National Oilwell Varco (NYSE - NOV)

Gary Quernemoen

www.nov.com

April 8, 2008

Introduction:

Located out of Houston Texas, National Oilwell Varco (NOV) is the fifth largest company by revenues in the ***Oil & Gas: Equipment & Services Industry***. It provides a comprehensive line of equipment for rigs and products used in oil and gas production. The company has a long tradition of pioneering innovations which improve the cost-effectiveness, efficiency, safety and environmental impact of oil and gas operations. NOV is a fairly new entity formed March 11, 2005 by the merger of Varco Int'l and Nat'l Oilwell. NOV claims over 140 years combined experience in providing the highest quality oilfield products and services. The Company conducts operations in approximately 700 locations across six continents.

New Acquisition:

NOV is currently in the process of acquiring **Grant Prideco**, a major manufacturer of drill pipe and drilling bits, for a price of $7 billion. The acquisition should be finalized in the second quarter of 2008. NOV will be taking on about $1billion of new debt in the transaction, but the combined company will still have a low debt-to-capital ratio of less than 20%. Valueline analyst Sigourney Romaine is confident the acquisition increase EPS as well as cash flow.

Business Activity:

Drilling Solutions

Engineering and Project Mgmt

Well Service & Completion

Supply Chain Solutions

Production Solutions

Downhole Tools

Tubular & Corrosion Control

Lifting & Handling Solutions

National Oilwell Varco is a worldwide leader in the design, manufacture and sale of equipment and components used in oil and gas drilling and production The company provides oilfield inspection and other services as well as supply chain integration services to the **upstream oil and gas industry**. They have more than 150 Distribution Service Centers strategically located around the globe. With a vast mix of products in inventory and innovative supply chain solutions NOV has the reputation for being a global resource gateway. NOV has 30,000 employees worldwide. In 2007, total revenue of $9,789.0 million, a 39% increase from 2006, came from its three business segments:

1. **Rig Technology (56%)** This segment designs, manufactures, sells and services complete systems for the drilling, completion, and servicing of oil and gas wells. The segment offers a line of equipment that automates complex well construction and management operations, such as offshore and onshore drilling rigs; derricks; pipe lifting, racking, rotating and assembly systems; coiled tubing equipment and pressure pumping units; well workover rigs; wireline winches; and cranes. *(well workover rig = A big winch for running casing tools or clean outs in and out of a hole that is already drilled. Used for reworking older holes. It doesn't have a power head like a drill.)* This segment operates in the United States, Canada, Norway, the United Kingdom, China, Belarus, and India.
2. **Petroleum Services & Supplies (30%)** This segment provides consumable goods and services used to drill, complete, and workover wells and service pipelines, flowlines and other oilfield tubular goods. It manufactures, rents and sells products and equipment used to perform drilling operations, such as transfer pumps, solids control systems, drilling motors and other downhole tools, rig instrumentation systems, and mud pump consumables. This segment operates in the United States, Canada, the United Kingdom, China, Kazakhstan, Mexico, Russia, Argentina, India, Bolivia, the Netherlands, Singapore, Malaysia, Vietnam, and the United Arab Emirates.
3. **Distribution Services (14%)** This segment Services provides maintenance, repair and operating supplies and spare parts to drill site and production locations worldwide. It employs advanced information technologies to provide complete procurement, inventory management and logistics services to its customers

Strategy for Gaining Market Share:

NOV has been aggressive in acquiring and consolidating the equipment market to the point that now NOV is one of only a few choices drillers have in looking for equipment parts. It now has great pricing power. Its size gives the firm a low-cost advantage over competitors and its broad portfolio of products makes it a one-stop shop for many drillers. Mr Romaine of Morningstar estimates that **NOV has 60% share** in the rig equipment market and about **90% of all rigs have some NOV equipment on board**.

