DRIL-QUIP INC
Form 10-Q
November 06, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2009

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	**74-2162088**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

13550 HEMPSTEAD HIGHWAY

HOUSTON, TEXAS

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 x 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 definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x 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 x

As of November 2, 2009, the number of shares outstanding of the registrant s common stock, par value $.01 per share, was 39,441,723.

PART I FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

DRIL-QUIP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	December 31, 2008	September 30, 2009
	(In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 95,952	$ 139,018
Trade receivables, net	172,072	172,969
Inventories, net	222,203	259,980
Deferred income taxes	15,834	18,468
Prepaids and other current assets	8,213	6,447
Total current assets	514,274	596,882
Property, plant and equipment, net	160,810	192,520
Other assets	5,525	5,384
Total assets	$ 680,609	$ 794,786
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 31,715	$ 33,270
Current maturities of long-term debt	636	699
Accrued income taxes	7,153	1,572
Customer prepayments	51,153	49,787
Accrued compensation	9,702	17,048
Other accrued liabilities	13,380	16,709
Total current liabilities	113,739	119,085
Long-term debt	896	451
Deferred income taxes	6,524	6,730
Total liabilities	121,159	126,266
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, 39,022,597 and 39,440,723 shares issued and outstanding at December 31, 2008 and September 30, 2009, respectively	390	395
Additional paid-in capital	109,784	123,144
Retained earnings	478,146	554,607
Foreign currency translation adjustment	(28,870)	(9,626)
Total stockholders equity	559,450	668,520
Total liabilities and stockholders equity	$ 680,609	$ 794,786

The accompanying notes are an integral part of these statements.

DRIL-QUIP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

	Three months ended September 30,		Nine months ended September 30,	
	2008	2009	2008	2009
	(In thousands, except per share data)			
Revenues:				
Products	$ 108,533	$ 117,508	$ 338,415	$ 336,044
Services	23,738	20,649	68,813	62,821
Total revenues	132,271	138,157	407,228	398,865
Cost and expenses:				
Cost of sales:				
Products	59,626	66,136	195,130	191,787
Services	14,604	12,124	40,645	35,897
Total cost of sales	74,230	78,260	235,775	227,684
Selling, general and administrative	15,734	13,260	43,539	40,697
Engineering and product development	6,489	6,979	19,624	19,855
Special item		5,224		5,224
	96,453	103,723	298,938	293,460
Operating income	35,818	34,434	108,290	105,405
Interest income	497	66	3,130	410
Interest expense	(47)	(20)	(149)	(97)
Income before income taxes	36,268	34,480	111,271	105,718
Income tax provision	8,822	9,396	30,731	29,256
Net income	$ 27,446	$ 25,084	$ 80,540	$ 76,462
Earnings per common share:				
Basic	$ 0.70	$ 0.64	$ 2.00	$ 1.96
Diluted	$ 0.69	$ 0.63	$ 1.98	$ 1.94
Weighted average common shares outstanding:				
Basic	39,432	39,113	40,219	39,054
Diluted	39,832	39,565	40,625	39,440

The accompanying notes are an integral part of these statements.

DRIL-QUIP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Nine months ended September 30, 2008	Nine months ended September 30, 2009
	(In thousands)	
Operating activities		
Net income	$ 80,540	$ 76,462
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	12,656	13,345
Stock-based compensation expense	2,267	2,916
Gain on sale of equipment	(90)	(121)
Deferred income taxes	(934)	(2,297)
Special item non-cash		1,272
Changes in operating assets and liabilities:		
Trade receivables, net	(10,171)	8,494
Inventories, net	(44,772)	(28,638)
Prepaids and other assets	1,721	2,569
Excess tax benefit of stock option exercises	(399)	(4,965)
Trade accounts payable and accrued expenses	4,276	7,121
Net cash provided by operating activities	45,094	76,158
Investing activities		
Purchase of property, plant and equipment	(39,365)	(38,113)
Proceeds from sale of equipment	566	225
Net cash used in investing activities	(38,799)	(37,888)
Financing activities		
Repurchase of common stock	(100,038)	
Principal payments on long-term debt	(646)	(506)
Proceeds from exercise of stock options	376	3,866
Excess tax benefit of stock option exercises	399	4,965
Net cash provided by (used in) financing activities	(99,909)	8,325
Effect of exchange rate changes on cash activities	1,202	(3,529)
Increase (decrease) in cash and cash equivalents	(92,412)	43,066
Cash and cash equivalents at beginning of period	201,732	95,952
Cash and cash equivalents at end of period	$ 109,320	$ 139,018

