

DRIL-QUIP INC  
Form 10-K  
February 27, 2019

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-K

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(MARK ONE)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2018

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 001-13439

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DRIL-QUIP, INC.  
(Exact name of registrant as specified in its charter)

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Delaware	74-2162088
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

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6401 N. Eldridge Parkway	77041
Houston, Texas	

(Address of principal executive offices) (Zip code)  
Registrant's telephone number, including area code: (713) 939-7711

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Securities registered pursuant to Section 12(b) of the Act:  
Title of Each Class Name of Each Exchange On Which Registered  
Common Stock, \$.01 par value per share New York Stock Exchange  
Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of 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 such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements

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incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer

Non-Accelerated filer  Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

At June 29, 2018, the aggregate market value of the registrant's Common Stock held by non-affiliates of the registrant was approximately \$1,909,500,000 based on the closing price of such stock on such date of \$51.40.

At February 25, 2019, the number of shares outstanding of registrant's Common Stock was 36,387,703.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Proxy Statement for its 2019 Annual Meeting of Stockholders to be filed pursuant to Regulation 14A are incorporated by reference in Part III of this Form 10-K.

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**FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K 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 assurance 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 need for and the availability of expected sources of liquidity;
- the introduction into the market of the Company’s future products;
- the Company’s ability to deliver its backlog in a timely fashion;
- 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;
- 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;
- changes in customers’ future product and service requirements that may not be cost effective or within the Company’s capabilities; and
- future operations, financial results, business plans and cash needs.

These statements are based on assumptions and analysis 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 this report 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, South America, Africa and elsewhere;
- current and potential governmental regulatory actions in the United States and regulatory actions and political unrest in other countries;
- uncertainties regarding future oil and gas exploration and production activities, including new regulations, customs requirements and product testing requirements;
- operating interruptions (including explosions, fires, weather-related incidents, mechanical failure, unscheduled downtime, labor difficulties, transportation interruptions, spills and releases and other environmental risks);
- project terminations, suspensions or scope adjustments to contracts reflected in the Company’s backlog;
- the Company’s reliance on product development;
- technological developments;



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the Company's reliance on third-party technologies;  
acquisition and merger activities involving the Company or its competitors;  
the Company's dependence on key employees and technical personnel;  
increases in price or decreases in availability of raw materials;  
impact of environmental matters, including future environmental regulations;  
competitive products and pricing pressures;  
fluctuations in foreign currency, including those attributable to the Brexit;  
the ability of the Organization of Petroleum Exporting Countries (OPEC) to set and maintain production levels and pricing;  
the Company's reliance on significant customers;  
creditworthiness of the Company's customers;  
fixed-price contracts;  
changes in general economic, market or business conditions;  
access to capital markets;  
negative outcome of litigation, threatened litigation or government proceedings;  
terrorist threats or acts, war and civil disturbances; and  
changes to, and differing interpretations of, tax laws with respect to our operations and subsidiaries.

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.

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PART I

Item 1. Business

General

Dril-Quip, Inc., a Delaware corporation (the “Company” or “Dril-Quip”), designs, manufactures, sells and services highly engineered drilling and production equipment that is well suited primarily for use in deepwater, harsh environment and severe service applications. Dril-Quip’s products are used by major integrated, large independent and foreign national oil and gas companies and drilling contractors 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, diverters and safety valves. 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.

Dril-Quip has developed its broad line of subsea equipment, surface equipment and offshore rig equipment primarily through its internal product research and development efforts. The Company believes that it has achieved significant market share and brand name recognition with respect to its established products due to the technological capabilities, reliability, cost effectiveness and operational timesaving features of these 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 regional headquarter locations as well as in Macae, Brazil. The Company maintains additional facilities for fabrication and/or reconditioning and rework in Australia, Norway, Denmark, Nigeria, Indonesia, China, Ecuador, Egypt, Ghana, Hungary, Mexico, Qatar and Venezuela. The Company’s major operating subsidiaries are Dril-Quip (Europe) Limited, located in Aberdeen with branches in Denmark, Norway and Holland; Dril-Quip Asia Pacific PTE Ltd., located in Singapore; and Dril-Quip do Brasil LTDA, located in Macae, Brazil. Other operating subsidiaries include TIW Corporation (TIW) and Honing, Inc., both located in Houston, Texas; DQ Holdings Pty. Ltd., located in Perth, Australia; Dril-Quip Cross Ghana Ltd., located in Takoradi, Ghana; PT DQ Oilfield Services Indonesia, located in Jakarta, Indonesia; Dril-Quip (Nigeria) Ltd., located in Port Harcourt, Nigeria; Dril-Quip Egypt for Petroleum Services S.A.E., located in Alexandria, Egypt; Dril-Quip Oilfield Services (Tianjin) Co. Ltd., located in Tianjin, China with branches in Shenzhen and Beijing, China; Dril-Quip Qatar LLC, located in Doha, Qatar; Dril-Quip TIW Mexico S.A. de C.V., located in Villahermosa, Mexico; TIW de Venezuela S.A., located in Anaco, Venezuela and with a registered branch located in Shushufindi, Ecuador; TIW (UK) Limited, located in Aberdeen, Scotland; TIW Hungary LLC, located in Szolnok, Hungary; and TIW International LLC, with a registered branch located in Singapore.

Dril-Quip markets its products through its offices and sales representatives located in the major international energy markets throughout the world. In 2018, the Company generated approximately 61% of its revenues from foreign sales compared to 55% and 66% in 2017 and 2016, respectively.

The Company makes available, free of charge on its website, its Annual Report on Form 10-K and quarterly reports on Form 10-Q (in both HTML and XBRL formats), current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practical after it electronically files such reports with, or furnishes them to, the Securities and Exchange Commission (SEC). The Company’s website address is [www.dril-quip.com](http://www.dril-quip.com). Documents and information on the Company’s website, or on any other website, are not incorporated by reference into this Form 10-K. The SEC maintains a website ([www.sec.gov](http://www.sec.gov)) that contains reports the Company has filed with the SEC.

The Company also makes available free of charge on its website ([www.dril-quip.com/govern.html](http://www.dril-quip.com/govern.html)) its:

• Corporate Governance Guidelines,

• Code of Business Conduct and Ethical Practices,

Audit Committee Charter,  
Nominating and Governance Committee Charter, and  
Compensation Committee Charter.

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Any stockholder, who so requests, may obtain a printed copy of any of these documents from the Company. Changes in or waivers to the Company's Code of Business Conduct and Ethical Practices involving directors and executive officers of the Company will be posted on its website.

**Overview and Industry Outlook**

Both the market for 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. The level of capital expenditures has generally been dependent upon the prevailing view of future oil and gas prices, which are influenced by numerous factors affecting the supply and demand for oil and gas, including worldwide economic activity, interest rates and the cost of capital, environmental regulation, tax policies and the ability and/or desire of OPEC and other producing nations to set and maintain production levels and prices. The Brent crude oil price reached a high of \$115.19 per barrel in June 2014 and then began to drop sharply during 2015, and continued to drop in 2016, reaching a low of \$26.01 per barrel in the first quarter of 2016, before rebounding to end the year at \$54.96 per barrel. Oil prices began a slow recovery in 2017, with an average price of \$54.15 compared to an average price of \$43.67 in 2016. During 2018, crude oil prices fluctuated significantly, with a high of \$86.07 per barrel and ending the year at a low of \$50.57 per barrel. According to the December 2018 release of the Short-Term Energy Outlook published by the Energy Information Administration (EIA) of the U.S. Department of Energy, Brent Crude oil prices averaged approximately \$71.34 per barrel in 2018 and the price is forecasted to average \$61.00 per barrel in 2019 and \$65.00 per barrel in 2020.

On November 30, 2016, OPEC met and decided to cut production by approximately 1.2 million barrels per day. The reduced production helped to increase the average price per barrel between 2016 and 2017. Capital expenditures are also dependent on the cost of exploring for and producing oil and gas, the availability, expiration date and price of leases, the discovery rate of new oil and gas reserves, technological advances and alternative opportunities to invest in onshore exploration and production operations. Oil and gas prices and the level of drilling and production activity have historically been characterized by significant volatility. Future declines in oil and gas prices may further adversely affect the willingness of some oil and gas companies to make capital expenditures on exploration, drilling and production operations, which could have an adverse impact on the Company's results of operations, financial position and cash flows. In its December 2018 Short-Term Energy Outlook, the EIA projected United States crude oil production averaged an estimated 10.9 million barrels per day in 2018, with an average of 11.5 million barrels per day in the month of November, and is forecasted to average 12.1 million barrels per day in 2019.

Brent crude oil prices per barrel for the three-year period ended December 31, 2018 are summarized below:

	Brent Crude Oil Prices		
	2018	2017	2016
High	\$86.07	\$66.80	\$54.96
Low	50.57	43.98	26.01
Average	71.34	54.15	43.67
Closing, December 31,	\$50.57	\$66.73	\$54.96

The volatility in Brent crude oil prices over the past three years continues to have a significant effect on major integrated, large independent and foreign national oil and gas companies' capital expenditure budgets. The Company expects continued pressure in both crude oil and natural gas prices, as well as in the level of drilling and production related activities, particularly as they relate to offshore activities. Even during periods of high prices for oil and natural gas, companies exploring for oil and gas may cancel or curtail programs, seek to renegotiate contract terms, including the price of products and services, or reduce their levels of capital expenditures for exploration and production for a variety of reasons. Lower drilling and production activity had a negative impact on the Company's results for the year ended December 31, 2018 and is expected to improve slightly in 2019. A prolonged delay in the recovery of commodity prices could also lead to further material impairment charges to tangible or intangible assets or otherwise result in a material adverse effect on the Company's results of operations. See "Item 1A. Risk Factors—A material or

extended decline in expenditures by the oil and gas industry could significantly reduce our revenue and income.”

**Recent Developments**

As a result of continued unfavorable offshore market conditions and low commodity prices, the Company engaged in a strategic review with a third-party firm in 2018. In conjunction with the strategic review, the Company adjusted its forecast for recovery to reflect a more delayed recovery in the offshore industry, with pre-downturn demand not returning until after 2025.

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Additionally, the Company pursued a global transformation, which includes a reduction in workforce, realignment of facilities and restructuring of operations. We expect this transformation to allow us to maintain our global footprint in key markets, while supporting an integrated supply chain model that we expect to create more flexibility and allow us to continue serving our customers. The Company expects to complete the strategic restructuring by the end of 2019.

### Products and Services

Dril-Quip's revenues are generated from two sources: products and services. Product revenues are derived from the sale of drilling and production equipment. Service revenues are earned when the Company provides technical advisory assistance and rental tools during installation and retrieval of the Company's products. Additionally, the Company earns service revenues when rework and reconditioning services are provided. In 2018, the Company derived 69% of its revenues from the sale of its products, 19% of its revenues from services and 12% of its revenues from leasing rental tools, compared to 77%, 14% and 9% for products, services and leasing rental tools in 2017, respectively, and 80%, 12% and 8% for products, services and leasing rental tools in 2016, respectively. Service and leasing revenues generally correlate to revenues from product sales because increased product sales typically generate increased demand for technical advisory assistance services during installation and rental of running tools. However, existing customer equipment can be used in certain circumstances, which creates demand for services with no correlating product sales. The Company has substantial international operations, with approximately 61% of its revenues derived from foreign sales in 2018, 55% in 2017 and 66% in 2016. Substantially all of the Company's domestic revenue relates to operations in the U. S. Gulf of Mexico. Domestic revenue approximated 39% of the Company's total revenues in 2018, 45% in 2017 and 34% in 2016.

Product contracts are typically negotiated and sold separately from service contracts. In addition, service contracts are not typically 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 worldwide economic conditions in the 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 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.

Generally, the Company attempts to raise its prices as its costs increase. However, the actual pricing of the Company's products and services is impacted by a number of factors, including global oil prices, competitive pricing pressure, the level of utilized capacity in the oil service sector, maintenance of market share, the introduction of new products and general market conditions.

### Products

Dril-Quip designs, manufactures, fabricates, inspects, assembles, tests and markets subsea equipment, surface equipment and offshore rig equipment. The Company's products are used primarily to explore for oil and gas from offshore drilling rigs, such as floating rigs and jack-up rigs, and for drilling and production of oil and gas wells on offshore platforms, tension leg platforms (TLPs), Spars and moored vessels such as FPSOs. TLPs are floating production platforms that are connected to the ocean floor via vertical mooring tethers. A Spar is a floating cylindrical structure approximately six or seven times longer than its diameter and is anchored in place. FPSOs are floating production, storage and offloading monohull moored vessels. The TIW products are used in the drilling and production for oil and gas both onshore and offshore.

**Subsea Equipment.** Subsea equipment is used in the drilling and production of offshore oil and gas wells around the world. Included in the subsea equipment product line are subsea wellheads, mudline hanger systems, specialty connectors and associated pipe, production riser systems, subsea production trees, liner hangers, safety valves, subsea control systems and subsea manifolds.

Subsea wellheads are pressure-containing vessels that are sometimes referred to as a "wellhead housing" and are made from forged and machined steel. A casing hanger, also made of steel, lands inside the wellhead housing and suspends casing (pipe) downhole. As drilling depth increases, successively smaller diameter casing strings are installed, each suspended by an independent casing hanger. Subsea wellheads are utilized when drilling from floating drilling rigs, either semi-submersible or drillship types, or TLPs and Spars. The Company's flagship subsea wellhead, called the

SS-15® Subsea Wellhead System, is rated for 15,000 psi internal pressure and is offered to the industry in a variety of configurations. The Company's newest wellhead product, the SS-20™ BigBore™ II-e Subsea Wellhead System, is designed to contain higher pressures (20,000 pounds per square inch (psi)) and provides the ability to reduce the number of casing strings in the well design by increasing load carrying and pressure capacities of casing hangers and associated installation tools.

Mudline hanger systems are used in jack-up drilling operations to support the weight of the various casing strings at the ocean floor while drilling a well. They also provide a method to disconnect the casing strings in an orderly manner at the ocean floor after the well has been drilled, and subsequently reconnect to enable production of the well by either tying it back vertically to a subsequently installed platform or by installing a shallow water subsea tree.

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Large diameter weld-on specialty connectors (threaded or stab type) are used primarily in offshore wells drilled from floating drilling rigs, jack-up rigs, fixed platforms, TLPs and Spars. Specialty connectors join lengths of conductor or large diameter (16-inch or greater) casing. Specialty connectors provide a more rapid connection than other methods of connecting lengths of pipe. Connectors may be sold individually or as an assembly after being welded to sections of Company or customer supplied pipe. Dril-Quip's weld-on specialty connectors are designed to prevent cross threading and provide a quick, convenient method of joining casing joints with structural integrity compatible with casing strength.

Production riser systems are generally designed and manufactured to customer specifications. Production risers provide a vertical conduit from the subsea wellhead up to a TLP, Spar or FPSO floating at the surface.

A subsea production tree is an assembly composed of valves, a wellhead connector, control equipment and various other components installed on a subsea wellhead or a mudline hanger system and used to control the flow of oil and gas from a producing well. Subsea trees may be used as stand alone satellite wells or multiple well template mounted and cluster arrangements. These types typically produce via a subsea gathering system of manifolds and flowlines to a central control point located on a platform, TLP, Spar or FPSO. The use of subsea production trees has become an increasingly important method for producing wells located in hard-to-reach deepwater areas or economically marginal fields located in shallower waters. The Company is an established manufacturer of complicated dual-bore production trees. In addition, Dril-Quip manufactures a patented single bore (SingleBore™) subsea completion system which features a hydraulic valve mechanism instead of a wireline-installed mechanism that allows the operator to plug the tubing hanger annulus remotely from the surface via a hydraulic control line and subsequently unplug it when the well is put on production. This mechanism eliminates the need for an expensive multibore installation and workover riser, thereby saving both cost and installation time. The patented horizontal bore (HorizontalBore™) subsea production component accommodates numerous completion configuration possibilities and features large vertical access drill-through for passage of drill-bits, submersible pumps, coil tubing strings and Dril-Quip's slimline casing hanger system. Dril-Quip's subsea production trees are used in ultra-deepwater applications. These trees feature remote flowline and control connections, utilizing remotely operated intervention tools. The Company's subsea production trees are generally custom designed and manufactured to customer specifications.

A subsea control system provides control of subsea trees, manifolds, ocean floor process equipment and pipeline protection equipment. Dril-Quip has developed a variety of subsea control systems, including fiber optic based multiplex control systems that provide real time access to tree functions and tree equipment status. The control system can be packaged for shallow water or deepwater applications. Dril-Quip also manufactures control systems used in the installation, retrieval and workover of production equipment.

A subsea manifold is a structure located on the ocean floor consisting of valves, flowline connections and a control module used to collect and control the flow of oil and gas from subsea wells for delivery to a floating production unit or terminal.

Downhole Tools. Downhole tools are primarily comprised of liner hangers, production packers, safety valves and specialty downhole tools. A liner hanger is used to hang-off and seal casing into a previously installed casing string in the well bore, and can provide a means of tying back the liner for production to surface. Dril-Quip has developed a state-of-the-art liner hanger system and has installed its liner hangers in a number of difficult well applications, resulting in improved industry recognition and market opportunities. In addition to liner hanger systems that are well suited for onshore use, TIW offers expandable liner hanger systems that are typically utilized in challenging environments such as deepwater or High Pressure, High Temperature (HPHT) applications.

A safety valve is used to provide a quick, sure shutoff in the drill string at the drill floor and prevent flow up the drill pipe. The TIW Kelly Valve is located in the drill string below the kelly, the uppermost component of the drill string, and is designed to be closed under pressure to remove the kelly.

Surface Equipment. Surface equipment is principally used for flow control on offshore production platforms, TLPs and Spars. Included in the Company's surface equipment product line are platform wellheads, platform production trees and riser tensioners. Dril-Quip's development of platform wellheads and platform production trees was facilitated by adaptation of its existing subsea wellhead and tree technology to surface wellheads and trees.

Platform wellheads are pressure-containing forged and machined metal housings in which casing hangers are landed and sealed at the platform deck to suspend casings. The Company emphasizes the use of metal-to-metal sealing wellhead systems with operational time-saving features which can be used in high pressure, high temperature and corrosive drilling and production applications.

After installation of a wellhead, a platform production tree, consisting of gate valves, a surface wellhead connector, controls, tree cap and associated equipment, is installed on the wellhead to control and regulate oil or gas production. Platform production trees are similar to subsea production trees but utilize less complex equipment and more manual, rather than

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hydraulically actuated, valves and connectors. Platform wellheads and platform production trees and associated equipment are designed and manufactured in accordance with customer specifications.

Riser tensioners are used on a floating drilling/production vessel to provide a continuous and reliable upward force on a riser string that is independent of the movement of the floating vessel.

Offshore Rig Equipment. Offshore rig equipment includes drilling riser systems, wellhead connectors and diverters. The drilling riser system consists of (i) lengths of riser pipe and associated riser connectors that secure one to another; (ii) the telescopic joint, which connects the entire drilling riser system to the diverter at top of the riser at the rig and provides a means to compensate for vertical motion of the rig relative to the ocean floor; and (iii) the wellhead connector, which provides a means for remote connection and disconnection of the blowout preventer stack to or from the wellhead. Diverters are used to provide protection from shallow gas blowouts and to divert gases off of the rig during the drilling operation.

Wellhead connectors are used on production riser systems and drilling riser systems. They are also used on both TLPs and Spars, which are installed in deepwater applications. The principal markets for offshore rig equipment are new rigs, rig upgrades, TLPs and Spars. Drilling risers, wellhead connectors and diverters are generally designed and manufactured to customer specifications.

Certain of the Company's products are used in potentially hazardous drilling, completion and production applications that can cause personal injury, product liability and environmental claims. See "Item 1A. Risk Factors—Our business involves numerous operating hazards that may not be covered by insurance. The occurrence of an event not fully covered by insurance could have a material adverse effect on our results of operations, financial position and cash flows."

### Services

The Company provides services to customers, including technical advisory assistance as well as rework and reconditioning services on its customer-owned products. These services are provided from the Company's worldwide locations and represented approximately 19% of revenues in 2018 compared to 14% in 2017 and 12% in 2016.

Technical Advisory Assistance. Dril-Quip generally does not install products for its customers, but it does provide technical advisory assistance to the customer, if requested, in the installation of its products. The customer is not obligated to utilize these services and may use its own personnel or a third party to perform these services. Technical advisory assistance services performed by the Company are negotiated and sold separately from the Company's products. These services are not a prerequisite to the sale of the Company's products as its products are fully functional on a stand alone basis. The Company's technicians provide assistance in the onsite installation of the Company's products and are available on a 24-hour call out from the Company's facilities located in Houston, Texas; Midland, Texas; Oklahoma City, Oklahoma; Youngsville, Louisiana; Villahermosa, Mexico; Anaco, Venezuela; Shushufindi, Ecuador; Macae, Brazil; Aberdeen, Scotland; Szolnok, Hungary; Stavanger, Norway; Esbjerg, Denmark; Port Harcourt, Nigeria; Alexandria, Egypt; Takoradi, Ghana; Tianjin, China; Doha, Qatar; Singapore; and Perth, Australia. Reconditioning. The Company provides reconditioning of its customer-owned products at its facilities in Houston, Texas; Macae, Brazil; Aberdeen, Scotland; Stavanger, Norway; Esbjerg, Denmark; Port Harcourt, Nigeria; Alexandria, Egypt; Takoradi, Ghana; Balikpapan, Indonesia; Tianjin, China; Doha, Qatar; Singapore; and Perth, Australia. The Company does not typically service, repair or recondition its competitors' products.

### Leasing

The Company rents running and installation tools for use in installing its products. These tools are required to install and retrieve the Company's products that are purchased by customers. Rental or purchase of running tools is not a condition of the sale of the Company's products and is contracted for separately from product sales and other services offered by the Company. Running tools are available from Dril-Quip's locations in Houston, Texas; Midland, Texas; Oklahoma City, Oklahoma; Youngsville, Louisiana; Villahermosa, Mexico; Anaco, Venezuela; Shushufindi, Ecuador; Macae, Brazil; Aberdeen, Scotland; Szolnok, Hungary; Stavanger, Norway; Esbjerg, Denmark; Beverwijk, Holland; Singapore; and Perth, Australia. These rentals are provided from the Company's worldwide locations and represented approximately 12% of revenues in 2018 compared to 9% in 2017 and 8% in 2016.





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### Manufacturing

Dril-Quip has major manufacturing facilities in Houston, Texas; Aberdeen, Scotland; Singapore; and Macae, Brazil. See “Item 2. Properties—Manufacturing Facilities.” Dril-Quip maintains its high standards of product quality through the implementation of Advanced Product Quality Planning (APQP) methodologies, as well as through the use of quality control specialists.

The Company’s Houston, Aberdeen, Singapore and Macae manufacturing plants are ISO 14001, OHSAS 18001 and ISO 9001 certified. The Houston, Aberdeen, Singapore and Macae plants are also licensed to applicable American Petroleum Institute (API) product specifications and are API Q1, 9th edition and APIQ2 compliant. The Metallurgical Laboratory at the Houston operations is ISO 17025 certified for Crack Tip Opening Displacement, Hardness, Tensile and Charpy V-Notch testing. Dril-Quip works to maintain its high standards of product quality through the use of precision measuring equipment such as Gage Masters, Faro Arms, Coordinate Measuring Machine and the application of APQP. APQP entails concurrent engineering principles to identify and address potential quality concerns early in the product development process. The Company has the capability to manufacture its products globally and continues to have local capability in key critical markets.