Reasons To Buy:

1. NOV is at **the center of the largest boom** in the oil and natural-gas equipment market in more than 20 years.
2. If completed, the Grant Prideco (GRP) acquisition will offer an opportunity for NOV to extend its **market dominance** into drill pipe and drill bits. The continuing consolidation of the equipment market by NOV should strengthen the firm's long-term returns by placing drillers further at the company's mercy.
3. The key demand driver for NOV's products comes from **drillers needing to update and replace their old global rig fleets**. Historically, drillers have been cash-starved and have not maintained their rig fleets very well. However, because of higher oil and gas prices, drilling activity and rig day rates have soared. Drillers have plenty of cash and are under pressure to boost rig productivity. A driller can either upgrade its rigs to extend rig life or build brand-new rigs. For most drillers, both paths end up at NOV.
4, Many new deep-water rigs have been ordered, and **NOV has been earning as much as 300 million in revenue per rig** in late 2007. With rig construction costs showing minimal signs of slow-down, and the global equipment supply chain stretched, **NOV's pricing power should strengthen**.
5. **Backlog** for the company was at approximately $9.0 billion at December 31, 2007 compared to approximately $6.0 billion and $2.3 billion for December 31, 2006 and 2005, respectively. The backlog, was 89% international and 85% offshore, giving the Rig Technology division little exposure to the weaker North American land drilling markets.

Reasons For Concern:

1. **NOV has purchased more than 50 companies** over the past eight years. Further large-scale deals like Grant Prideco could pose managerial and integration headaches.
2. **NOV risks overpaying for Grant Prideco**. A surge on new fleet investments and orders for new drill pipe took place from 2004 to 2006. Land drillers are currently cutting back on purchases because of lower land drilling activity.
3. Many drillers believe upgrades on offshore rigs can add as many as 20 years of useful life. This would extend the life span of a rig from 25 to 45 years. If this is the case, new rig orders and NOV's results will suffer.
4. NOV is consistently **rated poorly for customer satisfaction**. Once a slowdown appears, customers may take their business elsewhere or actively seek out additional suppliers
5. National Oilwell Varco **shareholders will be diluted by the Grant Prideco merger** - The merger will dilute the ownership positions of the present stockholders of National Oilwell Varco. Based on the number of Grant Prideco shares outstanding as of December 17, 2007, National Oilwell Varco will issue to Grant Prideco shareholders approximately 56.3 million shares of National Oilwell Varco common stock in the merger.
6. **NOV is dependent upon the level of activity in the oil and gas industry, which is volatile.** The oil and gas industry historically has experienced significant volatility. Demand for services and products depends primarily upon the number of oil rigs in operation, the number of oil and gas wells being drilled, the depth and drilling conditions of these wells, the volume of production, the number of well completions, capital expenditures of other oilfield service companies and the level of workover activity. Drilling and workover activity can fluctuate significantly in a short period of time, particularly in the United States and Canada. The willingness of oil and gas operators to make capital expenditures to explore for and produce oil and natural gas and the willingness of oilfield service companies to invest in capital equipment will continue to be influenced by numerous factors over which the company has no control.

Competitors:

Close Competitors	TTM Sales $mil	Market Capitalization $Mil
National Oilwell Varco	7,873	18,653
Haliburton Company	15,264	31,580
Schlumberger, Ltd	23,277	96,021
Smith International, Inc.	8,764	11,976
Rowan Companies, Inc.	2,095	4,068

Financial Information:

National Oilwell Varco generated earnings of $1,337.1 million or $3.76 per share in its fiscal year ending December 31, 2007. These earnings were generated on sales/revenues of $9,789.0 million. Earnings per share increased 95 percent and revenue increased 39 percent from the Company's 2006 earnings and revenues, Backlog for capital equipment increased 50 percent throughout the year, despite steadily rising shipments out of backlog, due principally to growing numbers of new offshore drilling rig construction projects initiated during 2007.

Total Debt to Capitol is 11.8%. Free cash flow is $936 million.

Analyst Estimates:

Valueline
Future Sales Growth to 2010-12 = 20%; Future EPS to 2010-12 = 20%
Valueline looks for strong earnings growth in 2008 and out to 2010-2012, though not at the blistering pace of the last two years. These top-ranked shares have above average capital appreciation potential. Oil prices may ease from time to time, but black gold will remain essential to the world's economy. Demand for drilling equipment should grow fast as difficult new fields in deep water, requiring more sophisticated equipment are developed.

