weighted average diluted number of common shares outstanding for the purpose of calculating basic and diluted earnings per share:

| | Three months ended March 31, | |
|---|---------------------------------|---------------|
| | 2009 | 2010 |
| | (In thousands) | |
| Number of common shares outstanding at end of period basic | 39,023 | 39,800 |
| Effect of using weighted average common shares outstanding | | (72) |
| Weighted average basic common shares outstanding basic | 39,023 | 39,728 |
| Dilutive effect of common stock options | 292 | 244 |
| Weighted average diluted common shares outstanding diluted | 39,315 | 39,972 |

New Accounting Standards

In January 2010, the FASB issued Accounting Standards Update (ASU) 2010-06, Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures about Fair Value Measurements. This ASU requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10. The FASB's objective is to improve these disclosures and thus, increase transparency in financial reporting. The ASU is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Early application is permitted. The adoption of this accounting standard update will not have a material impact on the Company's condensed consolidated financial statements.

In October 2009, the FASB issued ASU 2009-13, Multiple-Deliverable Revenue Arrangements (ASU 2009-13). The new standard changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable based on the relative selling price. The selling price for each deliverable is based on vendor-specific objective evidence (VSOE) if available, third-party evidence if VSOE is not available, or estimated selling price if neither VSOE or third-party evidence is available. ASU 2009-13 is effective for revenue arrangements entered

into in fiscal years beginning on or after June 15, 2010. The Company does not expect that the provisions of the new standard will have a material effect on its condensed consolidated financial statements.

In June 2009, the Company adopted ASC Topic 825 regarding disclosures about the fair value of financial instruments for interim periods of publicly traded companies as well as in the annual financial statements. The standard also requires publicly traded companies to include disclosures about the fair value of its financial instruments whenever it issues summarized financial information for interim reporting periods. The adoption of this standard had no material effect on the Company's condensed consolidated financial statements.

In May 2009, the Company adopted ASC Topic 855 regarding subsequent events. ASC Topic 855 was updated in February 2010 by ASU 2010-09. ASU 2010-09 provides that an SEC filer is required to evaluate subsequent events through the date the financial statements are issued. Previously, the Company was required to state whether subsequent events were evaluated through the date the financial statements were issued or the date the financial statements were available to be issued. Pursuant to ASU 2010-09, the Company is no longer required to disclose the date through which the subsequent events have been evaluated.

3. Stock-Based Compensation and Stock Option Awards

During the three months ended March 31, 2010, the Company recognized approximately \$1.2 million of compensation expense compared to approximately \$997,000 for the three months ended March 31, 2009. Compensation expense is included in the selling, general and administrative expense line of the Condensed Consolidated Statements of Income. No stock-based compensation expense was capitalized during the three months ended March 31, 2010 or 2009. There were no options granted in the first quarter of 2010 or 2009. Refer to Note 12 of the Company's 2009 Form 10-K for additional information regarding stock-based compensation plans.

4. Inventories

Inventories consist of the following:

| | December 31, 2009 | March 31, 2010 |
|---|----------------------|-------------------|
| | (In thousands) | |
| Raw materials | \$ 50,853 | \$ 45,572 |
| Work in progress | 74,956 | 69,877 |
| Finished goods | 149,749 | 149,573 |
| | 275,558 | 265,022 |
| Less: allowance for obsolete and excess inventory | (24,201) | (23,703) |
| | \$ 251,357 | \$ 241,319 |

5. Geographic Areas

| | Three months ended March 31, 2009 2010 (In thousands) | |
|---|---|------------|
| <i>Revenues:</i> | | |
| Western Hemisphere | | |
| Products | \$ 53,402 | \$ 69,469 |
| Services | 10,161 | 10,752 |
| Intercompany | 15,737 | 12,596 |
| Total | \$ 79,300 | \$ 92,817 |
| Eastern Hemisphere | | |
| Products | \$ 34,179 | \$ 34,818 |
| Services | 9,608 | 8,174 |
| Intercompany | 397 | 1,337 |
| Total | \$ 44,184 | \$ 44,329 |
| Asia Pacific | | |
| Products | \$ 17,555 | \$ 17,546 |
| Services | 2,617 | 1,774 |
| Intercompany | (1) | 1,623 |
| Total | \$ 20,171 | \$ 20,943 |
| Summary | | |
| Products | \$ 105,136 | \$ 121,833 |
| Services | 22,386 | 20,700 |
| Intercompany | 16,133 | 15,556 |
| Eliminations | (16,133) | (15,556) |
| Total | \$ 127,522 | \$ 142,533 |
| <i>Income (loss) before income taxes:</i> | | |
| Western Hemisphere | \$ 16,129 | \$ 10,704 |
| Eastern Hemisphere | 13,943 | 9,537 |
| Asia Pacific | 6,472 | 10,842 |
| Eliminations | (1,720) | 3,549 |
| Total | \$ 34,824 | \$ 34,632 |