The Company’s primary raw material is cast steel ingots, from which it produces steel shaped forgings at its forging and heat treatment facility in Houston, Texas. The Company routinely purchases steel ingots from multiple suppliers on a purchase order basis and does not have any long-term supply contracts. The Company’s Houston facility has the capability to provide forgings and heat treatment for its Houston, Aberdeen, Singapore and Macae facilities.

Prolonged periods of low demand in the market for drilling and production equipment could have a greater effect on the Company than on certain of its competitors that have not made such large capital investments in their facilities.

Dril-Quip’s manufacturing facilities utilize state-of-the-art computer numerically controlled (CNC) machine tools and equipment, which contribute to the Company’s product quality and timely delivery. The Company has also developed a cost effective, in-house machine tool rebuild and refurbishment capability, which produces machine upgrades with customized features to enhance the economic manufacturing of its specialized products. This strategy provides the added advantage of in-house expertise for repairs and maintenance of these machines.

### Customers

The Company’s principal customers are major integrated, large independent and foreign national oil and gas companies. Drilling contractors and engineering and construction companies also represent a portion of the Company’s customer base. The Company’s customers are generally oil and gas companies that are well-known participants in exploration and production.

The Company is not dependent on any one customer or group of customers. In 2018, the Company’s top 15 customers represented approximately 56% of total revenues, and BP and its affiliated companies accounted for approximately 13% of total revenues. In 2017 and 2016, the Company’s top 15 customers represented approximately 49% and 75% of total revenues, respectively, and Chevron and its affiliated companies accounted for approximately 14% and 16% of total revenues, respectively. No other customer accounted for more than 10% of total revenues in 2018, 2017 or 2016.

The number and variety of the Company’s products required in a given year by any one customer depends upon the amount of that customer’s capital expenditure budget devoted to exploration and production and on the results of competitive bids for major projects. Consequently, a customer that accounts for a significant portion of revenues in one fiscal year may represent an immaterial portion of revenues in subsequent years. While the Company is not dependent on any one customer or group of customers, the loss of one or more of its significant customers could, at least on a short-term basis, have an adverse effect on the Company’s results of operations.

### Backlog

Backlog consists of firm customer orders of Dril-Quip products for which a purchase order, signed contract or letter of award has been received, satisfactory credit or financing arrangements exist and delivery is scheduled. Historically, the Company’s revenues for a specific period have not been directly related to its backlog as stated at a particular point in time. The Company’s product backlog was approximately \$270.0 million and \$207.3 million at December 31, 2018 and 2017, respectively. The backlog at the end of 2018 represents an increase of approximately \$62.7 million, or 30%, from the end of 2017. The Company’s backlog balance during 2018 was negatively impacted by translation

adjustments of approximately \$3.1 million, due primarily to the weakening of the Brazilian Real against the U.S. dollar, and approximately \$11.7 million in cancellations.

During the first quarter of 2018, Dril-Quip Asia-Pacific Pte Ltd. was awarded a contract to supply top-tensioned riser (TTR) systems and related services for the development of the Ca Rong Do Project (CRD Project) located offshore Vietnam operated by Repsol with the participation of Mubadala, PVEP and PetroVietnam. The CRD Project is included within the backlog balance presented in the accompanying consolidated financial statements; however, due to ongoing territorial discussions between China and Vietnam, the CRD Project may experience continued delays or cancellation.

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The Company expects to fill approximately 70% to 80% of the December 31, 2018 product backlog by December 31, 2019. The remaining backlog at December 31, 2018 consists of longer-term projects which are being designed and manufactured to customer specifications requiring longer lead times. In August 2012, the Company's Brazilian subsidiary, Dril-Quip do Brasil LTDA, was awarded a four-year contract by Petrobras, Brazil's national oil company. The contract was valued at \$650.0 million, net of Brazilian taxes, at exchange rates in effect at that time (approximately \$342.2 million based on the December 31, 2018 exchange rate of 3.8748 Brazilian real to 1.00 U.S. dollar) if all the equipment under the contract was ordered. Amounts are included in the Company's backlog as purchase orders or letters of award are received. As of December 31, 2018, the Company's backlog included \$9.3 million of purchase orders under this Petrobras contract. As part of an amendment to extend the term of the contract, Petrobras agreed to issue purchase orders totaling a minimum of approximately \$25.3 million (based on current exchange rates) before 2019. As of December 31, 2018, Petrobras has issued a total of three purchase orders (one during each year of 2016, 2017 and 2018) totaling the committed amount. The Company cannot provide assurance that Petrobras will order all of the equipment under the contract. See "Item 1A. Risk Factors—Our backlog is subject to unexpected adjustments and cancellations and is, therefore, an uncertain indicator of our future revenues and earnings."

### Marketing and Sales

Dril-Quip markets its products and services throughout the world directly through its sales personnel in multiple domestic and international locations. In addition, in certain foreign markets the Company utilizes independent sales agents or representatives to enhance its marketing and sales efforts.

Some of the locations in which Dril-Quip has sales agents or representatives are Trinidad, Indonesia, Malaysia, Saudi Arabia and United Arab Emirates. Although they do not have authority to contractually bind the Company, these representatives market the Company's products in their respective territories in return for sales commissions. The Company advertises its products and services in trade and technical publications targeted to its customer base. The Company also participates in industry conferences and trade shows to enhance industry awareness of its products. The Company's customers generally order products on a purchase order basis. Orders, other than those considered to be long-term projects, are typically filled within twelve months after receipt, depending on the type of product and whether it is sold out of inventory or requires some customization. Contracts for certain of the Company's larger, more complex products, such as subsea production trees, drilling risers and equipment for TLPs and Spars, can take a year or more to complete.

The primary factors influencing a customer's decision to purchase the Company's products are the quality, reliability and reputation of the product, price, technology, service and timely delivery. For large drilling and production system orders, project management teams coordinate customer needs with the Company's engineering, manufacturing and service organizations, as well as with subcontractors and vendors.

A portion of the Company's business consists of designing, manufacturing and selling equipment, as well as offering technical advisory assistance during installation of the equipment, for major projects pursuant to competitive bids. The number of such projects in any year may fluctuate. The Company's profitability on such projects is critically dependent on making accurate and cost effective bids and performing efficiently in accordance with bid specifications. Various factors, including availability of raw materials, changes in customer requirements and governmental regulations, can adversely affect the Company's performance on individual projects, with potential material adverse effects on project profitability.

### Product Development and Engineering

The technological demands of the oil and gas industry continue to increase as exploration and drilling expand into more hostile environments. Conditions encountered in these environments include water depths in excess of 10,000 feet, well pressures exceeding 15,000 psi, well flowing temperatures beyond 350°F (Fahrenheit) and mixed flows of oil, gas and water that may also be highly corrosive and impact material properties.

Since its founding in 1981, Dril-Quip has actively engaged in continuing development efforts to generate new products and improve existing products. When developing new products, the Company typically seeks to design the most technologically advanced version for a particular application to establish its reputation and qualification in that product. Thereafter, the Company leverages its expertise in the more technologically advanced product to produce less

costly and complex versions of the product for less demanding applications. The Company also focuses its activities on reducing the overall cost to the customer, which includes not only the initial capital cost but also operating, installation and maintenance costs associated with its products.

In the 1980s, the Company introduced its first product, specialty connectors, as well as mudline suspension systems, template systems and subsea wellheads. In the 1990s, the Company introduced a series of new products, including diverters, wellhead connectors, SingleBore™ subsea trees, improved severe service dual bore subsea trees, subsea and platform valves, platform wellheads, platform trees, subsea tree workover riser systems, drilling riser systems and TLP and Spar production riser systems. Since 2000, Dril-Quip has introduced multiple new products, including liner hangers, subsea control systems, subsea

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manifolds, riser tensioners, and enhanced versions of subsea wellhead connectors and Dril-Quip's industry leading subsea wellhead system(s).

Historically, Dril-Quip's product development work is primarily conducted at its facilities in Houston, Texas; however, such activities have gradually increased in other regions, such as Aberdeen, Scotland, Singapore and Brazil. In addition to the work of its product development staff, the Company's application engineering staff provides technical services to customers in connection with the design and sales of its products. The Company's ability to develop new products and maintain technological advantages is important to its future success. See "Item 1A. Risk Factors-Our business could be adversely affected if we do not develop new products and secure and retain patents related to our products."

The Company believes that the success of its business depends more on the technical competence, creativity and marketing abilities of its employees than on any individual patent, trademark or copyright. Nevertheless, as part of its ongoing product development and manufacturing activities, Dril-Quip's policy has been to seek patents when appropriate on inventions concerning new products and product improvements. All patent rights for products developed by employees are assigned to the Company and almost all of the Company's products have components that are covered by patents.

In 2018, major production milestones were met for several key global projects. In the North Sea, the last of an initial 18 subsea completion trees for a subsea field development project was successfully installed. Following the success of the aforementioned project, Dril-Quip was awarded a front-end engineering and design contract for a subsea production system project located off the coast of South America. Additionally, subsea trees were delivered and installed for a field development project off the coast of Gabon. Also, off the coast of Trinidad, multiple deepwater subsea wellhead systems were installed with the support of a service facility in Trinidad, continuing Dril-Quip's aftermarket support presence in the region established the previous year. With the completion of engineering, manufacturing, assembly and testing of dry tree equipment, Dril-Quip was able to support the tieback of multiple wells for projects in the Gulf of Mexico. Engineering, manufacturing, assembly and test work continued on additional dry tree projects in the Company's backlog. The requirements of the equipment in these projects represent significant technological challenges, the development of which is serving to enhance the Company's overall engineering capabilities.

Dril-Quip's continued efforts in developing technologically advanced products enable Dril-Quip to offer products for the harshest environments. The latest subsea wellhead system has been accepted by a major oil company for its high pressure, high temperature applications, further strengthening Dril-Quip's position in the subsea market.

In an ongoing test program, the Company continued the utilization of its recently constructed high-load horizontal test machine and fatigue test machine for rigorous validation testing of its existing specialty connector product line. Active engineering programs have been initiated in-house to continue development in specialty connector product enhancements as well as new product development. This high-load horizontal test machine has been instrumental in the development and qualification of our latest 20,000 psi wellhead system and riser connector that utilize Dril-Quip proprietary locking and sealing profiles. Engineering development efforts are on-going in subsea production systems. In early 2016, the Company announced that it is establishing a research and development facility in Singapore that focuses on materials and products suitable for HPHT applications. The new facility serves as an additional hub for research and development activities for the Company.

Dril-Quip has numerous U.S. registered trademarks, including Dril-Quip®, Quik-Thread®, Quik-Stab®, Multi-Thread®, MS-15®, SS-15®, SS-10®, SU-90®, DX® and TIW®. The Company has registered its trademarks in the countries where such registration is deemed material.

Although in the aggregate, the Company's patents and trademarks are of considerable importance to the manufacturing and marketing of many of its products, the Company does not consider any single patent or trademark or group of patents or trademarks to be material to its business as a whole, except the Dril-Quip® trademark. The Company also relies on trade secret protection for its confidential and proprietary information. The Company routinely enters into confidentiality agreements with its employees and suppliers. There can be no assurance, however, that others will not independently obtain similar information or otherwise gain access to the Company's trade secrets.

### Competition

Dril-Quip faces significant competition from other manufacturers and suppliers of exploration and production equipment. Several of its primary competitors are diversified multinational companies with substantially larger operating staffs and greater capital resources than those of the Company and which, in many instances, have been engaged in the manufacturing business for a much longer period of time than the Company. The Company competes principally with the petroleum production equipment segments of Baker Hughes, a GE Company; Schlumberger, Ltd.; TechnipFMC plc; and Aker Solutions.

Because of their relative size and diversity of products, several of the Company's competitors have the ability to provide "turnkey" services for drilling and production applications, which enables them to use their own products to the exclusion of

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Dril-Quip's products. See "Item 1A. Risk Factors—We may be unable to successfully compete with other manufacturers of drilling and production equipment." The Company also competes to a lesser extent with a number of other companies in various products. The principal competitive factors in the petroleum drilling and production equipment markets are quality, reliability and reputation of the product, price, technology, service and timely delivery.

### Employees

The total number of the Company's employees as of December 31, 2017 was 2,019. Of those 2,019 employees, 1,095 were located in the United States. As a result of worldwide reductions in workforce and natural attrition, the total number of the Company's employees as of December 31, 2018 was 1,926, a 5% reduction from December 31, 2017. Of those 1,926 employees, 946 were located in the United States. As a result of the Company's ongoing efforts to control costs, we expect to reduce approximately 15% of our workforce in 2019, resulting in \$7.3 million in severance costs being recognized in the year ended December 31, 2018. Substantially all of the Company's employees are not covered by collective bargaining agreements, and the Company considers its employee relations to be good.

The Company's operations depend in part on its ability to attract quality employees. While the Company believes that its wage and salary rates are competitive and that its relationship with its labor force is good, a significant increase in the wages and salaries paid by competing employers could result in a reduction of the Company's labor force, increases in the wage and salary rates paid by the Company or both. If either of these events were to occur, in the near-term, the profits realized by the Company from work in progress would be reduced and, in the long-term, the production capacity and profitability of the Company could be diminished and the growth potential of the Company could be impaired. See "Item 1A. Risk Factors—Loss of our key management or other personnel could adversely impact our business."

### Governmental Regulations

Many aspects of the Company's operations are affected by political developments and are subject to both domestic and foreign governmental regulations, including those relating to oilfield operations, the discharge of materials into the environment from our manufacturing or other facilities, health and worker safety aspects of our operations, or otherwise relating to human health and environmental protection. In addition, the Company depends on the demand for its services from the oil and gas industry and, therefore, is affected by changing taxes, price controls and other laws and regulations relating to the oil and gas industry in general, including those specifically directed to onshore and offshore operations. The adoption of laws and regulations curtailing 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 the Company's products. See "Item 1A. Risk Factors—Our operations and our customers' operations are subject to a variety of governmental laws and regulations that may increase our costs, limit the demand for our products and services or restrict our operations."

In recent years, increased concern has been raised over the protection of the environment. Legislation to regulate emissions of greenhouse gases has been introduced, but not enacted, in the U.S. Congress, and there has been a wide-ranging policy debate, both nationally and internationally, regarding the impact of these gases and possible means for their regulation. In addition, efforts have been made and continue to be made in the international community toward the adoption of international treaties or protocols that would address global climate change issues, such as the annual United Nations Climate Change Conferences. In November 2015, the United Nations Climate Change Conference (COP21) was held in Paris with the objective to achieve a legally binding and universal agreement on climate, with the aim of keeping global warming below 20 C (Celsius), from all nations, regardless of size. The Paris Agreement, signed by the U.S. on April 22, 2016, requires countries to review and "represent a progression" in their nationally determined contributions, which set greenhouse gas emission reduction goals, every five years. However, in August 2017, the United States informed the United Nations of its intent to withdraw from the Paris Agreement. The earliest possible effective withdrawal date from the Paris Agreement is November 2020. Also, the U.S. Environmental Protection Agency (EPA) has undertaken efforts to collect information regarding greenhouse gas emissions and their effects. Following a finding by the EPA that certain greenhouse gases represent a danger to human health, the EPA expanded its regulations relating to those emissions and adopted rules imposing permitting and reporting obligations. The results of the permitting and reporting requirements could lead to further regulation of these

greenhouse gases by the EPA. Moreover, specific design and operational standards apply to U.S. outer continental shelf vessels, rigs, platforms, vehicles, structures and equipment.

The U.S. Bureau of Safety and Environmental Enforcement (BSEE) regulates the design and operation of well control and other equipment at offshore production sites, among other requirements. BSEE has adopted stricter requirements for subsea drilling production equipment. In April 2016, BSEE published a final blowout preventer systems and well control rule, which focuses on blowout preventer requirements and includes reforms in well design, well control, casing, cementing, real-time monitoring and subsea containment, among other things. BSEE also finalized a rule in September 2016 concerning production safety systems for oil and natural gas operations on the Outer Continental Shelf. However, in December 2017, BSEE published a proposed rule that would revise a number of the requirements in the September 2016 rule. The final rule implementing these revisions was published in September 2018. In addition, in May 2018, BSEE published a proposed rule that would revise



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several requirements of the blowout preventer systems and well control rule. A final rule has not yet been issued. In addition, drilling in certain areas has been opposed by environmental groups and, in certain areas, has been restricted. For example, in December 2016, the Obama administration banned offshore drilling in portions of the Arctic and Atlantic oceans. Although the Trump administration announced a proposal in January 2018 to open most U.S. coastal waters to offshore drilling, several coastal states have taken steps to prohibit offshore drilling. For example, California passed laws in September 2018 barring the construction of new oil drilling-related infrastructure in state waters. Similarly, in November 2018, voters in Florida approved an amendment to the state constitution that would ban oil and gas drilling in offshore state waters. Further, in December 2018, environmental groups challenged incidental harassment authorizations issued by the National Marine Fisheries Service that allow companies to conduct air gun seismic surveys for oil and gas exploration off the Atlantic coast. The attorneys general for nine coastal states also sought to intervene as plaintiffs. To the extent that new laws or other governmental actions prohibit or restrict drilling or impose additional environmental protection requirements that result in increased costs to the oil and gas industry in general and the drilling industry in particular, the business of the Company could be adversely affected. Similarly, restrictions on authorizations needed to conduct seismic surveys could impact our customers' ability to identify oil and gas reserves, thereby reducing demand for our products. The Company cannot determine to what extent its future operations and earnings may be affected by new legislation, new regulations or changes in existing regulations. See "Item 1A. Risk Factors—Our business and our customers' businesses are subject to environmental laws and regulations that may increase our costs, limit the demand for our products and services or restrict our operations."

Our operations are also governed by laws and regulations related to workplace safety and worker health, such as the Occupational Safety and Health Act and regulations promulgated thereunder.

Based on the Company's experience to date, the Company does not currently anticipate any material adverse effect on its business or consolidated financial position as a result of future compliance with existing environmental, health and safety laws. However, future events, such as changes in existing laws and regulations or their interpretation, more vigorous enforcement policies of or by regulatory agencies, or stricter or different interpretations of existing laws and regulations, may require additional expenditures by the Company, which may be material.

## Executive Officers of the Registrant

Pursuant to Instruction 3 to Item 401(b) of Regulation S-K and General Instruction G(3) to Form 10-K, the following information is included in Part I of this Form 10-K:

The following table sets forth the names, ages (as of February 20, 2019) and positions of the Company's executive officers:

Name	Age	Position
		President, Chief
Blake T. DeBerry	59	Executive Officer and Director Senior Vice President and Chief
James A. Garipey	61	Operating Officer Vice President and Chief
Jeffrey J. Bird	52	Financial Officer

James C. Webster 49 Vice  
President,  
General  
Counsel  
and  
Secretary

Blake T. DeBerry has been President and Chief Executive Officer and a member of the Board of Directors of the Company since October 2011. Mr. DeBerry was Senior Vice President—Sales and Engineering from July 2011 until October 2011, and was Vice President—Dril-Quip Asia Pacific (which covers the Pacific Rim, Asia, Australia, India and the Middle East) from March 2007 to July 2011. He has been an employee of the Company since 1988 and has held a number of management and engineering positions in the Company's domestic and international offices. Mr. DeBerry holds a Bachelor of Science degree in mechanical engineering from Texas Tech University.

James A. Gariepy is Senior Vice President and Chief Operating Officer, positions he has held since October 2011. Mr. Gariepy was Senior Vice President—Manufacturing, Project Management and Service from July 2011 until October 2011, and was Vice President—Dril-Quip Europe (which covers Europe, Africa and Northern Eurasia) from March 2007 to July 2011. He has held domestic and international management positions since joining the Company in 2004. Mr. Gariepy holds a Bachelor of Science degree in mechanical engineering from the Lawrence Technological University and an MBA from the University of St. Thomas.

Jeffrey J. Bird is Vice President and Chief Financial Officer, positions he has held since he joined the Company in March 2017. From December 2014 through February 2017, he was Executive Vice President and Chief Financial Officer of Frank's International, a provider of engineered tubular services to the oil and gas industry. Prior to joining Frank's International, Mr. Bird was the Vice President of Finance and Chief Financial Officer of Ascend Performance Materials, a provider of chemicals, fibers and plastics in Houston, Texas, from September 2010. Prior to joining Ascend, Mr. Bird served in a variety of

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accounting and finance roles, primarily in the industrial manufacturing sector including serving as a division Chief Financial Officer at Danaher Corporation. Mr. Bird holds a BA in Accounting from Cedarville University in Ohio. James C. Webster is Vice President, General Counsel and Secretary. He joined the Company in February 2011 as Vice President and General Counsel and was elected to the additional position of Secretary in May 2011. From September 2005 until September 2010, he was Vice President, General Counsel and Secretary of M-I SWACO, at the time, a joint venture between Smith International, Inc. and Schlumberger Ltd., and then was an area general counsel for Schlumberger from September 2010 to February 2011 following Schlumberger's acquisition of Smith International. From 1999 to September 2005, he was an associate with, and later a partner in, the law firm of Gardere Wynne Sewell LLP (now part of Foley & Lardner LLP) in Houston. Mr. Webster holds an economics degree from the University of Arizona and a joint Law/MBA from Loyola University.

### Item 1A. Risk Factors

In this Item 1A., the terms "we," "our," "us" and "Dril-Quip" used herein refer to Dril-Quip, Inc. and its subsidiaries unless otherwise indicated or as the context so requires.

A material or extended decline in expenditures by the oil and gas industry could significantly reduce our revenue and income.

Our business depends upon 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. The level of capital expenditures is generally dependent on the prevailing view of future oil and gas prices, which are influenced by numerous factors affecting the supply and demand for oil and gas, including:

- worldwide economic activity;
- the level of exploration and production activity;
- interest rates and the cost of capital;
- environmental regulation;
- federal, state and foreign policies regarding exploration and development of oil and gas;
- the ability and/or desire of OPEC and other major producers to set and maintain production levels and pricing;
- governmental regulations regarding future oil and gas exploration and production;
- the cost of exploring and producing oil and gas;
- the cost of developing alternative energy sources;
- the availability, expiration date and price of onshore and offshore leases;
- the discovery rate of new oil and gas reserves in onshore and offshore areas;
- the success of drilling for oil and gas in unconventional resource plays such as shale formations;
- alternative opportunities to invest in onshore exploration and production opportunities;
- technological advances and new techniques that render drilling more efficient or reduce demand for, and production of, fossil fuels; and
- weather conditions and natural disasters.

Oil and gas prices and the level of drilling and production activity have been characterized by significant volatility in recent years. Worldwide military, political and economic events have contributed to crude oil and natural gas price volatility and are likely to continue to do so in the future.

We expect continued pressure in both crude oil and natural gas prices, as well as in the level of drilling and production related activities, particularly as they relate to offshore activities. Even during periods of high prices for oil and natural gas, companies exploring for oil and gas may cancel or curtail programs, seek to renegotiate contract terms, including the price of our products and services, or reduce their levels of capital expenditures for exploration and production for a variety of reasons. These risks are greater during periods of low or declining commodity prices. The sustained lower crude oil and natural gas prices, along with lower drilling and production activity, have had a negative impact on our results of operations.

We may not be able to satisfy technical requirements, testing requirements or other specifications under contracts and contract tenders.