Morningstar
Offering no estimates at this time. Fair Market Value raised $22.50 to $70 due to acquisition

Yahoo
Future Growth Estimates for next 5 years(per annum) = 40.2%

NASDAQ
Future Earnings Growth for next 5 years = 15.5%

Comments from the National Oilwell Varco Q4 2007 Earnings Call Transcript

1. **EPS rose 54%** from the fourth quarter of 2006.
2. **Revenues** improved 28% year-over-year. **Operating profit** was 21.6% of sales, an increase **of 51% year-over-year.**
3. **Operating profit** was **up 84%,** operating margins for the year expanded to 20.9% All three of our operating segments produced record revenues in 2007.
4. We're pleased to once again announce a **record level of new rig orders and backlog**
5. So far our **track record** on getting these rigs out of the shipyards has been very good. Looking forward, we **expect to open another aftermarket support facility** in Singapore later this year. NOV also continues to invest in new and better ways of drilling in 2008
6. Rig technology group won $**2.2 billion in new orders** during Q4, including major packages for four deepwater floaters. Orders eclipse last quarter's record levels by nearly 13% and lifted backlog through a record $9 billion. A little over $5 billion is on schedule to flow out as revenue in 2008, and most of the rest in 2009
7. The recap, **we expect to continue to sell into three important trends** in the rig fleet worldwide. The secular build out of additional **deepwater capabilities**, the **retooling of the jack-up fleet** with newer more capable rigs, and the **replacement of tired old land rigs** both here and abroad with smart new technology.
8. **We are building most of the deepwater rigs in the world today**, and the neat thing is that we are going to be supporting those rigs for the next 20 years.

SSG Judgments:

1. I eliminated two outliers in 1999 and 2000
2. I estimated future sales growth at a low estimate of 20% and a low estimate EPS at 20%
3. The Average PE has been dropping so a high PE of 20.4 was chosen and a low PE of 7.2 was chosen
4. The current price of $60.17 is in the BUY range.

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Stock Selection Guide ®

The most widely used aid to good investment judgment

Company: National Oilwell Varco, Inco Date: 04/04/08

Prepared by: GaryQ Data taken from: StkCntrl

Where traded: NYSE Major product/service: Oil & Gas E

CAPITALIZATION --- Outstanding Amounts Reference: Hemscott

Preferred ($M)	0.0	% Insiders	% Institution
Common (M Shares)	355.4	0.2	94.6
Debt ($M) 890.7	% to Tot.Cap. 11.8	% Potential Dil.	None