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 the Company s 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, 2008, 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 September 30, 2009, the results of operations for each of the three and nine-month periods ended September 30, 2009 and 2008, and the cash flows for each of the nine-month periods ended September 30, 2009 and 2008. 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 nine-month period ended September 30, 2009 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, 2008.

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, 2008.

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 using the first-in, first-out (FIFO) costing method and are stated at the lower of cost or market. Inventory is valued principally using standard costs, which are calculated based upon direct costs incurred and overhead allocations. 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 balances have been reduced by a reserve for excess and obsolete inventories. Inventory reserves of $20.8 million and $23.9 million were recorded at December 31, 2008 and September 30, 2009, 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.

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, 2008 and September 30, 2009, receivables included $44.8 million and $35.4 million of unbilled receivables, respectively. During the quarter ended September 30, 2009, there were 16 projects which represented approximately 9% of the Company s total revenue and approximately 11% of its product revenues which were accounted for using percentage-of-completion accounting. For the nine months ended September 30, 2009, there were 16 projects which represented 15% of the Company s total revenues and 18% of its product revenues, all of which were accounted for using percentage-of-completion accounting.

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 related 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 which 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.

The following table provides comprehensive income for the periods indicated:

	Three months ended September 30,		**Nine months ended September 30,**	
	2008	**2009**	**2008**	**2009**
	(In thousands)			
Net income	$ 27,446	$ 25,084	$ 80,540	$ 76,462
Foreign currency translation adjustment	(18,996)	(975)	(16,460)	19,245
Comprehensive income	$ 8,450	$ 24,109	$ 64,080	$ 95,707

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 September 30 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 September 30,		Nine months ended September 30,	
	2008	2009	2008	2009
	(In thousands)			
Number of common shares outstanding at end of period basic	39,023	39,440	39,023	39,440
Effect of using weighted average common shares outstanding	409	(327)	1,196	(386)
Weighted average basic common shares outstanding basic	39,432	39,113	40,219	39,054
Dilutive effect of common stock options	400	452	406	386
Weighted average diluted common shares outstanding diluted	39,832	39,565	40,625	39,440

New Accounting Standards

In September 2009, the Company adopted ASC Topic 105. This standard establishes the FASB Accounting Standards Codification (Codification) as the single source of the authoritative U. S. generally accepted accounting principles (U.S. GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of the authoritative U.S. GAAP for SEC registrants. The Codification supersedes all existing non-SEC accounting and reporting standards. Following the Codification, the FASB will not issue new standards in the form of statements, FASB staff positions or Emerging Issues Task Force. Instead, it will issue Accounting Standards Updates which serves to update the Codification, provide background information about the guidance and provide the basis for conclusions on changes to the Codification.

In May 2009, the Company adopted ASC Topic 855 regarding subsequent events. This standard establishes general standards of accounting for and disclosure of events or transactions that occur after the balance sheet date but before financial statements are issued or are available to be issued. This standard sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosure that an entity should make about events or transactions that occurred after the balance sheet date. The standard requires entities to disclose the date through which subsequent events have been evaluated as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. See Note 8 to the 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 January 2009, the Company adopted ASC Topic 805 regarding business combinations. The standard establishes principles and requirements for the recognition and measurement of assets, liabilities and goodwill including the requirement that most transaction costs and restructuring costs be expensed. In addition, the standard requires disclosures to enable users to evaluate the nature and financial effects of the business combination that occurs either during the reporting period or after the reporting period but before the financial statements are issued or are available to be issued. The adoption of this standard had no material effect on the Company s condensed consolidated financial statements.