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Our products are used primarily in deepwater, harsh environment and severe service applications. Our contracts with customers and customer requests for bids typically set forth detailed specifications or technical requirements for our products and services, which may also include extensive testing requirements. We anticipate that such testing requirements will become more common in our contracts. In addition, recent scrutiny of the drilling industry has resulted in more stringent technical specifications for our products and more comprehensive testing requirements for our products to ensure compliance with such specifications. We cannot assure you that our products will be able to satisfy the specifications or that we will be able to perform the full-scale testing necessary to prove that the product specifications are satisfied in future contract bids or under existing contracts, or that the costs of modifications to our products to satisfy the specifications and testing will not adversely affect our results of operations. If our products are unable to satisfy such requirements, or we are unable to perform any required full-scale testing, our customers may cancel their contracts and/or seek new suppliers, and our business, results of operations, cash flows or financial position may be adversely affected.

We rely on technology provided by third parties and our business may be materially adversely affected if we are unable to renew our licensing arrangements with them.

We have existing contracts and may enter into new contracts with customers that require us to use technology or to purchase components from third parties, including some of our competitors. In the ordinary course of our business, we have entered into licensing agreements with some of these third parties for the use of such technology, including a license from a competitor of a technology important to our subsea wellheads. We may not be able to renew our existing licenses or to purchase these components on terms acceptable to us, or at all. If we are unable to use a technology or purchase a component, we may not be able to meet existing contractual commitments without increased costs or modifications or at all. In addition, we may need to stop selling products incorporating that technology or component or to redesign our products, either of which could result in a material adverse effect on our business and operations.

We may be unable to successfully compete with other manufacturers of drilling and production equipment.

Several of our primary competitors are diversified multinational companies with substantially larger operating staffs and greater capital resources than ours and which have been engaged in the manufacturing business for a much longer time than us. If these competitors substantially increase the resources they devote to developing and marketing competitive products and services, we may not be able to compete effectively. Similarly, consolidation among our competitors could enhance their product and service offerings and financial resources, further intensifying competition.

The loss of a significant customer could have an adverse impact on our financial results.

Our principal customers are major integrated oil and gas companies, large independent and foreign national oil and gas companies throughout the world. Drilling contractors and engineering and construction companies also represent a portion of our customer base. In 2018, our top 15 customers represented approximately 56% of total revenues, and BP and its affiliated companies accounted for approximately 13% of total revenues. In 2017 and 2016, our top 15 customers represented approximately 49% and 75% of total revenues, respectively, and Chevron and its affiliated companies accounted for approximately 14% and 16% of total revenues, respectively. The loss of one or more of our significant customers could have an adverse effect on our results of operations, financial position and cash flows.

Our customers' industries are undergoing continuing consolidation that may impact our results of operations.

The oil and gas industry is rapidly consolidating and, as a result, some of our largest customers have consolidated and are using their size and purchasing power to seek economies of scale and pricing concessions. This consolidation may result in reduced capital spending by some of our customers or the acquisition of one or more of our primary customers, which may lead to decreased demand for our products and services. We cannot assure you that we will be able to maintain our level of sales to a customer that has consolidated or replace that revenue with increased business activity with other customers. As a result, the acquisition of one or more of our primary customers may have a significant negative impact on our results of operations, financial position or cash flows. We are unable to predict what effect consolidations in the industry may have on price, capital spending by our customers, our selling strategies, our competitive position, our ability to retain customers or our ability to negotiate favorable agreements with our

customers.

Increases in the cost of raw materials and energy used in our manufacturing processes could negatively impact our profitability.

Any increases in commodity prices for items such as nickel, molybdenum and heavy metal scrap that are used to make the steel alloys required for our products would result in an increase in our raw material costs. Similarly, any increase in energy costs would increase our product costs. If we are not successful in raising our prices on products to compensate for any increased raw material or energy costs, our margins will be negatively impacted.

We depend on third-party suppliers for timely deliveries of raw materials, and our results of operations could be adversely affected if we are unable to obtain adequate supplies in a timely manner.

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Our manufacturing operations depend upon obtaining adequate supplies of raw materials from third parties. The ability of these third parties to deliver raw materials may be affected by events beyond our control. Any interruption in the supply of raw materials needed to manufacture our products could adversely affect our business, results of operations and reputation with our customers.

Conditions in the global financial system may have impacts on our business and financial position that we currently cannot predict.

Uncertainty in the credit markets may negatively impact the ability of our customers to finance purchases of our products and services and could result in a decrease in, or cancellation of, orders included in our backlog or adversely affect the collectability of our receivables. If the availability of credit to our customers is reduced, they may reduce their drilling and production expenditures, thereby decreasing demand for our products and services, which could have a negative impact on our financial position. Additionally, unsettled conditions could have an impact on our suppliers, causing them to be unable to meet their obligations to us. A prolonged constriction on future lending by banks or investors could result in higher interest rates on future debt obligations or could restrict our ability to obtain sufficient financing to meet our long-term operational and capital needs.

We are exposed to the credit risks of our customers, and a general increase in the nonpayment and nonperformance by customers could have an adverse impact on our cash flows, results of operations and financial condition.

Our business is subject to risks of loss resulting from nonpayment or nonperformance by our customers. Certain of our customers finance their activities through cash flow from operations, the incurrence of debt or the issuance of equity. In an economic downturn, commodity prices typically decline, and the credit markets and availability of credit can be expected to be constrained. Additionally, certain of our customers' equity values could decline. The combination of lower cash flow due to commodity prices, a reduction in borrowing bases under reserve-based credit facilities and the lack of available debt or equity financing may result in a significant reduction in our customers' liquidity and ability to pay or otherwise perform on their obligations to us. Furthermore, some of our customers may be highly leveraged and subject to their own operating and regulatory risks, which increases the risk that they may default on their obligations to us. Any increase in the nonpayment and nonperformance by our customers could have an adverse impact on our operating results and could adversely affect our liquidity.

Our backlog is subject to unexpected adjustments and cancellations and is, therefore, an uncertain indicator of our future revenues and earnings.

The revenues projected in our backlog may not be realized or, if realized, may not result in profits. All of the projects currently included in our backlog are subject to change and/or termination at the option of the customer. In case of a change or termination, the customer is generally required to pay us for work performed and other costs necessarily incurred as a result of the change or termination.

We can give no assurance that our backlog will remain at current levels. Sales of our products are affected by prices for oil and natural gas, which have fluctuated significantly and may continue to do so in the future. Contracts denominated in foreign currency are also affected by changes in exchange rates, which may have a negative impact on our backlog. When drilling and production levels are depressed, a customer may no longer need the equipment or services currently under contract or may be able to obtain comparable equipment or services at lower prices. As a result, customers may delay projects, exercise their termination rights or attempt to renegotiate contract terms.

For example, during the first quarter of 2018, Dril-Quip Asia-Pacific Pte Ltd. was awarded a contract to supply TTR systems and related services for the development of the CRD Project located offshore Vietnam operated by Repsol with the participation of Mubadala, PVEP and PetroVietnam. The CRD Project is included within the backlog balance presented in the accompanying consolidated financial statements; however, due to ongoing territorial discussions between China and Vietnam, the CRD Project may experience continued delays or cancellation.

Continued declines in, or sustained low levels of, oil and natural gas prices could also reduce new customer orders, possibly causing a decline in our future backlog. If we experience significant project terminations, suspensions or scope adjustments to contracts reflected in our backlog, our financial condition, results of operations and cash flows may be adversely impacted.

Impairment in the carrying value of long-lived assets, inventory, intangible assets and goodwill could negatively affect our operating results.

We evaluate our property and equipment for impairment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable, and we could incur additional impairment charges related to the carrying value of our long lived assets.



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As a result of continued unfavorable offshore market conditions and low commodity prices, the Company engaged in a strategic review with a third-party firm in 2018. In conjunction with the strategic review, the Company adjusted its forecast for recovery to reflect a more delayed recovery in the offshore industry, with pre-downturn demand not returning until after 2025. Additionally, the Company pursued a global transformation, which includes a reduction in workforce, realignment of facilities and restructuring of operations. We expect this transformation to allow us to maintain our global footprint in key markets, while supporting an integrated supply chain model that we expect to create more flexibility and allow us to continue serving our customers. The Company expects to complete the strategic restructuring by the end of 2019.

During the fourth quarter of 2018, we incurred inventory and long-lived asset write-downs of approximately \$32.1 million and \$14.9 million, respectively, as a result of changes in our business structure and where specific products are manufactured. These charges are reflected as Impairment, restructuring and other charges in our consolidated statement of operations.

In connection with our preparation and review of financial statements for the year ended December 31, 2017, after considering current Brent crude (Brent) consensus forecasts and expected rig counts for the foreseeable future, we determined the carrying amount of certain of our long-lived assets in the Western Hemisphere exceeded the fair values of such assets due to projected declines in asset utilization, and that the cost of some of our worldwide inventory exceeded its market value. As a result, we recorded corresponding impairments and other charges. Primarily as a result of the factors described above, we recorded charges of approximately \$33.6 million related to inventory and \$27.4 million related to fixed assets. No additional impairments were recorded during the three months ended December 31, 2017. Additionally, no impairments were recorded for the year ended December 31, 2016.

For goodwill, an assessment for impairment is performed annually or when there is an indication an impairment may have occurred. We typically complete our annual impairment test for goodwill and other indefinite-lived intangibles using an assessment date of October 1. Goodwill is reviewed for impairment by comparing the carrying value of each of our three reporting units' net assets, including allocated goodwill, to the estimated fair value of the reporting unit. We determine the fair value of our reporting units using a discounted cash flow approach. We selected this valuation approach because we believe it, combined with our best judgment regarding underlying assumptions and estimates, provides the best estimate of fair value for each of our reporting units. Determining the fair value of a reporting unit requires the use of estimates and assumptions. Such estimates and assumptions include revenue growth rates, future operating margins, the weighted average cost of capital, a terminal growth value and future market conditions, among others. We believe that the estimates and assumptions used in our impairment assessments are reasonable. If the reporting unit's carrying value is greater than its calculated fair value, we recognize a goodwill impairment charge for the amount by which the carrying value of goodwill exceeds its calculated fair value.

At October 1, 2018, the Company performed its annual impairment test on each of its reporting units and concluded that there had been no impairment because the estimated fair values of each of those reporting units exceeded its carrying value. Relevant events and circumstances that could have a negative impact on goodwill include: macroeconomic conditions; industry and market conditions, such as commodity prices; operating cost factors; overall financial performance; the impact of dispositions and acquisitions; and other entity-specific events. Further declines in commodity prices or sustained lower valuation for the Company's common stock could indicate a reduction in the estimate of reporting unit fair value which, in turn, could lead to an impairment of reporting unit goodwill.

In December 2018, the overall offshore market conditions declined. This decline was evidenced by lower commodity prices, decline in expected offshore rig counts, decrease in our customers' capital budgets and potential delays associated with certain of our long term projects. Further, in December 2018 due to the decline in our stock price, our market capitalization dropped below the carrying value of our assets. As a result, an interim goodwill impairment analysis was performed in connection with our preparation and review of financial statements for the year ended December 31, 2018. Based on this analysis, we recorded an impairment loss of \$38.6 million for our Western Hemisphere reporting unit for the year ended December 31, 2018. Following this impairment charge, the Western Hemisphere reporting unit has no remaining goodwill balance. The remaining goodwill balance is associated with our Eastern Hemisphere reporting unit. Based on our interim goodwill impairment analysis the fair value of the Eastern

Hemisphere reporting unit exceeds its carry value by 71%. Further declines in the overall offshore market, commodity prices, or sustained lower valuation for the Company's common stock could indicate a reduction in the estimate of the Eastern Hemisphere's reporting unit fair value which, in turn, could lead to additional impairment charges associated with goodwill. No goodwill impairment losses were recorded for the years ended December 31, 2017 and 2016. During 2018, Brent crude oil prices fluctuated significantly, with a high of \$86.07 per barrel, a low of \$50.57 per barrel, and an average of \$71.34 per barrel. Although the prices have experienced some recovery in 2017 and 2018, continued weakness or volatility in market conditions may further deteriorate the financial performance or future prospects of our

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operating segments from current levels, which may result in an impairment of long-lived assets, inventory or goodwill and negatively impact our financial results in the period of impairment.

Our international operations expose us to instability and changes in economic and political conditions and other risks inherent to international business, which could have a material adverse effect on our results of operations, financial position or cash flows.

We have substantial international operations, with approximately 61% of our revenues derived from foreign sales in 2018, 55% in 2017 and 66% in 2016. We operate our business and market our products and services in many of the significant oil and gas producing areas in the world and are, therefore, subject to the risks customarily attendant to international operations and investments in foreign countries. Risks associated with our international operations include:

- volatility in general economic, social and political conditions;
- terrorist threats or acts, war and civil disturbances;
- expropriation or nationalization of assets;
- renegotiation or nullification of existing contracts;
- foreign taxation, including changes in laws or differing interpretations of existing laws;
- assaults on property or personnel;
- restrictive action by local governments;
- foreign and domestic monetary policies;
- limitations on repatriation of earnings;
- the occurrence of a trade war or other governmental action related to tariffs or trade agreements or policies;
- travel limitations or operational problems caused by public health threats; and
- changes in currency exchange rates.

Any of these risks could have an adverse effect on our ability to manufacture products abroad or the demand for our products and services in some locations. To date, we have not experienced any significant problems in foreign countries arising from local government actions or political instability, but there is no assurance that such problems will not arise in the future. Interruption of our international operations could have a material adverse effect on our overall operations.

Our international operations require us to comply with a number of U.S. and foreign regulations governing the international trade of goods, services and technology, which expose us to compliance risks.

Doing business on a worldwide basis exposes us and our subsidiaries to risks inherent in complying with the laws and regulations of a number of different nations, including various anti-bribery laws. We do business and have operations in a number of developing countries that have relatively underdeveloped legal and regulatory systems compared to more developed countries. Several of these countries are generally perceived as presenting a higher than normal risk of corruption, or as having a culture in which requests for improper payments are not discouraged. As a result, we may be subject to risks under the U.S. Foreign Corrupt Practices Act, the United Kingdom's Bribery Act of 2010 and similar laws in other countries that generally prohibit companies and their representatives from making, offering or authorizing improper payments to government officials for the purpose of obtaining or retaining business. We have adopted policies and procedures, including our Code of Business Conduct and Ethical Practices, which are designed to promote compliance with such laws. However, maintaining and administering an effective compliance program under applicable anti-bribery laws in developing countries presents greater challenges than is the case in more developed countries.

In addition, the movement of goods, services and technology subjects us to complex legal regimes governing international trade. Our import activities are governed by unique tariff and customs laws and regulations in each of the countries where we operate. Further, many of the countries in which we do business maintain controls on the export or reexport of certain goods, services and technology, as well as economic sanctions that prohibit or restrict business activities in, with or involving certain persons, entities or countries. These laws and regulations concerning import and export activity, including their recordkeeping and reporting requirements, are complex and frequently changing. Moreover, they may be adopted, enacted, amended, enforced or interpreted in a manner that could materially impact

our operations.

The precautions we take to prevent and detect misconduct, fraud or non-compliance with applicable laws and regulations governing international trade, including anti-bribery laws, may not be able to prevent such occurrences, and we could face unknown risks or losses. Our failure to comply with applicable laws or regulations or acts of misconduct could subject us to criminal or civil penalties, such as fines, imprisonment, sanctions, debarment from government contracts, seizure of shipments

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and loss of import and export privileges. In addition, actual or alleged violations of such laws and regulations could be expensive and consume significant time and attention of senior management to investigate and resolve, as well as damage our reputation and ability to do business, any of which could have a material adverse effect on our business and our results of operations, financial position and cash flows. We are also subject to the risks that our employees, agents and other representatives may act or fail to act in violation of such laws or regulations or our compliance policies and procedures.

The results of the United Kingdom's referendum on withdrawal from the European Union, including the subsequent exchange rate fluctuations and political and economic uncertainties, may have a negative effect on global economic conditions, financial markets and our business.

In a referendum held on June 23, 2016, voters in the United Kingdom (U.K.) approved the exit (Brexit) of the U.K. from the European Union (E.U.). On March 29, 2017, the U.K. government commenced the exit process under Article 50 of the Treaty of the European Union by notifying the European Council of the U.K.'s intention to leave the E.U. This notification started a two-year time period ending on March 29, 2019 for the U.K. and the remaining E.U. Member States to negotiate a withdrawal agreement. Negotiations remain ongoing to determine the future terms of the U.K.'s relationship with the E.U. The impact on the Company's business as a result of Brexit will depend, in part, on the outcome of tariff, trade, regulatory and other negotiations.

The consequences of Brexit, together with the protracted negotiations around the terms of Brexit, could introduce significant uncertainties into global financial markets and adversely impact the regions in which we and our clients operate. For example, importing and exporting activity from our Aberdeen manufacturing facility could be subject to higher costs and delays, which could cause disruptions in our delivery schedules to our customers. In the long term, Brexit could also create uncertainty with respect to the legal and regulatory requirements to which we and our customers in the U.K. are subject and lead to divergent national laws and regulations as the U.K. government determines which E.U. laws to modify or replace.

The referendum adversely impacted global markets, including currencies, and resulted in a decline in the value of the British pound sterling, as compared to the U.S. dollar and other currencies. Volatility in exchange rates could be expected to continue in the short term as the U.K. negotiates its exit from the E.U. A weaker British pound sterling compared to the U.S. dollar during a reporting period would cause local currency results of the Company's U.K. operations to be translated into fewer U.S. dollars.

Continued adverse consequences, such as deterioration in economic conditions and volatility in currency exchange rates, and the uncertainty surrounding Brexit could have a negative impact on the Company's financial position and results of operations.

Tax reform in the United States may have adverse effects on our financial position.

On December 22, 2017, the Tax Cuts and Jobs Act was enacted (US Tax Reform). US Tax Reform includes a number of changes that impacted our business. These changes include a reduction in the corporate tax rate from 35% to 21% starting in 2018, the elimination or reduction of certain domestic deductions and credits and limitations on the deductibility of interest expense and executive compensation. US Tax Reform also transitions U.S. international taxation from a worldwide tax system to a modified territorial system, which includes base erosion prevention measures on non-U.S. earnings, which have the effect of subjecting certain earnings of our foreign subsidiaries to U.S. taxation stemming from guidelines such as Global Low Tax Intangible Income (GILTI). The US Tax Reform also includes a one-time transition tax on the mandatory deemed repatriation of cumulative foreign earnings as of December 31, 2017.

US Tax Reform also provides for the acceleration of depreciation for certain assets placed into service after September 27, 2017 as well as prospective changes beginning in 2018, including repeal of the domestic manufacturing deduction. Changes in corporate tax rates, the taxation of foreign earnings and the deductibility of expenses had a material impact on the recoverability of our deferred tax assets, and resulted in an increase of the Company's effective tax rate in 2017. The provisions of US Tax Reform reduced the Company's effective tax rate in 2018, but it is important to note that the ultimate impact on the Company's effective tax rate will largely depend on the percentage of pre-tax earnings that is generated in the United States as compared to the rest of the world.

We are subject to taxation in many jurisdictions and there are inherent uncertainties in the final determination of our tax liabilities.

As a result of our international operations, we are subject to taxation in many jurisdictions. Accordingly, our effective income tax rate and other tax obligations in the future could be adversely affected by a number of factors, including changes in the mix of earnings in countries with differing statutory tax rates, the mix of business executed in deemed profit regimes compared to book income regimes, changes in the valuation of deferred tax assets and liabilities, disagreements with taxing authorities with respect to the interpretation of tax laws and regulations and changes in tax laws. In particular, foreign income tax returns of foreign subsidiaries and related entities are routinely examined by foreign tax authorities, and these tax

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examinations may result in assessments of additional taxes, interest or penalties. Refer to "Item 3. Legal Proceedings" regarding tax assessments in Brazil. We regularly assess all of these matters to determine the adequacy of our tax provision, which is subject to discretion. If our assessments are incorrect, it could have an adverse effect on our business and financial condition.

Moreover, the United States Congress, the Organization for Economic Co-operation and Development and other government agencies in the other jurisdictions where we and our subsidiaries do business have had an extended focus on issues related to the taxation of multinational corporations. One example is in the area of "base erosion and profit shifting," where payments are made between affiliates from a jurisdiction with high tax rates to a jurisdiction with lower tax rates. As a result, the tax laws in the United States and other countries in which we and our subsidiaries do business could change on a prospective or retroactive basis, and such changes could adversely affect us.

Our excess cash is invested in various financial instruments which may subject us to potential losses.

We invest excess cash in various financial instruments including 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. However, changes in the financial markets, including interest rates, as well as the performance of the issuers, can affect the market value of our short-term investments.

We may suffer losses as a result of foreign currency fluctuations and limitations on the ability to repatriate income or capital to the United States.

We conduct a portion of our business in currencies other than the U. S. dollar, and our operations are subject to fluctuations in foreign currency exchange rates. We cannot assure you that we will be able to protect the Company against such fluctuations in the future. Further, we cannot assure you that the countries in which we currently operate will not adopt policies limiting repatriation of earnings in the future.

Our foreign subsidiaries also hold significant amounts of cash that may be subject to both U.S. income taxes (subject to adjustment for foreign tax credits) and withholding taxes of the applicable foreign country if we repatriate that cash to the United States.

Our business involves numerous operating hazards that may not be covered by insurance. The occurrence of an event not fully covered by insurance could have a material adverse effect on our results of operations, financial position and cash flows.

Our products are used in potentially hazardous drilling, completion and production applications that can cause personal injury, product liability and environmental claims. In addition, certain areas where our products are used, including in and near the U.S. Gulf of Mexico, are close to high population areas and subject to hurricanes and other extreme weather conditions on a relatively frequent basis. A catastrophic occurrence at a location where our equipment and/or services are used may expose us to substantial liability for personal injury, wrongful death, product liability, environmental damage or commercial claims. Our general liability insurance program includes an aggregate coverage limit of \$200 million for claims with respect to property damage, injury or death and pollution. However, our insurance policies may not cover fines, penalties or costs and expenses related to government-mandated cleanup of pollution. In addition, our insurance does not provide coverage for all liabilities, and we cannot assure you that our insurance coverage will be adequate to cover claims that may arise or that we will be able to maintain adequate insurance at rates we consider reasonable. The occurrence of an event not fully covered by insurance could have a material adverse effect on our results of operations, financial position and cash flows.

We attempt to further limit our liability through contractual indemnification provisions with our customers. We generally seek to enter into contracts for the provision of our products and services that provide for (1) the responsibility of each party to the contract for personal injuries to, or the death of, its employees and damages to its property, (2) cross-indemnification with other contractors providing products and/or services to the other party to the contract with respect to personal injury, death and property damage and (3) the operator being responsible for claims brought by third parties for personal injury, death, property loss or damage relating to pollution or other well control events. Due to competitive market pressures, we may not be able to successfully obtain favorable contractual provisions, and a failure to do so may increase our risks and costs, which could materially impact our results of operations. In addition, we cannot assure you that any party that is contractually obligated to indemnify us will be

financially able to do so or that a court will enforce all such indemnities.

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We may lose money on fixed-price contracts.

A portion of our business consists of the designing, manufacturing and selling of our equipment for major projects pursuant to competitive bids, and is performed on a fixed-price basis. Under these contracts, we are typically responsible for all cost overruns, other than the amount of any cost overruns resulting from requested changes in order specifications. Our actual costs and any gross profit realized on these fixed-price contracts may vary from the estimated amounts on which these contracts were originally based. This may occur for various reasons, including:

- errors in estimates or bidding;
- changes in availability and cost of labor and materials;
- variations in productivity from our original estimates; and
- material changes in foreign currency exchange rates.

These variations and the risks inherent in our projects may result in reduced profitability or losses on projects.

Depending on the size of a project, variations from estimated contract performance could have a material adverse impact on our operating results.