1 VISUAL ANALYSIS of Sales, Earnings and Price

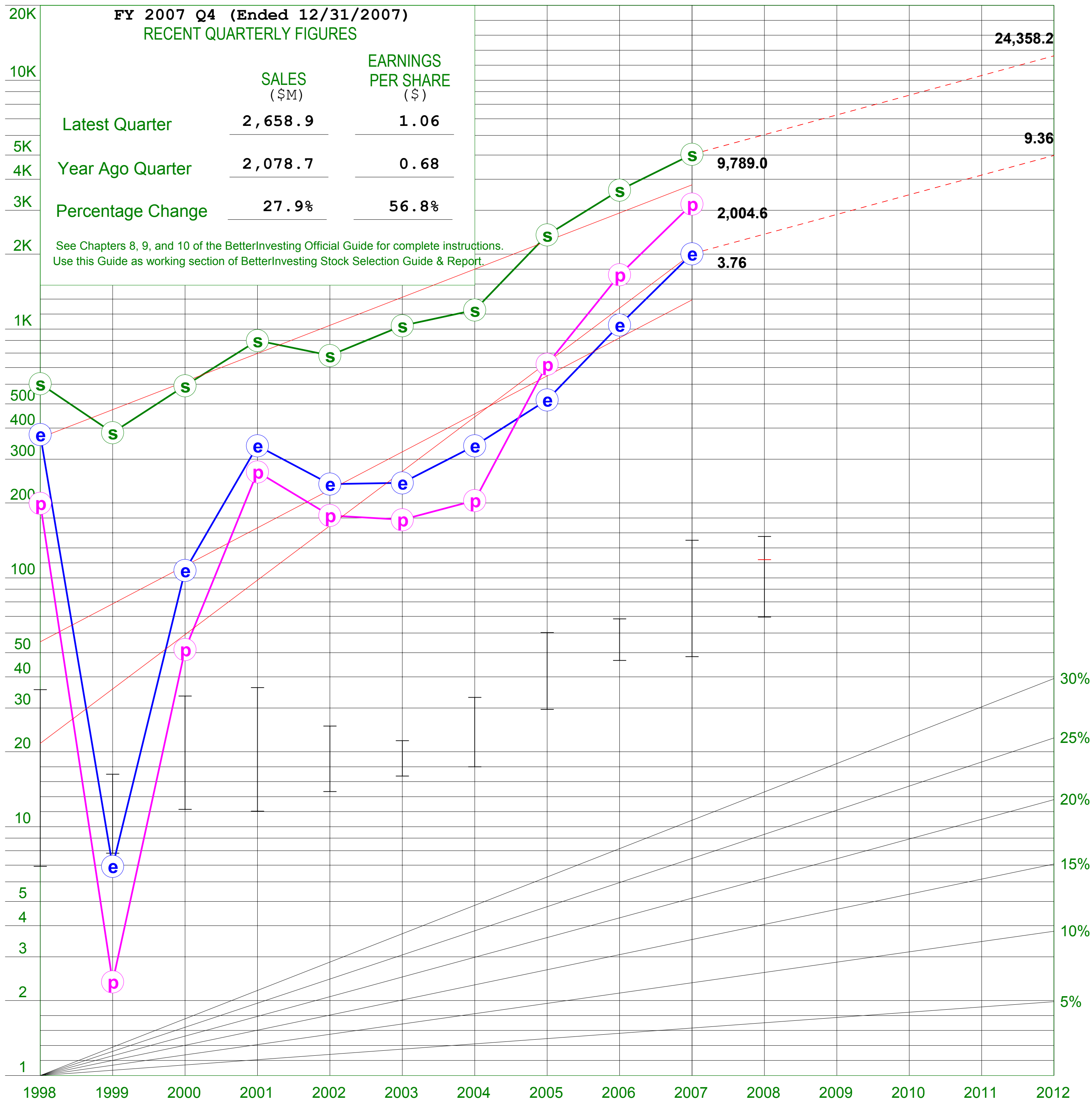
NOV

FY 2007 Q4 (Ended 12/31/2007)

RECENT QUARTERLY FIGURES

	SALES ($M)	EARNINGS PER SHARE ($)
Latest Quarter	2,658.9	1.06
Year Ago Quarter	2,078.7	0.68
Percentage Change	27.9%	56.8%

See Chapters 8, 9, and 10 of the BetterInvesting Official Guide for complete instructions.
Use this Guide as working section of BetterInvesting Stock Selection Guide & Report.



(1) Historical Sales Growth 29.7 %

(2) Estimated Future Sales Growth 20.0 %

(3) Historical Earnings Per Share Growth 42.1 %

(4) Estimated Future Earnings Per Share Growth 20.0 %

2 EVALUATING MANAGEMENT

Company National Oilwell Varco, Inco (NOV) 04/04/08

		1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	LAST 5 YEAR AVG.	TREND UP	TREND DOWN
A	% Pre-tax Profit on Sales (Net Before Taxes ÷ Sales)	10.7	0.2	2.8	9.6	7.4	5.4	5.6	9.8	14.8	20.5	11.2	UP	
B	% Earned on Equity (E/S ÷ Book Value)	20.5	0.4	4.2	11.9	7.8	7.1	8.4	8.1	13.6	20.1	11.5	UP	

3 PRICE-EARNINGS HISTORY as an indicator of the future

This shows how stock prices have fluctuated with earnings and dividends. It is a building block for translating earnings into future stock prices.