| | December 31, 2009 | March 31, 2010 (In thousands) |
|---------------------------------|----------------------|-------------------------------------|
| <i>Total Long-Lived Assets:</i> | | |
| Western Hemisphere | \$ 158,210 | \$ 162,300 |
| Eastern Hemisphere | 27,214 | 24,536 |
| Asia Pacific | 18,029 | 21,484 |
| Eliminations | (3,563) | (3,563) |
| | \$ 199,890 | \$ 204,757 |

| | December 31, 2009 | March 31, 2010 |
|----------------------|----------------------|-------------------|
| | (In thousands) | |
| <i>Total Assets:</i> | | |
| Western Hemisphere | \$ 518,475 | \$ 540,475 |
| Eastern Hemisphere | 158,112 | 145,085 |
| Asia Pacific | 147,644 | 158,937 |
| Eliminations | (6,985) | (8,475) |
| | \$ 817,246 | \$ 836,022 |

6. Commitments and Contingencies

In 2006, the Company entered into a contract in the amount of approximately \$47 million with MPF Corp. Ltd. (MPF) under which the Company was to construct risers and related equipment to be installed on an offshore drill ship being constructed for MPF. MPF and its affiliates filed a Chapter 11 bankruptcy case in September 2008 in the United States Bankruptcy Court for the Southern District of Texas, Houston Division (Case No. 08-36084). Under the Bankruptcy Code, at some point MPF must either assume this contract or reject it. The Company cannot be sure as to when its rights under the contract will be clarified. Currently, the Company has possession of all the raw materials purchased to date and work-in-progress under the contract. At the time of the bankruptcy filing, the Company had recognized approximately \$20 million in revenues under the contract and had received payments of approximately \$16 million. No further revenue has been recognized since the second quarter of 2008. The Company believes the remaining \$4 million of unpaid receivables will be realized through the workings of the contract or through its interest in the partially constructed inventory. In April 2010, the Company, MPF and a new third-party buyer signed a novation agreement which, subject to the bankruptcy court approval, will allow for the contract between MPF and the Company to be assumed and transferred to the new buyer. The novation agreement requires that the bankruptcy court approval must be received by no later than June 30, 2010. While the Company has made filings in the bankruptcy proceedings that it believes are appropriate to protect its rights, there can be no assurance that the Company will be able to receive the expected benefits of the contract with MPF. While the Company does not expect the outcome of this matter to have a material adverse effect on the Company's operations, financial position or cash flows, the Company may be required to write down or forfeit some portion of the revenues recognized to date if it becomes probable that the Company will not receive such funds or realize the value of the inventory in its possession.

The Company operates its business and markets its products and services in most of the significant oil and gas producing areas in the world and is, therefore, subject to the risks customarily attendant to international operations and dependency on the condition of the oil and gas industry. Additionally, products of the Company are used in potentially hazardous drilling, completion, and production applications that can cause personal injury, product liability, and environmental claims. Although exposure to such risk has not resulted in any significant problems in the past, there can be no assurance that current matters or future developments will not adversely impact the Company.

The Company is also involved in a number of legal actions arising in the ordinary course of business. Although no assurance can be given with respect to the ultimate outcome of such legal action, in the opinion of management, the ultimate liability with respect thereto will not have a material adverse affect on the Company's operations, financial position or cash flows.

7. Special Item

In August 2007, the Company's Brazilian subsidiary was served with assessments collectively valued at approximately BRL23.3 million (approximately U.S. \$13.1 million as of March 2010) from the State of Rio de Janeiro, Brazil, to collect a state tax on the importation of goods. Since 2007, the Company has vigorously contested the assessments in the Brazilian administrative and judicial systems. While pending, the amount of

interest, penalties and monetary restatement of fees on the tax assessments continued to accrue and totaled approximately BRL35.4 million (approximately U.S. \$19.9 million) as of March 2010.

Under the terms of an amnesty law enacted by the State of Rio de Janeiro in January 2010, the Company settled the pending assessments in March 2010 in the amount of BRL21.7 million (approximately U.S. \$12.2 million), pursuant to which all penalties were waived and accrued interest was reduced by 45%. Of the total amount paid, BRL10.6 million (approximately U.S. \$5.9 million) is reflected in Special Item on the Condensed Consolidated Statements of Income for the period ended March 31, 2010. The remaining BRL11.1 million (approximately U.S. \$6.3 million) is considered a prepaid tax that the Company's Brazilian subsidiary will utilize to offset future liabilities for state taxes on the importation of goods over the next five years.