Our business could be adversely affected if we do not develop new products and secure and retain patents related to our products.

Technology is an important component of our business and growth strategy, and our success as a company depends to a significant extent on the development and implementation of new product designs and improvements. Whether we can continue to develop systems and services and related technologies to meet evolving industry requirements and, if so, at prices acceptable to our customers will be significant factors in determining our ability to compete in the industry in which we operate. Many of our competitors are large multinational companies that may have significantly greater financial resources than we have, and they may be able to devote greater resources to research and development of new systems, services and technologies than we are able to do.

Our ability to compete effectively will also depend on our ability to continue to obtain patents on our proprietary technology and products. Although we do not consider any single patent to be material to our business as a whole, the inability to protect our future innovations through patents could have a material adverse effect.

We may be required to recognize a charge against current earnings because of over time method of accounting.

Revenues and profits on long-term project contracts are recognized on an over time basis. We calculate the percent complete and apply the percentage to determine revenues earned and the appropriate portion of total estimated costs. Accordingly, purchase order price and cost estimates are reviewed periodically as the work progresses, and adjustments proportionate to the percentage complete are reflected in the period when such estimates are revised. To the extent that these adjustments result in a reduction or elimination of previously reported profits, we would have to recognize a charge against current earnings, which could be significant depending on the size of the project or the adjustment.

Loss of our key management or other personnel could adversely impact our business.

We depend on the continued services of our executive officers and other key members of management, particularly our President and Chief Executive Officer. From time to time, there may be changes in our executive management team resulting from the hiring or departure of executives. Such changes in our executive management team may be disruptive to our business. The loss of one or more of our key employees or groups could have a material adverse effect on our results of operations, financial position and cash flows.

Acquisitions, dispositions and investments may not result in anticipated benefits and may present risks not originally contemplated, which could have a material adverse effect on our financial condition, results of operations and cash flows.

From time to time, we evaluate purchases and sales of assets, businesses or other investments. These transactions may not result in the anticipated realization of savings, creation of efficiencies, offering of new products or services, generation of cash or income or reduction of risk. In addition, acquisitions may be financed by borrowings, requiring us to incur debt, or by the issuance of our common stock. These transactions involve numerous risks, and we cannot ensure that:

- any acquisition would be successfully integrated into our operations and internal controls;

the due diligence conducted prior to an acquisition would uncover situations that could result in financial or legal exposure;  
the use of cash for acquisitions would not adversely affect our cash available for capital expenditures and other uses;

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any disposition, investment, acquisition or integration would not divert management resources from the operation of our business; or

any disposition, investment, acquisition or integration would not have a material adverse effect on our financial condition, results of operations or cash flows.

Restrictions in the agreement governing the Asset Backed Loan (ABL) Credit Facility could adversely affect our business, financial condition and results of operations.

The operating and financial restrictions in the ABL Credit Facility and any future financing agreements could restrict our ability to finance future operations, capital needs or to access to capital at a reasonable cost or otherwise pursue our business activities. For example, ABL Credit Facility limits our and our subsidiaries' ability to, among other things:

incur additional debt or issue guarantees;

incur or permit certain liens to exist;

make certain investments, acquisitions or other restricted payments, including payments for the purchase of equity interests in the Company;

dispose of assets;

engage in certain types of transactions with affiliates;

merge, consolidate or transfer all or substantially all of our assets; and

prepay certain indebtedness.

Furthermore, the ABL Credit Facility contains a covenant requiring us to maintain a fixed charge coverage ratio of 1.0 to 1.0 based on the ratio of consolidated EBITDA to fixed charges when availability under the ABL Credit Facility falls below the greater of \$10 million and 15% of the lesser of the borrowing base and aggregate commitments.

In addition, any borrowings under the ABL Credit Facility may be at variable rates of interest that expose us to interest rate risk. If interest rates increase, our debt service obligations on the variable rate indebtedness will increase even though the amount borrowed will remain the same, and our net income and cash flows will correspondingly decrease.

A failure to comply with the covenants in the agreement governing the ABL Credit Facility could result in an event of default, which, if not cured or waived, would permit the exercise of remedies against us that could have a material adverse effect on our business, results of operations and financial position. Remedies under the ABL Credit Facility include foreclosure on the collateral securing the indebtedness and termination of the commitments under the ABL Credit Facility, and any outstanding borrowings under the ABL Credit Facility may be declared immediately due and payable.

Our operations and our customers' operations are subject to a variety of governmental laws and regulations that may increase our costs, limit the demand for our products and services or restrict our operations.

Our business and our customers' businesses may be significantly affected by:

federal, state, local and foreign laws and other regulations relating to the oilfield operations, worker safety and the protection of the environment;

changes in these laws and regulations;

levels of enforcement of these laws and regulations; and

interpretation of existing laws and regulations.

In addition, we depend on the demand for our products and services from the oil and gas industry. This demand is affected by changing taxes, price controls and other laws and regulations relating to the oil and gas industry in general, including those specifically directed to offshore operations. For example, the adoption of laws and regulations curtailing exploration and development drilling for oil and gas for economic or other policy reasons could adversely affect our operations by limiting demand for our products. We cannot determine the extent to which our future operations and earnings may be affected by new legislation, new regulations or changes in existing regulations and enforcement thereof.

Various new regulations intended to improve particularly offshore safety systems and environmental protection have been issued since 2010 that have increased the complexity of the drilling permit process and may limit the opportunity

for some operators to continue deepwater drilling in the U.S. Gulf of Mexico, which could adversely affect the Company's financial operations. Third-party challenges to industry operations in the U.S. Gulf of Mexico may also serve to further delay or restrict activities. If the new regulations, policies, operating procedures and possibility of increased legal liability are viewed by our

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current or future customers as a significant impairment to expected profitability on projects, they could discontinue or curtail their operations, thereby adversely affecting our financial operations by decreasing demand for our products. Because of our foreign operations and sales, we are also subject to changes in foreign laws and regulations that may encourage or require hiring of local contractors or require foreign contractors to employ citizens of, or purchase supplies from, a particular jurisdiction. If we fail to comply with any applicable law or regulation, our business, results of operations, financial position and cash flows may be adversely affected.

Our businesses and our customers' businesses are subject to environmental laws and regulations that may increase our costs, limit the demand for our products and services or restrict our operations.

Our operations and the operations of our customers are also subject to federal, state, local and foreign laws and regulations relating to the protection of human health and the environment. These environmental laws and regulations affect the products and services we design, market and sell, as well as the facilities where we manufacture our products. For example, our operations are subject to numerous and complex laws and regulations that, among other things, may regulate the management and disposal of hazardous and non-hazardous wastes; require acquisition of environmental permits related to our operations; restrict the types, quantities and concentrations of various materials that can be released into the environment; limit or prohibit operation activities in certain ecologically sensitive and other protected areas; regulate specific health and safety criteria addressing worker protection; require compliance with operational and equipment standards; impose testing, reporting and record-keeping requirements; and require remedial measures to mitigate pollution from former and ongoing operations. We are required to invest financial and managerial resources to comply with such environmental, health and safety laws and regulations and anticipate that we will continue to be required to do so in the future. In addition, environmental laws and regulations could limit our customers' exploration and production activities. These laws and regulations change frequently, which makes it impossible for us to predict their cost or impact on our future operations. For example, legislation to regulate emissions of greenhouse gases has been introduced, but not enacted, in the U.S. Congress, and there has been a wide-ranging policy debate, both nationally and internationally, regarding the impact of these gases and possible means for their regulation. In addition, efforts have been made and continue to be made in the international community toward the adoption of international treaties or protocols that would address global climate change issues, such as the annual United Nations Climate Change Conferences, including the United Nations Climate Change Conference in Paris (COP 21) in November 2015, which resulted in the creation of the Paris Agreement. The Paris Agreement, signed by the U.S. on April 22, 2016, requires countries to review and "represent a progression" in their nationally determined contributions, which set greenhouse gas emission reduction goals, every five years. However, in August 2017, the United States informed the United Nations of its intent to withdraw from the Paris Agreement. The earliest possible effective withdrawal date from the Paris Agreement is November 2020. Also, the EPA has undertaken efforts to collect information regarding greenhouse gas emissions and their effects. Following a finding by the EPA that certain greenhouse gases represent a danger to human health, the EPA expanded its regulations relating to those emissions and adopted rules imposing permitting and reporting obligations. The results of the permitting and reporting requirements could lead to further regulation of these greenhouse gases by the EPA. Subsequent to the Paris Agreement, there has been no significant legislative progress in cap and trade proposals or greenhouse gas emission reductions. The adoption of legislation or regulatory programs to reduce greenhouse gas emissions could also increase the cost of consuming, and thereby reduce demand for, the hydrocarbons that our customers produce. Consequently, such legislation or regulatory programs could have an adverse effect on our financial condition and results of operations. It is too early to determine whether, or in what form, further regulatory action regarding greenhouse gas emissions will be adopted or what specific impact a new regulatory action might have on us or our customers. Generally, the anticipated regulatory actions do not appear to affect us in any material respect that is different, or to any materially greater or lesser extent, than other companies that are our competitors. However, our business and prospects could be adversely affected to the extent laws are enacted or modified or other governmental action is taken that prohibits or restricts our customers' exploration and production activities or imposes environmental protection requirements that result in increased costs to us or our customers.

Environmental laws may provide for “strict liability” for damages to natural resources or threats to public health and safety, rendering a party liable for environmental damage without regard to negligence or fault on the part of such party. Sanctions for noncompliance may include revocation of permits, corrective action orders, administrative or civil penalties and criminal prosecution. Some environmental laws and regulations provide for joint and several strict liability for remediation of spills and releases of hazardous substances. In addition, we may be subject to claims alleging personal injury or property damage as a result of alleged exposure to hazardous substances, as well as damage to natural resources. These laws and regulations also may expose us to liability for the conduct of or conditions caused by others, or for our acts that were in compliance with all applicable laws and regulations at the time such acts were performed. Any of these laws and regulations could result in claims, fines or expenditures that could be material to results of operations, financial position and cash flows.

Our business could be adversely affected by a failure or breach of our information technology systems.

Our business operations depend on our information technology (IT) systems. Despite our security and back-up measures, our IT systems are vulnerable to cyber incidents or attacks, natural disasters and other disruptions or failures. Due to the nature

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of cyber-attacks, breaches to our IT systems could go unnoticed for a prolonged period of time. The failure of our IT systems to perform as anticipated for any reason or any significant breach of security could disrupt our business and result in numerous adverse consequences, including reduced effectiveness and efficiency of our operations and those of our customers, the loss, theft, corruption or inappropriate disclosure of confidential information or critical data, increased overhead costs, loss of revenue, loss of intellectual property and damage to our reputation, which could have a material adverse effect on our business and results of operations. In addition, we may be required to incur significant costs to prevent or respond to damage caused by these disruptions or security breaches in the future.

Our business is subject to complex and evolving U.S. and foreign laws and regulations regarding privacy and data protection.

The regulatory environment surrounding data privacy and protection is constantly evolving and can be subject to significant change. New laws and regulations governing data privacy and the unauthorized disclosure of confidential information, including the European Union General Data Protection Regulation and recent California legislation, pose increasingly complex compliance challenges and potentially elevate our costs. Any failure, or perceived failure, by us to comply with applicable data protection laws could result in proceedings or actions against us by governmental entities or others, subject us to significant fines, penalties, judgments and negative publicity, require us to change our business practices, increase the costs and complexity of compliance, and adversely affect our business. As noted above, we are also subject to the possibility of cyber incidents or attacks, which themselves may result in a violation of these laws. Additionally, if we acquire a company that has violated or is not in compliance with applicable data protection laws, we may incur significant liabilities and penalties as a result.

The market price of our common stock may be volatile.

The trading price of our common stock and the price at which we may sell common stock in the future are subject to large fluctuations in response to any of the following:

- limited trading volume in our common stock;
- quarterly variations in operating results;
- general financial market conditions;
- the prices of natural gas and oil;
- announcements by us and our competitors;
- our liquidity;
- changes in government regulations;
- our ability to raise additional funds;
- our involvement in litigation; and
- other events.

We do not anticipate paying dividends on our common stock in the near future.

We have not paid any dividends in the past and do not intend to pay cash dividends on our common stock in the foreseeable future. Our Board of Directors reviews this policy on a regular basis in light of our earnings, financial position and market opportunities. We currently intend to retain any earnings for the future operation and development of our business as well as potential stock repurchases or acquisition opportunities.

Provisions in our corporate documents and Delaware law could delay or prevent a change in control of the Company, even if that change would be beneficial to our stockholders.

The existence of some provisions in our corporate documents and Delaware law could delay or prevent a change in control of our company, even if that change would be beneficial to our stockholders. Our certificate of incorporation and bylaws contain provisions that may make acquiring control of our company difficult, including:

- provisions relating to the classification, nomination and removal of our directors;
- provisions regulating the ability of our stockholders to bring matters for action at annual meetings of our stockholders;
- provisions requiring the approval of the holders of at least 80% of our voting stock for a broad range of business combination transactions with related persons; and
- the authorization given to our Board of Directors to issue and set the terms of preferred stock.





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In addition, the Delaware General Corporation Law imposes restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock.

## Item 1B. Unresolved Staff Comments

None.

## Item 2. Properties

## Manufacturing Facilities

Location	Building Size (Approximate Square Feet)	Land (Approximate Acreage)	Owned or Leased
Houston, Texas			
—Hempstead Highway	175,000	12.9	Owned
—N. Eldridge Parkway	1,731,000	218	Owned
—S. Main Street	127,000	2.9	Owned
Youngsville, Louisiana	36,100	0.8	Owned
Aberdeen, Scotland	222,800	24.1	Owned
Singapore	293,200	14.4	Leased
Macaé, Brazil	169,600	10.6	Owned

The Company's forging and heat treatment activities are performed at the Houston Eldridge Parkway facility. For additional information on our manufacturing facilities, see "Item 1. Business - General" and "Manufacturing".

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## Sales, Service and Reconditioning Facilities

Location*	Building Size (Approximate Square Feet)	Land (Approximate Acreage)	Activity
Midland, Texas	10,000	0.2	Sales/Service/Warehouse
Oklahoma City, Oklahoma*	6,000	0.1	Sales/Warehouse
Villahermosa, Mexico*	12,400	0.3	Sales/Service/Warehouse
Anaco, Venezuela*	3,000	0.1	Sales/Service/Warehouse
Quito, Ecuador	2,600	0.1	Sales
Shushufindi, Ecuador	135,800	3.1	Sales/Service/Warehouse
Szolnok, Hungary	4,300	0.1	Sales/Service/Warehouse
Beverwijk, Holland	32,000	0.7	Sales/Warehouse
Stavanger, Norway*	42,000	6.1	Sales/Service/Reconditioning/Warehouse/Fabrication
Esbjerg, Denmark	19,100	2.6	Sales/Service/Reconditioning/Warehouse
Takoradi, Ghana	2,500	0.8	Service/Reconditioning/Warehouse
Port Harcourt, Nigeria	6,600	0.1	Service/Reconditioning/Warehouse
Cairo, Egypt	2,200	—	Sales
Alexandria, Egypt	5,200	0.6	Service/Reconditioning/Warehouse
Balikpapan, Indonesia	2,000	—	Reconditioning
Doha, Qatar	8,900	—	Service/Reconditioning/Warehouse
Shekou, China	11,100	—	Sales/Service/Warehouse
Perth and Welshpool, Australia	28,000	2.9	Sales/Service/Reconditioning/Warehouse
Mumbai, India	130	—	Sales
Jakarta, Indonesia	150	—	Sales
Kuala Lumpur, Malaysia	400	—	Sales
Beijing, China	120	—	Sales

\*These facilities are owned; all other facilities are leased.

The Company also performs sales, service and reconditioning activities at its facilities in Houston, Youngsville, Alberta, Aberdeen, Singapore and Macae. For additional information on our manufacturing facilities, see "Item 1. Business - General".

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Item 3. Legal Proceedings

Brazilian Tax Issue

From 2002 to 2007, the Company's Brazilian subsidiary imported goods through the State of Espirito Santo in Brazil and subsequently transferred them to its facility in the State of Rio de Janeiro. During that period, the Company's Brazilian subsidiary paid taxes to the State of Espirito Santo on its imports. Upon the final sale of these goods, the Company's Brazilian subsidiary collected taxes from customers and remitted them to the State of Rio de Janeiro net of the taxes paid on importation of those goods to the State of Espirito Santo in accordance with the Company's understanding of Brazilian tax laws.

In December 2010 and January 2011, the Company's Brazilian subsidiary was served with two assessments totaling approximately \$13.0 million from the State of Rio de Janeiro to cancel the credits associated with the tax payments to the State of Espirito Santo (Santo Credits) on the importation of goods from July 2005 to October 2007. The Company has objected to these assessments on the grounds that they would represent double taxation on the importation of the same goods and that the Company is entitled to the credits under applicable Brazilian law. The Company's Brazilian subsidiary filed appeals with a State of Rio de Janeiro judicial court to annul both of these tax assessments following rulings against the Company by the tax administration's highest council. In connection with those appeals, the Company deposited with the court a total amount of approximately \$8.8 million in December 2014 and December 2016 as the full amount of the assessments with penalties and interest. The Company believes that these credits are valid and that success in the judicial court process is probable. Based upon this analysis, the Company has not accrued any liability in conjunction with this matter.

Since 2007, the Company's Brazilian subsidiary has paid taxes on the importation of goods directly to the State of Rio de Janeiro and the Company does not expect any similar issues to exist for periods subsequent to 2007.

General

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, property damage and environmental claims. Although exposure to such risk has not resulted in any significant problems in the past, there can be no assurance that ongoing and future developments will not adversely impact the Company.

For a further description of the Company's legal proceedings, see "Commitments and Contingencies," Note 15 of Notes to Consolidated Financial Statements. 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 action, in the opinion of management, the ultimate liability with respect thereto will not have a material adverse effect on the Company's results of operations, financial position or cash flows.

Item 4. Mine Safety Disclosure

Not applicable.

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## PART II

Item 5. Market for Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities  
The Company's common stock is publicly traded on the New York Stock Exchange under the symbol "DRQ".

There were approximately 170 stockholders of record of the Company's common stock as of December 31, 2018. This number includes the Company's employees and directors that hold shares, but does not include the number of security holders for whom shares are held in a "nominee" or "street" name.

The Company has not paid any dividends in the past and does not currently anticipate paying any dividends in the foreseeable future. The Company intends to reinvest any retained earnings for the future operation and development of its business, or to use for potential stock repurchases or acquisition opportunities. The Board of Directors will review this policy on a regular basis in light of the Company's earnings, financial position, market opportunities and restrictions under the ABL Credit Facility.

Information concerning securities authorized for issuance under equity compensation plans is included in "Stock-Based Compensation and Stock Awards", Note 18 of Notes to Consolidated Financial Statements.

## Repurchase of Equity Securities

The following table summarizes the repurchase and cancellation of our common stock during the year ended December 31, 2018:

	Twelve months ended December 31, 2018			
	Total Number of Shares Purchased	Average Price paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Dollar Value (in millions) of Shares that May Yet be Purchased Under the Plans or Programs
April 1-30, 2018	—	—	—	\$ 100.0
May 1-31, 2018	219,102	\$ 44.87	219,102	90.2
June 1-30, 2018	—	—	—	90.2
July 1-31, 2018	—	—	—	90.2
August 1-31, 2018	639,584	51.49	639,584	57.2
September 1-30, 2018	755,937	50.46	755,937	19.1
October 1-31, 2018	376,583	50.60	376,583	—
	1,991,206	\$ 50.22	1,991,206	\$ —

(1) On July 26, 2016, the Board of Directors authorized a share repurchase plan under which the Company can repurchase up to \$100 million of its common stock. The repurchase plan had no set expiration date although the maximum repurchase limit under the plan has now been met. During the year ended December 31, 2018, the Company purchased 1,991,206 shares under the share repurchase plan at an average price of approximately \$50.22 per share totaling approximately \$100 million, pursuant to a 10b5-1 plan, which is reflected in "Retained earnings" in the Consolidated Balance Sheet. All repurchased shares have been cancelled as of December 31, 2018.

## Performance Graph

The following graph compares the cumulative total shareholder return on our common stock to the cumulative total shareholder return on the Standard & Poor's 500 Stock Index and the Philadelphia Oil Service Sector Index ("OSX"), an index of oil and natural gas related companies that represents an industry composite of peers. This graph covers the period from December 31, 2013 through December 31, 2018. This comparison assumes the investment of \$100 on December 31, 2013 and the reinvestment of all dividends, if any. The shareholder return set forth is not necessarily

indicative of future performance.

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COMPARISON OF 5 YEARS  
CUMULATIVE TOTAL RETURN  
Among Dril-Quip, Inc., the S&P 500 Index  
and the Philadelphia Oil Service Index (OSX)

The performance graph above is furnished and not filed for purposes of Section 18 of the Exchange Act and will not be incorporated by reference into any registration statement filed under the Securities Act of 1933, as amended (the “Securities Act”), unless specifically identified therein as being incorporated therein by reference. The performance graph is not soliciting material subject to Regulation 14A.

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## Item 6. Selected Financial Data

The information set forth below should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the Consolidated Financial Statements and Notes thereto included elsewhere in this report on Form 10-K.

	Year Ended December 31,				
	2018	2017	2016	2015	2014
	(In thousands, except per share amounts)				
Statement of Operations Data:					
Revenues:					
Products	\$265,052	\$351,132	\$433,012	\$685,364	\$773,205
Services	72,414	61,945	64,094	96,297	100,216
Leasing	47,160	42,392	41,625	62,649	57,536
Total revenues	384,626	455,469	538,731	844,310	930,957
Cost and expenses:					
Cost of sales:					
Products	200,494	246,005	268,405	382,925	428,125
Services	62,109	53,303	52,611	66,088	74,625
Leasing	8,896	6,086	7,388	10,273	10,777
Total cost of sales	271,499	305,394	328,404	459,286	513,527
Selling, general and administrative	104,039	116,251	53,246	88,044	92,762
Engineering and product development	39,422	42,160	44,325	48,145	45,920
Impairment, restructuring and other charges	98,602	60,968	—	—	—
Gain on Sale of Assets	(6,198 )	(168 )	(103 )	—	—
Total costs and expenses	507,364	524,605	425,872	595,475	652,209
Operating income (loss)	(122,738 )	(69,136 )	112,859	248,835	278,748
Interest income	8,040	3,564	3,037	948	667
Interest expense	(291 )	(72 )	(28 )	(12 )	(35 )
Income (loss) before income taxes	(114,989 )	(65,644 )	115,868	249,771	279,380
Income tax (benefit) provision	(19,294 )	34,995	22,647	57,763	70,668
Net income (loss)	\$(95,695 )	\$(100,639)	\$93,221	\$192,008	\$208,712
Earnings (loss) per common share:					
Basic	\$(2.58 )	\$(2.69 )	\$2.48	\$5.00	\$5.22
Diluted	\$(2.58 )	\$(2.69 )	\$2.47	\$4.98	\$5.19
Weighted average common shares outstanding:					
Basic	37,075	37,457	37,537	38,364	39,964
Diluted	37,075	37,457	37,667	38,531	40,190
Statement of Cash Flows Data:					
Net cash provided by (used in) operating activities	\$45,503	\$107,993	\$246,522	\$190,155	\$149,313
Net cash used in investing activities	(15,173 )	(44,892 )	(157,849 )	(26,655 )	(41,571 )
Net cash provided by (used in) financing activities	\$(99,199 )	\$560	\$(21,893 )	\$(73,565 )	\$(186,827)
Other Data:					
Depreciation and amortization	\$35,312	\$40,974	\$31,857	\$30,477	\$31,155
Capital expenditures	\$32,061	\$27,622	\$25,763	\$27,079	\$42,549

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	As of December 31,				
	2018	2017	2016	2015	2014
	(In thousands)				
Balance Sheet Data:					
Working capital	\$770,723	\$908,638	\$955,231	\$1,023,483	\$928,498
Total assets	\$1,192,510	\$1,399,805	\$1,461,404	\$1,428,250	\$1,449,251
Total stockholders' equity	\$1,096,162	\$1,294,461	\$1,356,424	\$1,324,458	\$1,245,192

## Item 7. 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 aspects of the Company's financial position, results of operations, comprehensive income and cash flows during the periods included in the accompanying consolidated financial statements. This discussion should be read in conjunction with the Company's consolidated financial statements and notes thereto presented elsewhere in this report.