PRESENT PRICE 66.240 HIGH THIS YEAR 82.000 LOW THIS YEAR 38.905

	Year	A PRICE HIGH	B PRICE LOW	C Earnings Per Share	D Price Earnings Ratio HIGH A ÷ C	E Price Earnings Ratio LOW B ÷ C	F Dividend Per Share	G % Payout F ÷ C X 100	H % High Yield F ÷ B X 100
1	2003	12.4	8.9	0.45	27.4	19.7	0.000	0.0	0.0
2	2004	18.5	9.7	0.64	29.0	15.2	0.000	0.0	0.0
3	2005	33.7	16.6	0.97	34.6	17.0	0.000	0.0	0.0
4	2006	38.3	26.0	1.95	19.7	13.3	0.000	0.0	0.0
5	2007	79.3	27.0	3.76	21.1	7.2	0.000	0.0	0.0
6	TOTAL		88.2		131.8	72.4		0.0	
7	AVERAGE		17.6		26.4	14.5		0.0	

8 AVERAGE PRICE EARNINGS RATIO 20.4 9 CURRENT PRICE EARNINGS RATIO 17.6

Proj. P/E [14.72] Based on Next 4 qtr. EPS [4.50] Current P/E Based on Last 4 qtr. EPS [3.75]
PEG=74

4 EVALUATING RISK and REWARD over the next 5 years

Assuming one recession and one business boom every 5 years, calculations are made of how high and how low the stock might sell. The upside-downside ratio is the key to evaluating risk and reward.

A HIGH PRICE -- NEXT 5 YEARS

Avg. High P/E ~~26.4~~ 20.4 (3D7 as adj.) X Estimate High Earnings/Share 9.36 = Forecast High Price $ 190.9 (4A1)

B LOW PRICE -- NEXT 5 YEARS

(a) Avg. Low P/E ~~14.5~~ 7.2 (3E7 as adj.) X Estimated Low Earnings/Share ~~3.76~~ 3.75 = $ 27.0

(b) Avg. Low Price of Last 5 Years = 17.6 (3B7)

(c) Recent Severe Market Low Price = 26.0

(d) Price Dividend Will Support Present Divd. / High Yield (H) = 0.000 / 0.000 = 0.0

Selected Estimate Low Price = $ 27.0 (4B1)

C ZONING

190.9 (4A1) High Forecast Price Minus 27.0 (4B1) Low Forecast Price Equals 163.9 (C) Range. 1/3 of Range = 41.0 (4CD)

(4C2) Lower 1/3 = (4B1) 27.0 to 68.0 (Buy) Note: Ranges changed to 25%/50%/25%

(4C3) Middle 1/3 = 68.0 to 149.9 (Maybe)

(4C4) Upper 1/3 = 149.9 to 190.9 (4A1) (Sell)

Present Market Price of 66.240 is in the Buy (4C5) Range

D UP-SIDE DOWN-SIDE RATIO (Potential Gain vs. Risk of Loss)

High Price (4A1) 190.9 Minus Present Price 66.240 / Present Price 66.240 Minus Low Price (4B1) 27.0 = 124.7 / 39.2 = 3.2 (4D) To 1

E PRICE TARGET (Note: This shows the potential market price appreciation over the next five years in simple interest terms.)

High Price (4A1) 190.9 / Present Market Price 66.240 = (2.882) X 100 = (288.2) - 100 = 188.2 (4E) % Appreciation

Relative Value: 86.3% Proj. Relative Value: 72.2%

5 5-YEAR POTENTIAL

This combines price appreciation with dividend yield to get an estimate of total return. It provides a standard for comparing income and growth stocks.

Note: Results are expressed as a simple rate; use the table below to convert to a compound rate.

A Present Full Year's Dividend $ 0.000 / Present Price of Stock $ 66.240 = 0.000 X 100 = 0.0 (5A) Present Yield or % Returned on Purchase Price

B AVERAGE YIELD OVER NEXT 5 YEARS

Avg. Earnings Per Share Next 5 Years 6.50 X Avg. % Payout (3G7) 0.0 = 0.0 / Present Price $ 66.240 = 0.0 (5B) %

C ESTIMATED AVERAGE ANNUAL RETURN OVER NEXT FIVE YEARS

5 Year Appreciation Potential (4E) 188.2 / 5 = 37.6 %

Average Yield (5B) 0.0 %

Average Total Annual Return Over the Next 5 Years (5C) 37.6 %

	P.A.R.	Tot. Ret.
Average Yield	0.0%	0.0%
Annual Appreciation	14.3%	23.6%
% Compd Ann Rate of Ret	14.3%	23.6%

Printed: 04/10/08 06:37 PM Prepared by: GaryQ Using The Investor's Toolkit