In January 2009, the Company adopted ASC Topic 810 regarding noncontrolling interest in consolidated financial statements. The standard established accounting and reporting standards for noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The adoption of this standard had no material effect on the Company s condensed consolidated financial statements.

In January 2008, the Company adopted ASC Topic 820-10. In February 2008, ASC 820-10-55 was issued. The standard provides a one year deferral of the effective date of ASC 820-10 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. ASC 820-10 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. ASC 820-10 applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. The Company does not have any assets or liabilities that would be recognized or disclosed on a fair value basis as of December 31, 2008 or September 30, 2009.

3. Stock-Based Compensation and Stock Option Awards

During the three and nine months ended September 30, 2009, the Company recognized $1.0 million and $2.9 million, respectively, of compensation expense compared to $770,000 and $2.3 million, respectively, for the three and nine months ended September 30, 2008. Stock compensation expense for the quarter ended September 30, 2009 excludes $1.3 million for the accelerated vesting of options due to the costs associated with the death of one of the Company s Co-Chief Executive Officers. The additional expense has been included in the line entitled special item in the Condensed Consolidated Statements of Income. 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 and nine months ended September 30, 2009 or 2008. During the three and nine months ended September 30, 2009 and 2008, there were no stock options granted. On October 28, 2009, the Nominating, Governance and Compensation Committee of the board of directors of the Company granted options to purchase an aggregate of 241,470 shares of Common Stock pursuant to the 2004 Plan, as amended, to certain officers and employees of the Company. Refer to Note 12 of the Company s 2008 Form 10-K for additional information regarding stock-based compensation plans.

4. Inventories

Inventories consist of the following:

	December 31, 2008	September 30, 2009
	(In thousands)	
Raw materials and supplies	$ 55,470	$ 56,581
Work in progress	71,926	70,848
Finished goods	115,636	156,439
	243,032	283,868
Less: allowance for obsolete and excess inventory	(20,829)	(23,888)
Total	$ 222,203	$ 259,980

5. Geographic Areas

	Three months ended September 30, 2008	Three months ended September 30, 2009	Nine months ended September 30, 2008	Nine months ended September 30, 2009
	(In thousands)			
Revenues:				
Western Hemisphere				
Products	$ 55,651	$ 55,754	$ 175,858	$ 166,025
Services	11,539	10,153	32,698	28,876
Intercompany	10,938	17,079	40,388	46,770
Total	$ 78,128	$ 82,986	$ 248,944	$ 241,671
Eastern Hemisphere				
Products	$ 31,439	$ 41,734	$ 109,342	$ 114,498
Services	10,287	7,916	27,788	26,459
Intercompany	395	36	1,382	1,356
Total	$ 42,121	$ 49,686	$ 138,512	$ 142,313
Asia Pacific				
Products	$ 21,443	$ 20,020	$ 53,215	$ 55,521
Services	1,912	2,580	8,327	7,486
Intercompany	4,545	1,053	5,921	2,170
Total	$ 27,900	$ 23,653	$ 67,463	$ 65,177
Summary				
Products	$ 108,533	$ 117,508	$ 338,415	$ 336,044
Services	23,738	20,649	68,813	62,821
Intercompany	15,878	18,168	47,691	50,296
Eliminations	(15,878)	(18,168)	(47,691)	(50,296)
Total	$ 132,271	$ 138,157	$ 407,228	$ 398,865
Income (loss) before income taxes:				
Western Hemisphere	$ 12,394	$ 11,154	$ 55,578	$ 48,057
Eastern Hemisphere	9,596	11,473	27,467	34,355
Asia Pacific	12,156	10,876	24,512	23,600
Eliminations	2,122	977	3,714	(294)
Total	$ 36,268	$ 34,480	$ 111,271	$ 105,718