## Overview

Dril-Quip designs, manufactures, sells and services highly engineered drilling and production equipment that is well suited primarily for use in deepwater, harsh environment and severe service applications. Dril-Quip's products are used by major integrated, large independent and foreign national oil and gas companies and drilling contractors 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, diverters and safety valves. 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.

**Oil and Gas Prices**

Both the market for 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. Oil and gas prices and the level of drilling and production activity have historically been characterized by significant volatility. See "Item 1A. Risk Factors—A material or extended decline in expenditures by the oil and gas industry could significantly reduce our revenue and income."

During 2018, Brent crude oil prices fluctuated significantly, with a high of \$86.07 per barrel, a low of \$50.57 per barrel, and an average of \$71.34 per barrel compared to an average of \$54.15 per barrel in 2017 and \$43.67 per barrel in 2016. According to the December 2018 release of the Short-Term Energy Outlook published by the EIA, Brent crude oil prices are projected to average \$61.00 per barrel in 2019 and \$65.00 per barrel in 2020. The International Energy Agency projected the global oil demand to grow by approximately 1.4 million barrels per day to a total of 100.6 million barrels per day in 2019 based on its December 2018 Oil Market Report.

## Rig Count

Detailed below is the average contracted offshore rig count (rigs currently drilling as well as rigs committed, but not yet drilling) for the Company's geographic regions for the years ended December 31, 2018, 2017 and 2016. The rig count data includes floating rigs (semi-submersibles and drillships) and jack-up rigs. The Company has included only these types of rigs as they are the primary assets used to deploy the Company's products.

	2018		2017		2016	
	Floating Rigs	Jack-up Rigs	Floating Rigs	Jack-up Rigs	Floating Rigs	Jack-up Rigs
Western Hemisphere	56	37	58	41	83	43
Eastern Hemisphere	57	63	56	60	62	65
Asia Pacific	34	231	34	222	29	221
Total	147	331	148	323	174	329





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Source: IHS—Petrodata RigBase— December 31, 2018, 2017 and 2016

According to IHS-Petrodata RigBase, as of December 31, 2018, there were 487 rigs contracted for the Company's geographic regions (146 floating rigs and 341 jack-up rigs), which represents a 3.4% increase from the rig count of 471 rigs (148 floating rigs and 323 jack-up rigs) as of December 31, 2017. The December 31, 2017 rig count represented a 2.2% increase from the rig count on December 31, 2016 of 461 rigs (151 floating rigs and 310 jack-up rigs).

The Company believes that the number of rigs (semi-submersibles, drillships and jack-up rigs) under construction impacts its backlog and resulting 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 the Company's backlog. According to IHS-Petrodata RigBase, at the end of 2018, 2017 and 2016, there were 121, 138 and 152 rigs, respectively, under construction. The expected delivery dates for the rigs under construction on December 31, 2018 are as follows:

	Floating Rigs	Jack-up Rigs	Total
2019	53	22	75
2020	22	11	33
2021	4	9	13
Total	79	42	121

However, given the sustained low level of oil and gas prices and oversupply of offshore drilling rigs, the Company believes it is possible that delivery of some rigs under construction could be postponed or cancelled, limiting the opportunity for supply of the Company's products.

#### Regulation

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.

In March 2018, the President of the United States issued a proclamation imposing a 25 percent global tariff on imports of certain steel products, effective March 23, 2018. The President subsequently proposed an additional 25 percent tariff on approximately \$50 billion worth of imports from China, and the government of China responded with a proposal of an additional 25 percent tariff on U.S. goods with a value of \$50 billion. The initial U.S. tariffs were implemented on July 6, 2018, covering \$34 billion worth of Chinese goods, with another \$16 billion of goods facing tariffs beginning on August 23, 2018.

In September 2018, the President directed the U.S. Trade Representative (USTR) to place additional tariffs on approximately \$200 billion worth of additional imports from China. These tariffs, which took effect on September 24, 2018, initially have been set at a level of 10 percent until the end of the year, at which point the tariffs were to rise to 25 percent. However, on December 19, 2018, USTR postponed the date on which the rate of the additional duties will increase to 25 percent until March 2, 2019.

In November 2018, the United States, Mexico and Canada signed the United States-Mexico-Canada Agreement (USMCA), the successor agreement to the North American Free Trade Agreement (NAFTA), which still requires ratification by the respective governments of all three signatories before going into effect. The President has indicated that he may withdraw the United States from NAFTA in order to encourage the U.S. Congress to vote on ratification of the USMCA.

If the President imposes additional tariffs on China or withdraws from or replaces NAFTA, or if any additional tariffs or trade restrictions are initiated by or against the United States, such action could cause our cost of raw materials to increase or affect the markets for our products. However, given the uncertainty regarding the scope and duration of these trade actions by the United States and other countries, their ultimate impact on our business and operations

remains uncertain.

**Business Environment**

Oil and gas prices and the level of 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. Lower crude oil and natural gas prices have resulted in a trend of customers seeking to renegotiate contract terms with the Company, including reductions in the prices of its products and services,

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extensions of delivery terms and, in some instances, contract cancellations or revisions. In some cases, a customer may already hold an inventory of the Company's equipment, which may delay the placement of new orders. In addition, some of the Company's customers could experience liquidity or solvency issues or could otherwise be unable or unwilling to perform under a contract, which could ultimately lead a customer to enter bankruptcy or otherwise encourage a customer to seek to repudiate, cancel or renegotiate a contract. An extended period of reduced crude oil and natural gas prices may accelerate these trends. If the Company experiences significant contract terminations, suspensions or scope adjustments to its contracts, then its financial condition, results of operations and cash flows may be adversely impacted.

The Company expects continued pressure in both crude oil and natural gas prices, as well as in the level of drilling and production related activities. Even during periods of high prices for oil and natural gas, companies exploring for oil and gas may cancel or curtail programs, seek to renegotiate contract terms, including the price of products and services, or reduce their levels of capital expenditures for exploration and production for a variety of reasons. Lower drilling and production activity had a negative impact on the Company's results for the year ended December 31, 2018 and is expected to improve slightly in certain markets in 2019. A prolonged delay in the recovery of commodity prices could also lead to further material impairment charges to tangible or intangible assets or otherwise result in a material adverse effect on the Company's results of operations.

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 investments in foreign countries. These risks include nationalization, expropriation, war, acts of terrorism and civil disturbance, restrictive action by local governments, limitation on repatriation of earnings, change in foreign tax laws and change in currency exchange rates, any of which could have an adverse effect on either the Company's ability to manufacture its products in its facilities abroad or the demand in certain regions for the Company's products or both. To date, the Company has not experienced any significant problems in foreign countries arising from local government actions or political instability, but there is no assurance that such problems will not arise in the future. Interruption of the Company's international operations could have a material adverse effect on its overall operations. Revenues. Dril-Quip's revenues are generated from three sources: products, services and leasing rental tools. Product revenues are derived from the sale of drilling and production equipment. Service revenues are earned when the Company provides technical advisory assistance and rental tools during installation and retrieval of the Company's products. Additionally, the Company earns service revenues when rework and reconditioning services are provided. In 2018, the Company derived 69% of its revenues from the sale of its products, 19% of its revenues from services and 12% of its revenues from leasing rental tools, compared to 77%, 14% and 9% for products, services and leasing rental tools in 2017, respectively, and 80%, 12% and 8% for products, services and leasing rental tools in 2016, respectively. Service and leasing revenues generally correlate to revenues from product sales because increased product sales typically generate increased demand for technical advisory assistance services during installation and rental of running tools. However, existing customer equipment can be used in certain circumstances, which creates demand for services with no correlating product sales. The Company has substantial international operations, with approximately 61% of its revenues derived from foreign sales in 2018, 55% in 2017 and 66% in 2016. Substantially all of the Company's domestic revenue relates to operations in the U.S. Gulf of Mexico. Domestic revenue approximated 39% of the Company's total revenues in 2018, 45% in 2017 and 34% in 2016.

Product contracts are typically negotiated and sold separately from service contracts. In addition, service contracts are not typically 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 worldwide economic conditions in the 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. Generally, the Company attempts to raise its prices as its costs increase. However, the actual pricing of the Company's products and services is impacted by a number of factors, including global oil prices, competitive pricing pressure, the

level of utilized capacity in the oil service sector, maintenance of market share, the introduction of new products and general market conditions.

The Company accounts for larger and more complex projects that have relatively longer manufacturing time frames on an over time basis. During 2018, there were 22 projects that were accounted for using the over time method, which represented approximately 16% of the Company's total revenues and 23% of the Company's product revenues. During 2017, there were eight projects that were accounted for using the over time method, which represented approximately 13% of the Company's total revenues and 16% of the Company's product revenues. During 2016, there were ten projects that were accounted for using the over time method, which represented approximately 14% of the Company's total revenues and 17% of the Company's product revenues. These percentages 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

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progresses, and adjustments proportionate to the percentage complete are reflected in the period when such estimates are revised. Losses, if any, are recorded in full in the period they become known. Amounts received from customers in excess of revenues recognized are classified as a current liability. See "Item 1A. Risk Factors—We may be required to recognize a charge against current earnings because of over time method of accounting."

**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, costs from projects accounted for under the over time method, over/under manufacturing overhead absorption 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, business development expenses, compensation expense, stock-based compensation expense, legal expenses, foreign currency transaction gains and losses and other related administrative functions. The Company's U.K. subsidiary, whose functional currency is the British pound sterling, conducts a portion of its operations in U.S. dollars. As a result, this subsidiary holds significant monetary assets denominated in U.S. dollars. These monetary assets are subject to changes in exchange rates between the U.S. dollar and the British pound sterling, which has resulted in pre-tax non-cash foreign currency gains during the year ended December 31, 2018 totaling \$1.0 million.

**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.

**Impairment, Restructuring and Other Charges.** Impairment, restructuring and other charges consist of certain goodwill, inventory, long-lived assets and other restructuring costs of \$38.6 million, \$32.1 million, \$14.9 million and \$13.0 million, respectively, which occurred in connection with our preparation and review of financial statements for the year ended December 31, 2018.

For the year ended December 31, 2017, the balance consisted of certain inventory and fixed asset write-downs of \$27.4 million and \$33.6 million, respectively. For more detail, see "Impairment, Restructuring and Other Charges", Note 8 of Notes to Consolidated Financial Statements and "Goodwill", Note 9 of Notes to Consolidated Financial Statements.

**Income Tax Provision.** Income tax benefit for 2018 was \$19.3 million on net loss before taxes of \$115.0 million, resulting in an effective income tax rate of 16.8%. Income tax expense in 2017 was \$35.0 million on net loss before taxes of \$65.6 million, resulting in an effective tax rate of approximately negative 53%. The change in the 2018 effective income tax rate was primarily impacted by the recording of a valuation allowance against the net U.S. deferred tax assets as well as those in various foreign countries, goodwill impairment, and the impact of US Tax Reform and foreign tax credits.

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## Results of Operations

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

	Year Ended December 31,		
	2018	2017	2016
Revenues:			
Products	68.9 %	77.1 %	80.4 %
Services	18.8	13.6	11.9
Leasing	12.3	9.3	7.7
Total revenues	100.0	100.0	100.0
Cost of sales:			
Products	52.1	54.0	49.8
Services	16.1	11.7	9.8
Leasing	2.3	1.3	1.4
Total cost of sales	70.5	67.0	61.0
Selling, general and administrative	27.0	25.5	9.9
Engineering and product development	10.2	9.3	8.2
Impairment, restructuring and other charges	25.6	13.4	—
Gain on sale of assets	(1.6 )	—	—
Total costs and expenses	131.7	115.2	79.1
Operating income	(31.7 )	(15.2 )	20.9
Interest income	2.1	0.8	0.6
Interest expense	(0.1 )	—	—
Income before income taxes	(29.7 )	(14.4 )	21.5
Income tax provision	(5.0 )	7.7	4.2
Net income	(24.7 )%	(22.1 )%	17.3 %

The following table sets forth, for the periods indicated, a breakdown of our products and service revenues:

	Year Ended December		
	2018	2017	2016
	(In millions)		
Revenues:			
Products:			
Subsea equipment	\$209.1	\$291.2	\$375.3
Downhole tools	32.2	33.4	6.9
Surface equipment	19.6	14.5	16.7
Offshore rig equipment	4.1	12.1	34.1
Total products	265.0	351.2	433.0
Services	72.4	61.9	64.1
Leasing	47.2	42.4	41.6
Total revenues	\$384.6	\$455.5	\$538.7

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## Year Ended December 31, 2018 Compared to Year Ended December 31, 2017

**Revenues.** Revenues decreased by \$70.9 million, or approximately 16%, to \$384.6 million in 2018 from \$455.5 million in 2017. The overall decrease in revenue was driven by lower product revenues of \$86.2 million, partially offset by an increase in service revenues of \$10.5 million and leasing revenues of \$4.8 million. Product revenues decreased by approximately \$86.2 million for the year ended December 31, 2018 compared to the same period in 2017 as a result of decreased revenues of \$82.1 million in subsea equipment, \$8.0 million in offshore rig equipment and \$1.2 million in downhole tools, offset by increased revenues of \$5.1 million from surface equipment sales. Product revenues decreased in the Western Hemisphere by \$46.9 million and in Asia Pacific by \$41.3 million, partially offset by increased revenues in the Eastern Hemisphere of \$2.0 million. The overall decreased revenues were largely due to decreases in the demand for exploration and production equipment, especially subsea equipment, as a result of deteriorating and sustained low oil and gas prices in 2018 and 2017. In any given time period, the revenues recognized between the various product lines and geographic areas will vary depending upon the timing of shipments to customers, completion status of the projects accounted for under the over-time method, market conditions and customer demand. Service revenues increased by approximately \$10.5 million, resulting from increased service revenues in the Western Hemisphere of \$4.1 million, in Asia Pacific of \$4.0 million and in the Eastern Hemisphere of \$2.4 million. The increase in service revenues was largely due to increased technical advisory assistance and reconditioning of customer-owned property. Leasing revenues increased by approximately \$4.8 million for the year ended December 31, 2018 compared to the same period in 2017 as a result of increased rental tool sales of \$4.8 million in Asia Pacific and \$2.8 million in the Eastern Hemisphere, partially offset by a decrease of \$2.8 million in the Western Hemisphere.

**Cost of Sales.** Cost of sales decreased by \$33.9 million, or 11%, to \$271.5 million for 2018 from \$305.4 million for 2017. As a percentage of revenues, cost of sales was approximately 71% in 2018 and 67% in 2017. Cost of sales as a percentage of revenue increased in 2018, primarily as a result of unabsorbed manufacturing costs, product mix and pricing concessions.

**Selling, General and Administrative Expenses.** For 2018, selling, general and administrative expenses decreased by approximately \$12.3 million, or 11%, to \$104.0 million from \$116.3 million in 2017. The Company experienced a non-cash pre-tax foreign currency transaction gain of \$1.0 million for the year ended December 31, 2018, compared to an \$8.3 million loss for the same period in 2017. The decrease is primarily due to lower employee costs of \$5.5 million and lower insurance costs of \$1.7 million, offset by increases in Corporate costs of \$1.4 million and other various costs of \$2.8 million. Severance costs were incurred during 2018; however, these are considered part of the restructuring plan and are included within the "Impairment, restructuring and other charges" line in our consolidated statement of operations. For the year ended December 31, 2017, we incurred \$3.0 million in severance costs. Selling, general and administrative expenses as a percentage of revenues increased to 27% for the year ended December 31, 2018 from 26% for the same period of 2017.

**Engineering and Product Development Expenses.** For 2018, engineering and product development expenses decreased by approximately \$2.8 million, or 7%, to \$39.4 million from \$42.2 million in 2017, primarily due to a reduction in payroll related expenses. Engineering and product development expenses as a percentage of revenues increased to 10% in 2018 from 9% in 2017, largely due to the decrease in revenues.

**Impairment, Restructuring and Other Charges.** In December 2018, the overall offshore market conditions declined. This decline was evidenced by lower commodity prices, decline in expected offshore rig counts, decrease in our customers' capital budgets and potential delays associated with certain of our long term projects. Further, in December 2018 due to the decline in our stock price, our market capitalization dropped below the carrying value of our assets. As a result, an interim goodwill impairment analysis was performed in connection with the preparation and review of financial statements for the year ended December 31, 2018. Based on this analysis, we recorded an impairment loss of \$38.6 million for our Western Hemisphere reporting unit for the year ended December 31, 2018. No goodwill impairment losses were recorded for the years ended December 31, 2017 and 2016. For further information, see "Goodwill", Note 9 of Notes to Consolidated Financial Statements.



Additionally, we incurred restructuring, long-lived asset impairments and other charges associated with the cost reduction plan of \$60.0 million during the year ended December 31, 2018.

We recognized an impairment during the year ended December 31, 2017 of approximately \$33.6 million related to inventory and \$27.4 million related to fixed assets, as a result of decreased Brent crude (Brent) prices and certain asset utilization. For further discussion, see "Impairment, Restructuring and Other Charges", Note 8 of Notes to Consolidated Financial Statements.

**Income Tax Provision.** Income tax benefit for 2018 was \$19.3 million on net loss before taxes of \$115.0 million, resulting in an effective income tax rate of 16.8%. Income tax expense in 2017 was \$35.0 million on net loss before taxes of \$65.6 million, resulting in an effective tax rate of approximately negative 53%. The change in the effective income tax rate was primarily impacted by the change in valuation allowance against the net U.S. deferred tax assets as well as those in various

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foreign countries, change in uncertain tax positions versus the prior year, goodwill impairment, and the impact of US Tax Reform and foreign tax credits.

Net Income (Loss). Net loss was approximately \$95.7 million in 2018, compared to \$100.6 million in 2017, for the reasons set forth above.

Year Ended December 31, 2017 Compared to Year Ended December 31, 2016

Revenues. Revenues decreased by \$83.2 million, or approximately 15%, to \$455.5 million in 2017 from \$538.7 million in 2016. The overall decrease in revenues was impacted by a 6.4% decrease in the average contracted offshore rig count (including floating and jack-up rigs) in 2017 as compared to 2016. Product revenues decreased by approximately \$81.8 million for the year ended December 31, 2017 compared to the same period in 2016 as a result of decreased revenues of \$84.1 million in subsea equipment, \$2.2 million in surface equipment and \$22.0 million in offshore rig equipment, partially offset by an increase in product revenues of \$26.5 million related to downhole tool sales. Product revenues decreased in the Western Hemisphere by \$37.3 million, in Asia Pacific by \$7.4 million and in the Eastern Hemisphere by \$37.2 million. The decreased revenues were largely due to decreases in the demand for exploration and production equipment, especially subsea equipment, as a result of deteriorating oil and gas prices in 2015 and 2016. In any given time period, the revenues recognized between the various product lines and geographic areas will vary depending upon the timing of shipments to customers, completion status of the projects accounted for under the over time accounting method, market conditions and customer demand. Service revenues decreased by approximately \$2.2 million, resulting from decreased service revenues in the Eastern Hemisphere of \$6.4 million, partially offset by increased service revenues in Asia Pacific of \$3.0 million and in the Western Hemisphere of \$1.2 million. Leasing revenues increased by \$0.8 million, resulting from increased leasing revenues of \$0.8 million and \$0.4 million in the Asia Pacific and Western Hemisphere regions, respectively, partially offset by a decrease in the Eastern Hemisphere of \$0.4 million. The decrease in service and leasing revenues was largely due to the decline in oil and gas prices leading to decreased exploration and production activities.

Cost of Sales. Cost of sales decreased by \$23.0 million, or 7.0%, to \$305.4 million for 2017 from \$328.4 million for 2016. As a percentage of revenues, cost of sales was approximately 67.1% in 2017 and 61.0% in 2016. Cost of sales as a percentage of revenue increased in 2017, primarily as a result of unabsorbed manufacturing costs, product mix and pricing concessions, as well as the inclusion of a full year of expenses from the TIW business.

Selling, General and Administrative Expenses. For 2017, selling, general and administrative expenses increased by approximately \$62.9 million, or 118.4%, to \$116.1 million from \$53.1 million in 2016. The Company experienced a non-cash pre-tax foreign currency transaction loss of \$8.3 million for the year ended December 31, 2017, compared to a gain of \$31.7 million for the same period in 2016. In addition, the Company recognized recurring TIW expenses of \$25.1 million for the year ended December 31, 2017 compared to \$5.3 million for the year ended December 31, 2016. Severance costs totaled \$3.0 million for the year ended December 31, 2017, compared to \$2.0 million severance costs for the same period of 2016. Corporate expenses totaled \$36.7 million and \$33.7 million for the year ended December 31, 2017 and 2016, respectively. These increases in costs were partially offset by lower selling costs in the Eastern Hemisphere of \$1.0 million for the year ended December 31, 2017 as a result of reduced headcount and salary reductions in the region. Selling, general and administrative expenses as a percentage of revenues increased to 25.5% for the year ended December 31, 2017 from 9.9% for the same period of 2016.

Engineering and Product Development Expenses. For 2017, engineering and product development expenses decreased by approximately \$2.1 million, or 4.9%, to \$42.2 million from \$44.3 million in 2016 primarily due to a reduction in payroll related expenses. Engineering and product development expenses as a percentage of revenues increased to 9.3% in 2017 from 8.2% in 2016 largely due to the decrease in revenues. Engineering costs related to TIW for the years ended December 31, 2017 and 2016 were \$3.8 million and \$1.0 million, respectively.

Impairment, Restructuring and Other Charges. In connection with our preparation and review of financial statements for the year ended December 31, 2017, after considering current Brent consensus forecasts and expected rig counts for the foreseeable future, we determined the carrying amount of certain of our long-lived assets in the Western Hemisphere exceeded the fair values of such assets due to projected declines in asset utilization, and that the cost of some of our worldwide inventory exceeded its market value. As a result, we recorded corresponding impairments and

other charges. Primarily as a result of the factors described above, we recorded charges of approximately \$33.6 million related to inventory and \$27.4 million related to fixed assets. No additional impairments were recorded during the three months ended December 31, 2017. Additionally, no impairments of long-lived assets were recorded in 2016 or 2015.

**Income Tax Provision.** Income tax expense for 2017 was \$35.0 million on net loss before taxes of \$65.6 million, resulting in an effective income tax rate of approximately negative 53%. Income tax expense in 2016 was \$22.6 million on income before taxes of \$115.9 million, resulting in an effective tax rate of approximately 19.5%. The change in the effective income tax rate was primarily impacted by the effects of US Tax Reform where estimated provisional reserves were established for the

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re-measurement of deferred tax assets, for the one-time transition tax, the recording of a valuation allowance against the net U.S. deferred tax assets as well as those in various foreign countries, and various credits and deductions in the U.K.