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

The following is management's discussion and analysis of certain significant factors that have affected certain aspects of the Company's financial position, results of operations and cash flows during the periods included in the accompanying unaudited condensed consolidated financial statements. This discussion should be read in conjunction with the unaudited condensed consolidated financial statements presented elsewhere herein, as well as the discussion under Risk Factors, Management's Discussion and Analysis of Financial Condition and Results of Operations and the annual consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

Overview and Industry Outlook

Dril-Quip designs, manufactures, sells and services highly engineered offshore drilling and production equipment that is well suited for use in deepwater, harsh environment and severe service applications. The Company designs and manufactures subsea equipment, surface equipment and offshore rig equipment for use by major integrated, large independent and foreign national oil and gas companies in offshore areas throughout the world. The Company's principal products consist of subsea and surface wellheads, subsea and surface production trees, subsea control systems and manifolds, mudline hanger systems, specialty connectors and associated pipe, drilling and production riser systems, liner hangers, wellhead connectors and diverters. Dril-Quip also provides technical advisory assistance on an as-requested basis during installation of its products, as well as rework and reconditioning services for customer-owned Dril-Quip products and rental of running tools for use in connection with the installation and retrieval of its products.

Both the market for offshore drilling and production equipment and services and the Company's business are substantially dependent on the condition of the oil and gas industry and, in particular, the willingness of oil and gas companies to make capital expenditures on exploration, drilling and production operations offshore. Oil and gas prices and the level of offshore drilling and production activity have historically been characterized by significant volatility. Declines in oil and gas prices may adversely affect the willingness of some oil and gas companies to make capital expenditures on exploration, drilling and production operations offshore, which could have an adverse impact on the Company's operations, financial position or cash flows.

According to the Energy Information Administration (EIA) of the U.S. Department of Energy, average crude oil (West Texas Intermediate Cushing) and natural gas (Henry Hub) closing prices are listed below as the average of the closing prices for the periods covered by this report:

| | Three months ended March 31, | |
|----------------------|---------------------------------|----------|
| | 2009 | 2010 |
| Crude oil (\$/Bbl) | \$ 42.90 | \$ 78.81 |
| Natural gas (\$/Mcf) | \$ 4.71 | \$ 5.30 |

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During the first quarter of 2009, crude oil prices ranged between \$34.03 per barrel and \$53.87 per barrel with an average quarterly price of \$42.90. For the first quarter of 2010, crude oil prices ranged between \$71.15 per barrel and \$83.45 per barrel with an average quarterly price of \$78.81. Crude oil prices ended the first quarter of 2010 at \$83.45 per barrel and natural gas prices at March 31, 2010 were \$3.76 per Mcf.

According to the April 2010 release of the Short-Term Energy Outlook published by the EIA, West Texas Intermediate crude oil prices are projected to average \$80.74 per barrel in 2010 and \$83.50 in 2011. The EIA's projections for crude oil prices have remained relatively stable since October 2009 despite the fluctuations in daily oil prices. EIA projects that world consumption will grow by 1.5 million barrels per day in 2010 and 1.6 million barrels per day in 2011. This growth is the result of expected recovery in the global economy, with world gross domestic product assumed to rise by more than 3% per year. In April 2010, the EIA projected Henry Hub natural gas prices to average \$4.32 per Mcf in 2010. In its April 2010 Oil Market Report, the International Energy Agency stated that oil demand in 2009 was 84.9 million barrels per day, compared to an estimated 86.6 million barrels per day in 2010.

Detailed below is the average contracted rig count for our geographic regions for the three months ended March 31, 2009 and 2010. The rig count data includes floating rigs (semi-submersibles and drill ships) and jack-ups. The Company has included only these types of rigs as they are the primary end users of the Company's products.

| | Three months March 31, | |
|--------------------|---------------------------|------|
| | 2009 | 2010 |
| Western Hemisphere | 177 | 176 |
| Eastern Hemisphere | 161 | 142 |
| Asia Pacific | 239 | 234 |

Source: ODS Petrodata RigBase March 31, 2009 and 2010

The table represents rigs under contract and includes rigs currently drilling as well as rigs committed, but not yet drilling.