	December 31, 2008	September 30, 2009
	(In thousands)	
Total Long-Lived Assets:		
Western Hemisphere	$ 147,460	$ 173,482
Eastern Hemisphere	22,892	28,295
Asia Pacific	16,402	16,546
Eliminations	(20,419)	(20,419)
Total	$ 166,335	$ 197,904

	December 31, 2008	September 30, 2009
	(In thousands)	
Total Assets:		
Western Hemisphere	$ 465,797	$ 522,486
Eastern Hemisphere	125,497	172,788
Asia Pacific	120,943	136,333
Eliminations	(31,628)	(36,821)
Total	$ 680,609	$ 794,786

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. Since MPF is not required to make a decision on the handling of the contract immediately, 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. 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.

In August 2007, the Company s Brazilian subsidiary was served with assessments collectively valued at approximately BRL23.3 million (approximately U.S. $13.5 million as of November 5, 2009) from the State of Rio de Janeiro, Brazil, to collect a state tax on the importation of goods. The Company believes that its subsidiary is not liable for the taxes and are vigorously contesting the assessments in the Brazilian administrative and judicial systems. At this time, the ultimate disposition of this matter cannot be determined and therefore, it is not possible to reasonably estimate the amount of loss or the range of possible losses that might result from an adverse judgment or settlement of these assessments. Accordingly, no liability has been accrued in conjunction with this matter. The Company does not expect the liability, if any, resulting from these assessments to have a material adverse effect on its operations, financial position or cash flows. At present, the amount of the tax assessments with principal, penalty, interest and monetary restatement is approximately BRL33.4 million (approximately U.S. $19.4 million as of November 5, 2009).

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 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 to thereto will not have a material adverse effect on the Company s operations, financial position or cash flows.

7. Special Item
In September 2009, Gary D. Smith, one of the Company s Co-Chief Executive Officers, unexpectedly passed away. Under the terms of Mr. Smith s employment contract, the Company was obligated to pay Mr. Smith s base salary, including accrued vacation, and his annual bonus through the remaining employment period (October 27, 2012). In addition, stock options owned by Mr. Smith that were outstanding at the date of his death were immediately vested under the terms of the contract. Accordingly, the Company recognized a pre-tax expense of $5,224,000 during the third quarter of 2009. The contractual obligation, including related payroll taxes, totaled $4,386,000, of which $434,000 had been previously accrued. The acceleration of the vesting increased non-cash expenses by $1,272,000.

8. Subsequent Events
In October 2009, Dril-Quip Asia Pacific Pte Ltd., a wholly owned subsidiary of Dril-Quip, Inc., entered into an agreement with Lum Chang Building Contractors Pte Ltd. for the construction of a new manufacturing facility in Singapore on approximately 11.2 acres of land leased to Dril-Quip Asia Pacific Pte Ltd. through 2037. The agreement, which is effective as of October 16, 2009, is valued at approximately SGD46.5 million (approximately U.S. $33.5 million).

The Company has evaluated subsequent events through November 5, 2009, the date of the issuance of these condensed consolidated financial statements.

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 included 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, 2008.

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 the Company s 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 for the periods covered by this report:

	Three months ended September 30,		Nine months ended September 30,	
	2008	2009	2008	2009
Crude Oil ($/Bbl)	$ 118.25	$ 68.14	$ 113.54	$ 57.59
Natural gas ($/Mcf)	9.29	3.26	9.98	3.93

During the third quarter of 2008, West Texas Intermediate crude oil prices ranged between $91.15 per barrel and $145.66 per barrel with an average quarterly price of $118.2