Net Income (Loss). Net loss was approximately \$100.6 million in 2017, compared to net income of \$93.2 million in 2016, for the reasons set forth above.

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## Non-GAAP Financial Measures

We have performed a detailed analysis of the non-GAAP measures that are relevant to our business and its operations and determined that the appropriate unit of measure to analyze our performance is Adjusted EBITDA (earnings before interest, taxes, depreciation and amortization, as well as other significant non-cash items and other adjustments for certain charges and credits). The Company believes that the exclusion of these charges and credits from these financial measures enables it to evaluate more effectively the Company's operations period over period and to identify operating trends that could otherwise be masked by excluded items. It is our determination that Adjusted EBITDA is a more relevant measure of how the Company reviews its ability to meet commitments and pursue capital projects.

## Adjusted EBITDA

We calculate Adjusted EBITDA as one of the indicators to evaluate and compare the results of our operations from period to period by removing the effect of our capital structure from our operating structure and certain other items, including those that affect the comparability of operating results. This measurement is used in concert with net income, its most directly comparable financial measure, and net cash from operating activities, which measures actual cash generated in the period. In addition, we believe that Adjusted EBITDA is a supplemental measurement tool used by analysts and investors to help evaluate overall operating performance, ability to pursue and service possible debt opportunities and analyze possible future capital expenditures. Adjusted EBITDA does not represent funds available for our discretionary use and is not intended to represent or to be used as a substitute for net income, as measured under U.S. generally accepted accounting principles. The items excluded from Adjusted EBITDA, but included in the calculation of reported net income, are significant components of the consolidated statements of income and must be considered in performing a comprehensive assessment of overall financial performance. Our calculation of Adjusted EBITDA may not be consistent with calculations of Adjusted EBITDA used by other companies.

The following table reconciles our reported net income to Adjusted EBITDA for each of the respective periods:

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Net Income (Loss)	\$ (95,695)	\$ (100,639)	\$ 93,221
Add:			
Interest (income) expense	(7,749 )	(3,492 )	(3,009 )
Income tax expense (benefit)	(19,294 )	34,995	22,647
Depreciation and amortization expense	35,312	40,974	31,857
Restructuring costs, including severance	13,071	5,170	5,476
Long-lived asset, inventory and goodwill impairments	85,531	60,968	—
Gain on sale of assets	(6,198 )	—	—
Foreign currency loss (gain)	(1,007 )	8,292	(31,764 )
Stock compensation expense	13,459	14,270	12,217
Adjusted EBITDA (1)	\$ 17,430	\$ 60,538	\$ 130,645

(1) Adjusted EBITDA for the years ended December 31, 2017 and 2016 included negative Adjusted EBITDA of approximately \$(2.6) million and \$(3.1) million, respectively, related to TIW. These decreases in Adjusted EBITDA were related to lower international orders for the years ended December 31, 2017 and 2016.

Adjusted EBITDA does not measure financial performance under GAAP and, accordingly, should not be considered as an alternative to net income as an indicator of operating performance.

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## Liquidity and Capital Resources

## Cash Flows

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

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Net cash provided by operating activities	\$45,503	\$107,993	\$246,522
Net cash used in investing activities	(15,173 )	(44,892 )	(157,849 )
Net cash provided by (used in) financing activities	(99,199 )	560	(21,893 )
	(68,869 )	63,661	66,780
Effect of exchange rate changes on cash activities	(6,211 )	6,022	(24,619 )
Increase (decrease) in cash and cash equivalents	\$(75,080)	\$69,683	\$42,161

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 year, as these are non-cash changes. As a result, changes reflected in certain accounts on the Consolidated Statements of Cash Flows may not reflect the changes in corresponding accounts on the 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, (ii) to fund working capital and (iii) to fund the repurchase of the Company's shares. The Company's principal source of funds is cash flows from operations. As of December 31, 2018, the Company had availability of \$52.2 million under the ABL Credit Facility. The Company may use its liquidity for, among other things, the support of the Company's research and development efforts, the funding of key projects and spending required by any upturn in the Company's business and the pursuit of possible acquisitions.

Net cash provided by operating activities in 2018 decreased by approximately \$62.5 million, primarily due to decreases resulting from the change in operating assets and liabilities of \$71.3 million, offset by a decreased net loss of \$4.9 million between 2018 and 2017 and increases in non-operating assets and liabilities of approximately \$3.9 million. Decreases in the change in operating assets and liabilities of \$71.3 million related to the change in trade receivables of \$38.0 million as a result of increased settlements with customers during 2018, prepaid and other assets of \$25.2 million and trade accounts payable and accrued expenses of \$20.5 million, offset by increases in inventory of \$12.3 million as a result of reductions in customer orders and efforts to utilize existing inventory and other costs of \$0.3 million. Net cash provided by operating activities decreased \$138.5 million in 2017 compared to 2016, primarily due to the transition to a net loss of \$100.6 million compared to net income in 2016 of \$93.2 million.

Net loss increased by \$4.9 million to \$95.7 million in 2018 from a net loss of \$100.6 million in 2017. Net income decreased by \$193.8 million to a net loss of \$100.6 million in 2017 from net income of \$93.2 million in 2016. The reasons for the changes in net income (loss) are set forth in the "Results of Operations" section above.

The change in operating assets and liabilities of \$75.6 million during 2017 primarily related to decreases in inventories of \$64.3 million as a result of reductions in customer orders and efforts to utilize existing inventory, as well as decreases in deferred income taxes as a result of the newly implemented tax legislation in December 2017 of \$24.5 million, decreases in accounts receivable of \$21.9 million, and decreases in accounts payable and accrued expenses of \$1.6 million.

Net cash used in investing activities decreased by approximately \$29.7 million due to increased capital expenditures related to facilities in the Western and Asia Pacific Hemispheres, partially offset by increased proceeds related to sales of assets and no acquisitions occurring in 2018. Capital expenditures by the Company were \$32.1 million, \$27.6 million and \$25.8 million in 2018, 2017 and 2016, respectively. Capital expenditures in 2018, 2017 and 2016 included expanding worldwide manufacturing facilities as well as increased expenditures on machinery and equipment and running tools. Capital expenditures in 2018 included \$14.0 million for facilities, \$12.6 million for rental tools, \$2.9 million for machinery and equipment and other expenditures of \$2.6 million. Capital expenditures in 2017 were primarily \$15.7 million for facilities, \$5.5 million for machinery and equipment, \$5.6 million for running tools and other expenditures of \$0.8 million. Capital expenditures in 2016 were comprised of \$10.8 million for facilities, \$6.0

million for machinery and equipment, \$7.9 million for running tools and other expenditures of \$1.1 million. The Company acquired The Technologies Alliance Inc. d/b/a OilPatch Technologies (OPT) for approximately \$19.9 million, net of cash and working capital adjustments, during the first quarter of 2017.

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Repurchase of Equity Securities

On February 26, 2015, the Company announced that the Board of Directors had authorized a stock repurchase plan under which the Company was authorized to repurchase up to \$100 million of its common stock. As part of the repurchase plan, the Company repurchased 400,500 shares under this plan for a total of \$24.2 million during 2017. All repurchased shares were subsequently cancelled.

On July 26, 2016, the Board of Directors authorized a stock repurchase plan under which the Company was authorized to repurchase up to \$100 million of its common stock. During the year ended December 31, 2018, we purchased, and subsequently cancelled, 1,991,206 shares for \$100.0 million. The repurchase plan was completed on October 19, 2018. All repurchased shares have been cancelled as of December 31, 2018. Refer to "Item 5 - Market for Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities" for further discussion.

On February 26, 2019, the Company announced that the Board of Directors had authorized a new stock repurchase program under which the Company is authorized to repurchase up to \$100 million of its common stock. The repurchase program has no set expiration date. Repurchases under the program will be made through open market purchases, privately negotiated transactions or plans, instructions or contracts established under Rule 10b5-1 under the Exchange Act. The manner, timing and amount of any purchase will be determined by management based on an evaluation of market conditions, stock price, liquidity and other factors. The program does not obligate the Company to acquire any particular amount of common stock and may be modified or superseded at any time at the Company's discretion. Any repurchased shares are expected to be cancelled. No repurchases have been made pursuant to this program at the time of this filing.

Contractual Obligations

The following table presents long-term contractual obligations of the Company and the related payments in total and by year as of December 31, 2018:

	Payments Due by Year						
Contractual Obligations	2019	2020	2021	2022	2023	After 2023	Total
	(In millions)						
Operating lease obligations	\$2.0	1.5	0.8	0.5	0.4	4.2	\$9.4

In addition to the above, the Company has issued purchase orders in the ordinary course of business for the purchase of goods and services. These purchase orders are enforceable and legally binding. However, none of the Company's purchase obligations call for deliveries of goods or services for time periods in excess of one year.

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 at current activity levels. However, if work activity increases, there could be a strain on working capital.

Asset Backed Loan (ABL) Credit Facility

On February 23, 2018, the Company, as borrower, and the Company's subsidiaries TIW Corporation and Honing, Inc., as guarantors, entered into a five-year senior secured revolving credit facility (the "ABL Credit Facility") with JPMorgan Chase Bank, N.A., as administrative agent, and other financial institutions as lenders with total commitments of \$100.0 million, including up to \$10.0 million available for letters of credit. The maximum amount that the Company may borrow under the ABL Credit Facility is subject to the borrowing base, which is based on a percentage of eligible accounts receivable and eligible inventory, subject to reserves and other adjustments.

As of December 31, 2018, the availability under the ABL Credit Facility was \$52.2 million, after taking into account the outstanding letters of credit of approximately \$1.7 million issued under the facility. For additional information on the ABL Credit Facility, see "Asset Backed Loan (ABL) Credit Facility," Note 14 of Notes to Consolidated Financial Statements.

Backlog

Backlog typically consists of firm customer orders of Dril-Quip products for which a purchase order, signed contract or letter of award has been received, satisfactory credit or financing arrangements exist and delivery is scheduled.



Historically, the Company's revenues for a specific period have not been directly related to its backlog as stated at a particular point in time.

The Company believes that its backlog should help mitigate the impact of negative market conditions; however, slow recovery in the commodity prices or an extended downturn in the global economy or future restrictions on, or declines in, oil and gas exploration and production could have a negative impact on the Company and its backlog. The Company's product

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backlog was approximately \$270.0 million at December 31, 2018 and \$207.3 million at December 31, 2017. The backlog at the end of 2018 represents an increase of approximately \$62.7 million, or 30.2% from the end of 2017. The Company's backlog balance during 2018 was negatively impacted by translation adjustments of approximately \$3.1 million, due primarily to the weakening of the U.S. dollar and by approximately \$11.7 million in cancellations.

The following table represent the change in backlog.

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Beginning Backlog	\$207,303	\$317,579	\$684,945
Bookings:			
Product	342,474	241,235	179,693
Service	72,414	61,945	64,094
Leasing	47,160	42,392	41,625
Cancellation/Revision adjustments	(11,675 )	(3,105 )	(112,770 )
Translation adjustments	(3,082 )	2,726	(1,277 )
Total Bookings	447,291	345,193	171,365
Revenues:			
Product	265,052	351,132	433,012
Service	72,414	61,945	64,094
Leasing	47,160	42,392	41,625
Total Revenue	384,626	455,469	538,731
Ending Backlog (1)	\$269,968	\$207,303	\$317,579

(1) The backlog data shown above includes all bookings as of December 31, 2018, including contract awards and signed purchase orders for which the contracts would not be considered enforceable or qualify for the practical expedient under ASC 606. As of December 31, 2018, approximately \$84 million related to contract awards is included in our backlog. As a result, this table above will not agree to the disclosed performance obligations of \$42.0 million within "Revenue Recognition (Adoption of ASC 606)", Note 5 of Notes to Consolidated Financial Statements.

During the first quarter of 2018, Dril-Quip Asia-Pacific Pte Ltd. was awarded a contract to supply top-tensioned riser (TTR) systems and related services for the development of the CRD Project located offshore Vietnam operated by Repsol with the participation of Mubadala, PVEP and PetroVietnam. The CRD Project is included within the backlog balance presented in the table above; however, due to ongoing territorial discussions between China and Vietnam, the CRD Project may experience continued delays or cancellation.

The Company expects to fill approximately 70% to 80% of the December 31, 2018 product backlog by December 31, 2019. The remaining backlog at December 31, 2018 consists of longer-term projects which are being designed and manufactured to customer specifications requiring longer lead times. In August 2012, the Company's Brazilian subsidiary, Dril-Quip do Brasil LTDA, was awarded a four-year contract by Petrobras, Brazil's national oil company. Following an interim amendment to extend the term of the contract pending the resolution of discussions, the Company entered into an amendment on October 17, 2016 to extend the duration of the contract until July 2020. The contract was valued at \$650.0 million, net of Brazilian taxes, at exchange rates in effect at that time (approximately \$342.2 million based on the December 31, 2018 exchange rate of 3.8748 Brazilian real to 1.00 U.S. dollar) if all the equipment under the contract was ordered. Amounts are included in the Company's backlog as purchase orders under the contract are received. Revenues of approximately \$164.0 million have been recognized on this contract through December 31, 2018. As of December 31, 2018, the Company's backlog included \$9.3 million of purchase orders under this Petrobras contract. The Company has not recognized revenue of approximately \$1.0 million as of December 31, 2018 for certain items of equipment that were completed but not yet accepted for delivery by Petrobras. If Petrobras does not ultimately accept these items for delivery or if they refuse to accept these or similar items completed in the future, the Company's results of operations may be adversely affected. As part of the amendment to the contract, Petrobras agreed to issue purchase orders totaling a minimum of approximately \$25.3 million (based on current exchange rates) before 2019. As of December 31, 2018, Petrobras had issued a total of three purchase orders (one during each year of 2016, 2017 and 2018) totaling the committed amount. The Company cannot provide assurance

that Petrobras will order all of the equipment under the contract. See “Item 1A. Risk Factors—Our backlog is subject to unexpected adjustments and cancellations and is, therefore, an uncertain indicator of our future revenues and earnings.”

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### Geographic Segments

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 regional headquarter locations as well as in Macae, Brazil. Revenues for each of these segments are dependent upon the ultimate sale of products and services to the Company's customers. For information on revenues by geographic segment, see "Geographic Segments", Note 16 of Notes to Consolidated Financial Statements.

### Currency Risk

The Company has operations in various countries around the world and conducts business in a number of different currencies other than the U.S. dollar, principally the British pound sterling and the Brazilian real. Our significant foreign subsidiaries may also have monetary assets and liabilities not denominated in their functional currency. These monetary assets and liabilities are exposed to changes in currency exchange rates which may result in non-cash gains and losses primarily due to fluctuations between the U.S. dollar and each subsidiary's functional currency.

The Company generally attempts to minimize its currency exchange risk by seeking international contracts payable in local currency in amounts equal to the Company's estimated operating costs payable in local currency and in U.S. dollars for the balance of the contracts. The Company had, net of income taxes, a transaction gain of \$0.8 million in 2018, a transaction loss in \$4.0 million in 2017 and a transaction gain of \$25.6 million in 2016. There is no assurance that the Company will be able to protect itself against such fluctuations in the future. The Company has put in place an active cash management process to convert excess foreign currency and concentrate this cash in certain of our holding company bank accounts to minimize foreign currency risk and increase investment income.

The Company conducts business in certain countries that limit repatriation of earnings. Further, there can be no assurance that the countries in which the Company currently operates will not adopt policies limiting repatriation of earnings in the future. The Company also has significant investments in countries other than the United States, principally its manufacturing operations in Scotland, Singapore, Brazil and, to a lesser extent, Norway. The functional currency of these foreign operations is the local currency except for Singapore, where the U.S. dollar is used. Financial statement assets and liabilities in the functional currency are translated at the end of the period exchange rates. Resulting translation adjustments are reflected as a separate component of stockholders' equity and have no current effect on earnings or cash flow.

### Critical Accounting Policies

The Company's discussion and analysis of its financial condition and results of operations are based on the Company's consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of the consolidated financial statements requires the Company to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. There can be no assurance that actual results will not differ from those estimates. The Company believes the following accounting policies affect its more significant judgments and estimates used in preparation of its consolidated financial statements.

### Revenue Recognition

#### Product revenues

The Company recognizes product revenues from two methods:

- product revenues are recognized over time as control is transferred to the customer; and
- product revenues from the sale of products that do not qualify for the over time method are recognized as point in time.

#### Revenues recognized under the over time method

The Company uses the over time method on long-term project contracts that 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;

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product requirements cannot be filled directly from the Company's standard inventory; and the Company has an enforceable right to payment for any work completed to date and the enforceable payment includes a reasonable profit margin.

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 percentage complete and applies the percentage to determine the revenues earned and the appropriate portion of total estimated costs to be recognized. Losses, if any, are recorded in full in the period they become known. Historically, the Company's estimates of total costs and costs to complete have approximated actual costs incurred to complete the project.

Under the over time method, billings may not 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 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, 2018 and 2017, receivables included \$57.0 million and \$41.0 million of unbilled receivables, respectively. For the year ended December 31, 2018, there were 22 projects representing approximately 16% of the Company's total revenues and approximately 23% of its product revenues, and eight projects during 2017 representing approximately 13% of the Company's total revenues and approximately 16% of its product revenues, which were accounted for using over time method of accounting.

Revenues recognized under the point in time method

Revenues from the sale of standard inventory products, not accounted for under the over time method, are recorded at the point in time that the customer obtains control of the promised asset and the Company satisfies its performance obligation. This point in time recognition aligns with the time of shipment, which is when the Company typically has a present right to payment, title transfers to the customer, the customer or its carrier has physical possession and the customer has significant risks and rewards of ownership. The Company may provide product storage to some customers. Revenues for these products are recognized at the point in time that control of the product transfers to the customer, the reason for storage is requested by the customer, the product is separately identified, the product is ready for physical transfer to the customer and the Company does not have the ability to use or direct the use of the product. This point in time typically occurs when the products are moved to storage. We receive payment after control of the products has transferred to the customer.

Service revenues

The Company recognizes service revenues from two sources:

technical advisory assistance; and

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

The Company generally does not install products for its customers, but it does provide technical advisory assistance.

The Company normally negotiates contracts for products, including those accounted for under the over time 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 assistance services. The customer may use a third party or their own personnel. The contracts for these services are typically considered day-to-day.

Rework and reconditioning service revenues are recorded using the over time method based on the remaining steps that need to be completed as the refurbishment process is performed. The measurement of progress considers, among other things, the time necessary for completion of each step in the reconditioning plan, the materials to be purchased, labor and ordering procedures. We receive payment after the services have been performed by billing customers periodically (typically monthly).

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 net realizable value. Company manufactured inventory is valued principally using standard costs, which are calculated based upon direct costs incurred and overhead allocations and approximate actual

costs. 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.

Inventory Reserves. Periodically, obsolescence reviews are performed on slow-moving inventories and reserves are established based on current assessments about future demands and market conditions. The Company determines the reserve percentages based on an analysis of stocking levels, historical sales levels and future sales forecasts anticipated for inventory

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items by product type. The inventory values have been reduced by a reserve for excess and slow-moving inventories of \$108.6 million and \$83.6 million as of December 31, 2018 and 2017, respectively. If market conditions are less favorable than those projected by management, additional inventory reserves may be required.

**Goodwill and indefinite-lived intangible assets.** For goodwill and intangible assets with indefinite lives, an assessment for impairment is performed annually or when there is an indication an impairment may have occurred. We complete our annual impairment test for goodwill and other indefinite-lived intangibles using an assessment date of October 1. Goodwill is reviewed for impairment by comparing the carrying value of each of our reporting unit's net assets, including allocated goodwill, to the estimated fair value of the reporting unit. We determine the fair value of our reporting units using a discounted cash flow approach. We selected this valuation approach because we believe it, combined with our best judgment regarding underlying assumptions and estimates, provides the best estimate of fair value for each of our reporting units. Determining the fair value of a reporting unit requires the use of estimates and assumptions. Such estimates and assumptions include revenue growth rates, future operating margins, the weighted average cost of capital ("discount rates"), a terminal growth value, and future market conditions, among others. We believe that the estimates and assumptions used in our impairment assessments are reasonable. If the reporting unit's carrying value is greater than its calculated fair value, we recognize a goodwill impairment charge for the amount by which the carrying value of goodwill exceeds its fair value.

**Contingent Liabilities.** The Company establishes reserves for estimated loss contingencies when the Company believes a loss is probable and the amount of the loss can be reasonably estimated. Revisions to contingent liabilities are reflected in net income in the period in which different or additional facts or information become known or circumstances change that affect the Company's previous assumptions with respect to the likelihood or amount of loss. Reserves for contingent liabilities are based upon the Company's assumptions and estimates regarding the probable outcome of the matter. Should the outcome differ from the Company's assumptions and estimates, revisions to the estimated reserves for contingent liabilities would be required.

### **Off-Balance Sheet Arrangements**

The Company has no derivative instruments and no off-balance sheet hedging or financing arrangements, contracts or operations.

### **New Accounting Standards**

The information set forth under Note 3 of Notes to Consolidated Financial Statements under the caption "New Accounting Standards" is incorporated herein by reference.

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

The Company is currently exposed to certain market risks related to interest rate changes on its short-term investments and fluctuations in foreign currency 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. There have been no material changes in market risks for the Company from December 31, 2017.

### **Foreign Currency Exchange Rate Risk**

Through its subsidiaries, the Company conducts a portion of its business in currencies other than the United States dollar. There is no assurance that the Company will be able to protect itself against currency fluctuations in the future. In periods where the dollar is strong as compared to other currencies, it is possible that foreign sales may reflect a decline in profits due to translation. It does not appear the Company's sales have experienced significant profit declines. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Currency Risk" in Item 7 of this report.

The Company uses a sensitivity analysis model to measure the potential impact on revenue and net income of a 10% adverse movement of foreign currency exchange rates against the U.S. dollar over the previous year. Based upon this model, a 10% decrease would have resulted in a decrease in revenues of approximately \$13.0 million and an increase in net income of approximately \$0.1 million for 2018. There can be no assurance that the exchange rate decrease projected above will materialize as fluctuations in exchange rates are beyond the Company's control.





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Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Management has designed its internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our principal executive officers and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control—Integrated Framework (2013), our management has concluded that our internal control over financial reporting was effective as of December 31, 2018.

PricewaterhouseCoopers LLP, the independent registered public accounting firm, who audited the consolidated financial statements included in this Annual Report on Form 10-K, has also audited the effectiveness of our internal control over financial reporting, as stated in their report which appears herein.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Dril-Quip, Inc.

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Dril-Quip, Inc. and its subsidiaries (the “Company”) as of December 31, 2018 and 2017, and the related consolidated statements of income (loss), comprehensive income (loss), stockholders’ equity and cash flows for each of the three years in the period ended December 31, 2018, including the related notes and financial statement schedule listed in the index appearing under Item 15(a)(2) (collectively referred to as the “consolidated financial statements”). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the COSO.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on the Company’s consolidated financial statements and on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

## Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Houston, Texas  
February 27, 2019

We have served as the Company's auditor since 2014.

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## DRIL-QUIP, INC.