The Company believes that the number of rigs (semi-submersibles, jack-ups and drill ships) under construction impacts its revenues because in certain cases, its customers order some of the Company's products during the construction of such rigs. As a result, an increase in rig construction activity tends to favorably impact the Company's backlog while a decrease in rig construction activity tends to negatively impact its backlog. According to ODS-Petrodata, at the end of March 2009 and 2010, there were 162 and 133 rigs, respectively, under construction and the expected delivery dates for the rigs under construction on March 31, 2010 are as follows:

| | |
|------|----|
| 2010 | 55 |
| 2011 | 41 |
| 2012 | 28 |
| 2013 | 1 |
| 2014 | 8 |

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The demand for the Company's products and services is also affected by laws and regulations relating to the oil and gas industry in general, including those specifically directed to offshore operations. The adoption of new laws and regulations, or changes to existing laws or regulations, that curtail exploration and development drilling for oil and gas for economic or other policy reasons could adversely affect the Company's operations by limiting demand for its products.

Oil and gas prices and the level of offshore drilling and production activity have been characterized by significant volatility in recent years. Worldwide military, political, economic and other events have contributed

to oil and natural gas price volatility and are likely to continue to do so in the future. In mid-2008 oil and gas prices began to decline. The economic volatility continued in the first half of 2009 and began to stabilize somewhat in the latter half of the year. In the first quarter of 2010 crude oil prices were over \$70.00 per barrel on a daily basis and through April 2010 the prices for crude oil have closed over \$80.00 per barrel each day. The Company expects continued volatility in both crude oil and natural gas prices as well as in the level of drilling and production related activities. The volatility in prices appears to have impacted the land drilling activity more so than offshore drilling, particularly in deeper offshore waters, where Dril-Quip's products are more often utilized. Even during periods of high prices for oil and natural gas, companies exploring for oil and gas may cancel or curtail programs, or reduce their levels of capital expenditures for exploration and production for a variety of reasons. In addition, a significant and prolonged decline in hydrocarbon prices would also likely have a material adverse effect on the Company's results of operations. The Company believes that its backlog should help mitigate the impact of negative market conditions; however, a prolonged decline in commodity prices, an extended continuation of the downturn in the global economy or future restrictions or declines in offshore oil and gas exploration and production could have a negative impact on the Company. The Company's backlog at March 31, 2010 was approximately \$550 million compared to approximately \$573 million at March 31, 2009 and \$563 million at December 31, 2009. The Company can give no assurance that backlog will remain at current levels. All of the Company's projects currently included in its backlog are subject to change and/or termination at the option of the customer. In the case of a change or termination, the customer is required to pay the Company for work performed and other costs necessarily incurred as a result of the change or termination. In the past, terminations and cancellations have been immaterial to the Company's overall operating results.

Recent Industry Event

On April 22, 2010, a deepwater Gulf of Mexico drilling rig known as the Deepwater Horizon that was operated by BP Exploration & Production, Inc. (BP) sank after an apparent blowout and fire that began on April 20, 2010. The Company is a party to an ongoing contract with an affiliate of BP to supply wellhead systems in connection with BP's Gulf of Mexico operations, and the Company's wellhead and certain of its other equipment were in use on the Deepwater Horizon at the time of the incident. The Departments of Homeland Security and Interior have begun a joint investigation into the cause of the incident. The U.S. Coast Guard and the Minerals Management Service share jurisdiction over the investigation into the incident. We have been designated as a party-in-interest and received a request for certain information from the joint investigation team. We have also been invited to attend hearings that have been scheduled in furtherance of that investigation. We have also received a request to preserve information from the joint investigation team. We are cooperating in the investigation. We may also receive additional invitations and/or requests for participation in hearings or investigations from other governmental bodies related to the incident.

The Company cannot predict at this time the impact that this incident may have on governmental laws or governmental regulation of offshore oil and gas exploration and production activities or the level of demand for the Company's products in future periods.

Revenues. Dril-Quip's revenues are generated from two sources: products and services. Product revenues are derived from the sale of offshore drilling and production equipment. Service revenues are earned when the Company provides technical advisory assistance for installation of the Company's products, reconditioning services and rental of running tools for installation and retrieval of the Company's products. For each of the three months ended March 31, 2009 and 2010, the Company derived 82% and 86%, respectively, of its revenues from the sale of its products and 18% and 14%, respectively, of its revenues from services. Product contracts are negotiated and sold separately from service contracts. In addition, service contracts are not included in the product contracts or related sales orders and are not offered to the customer as a condition of the sale of the Company's products. The demand for products and services is generally based on world-wide economic conditions in the offshore oil and gas industry, and is not based on a specific relationship between the two types of contracts. Substantially all of the Company's sales are made on a purchase order basis. Purchase orders are subject to change and/or termination at the option of the customer. In case of a change or termination, the customer is required to pay the Company for work performed and other costs necessarily incurred as a result of the change or termination.