## CONSOLIDATED STATEMENTS OF INCOME (LOSS)

	Year Ended December 31,		
	2018	2017	2016
	(In thousands, except per share data)		
Revenues:			
Products	\$265,052	\$351,132	\$433,012
Services	72,414	61,945	64,094
Leasing	47,160	42,392	41,625
Total revenues	384,626	455,469	538,731
Cost and expenses:			
Cost of sales:			
Products	200,494	246,005	268,405
Services	62,109	53,303	52,611
Leasing	8,896	6,086	7,388
Total cost of sales	271,499	305,394	328,404
Selling, general and administrative	104,039	116,251	53,246
Engineering and product development	39,422	42,160	44,325
Impairment, restructuring and other charges	98,602	60,968	—
Gain on sale of assets	(6,198 )	(168 )	(103 )
Total costs and expenses	507,364	524,605	425,872
Operating income (loss)	(122,738 )	(69,136 )	112,859
Interest income	8,040	3,564	3,037
Interest expense	(291 )	(72 )	(28 )
Income (loss) before income taxes	(114,989 )	(65,644 )	115,868
Income tax provision (benefit)	(19,294 )	34,995	22,647
Net income (loss)	\$(95,695 )	\$(100,639 )	\$93,221
Earnings (loss) per common share:			
Basic	\$(2.58 )	\$(2.69 )	\$2.48
Diluted	\$(2.58 )	\$(2.69 )	\$2.47
Weighted average common shares outstanding:			
Basic	37,075	37,457	37,537
Diluted	37,075	37,457	37,667

The accompanying notes are an integral part of these consolidated financial statements.

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DRIL-QUIP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Net income (loss)	\$ (95,695 )	\$ (100,639 )	\$ 93,221
Other comprehensive income (loss), net of tax:			
Foreign currency translation adjustments	(18,823 )	24,117	(49,141 )
Total comprehensive income (loss)	\$ (114,518 )	\$ (76,522 )	\$ 44,080

The accompanying notes are an integral part of these consolidated financial statements.

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Table of ContentsDRIL-QUIP, INC.  
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2018	2017
	(In thousands)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$418,100	\$493,180
Trade receivables, net	202,165	191,629
Inventories, net	191,194	291,087
Prepays and other current assets	41,522	32,653
Total current assets	852,981	1,008,549
Property, plant and equipment, net	274,123	284,247
Deferred income taxes	7,995	5,364
Goodwill	7,714	47,624
Intangible assets	34,974	38,408
Other assets	14,723	15,613
Total assets	\$1,192,510	\$1,399,805
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$26,693	\$33,480
Accrued income taxes	3,138	24,714
Customer prepayments	9,648	4,767
Accrued compensation	10,537	11,412
Other accrued liabilities	32,242	25,538
Total current liabilities	82,258	99,911
Deferred income taxes	2,466	3,432
Income tax payable	9,623	—
Other long-term liabilities	2,001	2,001
Total liabilities	96,348	105,344
Commitments and contingencies (Note 15)		
Stockholders' equity:		
Preferred stock: 10,000,000 shares authorized at \$0.01 par value (none issued)	—	—
Common stock:		
100,000,000 shares authorized at \$0.01 par value at December 31, 2018 and 2017, 36,264,001 and 38,132,693 issued and outstanding at December 31, 2018 and 2017	376	372
Additional paid-in capital	34,953	20,083
Retained earnings	1,205,946	1,400,296
Accumulated other comprehensive losses	(145,113 )	(126,290 )
Total stockholders' equity	1,096,162	1,294,461
Total liabilities and stockholders' equity	\$1,192,510	\$1,399,805

The accompanying notes are an integral part of these consolidated financial statements.



Table of ContentsDRIL-QUIP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Operating activities			
Net income (loss)	\$(95,695 )	\$(100,639)	\$93,221
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	35,312	40,974	31,857
Stock-based compensation expense	13,459	14,270	12,217
Impairment, restructuring and other non-cash charges	98,602	60,968	—
Loss (gain) on sale of equipment	(6,198 )	(168 )	(103 )
Deferred income taxes	(4,091 )	17,231	(3,400 )
Changes in operating assets and liabilities:			
Trade receivables, net	(11,855 )	26,112	106,544
Inventories, net	49,926	37,642	7,873
Prepays and other assets	(15,084 )	10,107	9,816
Excess tax benefits of stock options and awards	—	—	(135 )
Accounts payable and accrued expenses	(18,755 )	1,765	(11,368 )
Other, net	(118 )	(269 )	—
Net cash provided by operating activities	45,503	107,993	246,522
Investing activities			
Purchase of property, plant and equipment	(32,061 )	(27,622 )	(25,763 )
Proceeds from sale of equipment	16,888	3,170	357
Acquisition of business, net of cash acquired	—	(20,440 )	(132,443 )
Net cash used in investing activities	(15,173 )	(44,892 )	(157,849 )
Financing activities			
Proceeds from exercise of stock options	1,616	560	2,206
Excess tax benefits of stock options and awards	—	—	135
ABL Credit Facility issuance costs	(815 )	—	—
Repurchase of common shares	(100,000 )	—	(24,234 )
Net cash provided by (used) in financing activities	(99,199 )	560	(21,893 )
Effect of exchange rate changes on cash activities	(6,211 )	6,022	(24,619 )
Increase (decrease) in cash and cash equivalents	(75,080 )	69,683	42,161
Cash and cash equivalents at beginning of year	493,180	423,497	381,336
Cash and cash equivalents at end of year	\$418,100	\$493,180	\$423,497

The accompanying notes are an integral part of these consolidated financial statements.

Table of ContentsDRIL-QUIP, INC.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	(In thousands)				
Balance at December 31, 2015	\$ 378	\$ —	\$ 1,425,344	\$ (101,264 )	\$ 1,324,458
Foreign currency translation adjustment	—	—	—	(49,141 )	(49,141 )
Net income	—	—	93,221	—	93,221
Comprehensive income	—	—	—	—	44,080
Options exercised and awards vested (163,547 shares)	1	2,205	—	—	2,206
Stock option expense	—	12,217	—	—	12,217
Excess tax benefits - stock options and awards	—	(2,241 )	—	—	(2,241 )
Repurchase of common stock (400,500 shares)	(4 )	(6,713 )	(17,517 )	—	(24,234 )
Other	—	—	(60 )	(2 )	(62 )
Balance at December 31, 2016	375	5,468	1,500,988	(150,407 )	1,356,424
Foreign currency translation adjustment	—	—	—	24,117	24,117
Net loss	—	—	(100,639 )	—	(100,639 )
Comprehensive loss	—	—	—	—	(76,522 )
Options exercised and awards vested (208,163 shares)	—	560	—	—	560
Stock option expense	—	14,270	—	—	14,270
Other	(3 )	(215 )	(53 )	—	(271 )
Balance at December 31, 2017	372	20,083	1,400,296	(126,290 )	1,294,461
Foreign currency translation adjustment	—	—	—	(18,823 )	(18,823 )
Net loss	—	—	(95,695 )	—	(95,695 )
Comprehensive loss	—	—	—	—	(114,518 )
Repurchase of common stock (1,991,206 shares)	(20 )	—	(99,980 )	—	(100,000 )
Options exercised and awards vested (261,055 shares)	25	1,591	—	—	1,616
Stock option expense	—	13,459	—	—	13,459
ASC 606 Implementation	—	—	1,683	—	1,683
Other	(1 )	(180 )	(358 )	—	(539 )
Balance at December 31, 2018	\$ 376	\$ 34,953	\$ 1,205,946	\$ (145,113 )	\$ 1,096,162

The accompanying notes are an integral part of these consolidated financial statements.

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### DRIL-QUIP, INC.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

##### 1. Organization

Dril-Quip, Inc., a Delaware corporation (the “Company” or “Dril-Quip”), designs, manufactures, sells and services highly engineered drilling and production equipment that is well suited primarily 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, diverters and safety valves. Dril-Quip’s products are used by major integrated, large independent and foreign national oil and gas companies and drilling contractors 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 regional headquarter locations as well as in Macae, Brazil. The Company’s major subsidiaries are Dril-Quip (Europe) Limited, located in Aberdeen with branches in Denmark, Norway and Holland; Dril-Quip Asia Pacific PTE Ltd., located in Singapore; and Dril-Quip do Brasil LTDA, located in Macae, Brazil. Other operating subsidiaries include TIW Corporation (TIW) and Honing, Inc., both located in Houston, Texas; DQ Holdings Pty. Ltd., located in Perth, Australia; Dril-Quip Cross (Ghana) Ltd., located in Takoradi, Ghana; PT DQ Oilfield Services Indonesia, located in Jakarta, Indonesia; Dril-Quip (Nigeria) Ltd., located in Port Harcourt, Nigeria; Dril-Quip Egypt for Petroleum Services S.A.E., located in Alexandria, Egypt; Dril-Quip Oilfield Services (Tianjin) Co. Ltd., located in Tianjin, China, with branches in Shezhen and Beijing, China; Dril-Quip Qatar LLC, located in Doha, Qatar; Dril-Quip TIW Mexico S.A. de C.V., located in Villahermosa, Mexico; TIW de Venezuela S.A., located in Anaco, Venezuela and with a registered branch located in Shushufindi, Ecuador; TIW (UK) Limited, located in Aberdeen, Scotland; TIW Hungary LLC, located in Szolnok, Hungary; and TIW International LLC, with a registered branch located in Singapore. For a listing of all of Dril-Quip’s subsidiaries, please see Exhibit 21.1 to this report.

On January 6, 2017, the Company acquired The Technologies Alliance Inc. d/b/a OilPatch Technologies (OPT) for approximately \$20.0 million, which was integrated into the Company’s existing Western Hemisphere operations.

##### 2. Significant Accounting Policies

###### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. 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 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.

###### 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.

Trade Receivables

The Company maintains an allowance for doubtful accounts on trade receivables equal to amounts estimated to be uncollectible. This estimate is based upon historical collection experience combined with a specific review of each customer's outstanding trade receivable balance. Management believes that the allowance for doubtful accounts is adequate; however, actual write-offs may exceed the recorded allowance.

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### 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 net realizable value. Company manufactured inventory is valued principally using standard costs, which are calculated based upon direct costs incurred and overhead allocations and approximate actual costs.

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.

Inventory Reserves. Periodically, obsolescence reviews are performed on slow-moving inventories and reserves are established based on current assessments about future demands and market conditions. The Company determines the reserve percentages based on an analysis of stocking levels, historical sales levels and future sales forecasts anticipated for inventory items by product type. The inventory values have been reduced by a reserve for excess and slow-moving inventories of \$108.6 million and \$83.6 million as of December 31, 2018 and 2017, 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. We capitalize costs incurred to enhance, improve and extend the useful lives of our property and equipment and expense costs incurred to repair and maintain the existing condition of our assets.

Goodwill and indefinite-lived intangible assets. For goodwill and intangible assets with indefinite lives, an assessment for impairment is performed annually or when there is an indication an impairment may have occurred. We complete our annual impairment test for goodwill and other indefinite-lived intangibles using an assessment date of October 1. Goodwill is reviewed for impairment by comparing the carrying value of each of our reporting unit's net assets, including allocated goodwill, to the estimated fair value of the reporting unit. We determine the fair value of our reporting units using a discounted cash flow approach. We selected this valuation approach because we believe it, combined with our best judgment regarding underlying assumptions and estimates, provides the best estimate of fair value for each of our reporting units. Determining the fair value of a reporting unit requires the use of estimates and assumptions. Such estimates and assumptions include revenue growth rates, future operating margins, the weighted average cost of capital ("discount rates"), a terminal growth value, and future market conditions, among others. We believe that the estimates and assumptions used in our impairment assessments are reasonable. If the reporting unit's carrying value is greater than its calculated fair value, we recognize a goodwill impairment charge for the amount by which the carrying value of goodwill exceeds its fair value.

### Impairment of Long-Lived Assets

Long-lived assets, including property, plant and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the carrying amount of an asset exceeds the estimated undiscounted future cash flows expected to be generated by the asset, an impairment charge is recognized by reflecting the asset at its fair value. We review the recoverability of the carrying value of our assets based upon estimated future cash flows while taking into consideration assumptions and estimates, including the future use of the asset, remaining useful life of the asset and service potential of the asset. Additionally, inventories are valued at the lower of cost or net realizable value.

### Restructuring costs and other charges

As a result of unfavorable market conditions, combined with the impact of decreased capital expenditure budgets within the industry driven by sustained low oil prices, we announced a cost reduction plan primarily focused on workforce reductions and the reorganization of certain facilities in the second quarter of 2018. We incurred restructuring and other charges associated with the cost reduction plan of \$60.0 million during the year ended December 31, 2018. Costs incurred for employee termination benefits during the year ended December 31, 2018 were \$7.3 million. Additionally, we incurred non-cash inventory and long-lived asset write-downs of approximately \$32.1 million and \$14.9 million, respectively, as a result of expected changes in our business structure and where specific products are manufactured. Remaining costs incurred of approximately \$5.7 million related to

professional fees for consulting services for the strategic planning and implementation efforts. These charges are reflected as "Impairment, restructuring and other charges" in our consolidated statement of operations. We did not incur restructuring charges during the years ended December 31, 2017 and 2016.

Additionally, in connection with our preparation and review of the financial statements for the year ended December 31, 2018, we recorded an impairment charge of \$38.6 million for the fourth quarter of 2018 as a result of our updated assessment of current market conditions and restructuring efforts. For further information, see Note 9, Goodwill.

Income Taxes

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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. Valuation allowances are established when necessary to reduce deferred income tax assets to the amounts that are expected more likely than not to be realized in the future. The Company classifies interest and penalties related to uncertain tax positions as income taxes in its financial statements.

Revenue Recognition

Product revenues

The Company recognizes product revenues from two methods:

- product revenues are recognized over time as control is transferred to the customer; and
- product revenues from the sale of products that do not qualify for the over time method are recognized as point in time.

Revenues recognized under the over time method

The Company uses the over time method on long-term project contracts that 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;
- product requirements cannot be filled directly from the Company's standard inventory; and

- The Company has an enforceable right to payment for any work completed to date and the enforceable payment includes a reasonable profit margin.

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 percentage complete and applies the percentage to determine the revenues earned and the appropriate portion of total estimated costs to be recognized. Losses, if any, are recorded in full in the period they become known. Historically, the Company's estimates of total costs and costs to complete have approximated actual costs incurred to complete the project.

Under the over time method, billings may not 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 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, 2018 and 2017, receivables included \$57.0 million and \$41.0 million of unbilled receivables, respectively. For the year ended December 31, 2018, there were 22 projects representing approximately 16% of the Company's total revenues and approximately 23% of its product revenues, and eight projects during 2017 representing approximately 13% of the Company's total revenues and approximately 16% of its product revenues, which were accounted for using over time method of accounting.

Revenues recognized under the point in time method

Revenues from the sale of standard inventory products, not accounted for under the over time method, are recorded at the point in time that the customer obtains control of the promised asset and the Company satisfies its performance obligation. This point in time recognition aligns with the time of shipment, which is when the Company typically has a present right to payment, title transfers to the customer, the customer or its carrier has physical possession and the customer has significant risks and rewards of ownership. The Company may provide product storage to some customers. Revenues for these products are recognized at the point in time that control of the product transfers to the customer, the reason for storage is requested by the customer, the product is separately identified, the product is ready for physical transfer to the customer and the Company does not have the ability to use or direct the use of the product.

This point in time typically occurs when the products are moved to storage. We receive payment after control of the products has transferred to the customer.



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### Service revenues

The Company recognizes service revenues from two sources:

technical advisory assistance; and

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

The Company generally does not install products for its customers, but it does provide technical advisory assistance.

The Company normally negotiates contracts for products, including those accounted for under the over time 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 assistance services. The customer may use a third party or their own personnel. The contracts for these services are typically considered day-to-day.

Rework and reconditioning service revenues are recorded using the over time method based on the remaining steps that need to be completed as the refurbishment process is performed. The measurement of progress considers, among other things, the time necessary for completion of each step in the reconditioning plan, the materials to be purchased, labor and ordering procedures. We receive payment after the services have been performed by billing customers periodically (typically monthly).

### Lease revenues

The Company earns lease revenues from the rental of running tools. Rental revenues are recognized within leasing revenues on a dayrate basis over the lease term.

### Practical Expedients

We do not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less.

### 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. The Company experienced exchange losses (gains) of approximately \$(0.8) million, \$12.7 million and \$(25.6) million during the year ended December 31, 2018, 2017 and 2016, respectively, net of income taxes. These amounts are included in selling, general and administrative costs in the Consolidated Statements of Income on a pre-tax basis.

### Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and cash equivalents, receivables and payables. The carrying values of these financial instruments approximate their respective fair values as they are short-term in nature.

### 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 actual 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.

### 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 and awards using the treasury stock method.

## 3. New Accounting Standards

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02 "Leases (Topic 842)" to increase transparency and comparability among organizations by requiring (1) recognition of

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lease assets and lease liabilities on the balance sheet and (2) disclosure of key information about leasing arrangements. Topic 842 is effective for fiscal years and interim periods beginning after December 15, 2018. A modified retrospective approach is required for adoption for all leases that exist at or commence after the date of initial application with an option to use certain practical expedients. We expect to use the package of practical expedients that allows us to not reassess: (1) whether any expired or existing contracts are or contain leases, (2) lease classification for any expired or existing leases and (3) initial direct costs for any expired or existing leases. We additionally expect to use the practical expedient that allows lessees to treat the lease and non-lease components of leases as a single lease component. We will adopt this guidance at the adoption date of January 1, 2019, using the transition method that allows us to initially apply Topic 842 as of January 1, 2019 and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. We do not expect to recognize a material adjustment to retained earnings upon adoption. We are additionally assessing the impact of Topic 842 on our internal controls over financial reporting.

We determine if an arrangement is a lease at inception. We lease certain offices, shop and warehouse facilities, automobiles and equipment under both operating and capital lease arrangements. Capital leases are expected to be accounted for as finance leases upon adoption of Topic 842, and we do not expect any significant changes to the accounting for such leases upon adoption. Under Topic 842, operating leases result in the recognition of right-of-use (“ROU”) assets and lease liabilities on the balance sheet. ROU assets represent our right to use the leased asset for the lease term and lease liabilities represent our obligation to make lease payments. Under Topic 842, operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, upon adoption of Topic 842, we will use our estimated incremental borrowing rate at the commencement date to determine the present value of lease payments. The operating lease ROU assets will also include any lease payments made and exclude lease incentives. Our lease terms may include options to extend or terminate the lease that we are reasonably certain to exercise. Lease expense under Topic 842 will be recognized on a straight-line basis over the lease term. We have lease agreements with lease and non-lease components, and we expect to account for the lease and non-lease components as a single lease component under Topic 842.

The adoption of Topic 842 will have an estimated \$7.1 million impact on our consolidated balance sheet based on our current portfolio of leases due to the recognition of the ROU assets and lease liabilities. The adoption of Topic 842 is not expected to have a material impact on our consolidated income statement or our consolidated cash flow statement. Because of the transition method we will use to adopt Topic 842, Topic 842 will not be applied to periods prior to adoption and the adoption of Topic 842 will have no impact on our previously reported results. The future minimum lease payments for our operating leases as of December 31, 2018 are discussed in Note 15 to the consolidated financial statements. The undiscounted total of such payments was \$9.4 million. Upon adoption of Topic 842, we expect to recognize operating lease ROU assets and lease liabilities that reflect the present value of these future payments. After the adoption of Topic 842, we will first report the operating lease ROU assets and lease liabilities as of March 31, 2019 based on our lease portfolio as of that date.

The components of our historic lease expense and the future lease payments are discussed in Note 13 to the consolidated financial statements. The capital leases addressed in Note 14 are expected to be accounted for as finance leases upon adoption of Topic 842, and we do not expect any significant changes to the accounting for such leases upon adoption.

#### Adoption of ASC Topic 606, “Revenue from Contracts with Customers”

In May 2014, the FASB issued ASU 2014-09 “Revenue from Contracts with Customers (Topic 606).” On January 1, 2018, we adopted the new accounting standard ASC 606, Revenue from Contracts with Customers and all the related amendments (the “new revenue standard”) for contracts that are not completed at the date of initial application using the modified retrospective method.

We recognized the cumulative effect of the initial application of the new revenue standard as an increase to the opening balance of retained earnings at January 1, 2018 for \$1.7 million. Therefore, the comparative information for prior periods has not been restated and continues to be reported under the accounting standards in effect for those

periods.

A majority of the Company's revenues are not subject to the new revenue standard. The adoption of ASC 606 resulted in a decrease of approximately \$1.6 million in our results from operations for the year ended December 31, 2018 and did not have a material impact on the Company's consolidated financial position, results of operations, equity or cash flows. A majority of our product revenues continues to be recognized when products are shipped from our facilities.

#### 4. Business Acquisitions

##### TIW Acquisition

On October 14, 2016, the Company entered into an agreement with Pearce Industries, Inc. to acquire all the outstanding common stock, par value \$100.00 per share, of TIW for a cash purchase price of \$142.7 million, which was subject to customary adjustments for cash and working capital. The acquisition closed on November 10, 2016 with the intention to

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strengthen the Company's liner hanger sales and increase market share. Additionally, the acquisition of TIW gave Dril-Quip a presence in the onshore oil and gas market. Total acquisition costs through December 31, 2017 in connection with the purchase of TIW were \$2.5 million and were expensed in general and administrative costs.

Summary of Unaudited Pro Forma Information

TIW's results of operations have been included in Dril-Quip's financial statements for the period subsequent to the closing of the acquisition on November 10, 2016. Business acquired from TIW contributed revenues of \$49.4 million, a pre-tax operating loss of \$15.5 million and a net loss of \$15.9 million for the year ended December 31, 2017.

OPT

On January 6, 2017, the Company acquired OPT for approximately \$20.0 million, which was subject to customary adjustments for cash and working capital. The acquisition was accounted for as a business combination in accordance with ASC 805. The purchase price was subject to closing adjustments and was funded with cash on hand. The acquisition does not have a material impact on the Company's Consolidated Balance Sheets. OPT's results of operations for the periods prior to this acquisition were not material to the Company's Consolidated Statements of Operations.

Other long-term liabilities consist of contingent consideration related to the OPT acquisition in the amount of \$2.0 million.

5. Revenue Recognition (Adoption of ASC 606)

Revenues from contracts with customers consisted of the following:

	Twelve months ended				
	December 31, 2018				
	Western Hemisphere	Eastern Hemisphere	Asia-Pacific	Intercompany	Total
	(In thousands)				
Product Revenues	\$ 170,282	\$ 71,719	\$ 23,051	\$	—\$265,052
Service Revenues	40,958	19,687	11,769	—	72,414
Total	\$ 211,240	\$ 91,406	\$ 34,820	\$	—\$337,466

Contract Balances

Balances related to contracts with customers consisted of the following:

Contract Assets (amounts shown in thousands)

Contract Assets at December 31, 2017 \$41,825

Additions 63,379

Transfers to Accounts Receivable (22,016 )

Contract Assets at December 31, 2018 \$83,188

Contract Liabilities (amounts shown in thousands)

Contract Liabilities at December 31, 2017 \$ 4,767

Additions 114,236

Revenue Recognized (109,355)

Contract Liabilities at December 31, 2018 \$ 9,648

Receivables, which are included in trade receivables, net, were \$190.3 million and \$136.5 million for the years ended December 31, 2018 and 2017, respectively. The amount of revenues from performance obligations satisfied (or partially satisfied) in previous periods was \$12.1 million for the year ended December 31, 2018. The contract liabilities primarily relate to advance payments from customers and are included in "Customer prepayments" in our accompanying consolidated balance sheets. The contract assets primarily relate to unbilled amounts typically resulting from sales under contracts when the over



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time method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer and is included in "Trade receivables, net" in our accompanying consolidated balance sheets. Contract assets are transferred to the receivables when the rights become unconditional.

Obligations for returns and refunds were considered immaterial as of December 31, 2018.