The Company accounts for larger and more complex projects that have relatively longer manufacturing time frames on a percentage-of-completion basis. For the first three months of 2010, 16 projects representing approximately 16% of the Company's total revenue and approximately 19% of its product revenue were accounted for using percentage-of-completion accounting compared to 14 projects representing approximately 21% of the Company's total revenue and 26% of its product revenue for the first three months of 2009. This percentage may fluctuate in the future. Revenues accounted for in this manner are generally recognized based upon a calculation of the percentage complete, which is used to determine the revenue earned and the appropriate portion of total estimated cost of sales. Accordingly, price and cost estimates are reviewed periodically as the work progresses, and adjustments proportionate to the percent complete are reflected in the period when such estimates are revised. Losses, if any, are recognized when they first become known. Amounts received from customers in excess of revenues recognized are classified as a current liability.

The Company has substantial international operations, with approximately 66% and 56% of its revenues derived from foreign sales for the three months ended March 31, 2009 and 2010, respectively.

Cost of Sales. The principal elements of cost of sales are labor, raw materials and manufacturing overhead. Cost of sales as a percentage of revenues is influenced by the product mix sold in any particular period and market conditions. The Company's costs related to its foreign operations do not significantly differ from its domestic costs.

Selling, General and Administrative Expenses. Selling, general and administrative expenses include the costs associated with sales and marketing, general corporate overhead, compensation expense, stock option expense, legal expenses, foreign currency transaction gains and losses and other related administrative functions.

Engineering and Product Development Expenses. Engineering and product development expenses consist of new product development and testing, as well as application engineering related to customized products.

Income Tax Provision. The Company's effective income tax rate has historically been lower than the statutory rate primarily due to foreign income tax rate differentials, research and development credits and deductions related to domestic production activities.

Results of Operations

The following table sets forth, for the periods indicated, certain statement of operations data expressed as a percentage of revenues:

| | Three months ended March 31, | |
|--|---|-------------|
| | 2009 | 2010 |
| Revenues: | | |
| Products | 82.4% | 85.5% |
| Services | 17.6 | 14.5 |
| | | |
| Total revenues | 100.0 | 100.0 |
| Cost of sales: | | |
| Products | 47.0 | 48.7 |
| Services | 9.5 | 8.7 |
| | | |
| Total cost of sales | 56.5 | 57.4 |
| Selling, general and administrative expenses | 11.4 | 9.4 |
| Engineering and product development expenses | 4.9 | 4.8 |
| Special item (1) | | 4.1 |
| | | |
| Operating income | 27.2 | 24.3 |
| Interest income | 0.1 | |
| Interest expense | | |
| | | |
| Income before income taxes | 27.3 | 24.3 |
| Income tax provision | 8.0 | 6.3 |
| | | |
| Net income | 19.3% | 18.0% |

(1) See Note 7 of the Notes to Condensed Consolidated Financial Statements included in Item 1 of Part 1 of this report. The following table sets forth, for the periods indicated, a breakdown of our products and service revenues:

| | Three months ended March 31, | |
|------------------------|---|-------------|
| | 2009 | 2010 |
| | (In millions) | |
| Revenues: | | |
| Products | | |
| Subsea equipment | \$ 75.6 | \$ 94.2 |
| Surface equipment | 6.3 | 7.0 |
| Offshore rig equipment | 23.2 | 20.6 |
| | | |
| Total products | 105.1 | 121.8 |
| Services | 22.4 | 20.7 |
| | | |
| Total revenues | \$ 127.5 | \$ 142.5 |

Three Months Ended March 31, 2010 Compared to Three Months Ended March 31, 2009.

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Revenues. Revenues increased by \$15.0 million, or approximately 11.8%, to \$142.5 million in the three months ended March 31, 2010 from \$127.5 million in the three months ended March 31, 2009. Product revenues increased by approximately \$16.7 million for the three months ended March 31, 2010 compared to the same period in 2009 as a result of increased revenues of \$18.6 million in subsea equipment and \$700,000 in surface equipment, partially offset by a \$2.6 million decrease in offshore rig equipment. Product revenues increased in the Western Hemisphere and Eastern Hemisphere by \$16.1 million and \$600,000, respectively. Product revenues

in Asia-Pacific were basically flat between 2009 and 2010. Service revenues decreased by approximately \$1.7 million as a result of decreases of \$1.4 million in the Eastern Hemisphere and \$800,000 in Asia-Pacific, partially offset by an increase of \$500,000 in the Western Hemisphere. The majority of the decreases in service revenues were due to a decrease in the rental of running tools and the reconditioning services of customer-owned Dril-Quip products, partially offset by an increase in technical advisory services.

Cost of Sales. Cost of sales increased by \$9.8 million, or approximately 13.6%, to \$81.8 million for the three months ended March 31, 2010 from \$72.0 million for the same period in 2009. As a percentage of revenues, cost of sales were approximately 57.4% and 56.5% for the three-month periods ended March 31, 2010 and 2009, respectively.

Selling, General and Administrative Expenses. For the three months ended March 31, 2010, selling, general and administrative expenses decreased by approximately \$1.1 million, or 7.6%, to \$13.4 million from \$14.5 million in the 2009 period. The decrease in selling, general and administrative expenses was primarily due to the effect of foreign currency transaction gains and losses, partially offset by increased stock option expenses. The Company experienced approximately \$1.7 million in foreign currency transaction gains in the first quarter of 2010 as compared to \$79,000 in foreign currency transaction losses in the first quarter of 2009. Stock option expense for the first quarter of 2010 totaled \$1.2 million compared to \$997,000 in the first quarter of 2009. Selling, general and administrative expenses as a percentage of revenues decreased from 11.4% in 2009 to 9.4% in 2010.

Engineering and Product Development Expenses. For each of the three-month periods ended March 31, 2010 and 2009, engineering and product development expenses totaled \$6.8 million and \$6.3 million, respectively. Engineering and product development expenses as a percentage of revenues decreased from 4.9% in 2009 to 4.8% in 2010.

Special Item. Under the terms of an amnesty law enacted by the State of Rio de Janeiro, Brazil, the Company settled pending assessments regarding state tax on the importation of goods in March 2010 in the amount of BRL21.7 million (approximately U.S. \$12.2 million). Of the total amount paid, BRL10.6 million (approximately U.S. \$5.9 million) is reflected in *Special Item* on the Condensed Consolidated Statements of Income for the period ended March 31, 2010. The remaining BRL11.1 million (approximately U.S. \$6.3 million) is considered a prepaid tax that the Company's Brazilian subsidiary will utilize to offset future liabilities for state taxes on the importation of goods over the next five years. See Note 7 of the Notes to Condensed Consolidated Financial Statements included in Item 1 of Part 1 of this report.

Interest Income. Interest income for the three-month period ended March 31, 2010 was approximately \$61,000 as compared to approximately \$212,000 for the three-month period ended March 31, 2009. This decrease was due to reduced interest earned on short-term investments from lower interest rates. Due to the recent global financial crisis, the Company continues to keep the majority of its short-term investments in funds which invest in U.S. Treasury obligations, which normally earn lower interest rates than money market funds.

Interest expense. Interest expense for the three months ended March 31, 2010 was \$27,000 compared to \$48,000 for the same period in 2009.

Income tax provision. Income tax expense for the three months ended March 31, 2010 was \$8.9 million on income before taxes of \$34.6 million, resulting in an effective income tax rate of approximately 26%. Income tax expense for the three months ended March 31, 2009 was \$10.2 million on income before taxes of \$34.8 million, resulting in an effective income tax rate of approximately 29%. The decrease in the effective income tax reflects the difference in income before income taxes among the Company's three geographic areas, which have different income tax rates.

Net Income. Net income was approximately \$25.7 million for the three months ended March 31, 2010 and \$24.7 million for the same period in 2009, for the reasons set forth above.

Liquidity and Capital Resources

Cash flows provided by (used in) type of activity were as follows:

| | Three months March 31, | |
|--|---------------------------|-----------|
| | 2009 | 2010 |
| | (In thousands) | |
| Operating activities | \$ 39,271 | \$ 22,909 |
| Investing activities | (13,599) | (7,112) |
| Financing activities | (151) | 4,379 |
| | 25,521 | 20,176 |
| Effect of exchange rate changes on cash activities | 70 | (549) |
| Increase (decrease) in cash and cash equivalents | \$ 25,591 | \$ 19,627 |

Statements of cash flows for entities with international operations that are local currency functional exclude the effects of the changes in foreign currency exchange rates that occur during any given period, as these are noncash changes. As a result, changes reflected in certain accounts on the Condensed Consolidated Statements of Cash Flows may not reflect the changes in corresponding accounts on the Condensed Consolidated Balance Sheets.

The primary liquidity needs of the Company are (i) to fund capital expenditures to improve and expand facilities and manufacture additional running tools and (ii) to fund working capital. Recently, the Company's principal sources of funds have been cash flows from operations.

During the three months ended March 31, 2010, the Company generated \$22.9 million of cash from operations as compared to \$39.3 million for the same period in 2009. The decrease in cash generated from operating activities for the first three months of 2010 includes the settlement of pending assessments between the Company and the State of Rio de Janeiro of \$12.2 million. As discussed in Note 7 of the Notes to Condensed Consolidated Financial Statements, \$5.9 million is reflected as a pre-tax decrease on the Condensed Consolidated Statements of Income and \$6.3 million is reflected in the total assets of the Condensed Consolidated Balance Sheet. Cash totaling approximately \$9.5 million was used during the first quarter of 2010 due to increases in operating assets and liabilities, compared to \$10.8 million that was provided during the same period in 2009. The increases in operating assets and liabilities during the first three months of 2010 reflected an increase of \$8.3 million in receivables primarily due to increased revenues. The increase in accounts receivable was partially offset by a decrease in inventory of \$4.8 million. The majority of the decrease in inventory was in raw materials and work-in-progress. Prepaid and other assets increased by \$4.8 million largely due to the settlement discussed above. Accounts payable and accrued expenses decreased by \$317,000.

Capital expenditures by the Company were \$7.6 million and \$13.8 million in the first three months of 2010 and 2009, respectively. The capital expenditures for the first quarter of 2010 were primarily \$1.9 million for machinery and equipment, \$4.3 million for facilities and \$1.3 million for running tools and other expenditures of \$100,000. Principal payments on long-term debt were approximately \$171,000 during the three months ended March 31, 2010.

Dril-Quip (Europe) Limited has a credit agreement with the Bank of Scotland dated March 21, 2001 in the original amount of U.K. Pounds Sterling 4.0 million (approximately U.S. \$6.1 million as of March 2010). Borrowing under this facility bears interest at the Bank of Scotland base rate, which was 0.50% at March 31, 2010, plus 1%, and is repayable in 120 equal monthly installments, plus interest. Substantially all of this facility was used to finance capital expenditures in Norway. The outstanding balance of this facility at March 31, 2010 was approximately U.S. \$656,000. The facility is secured by land and buildings in Aberdeen, Scotland and contains no restrictive financial covenants.

The Company believes that cash generated from operations plus cash on hand will be sufficient to fund operations, working capital needs and anticipated capital expenditure requirements for the next twelve months. However, any significant future declines in hydrocarbon prices could have a material adverse effect on the Company's liquidity. Should market conditions result in unexpected cash requirements, the Company believes

that additional borrowing from commercial lending institutions would be available and adequate to meet such requirements.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

Critical Accounting Policies

Refer to our Annual Report on Form 10-K for the year ended December 31, 2009 for a discussion of our critical accounting policies. During the three months ended March 31, 2010 there were no material changes in the Company's judgments or assumptions associated with the development of our critical accounting policies.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company is currently exposed to certain market risks related to interest rate changes and fluctuations in foreign exchange rates. The Company does not engage in any material hedging transactions, forward contracts or currency trading which could mitigate the market risks inherent in such transactions.

Foreign Exchange Rate Risk

Through its subsidiaries, the Company conducts a portion of its business in currencies other than the United States dollar, principally the British pound sterling and to a lesser extent, the Brazilian real. The Company experienced a foreign currency pre-tax gain of approximately \$1.7 million during the three month period ended March 31, 2010 compared to a foreign currency pre-tax loss of approximately \$79,000 in the same period of 2009. Historically, the Company's foreign currency gains and losses have not been significant. However, when significant disparities between the British pound sterling and the U.S. dollar or the Brazilian real and the U.S. dollar occur, there can be no assurance that the Company will be able to protect itself against such currency fluctuations.

Interest Rate Risk

As described in Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources, the Company has entered into a loan that requires the Company to pay interest at a floating rate. The floating-rate obligation exposes the Company to the risk of increased interest expense in the event of increases in the short-term interest rates. Based upon the March 31, 2010 balance of approximately \$656,000 related to this floating rate obligation, each 1.0% rise in interest rates would result in additional annual interest expense to the Company of approximately \$6,500 or \$1,625 per quarter.

Item 4. Controls and Procedures

In accordance with Exchange Act Rules 13a-15 and 15d-15, the Company carried out an evaluation, under the supervision and with the participation of management, including the Company's Co-Chief Executive Officers and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Company's Co-Chief Executive Officers and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of March 31, 2010 to provide reasonable assurance that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and such information is accumulated and communicated to management, including the Company's Co-Chief Executive Officers and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure.

Management's Annual Reports on Internal Control over Financial Reporting appears on page 35 of the 2009 Annual Report on Form 10-K.

There has been no change in the Company's internal controls over financial reporting that occurred during the quarter ended March 31, 2010 that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

In March 2010, the Company settled a dispute with the State of Rio de Janeiro, Brazil regarding the state tax on the importation of goods. See Note 7 of the Notes to Condensed Consolidated Financial Statements included in Item 1 of Part 1 of this report, as well as Legal Proceedings in Item 3 of Part I of the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

The Company also is involved in a number of legal actions arising in the ordinary course of business. Although no assurance can be given with respect to the ultimate outcome of such legal actions, in the opinion of management, the ultimate liability with respect thereto will not have a material adverse effect on the Company's financial position.

Item 1A. Risk Factors.

There have been no material changes from the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q includes certain statements that may be deemed to be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Statements contained in all parts of this document that are not historical facts are forward-looking statements that involve risks and uncertainties that are beyond the control of Dril-Quip, Inc. (the Company or Dril-Quip). You can identify the Company's forward-looking statements by the words anticipate, estimate, expect, may, project, believe and similar expressions, or by the Company's discussion of strategies or trends. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, no assurances can be given that these expectations will prove to be correct. These forward-looking statements include the following types of information and statements as they relate to the Company:

future operating results and cash flow;

scheduled, budgeted and other future capital expenditures;

working capital requirements;

the availability of expected sources of liquidity;

the introduction into the market of the Company's future products;

the market for the Company's existing and future products;

the Company's ability to develop new applications for its technologies;

the exploration, development and production activities of the Company's customers;

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compliance with present and future environmental regulations and costs associated with environmentally related penalties, capital expenditures, remedial actions and proceedings;

effects of pending legal proceedings; and

future operations, financial results, business plans and cash needs.

These statements are based on assumptions and analyses in light of the Company's experience and perception of historical trends, current conditions, expected future developments and other factors the Company believes were appropriate in the circumstances when the statements were made. Forward-looking statements by their nature involve substantial risks and uncertainties that could significantly impact expected results, and actual future results could differ materially from those described in such statements. While it is not possible to identify all factors, the Company continues to face many risks and uncertainties. Among the factors that could cause actual future results to differ materially are the risks and uncertainties discussed under Item 1A. Risk Factors in Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 and the following:

the volatility of oil and natural gas prices;

the cyclical nature of the oil and gas industry;

uncertainties associated with the United States and worldwide economies;

uncertainties regarding political tensions in the Middle East and elsewhere;

current and potential governmental regulatory actions in the United States and regulatory actions and political unrest in other countries;

operating interruptions (including explosions, fires, weather-related incidents, mechanical failure, unscheduled downtime, labor difficulties, transportation interruptions, spills and releases and other environmental risks);

the Company's reliance on product development;

technological developments;

the Company's dependence on key employees and skilled machinists, fabricators and technical personnel;

the Company's reliance on sources of raw materials;

control by certain stockholders;

impact of environmental matters, including future environmental regulations;

competitive products and pricing pressures;

fluctuations in foreign currency;

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the Company's reliance on significant customers;

creditworthiness of the Company's customers;

fixed-price contracts;

the worldwide financial crisis;

access to capital markets; and

war and terrorist acts.

Many of such factors are beyond the Company's ability to control or predict. Any of the factors, or a combination of these factors, could materially affect the Company's future results of operations and the ultimate accuracy of the forward-looking statements. Management cautions against putting undue reliance on forward-looking statements or projecting any future results based on such statements or present or prior earnings levels. Every forward-looking statement speaks only as of the date of the particular statement, and the Company undertakes no obligation to publicly update or revise any forward-looking statement.

Item 6. Exhibits.

(a) Exhibits

The following exhibits are filed herewith:

Exhibit

| No. | Description |
|------|--|
| *3.1 | Restated Certificate of Incorporation of the Company (Incorporated herein by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (Registration No. 333-33447)). |
| *3.2 | Certificate of Designations of Series A Junior Participating Preferred Stock of the Company (Incorporated herein by reference to Exhibit 3.1 to the Company's report on Form 8-K dated November 25, 2008). |
| *3.3 | Amended and restated Bylaws of the Company (Incorporated herein by reference to Exhibit 3.1 to the Company's report on Form 8-K dated December 21, 2007). |
| *4.1 | Form of certificate representing Common Stock (Incorporated herein by reference to Exhibit 4.2 the Company's Registration Statement on Form S-1 (Registration No. 333-33447)). |
| *4.2 | Registration Rights Agreement among the Company and certain stockholders (Incorporated herein by reference to Exhibit 4.2 to the Company's Registration Statement Form S-1 (Registration No. 333-33447)). |
| *4.3 | Rights Agreement dated as of November 24, 2008 between Dril-Quip, Inc. and Mellon Investor Services LLC, as Rights Agent (Incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on November 25, 2008). |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Larry E. Reimert. |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of J. Mike Walker. |
| 31.3 | Rule 13a-14(a)/15d-14(a) Certification of Jerry M. Brooks. |
| 32.1 | Section 1350 Certification of Larry E. Reimert. |
| 32.2 | Section 1350 Certification of J. Mike Walker. |
| 32.3 | Section 1350 Certification of Jerry M. Brooks. |

* Incorporated herein by reference as indicated.