**Remaining Performance Obligations**

The aggregate amount of the transaction price allocated to remaining performance obligations from our over time product lines was \$42.0 million as of December 31, 2018. The Company expects to recognize revenue on approximately 98% and 2% of the remaining performance obligations over the next 12 and 24 months, respectively, with the remainder recognized thereafter.

The Company applies the practical expedient available under the new revenue standard and does not disclose information about remaining performance obligations that have original expected durations of one year or less.

**6. Inventories, net**

Inventories consist of the following:

	December 31,	
	2018	2017
	(In thousands)	
Raw materials and supplies	\$55,878	\$70,188
Work in progress	51,251	65,382
Finished goods	192,632	239,083
	299,761	374,653
Less: allowance for obsolete and excess inventory	(108,567 )	(83,566 )
Total inventory	\$191,194	\$291,087

**7. Property, Plant and Equipment, net**

Property, plant and equipment consists of:

	Estimated Useful Lives	December 31,	
		2018	2017
		(In thousands)	
Land improvements	10-25 years	\$7,774	\$7,485
Buildings	15-40 years	212,501	183,437
Machinery, equipment and other	3-10 years	375,240	361,959
		595,515	552,881
Less accumulated depreciation		(349,701 )	(315,091 )
		245,814	237,790
Land		12,524	13,464
Construction work in process		15,785	32,993
Total property, plant and equipment		\$274,123	\$284,247

Depreciation expense totaled \$32.8 million, \$38.6 million and \$31.6 million for 2018, 2017 and 2016, respectively.

**8. Impairment, Restructuring and Other Charges****Restructuring Charges**

As a result of unfavorable market conditions, including lower commodity prices, the decline in expected offshore rig counts, decreases in our customers' capital budgets and potential delays associated with certain of our long term projects, as well as the decline in our stock price in December 2018 which resulted in our market capitalization decreasing to below the





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carrying value of our assets, we announced a cost reduction plan primarily focused on workforce reductions and the reorganization of certain facilities in the second quarter of 2018. In conjunction with the strategic review, the Company adjusted its forecast for recovery to reflect a more delayed recovery in the offshore industry, with pre-downturn demand not returning until after 2025. We incurred restructuring and other charges associated with the cost reduction plan of \$60.0 million during the year ended December 31, 2018. Costs incurred for employee termination benefits during the year ended December 31, 2018 were \$7.3 million. Additionally, we incurred non-cash inventory and long-lived asset write-downs of approximately \$32.1 million and \$14.9 million, respectively, as a result of changes in our business structure and where specific products are manufactured. Remaining costs incurred of approximately \$5.7 million related to professional fees for consulting services for the strategic planning and implementation efforts. These charges are reflected as "Impairment, restructuring and other charges" in our consolidated statement of operations. We did not incur restructuring charges during the years ended December 31, 2017 and 2016.

The following table summarizes the components of charges included in "Impairment, restructuring and other charges" in our consolidated statement of operations for the year ended December 31, 2018 (in thousands):

	Year Ended December 31, 2018
Inventory impairment	\$ 32,070
Long-lived asset impairment	14,902
Severance	7,324
Professional service fees	5,300
Exit costs	447
Total restructuring and other charges	\$ 60,043

The following table summarizes the changes to our accrued liability balance related to restructuring and other charges for the year ended December 31, 2018 (in thousands):

	December 31, 2018
Balance at January 1, 2018	\$ —
Additions for costs expensed	12,624
Reductions for payments	(5,626 )
Ending balance at December 31, 2018	\$ 6,998
Goodwill	

In connection with our preparation and review of financial statements for the year ended December 31, 2018, we recorded an impairment charge of \$38.6 million for the fourth quarter of 2018 as a result of our updated assessment of current market conditions and restructuring efforts. For further information, see Note 9, Goodwill.

#### 2017 Impairment of Inventory and Long-lived Assets

In connection with our preparation and review of financial statements for the year ended December 31, 2017, after considering current Brent crude (Brent) consensus forecasts and expected rig counts for the foreseeable future, we determined the carrying amount of certain of our long-lived assets in the Western Hemisphere exceeded the fair values of such assets due to projected declines in asset utilization, and that the cost of some of our worldwide inventory exceeded its market value. As a result, we recorded corresponding impairments and other charges. Primarily as a result of the factors described above, we recorded charges of approximately \$33.6 million related to inventory and \$27.4 million related to fixed assets. No additional impairments were recorded during the three months ended December 31, 2017. Additionally, no impairments were recorded for the year ended December 31, 2016.

## 9. Goodwill

There was no impairment of goodwill during the years ended December 31, 2017 and 2016. The changes in the carrying amount of goodwill by reporting unit during the year ended December 31, 2018 were as follows:

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	Carrying Value	Foreign Currency Translation	Impairments	Carrying Value December 31, 2018
	(In thousands)			
Western Hemisphere	\$39,158	\$ (599 )	\$ (38,559 )	\$ —
Eastern Hemisphere	8,466	(752 )	—	7,714
Asia Pacific	—	—	—	—
Total	\$47,624	\$ (1,351 )	\$ (38,559 )	\$ 7,714

At October 1, 2018, the Company performed its annual impairment test on each of its reporting units and concluded that there had been no impairment because the estimated fair values of each of those reporting units exceeded its carrying value. Relevant events and circumstances that could have a negative impact on goodwill include:

macroeconomic conditions; industry and market conditions, such as commodity prices; operating cost factors; overall financial performance; the impact of dispositions and acquisitions; and other entity-specific events. Further declines in commodity prices or sustained lower valuation for the Company's common stock could indicate a reduction in the estimate of reporting unit fair value which, in turn, could lead to an impairment of reporting unit goodwill.

The fair values were determined using the net present value of the expected future cash flows for each reporting unit. During the Company's goodwill impairment analysis, the Company determined the fair value of each of its reporting units as a whole using discounted cash flow analysis, which requires significant assumptions and estimates about the future operations of each reporting unit. The assumptions about future cash flows and growth rates are based on our revised strategic budget for 2019 and for future periods, and management's beliefs about future activity levels. The discount rates we used for future periods could change substantially if the cost of debt or equity were to significantly increase or decrease, or if we were to choose different comparable companies in determining the appropriate discount rates for our reporting units. Forecasted cash flows in future periods were estimated using a terminal value calculation, which considered long-term earnings growth rates.

In December 2018, the overall offshore market conditions declined. This decline was evidenced by lower commodity prices, decline in expected offshore rig counts, decrease in our customers' capital budgets and potential delays associated with certain of our long term projects. Further, in December 2018 due to the decline in our stock price, our market capitalization dropped below the carrying value of our assets. As a result, an interim goodwill impairment analysis was performed in connection with our preparation and review of financial statements for the year ended December 31, 2018. Based on this analysis, we recorded an impairment loss of \$38.6 million for our Western Hemisphere reporting unit for the year ended December 31, 2018. Following this impairment charge, the Western Hemisphere reporting unit has no remaining goodwill balance. The remaining goodwill balance is associated with our Eastern Hemisphere reporting unit. Based on our interim goodwill impairment analysis the fair value of the Eastern Hemisphere reporting unit exceeds its carry value by 71%. Further declines in the overall offshore market, commodity prices, or sustained lower valuation for the Company's common stock could indicate a reduction in the estimate of the Eastern Hemisphere's reporting unit fair value which, in turn, could lead to additional impairment charges associated with goodwill. No goodwill impairment losses were recorded for the years ended December 31, 2017 and 2016.

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## 10. Intangible Assets

Intangible assets, the majority of which were acquired in the acquisition of TIW and OPT, consist of the following:

		2018			
	Estimated Useful Lives	Gross Book Value	Accumulated Amortization	Foreign Currency Translation	Net Book Value
(In thousands)					
Trademarks	15 years	\$8,236	\$ —	\$ (72)	) \$8,164
Patents	15 - 30 years	6,026	(1,925)	) (11)	) 4,090
Customer relationships	5 - 15 years	25,703	(2,953)	) (260)	) 22,490
Non-compete agreements	3 years	171	(113)	) —	) 58
Organizational Costs	indefinite	172	—	—	172
		\$40,308	\$ (4,991)	) \$ (343)	) \$34,974
		2017			
	Estimated Useful Lives	Gross Book Value	Accumulated Amortization	Foreign Currency Translation	Net Book Value
(In thousands)					
Trademarks	indefinite	\$8,416	\$ —	\$ 56	\$8,472
Patents	15 - 30 years	5,946	(968)	) 80	5,058
Customer relationships	5 - 15 years	26,503	(1,675)	) (64)	) 24,764
Non-compete agreements	3 years	171	(57)	) —	114
		\$41,036	\$ (2,700)	) \$ 72	\$38,408

At October 1, 2017, the Company performed its annual impairment test on its indefinite and definite-lived intangible assets and concluded that there had been no impairment because the estimated fair values of each of those intangible assets exceeded its carrying value. In December 2018, the overall offshore market conditions declined. This decline was evidenced by lower commodity prices, decline in expected offshore rig counts, decrease in our customers' capital budgets and potential delays associated with certain of our long term projects. As a result, we determined that the trademark asset is no longer indefinite lived and determined a 15-year useful life to be appropriate based on our current market forecast.

Amortization expense was \$2.4 million, \$2.4 million and \$0.2 million for 2018, 2017 and 2016, respectively. Based on the carrying value of intangible assets at December 31, 2018, amortization expense for the subsequent five years is estimated to be as follows: 2019—\$2.2 million; 2020—\$2.1 million; 2021—\$2.1 million; 2022—\$2.1 million; and 2023—\$2.1 million.

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## 11. Income Taxes

Income (loss) before income taxes consisted of the following:

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Domestic	\$(120,784)	\$(84,278)	\$33,543
Foreign	5,795	18,634	82,325
Total	\$(114,989)	\$(65,644)	\$115,868

The income tax provision (benefit) consists of the following:

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Current:			
Federal	\$(24,366)	\$20,435	\$8,461
Foreign	9,163	(2,671 )	15,246
Total current	(15,203 )	17,764	23,707
Deferred:			
Federal	—	20,592	1,121
Foreign	(4,091 )	(3,361 )	(2,181 )
Total deferred	(4,091 )	17,231	(1,060 )
Total	\$(19,294)	\$34,995	\$22,647

The difference between the effective income tax rate reflected in the provision for income taxes and the U.S. federal statutory rate was as follows:

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	Year Ended December 31,		
	2018	2017	2016
Federal income tax statutory rate	21.00 %	35.00 %	35.00 %
Foreign income tax rate differential	(0.94 )	2.41	(11.66)
Foreign development tax incentive	0.24	1.78	(0.93 )
Nondeductible goodwill impairment	(5.21 )	—	—
Exempt income	2.32	—	—
Foreign inclusions (SubF / GILTI net of FTC)	(2.40 )	—	—
Transition tax (net of FTC)	5.80	(28.62)	—
Nondeductible expenses	(1.03 )	(1.75 )	0.54
Foreign intellectual property tax benefit	—	16.06	(1.08 )
Manufacturing benefit	(1.18 )	—	(0.99 )
Change in valuation allowance	(1.99 )	(35.61)	—
Changes to PY Accruals	(1.17 )	(4.01 )	0.48
Deferred tax rate change	0.66	(20.66)	—
Change in Uncertain tax positions	(0.78 )	(25.59)	—
Interest on net equity	1.02	3.15	—
Other	0.44	4.53	(1.81 )
Effective tax rate	16.78 %	(53.31)%	19.55 %

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's net deferred tax assets (liabilities) are as follows:

	As of December 31,	
	2018	2017
	(In thousands)	
Deferred tax assets:		
Foreign tax credit carryforward	2,018	3,094
Interest	4,899	5,380
Intangibles	20,816	28,181

Net operating losses	
Allowance for doubtful accounts	1,729
Reserve for accrued liabilities	1,200
Stock options	3,357
Other	3,177
Total deferred tax assets	3,908
Valuation allowance	3,553
Deferred tax liabilities:	
Property, plant and equipment	1,003
Goodwill	1,811
Intangibles	1,811
Other	1,811
Total deferred tax liabilities	45,995
Net deferred tax asset (liability)	39,031

Tax operating loss carryforwards totaled \$18.1 million at December 31, 2018. These operating losses will expire as shown in the table below.

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Tax	
operating losses	Expiration
(in thousands)	
\$2,258	2019-2024
10,990	2025-2031
2,431	2032-2037
2,409	Indefinite
\$18,088	

In assessing the realizability of our deferred tax assets, the Company has assessed whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. In making this determination, the Company considered taxable income in prior years, if carryback is permitted, the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies. The Company has a three-year cumulative loss at December 31, 2018 in the United States and certain foreign jurisdictions and has recorded a valuation allowance at December 31, 2018 of \$31.8 million against deferred tax assets in those jurisdictions.

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act of 2017 (US Tax Reform). In 2017, we recorded provisional amounts for certain enactment-date effects of US Tax Reform by applying the guidance provided in Staff Accounting Bulletin 118 because we had not yet completed our enactment-date accounting for these said effects. In 2017, the Company recorded tax expense related to the enactment-date effects of US Tax Reform that included recording the one-time transition tax liability related to undistributed earnings of certain foreign subsidiaries that were not previously taxed and adjusting deferred tax assets and liabilities. The changes to the 2017 enactment-date provisional amounts increased the effective tax rate in 2018 by 13.7%. At December 31, 2018, we have now completed our accounting for all the enactment-date income tax effects of US Tax Reform. As further discussed below, during 2018, we recognized adjustments of \$15.8 million to the provisional amounts recorded at December 31, 2017 and included these adjustments as a component of income tax expense from continuing operations.

US Tax Reform eliminated the deferral of U.S. income tax on the historical unrepatriated earnings by imposing a transition tax, which is a one-time mandatory deemed repatriation tax on undistributed earnings. The transition tax is assessed on the U.S. shareholder's share of the foreign corporation's accumulated foreign earnings that have not previously been taxed. Earnings in the form of cash and cash equivalents will be taxed at a rate of 15.5% and all other earnings will be taxed at a rate of 8.0%. As of December 31, 2017, we accrued income tax liabilities of \$32.6 million under the transition tax.

Upon further analyses of US Tax Reform and additional Notices and regulations issued and proposed by the US Department of the Treasury and the Internal Revenue Service, we finalized our calculations of the transition tax liability during 2018. We decreased our December 31, 2017 provisional amount by \$15.8 million, which is included as a component of income tax expense from continuing operations.

Our deferred tax assets and liabilities are measured at the rate expected to apply when these temporary differences are expected to be realized or settled. As of December 31, 2017, we remeasured certain deferred tax assets and liabilities based on the rates at which they were expected to reverse in the future, by recording a provisional amount of \$13.6 million. Upon further analysis of certain aspects of US Tax Reform and refinement of our calculations during the year ended December 31, 2018, we adjusted our provisional amount by \$1.6 million, which is included as a component of income tax expense from continuing operations.

US Tax Reform subjects a US shareholder to tax on Global Intangible Low-Taxed Income (GILTI). We have elected to account for GILTI in the year that the tax is incurred as a period expense.



Certain undistributed earnings of the Company's foreign subsidiaries are considered to be indefinitely reinvested and, accordingly, no provision for income taxes has been provided thereon. The estimate of undistributed earnings of the Company's foreign subsidiaries amounted to \$453 million as of December 31, 2018. Upon distribution of those earnings in the form of dividends or otherwise, after consideration of the transition tax, the Company may be subject to both income taxes and withholding taxes payable. Determination of the amount of the potential tax liability on repatriation is not practicable at this time.

The Company evaluates uncertain tax positions for recognition and measurement in the consolidated financial statements. To recognize a tax position, the Company determines whether it is more likely than not that the tax positions will be sustained upon examination, including resolution of any related appeals or litigation, based on the technical merits of the position. A tax position that meets the more likely than not threshold is measured to determine the amount of benefit to be recognized in the consolidated financial statements. The amount of tax benefit recognized with respect to any tax position is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement. The Company had an uncertain tax position of \$18.6 million at December 31, 2018 due to uncertainty in tax positions taken in the U.S. and certain foreign tax

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jurisdictions. The tax years which remain subject to examination by major tax jurisdictions are the years ended December 31, 2012 through December 31, 2018.

A reconciliation of the beginning and ending amount of liabilities associated with uncertain tax positions is as follows:

	2018	2017	2016
	(In thousands)		
Balance at beginning of year	\$18,323	\$5,151	\$—
Additions for tax positions related to the current year	—	16,800	—
Additions for tax positions related to the prior year	325	—	3,628
Additions related to acquisitions	—	—	1,523
Settlements with tax authorities	—	(3,628)	—
Balance at end of year	\$18,648	\$18,323	\$5,151

The amounts above exclude accrued interest and penalties of \$1.1 million, \$0.6 million, and \$0.6 million at December 31, 2018, 2017 and 2016 respectively. The Company classifies interest and penalties relating to uncertain tax positions within Tax expense(benefit) in the Consolidated Statement of Income (Loss).

It is reasonably possible that the Company's existing liabilities for unrecognized tax benefits may increase or decrease in the year ending December 31, 2019, primarily due to the progression of any audits and the expiration of statutes of limitation. However, the Company cannot reasonably estimate a range of potential changes in its existing liabilities for unrecognized tax benefits due to various uncertainties, such as the unresolved nature of any possible audits. As of December 31, 2018, if recognized, \$8.2 million of the Company's unrecognized tax benefits would favorably impact the effective tax rate.

The Company paid \$3.8 million, \$8.4 million and \$23.0 million in income taxes in 2018, 2017 and 2016, respectively.

## 12. Other Accrued Liabilities

Current other accrued liabilities consist of the following:

	December 31,	
	2018	2017
	(In thousands)	
Payroll taxes	\$6,227	\$6,591
Property, sales and other taxes	7,898	8,340
Commissions payable	5,248	408
Accrued vendor costs	2,973	7,068
Accrued warranties	1,868	1,535
Severance	5,498	—
Other	2,530	1,596
Total	\$32,242	\$25,538

## 13. Employee Benefit Plans

The Company has a defined-contribution 401(k) plan covering domestic employees and a defined-contribution pension plan covering certain foreign employees. The Company generally makes contributions to the plans equal to each participant's eligible contributions for the plan year up to a specified percentage of the participant's annual compensation. The Company's contribution expense was \$4.1 million, \$4.3 million and \$4.6 million in 2018, 2017 and 2016, respectively.

## 14. Asset Backed Loan (ABL) Credit Facility

On February 23, 2018, the Company, as borrower, and the Company's subsidiaries TIW and Honing, Inc., as guarantors, entered into a five-year senior secured revolving credit facility (the "ABL Credit Facility") with JPMorgan Chase Bank, N.A., as administrative agent, and other financial institutions as lenders with total commitments of \$100.0 million, including up to \$10.0 million available for letters of credit. The maximum amount that the Company may borrow under the



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ABL Credit Facility is subject to the borrowing base, which is based on a percentage of eligible accounts receivable and eligible inventory, subject to reserves and other adjustments.

All obligations under the ABL Credit Facility are fully and unconditionally guaranteed jointly and severally by the Company, TIW, Honing, Inc., and future significant domestic subsidiaries, subject to customary exceptions.

Borrowings under the ABL Credit Facility are secured by liens on substantially all of the Company's personal property, and bear interest at the Company's option at either (i) the CB Floating Rate (as defined therein), calculated as the rate of interest publicly announced by JPMorgan Chase Bank, N.A., as its "prime rate," subject to each increase or decrease in such prime rate effective as of the date such change occurs, with such CB Floating Rate not being less than Adjusted One Month LIBOR (as defined therein) or (ii) the Adjusted LIBOR (as defined therein), plus, in each case, an applicable margin. The applicable margin ranges from 1.00% to 1.50% per annum for CBFRR loans and 2.00% to 2.50% per annum for Eurodollar loans and, in each case, is based on the Company's leverage ratio. The unused portion of the ABL Credit Facility is subject to a commitment fee that varies from 0.250% to 0.375% per annum, according to average unused commitments under the ABL Credit Facility. Interest on Eurodollar loans is payable at the end of the selected interest period, but no less frequently than quarterly. Interest on CB Floating Rate loans is payable monthly in arrears.

The ABL Credit Facility contains various covenants and restrictive provisions that limit the Company's ability to, among other things, (1) enter into asset sales; (2) incur additional indebtedness; (3) make investments or loans and create liens; (4) pay certain dividends or make other distributions and (5) engage in transactions with affiliates. The ABL Credit Facility also requires the Company to maintain a fixed charge coverage ratio of 1.0 to 1.0, based on the ratio of EBITDA (as defined therein) to Fixed Charges (as defined therein) during certain periods, including when availability under the ABL Credit Facility is under certain levels. If the Company fails to perform its obligations under the agreement that results in an event of default, the commitments under the ABL Credit Facility could be terminated and any outstanding borrowings under the ABL Credit Facility may be declared immediately due and payable. The ABL Credit Facility also contains cross default provisions that apply to the Company's other indebtedness. The Company is in compliance with the related covenants as of December 31, 2018.

As of December 31, 2018, the availability under the ABL Credit Facility was \$52.2 million, after taking into account the outstanding letters of credit of approximately \$1.7 million issued under the facility.

#### 15. Commitments and Contingencies

The Company leases certain offices, shop and warehouse facilities, automobiles and equipment. Total lease expense incurred was \$5.4 million, \$6.0 million and \$5.0 million in 2018, 2017 and 2016, respectively. Future annual minimum lease commitments at December 31, 2018 are as follows: 2019—\$2.0 million; 2020—\$1.5 million; 2021—\$0.8 million; 2022—\$0.5 million; 2023—\$0.4 million; and thereafter—\$4.2 million.

##### Brazilian Tax Issue

From 2002 to 2007, the Company's Brazilian subsidiary imported goods through the State of Espirito Santo in Brazil and subsequently transferred them to its facility in the State of Rio de Janeiro. During that period, the Company's Brazilian subsidiary paid taxes to the State of Espirito Santo on its imports. Upon the final sale of these goods, the Company's Brazilian subsidiary collected taxes from customers and remitted them to the State of Rio de Janeiro net of the taxes paid on importation of those goods to the State of Espirito Santo in accordance with the Company's understanding of Brazilian tax laws.

In December 2010 and January 2011, the Company's Brazilian subsidiary was served with two assessments totaling approximately \$13.0 million from the State of Rio de Janeiro to cancel the credits associated with the tax payments to the State of Espirito Santo (Santo Credits) on the importation of goods from July 2005 to October 2007. The Company has objected to these assessments on the grounds that they would represent double taxation on the importation of the same goods and that the Company is entitled to the credits under applicable Brazilian law. The Company's Brazilian subsidiary filed appeals with a State of Rio de Janeiro judicial court to annul both of these tax assessments following rulings against the Company by the tax administration's highest council. In connection with those appeals, the Company deposited with the court a total amount of approximately \$8.8 million in December 2014 and December

2016 as the full amount of the assessments with penalties and interest. The Company believes that these credits are valid and that success in the judicial court process is probable. Based upon this analysis, the Company has not accrued any liability in conjunction with this matter.

Since 2007, the Company's Brazilian subsidiary has paid taxes on the importation of goods directly to the State of Rio de Janeiro and the Company does not expect any similar issues to exist for periods subsequent to 2007.

#### General

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, certain of the Company's products are used in potentially hazardous drilling,

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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 ongoing and 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 effect on the Company's results of operations, financial position or cash flows.

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## 16. Geographic Segments

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Western Hemisphere			
Revenues			
Products			
Standard Products	\$135,687	\$215,907	\$250,466
Percentage of Completion	34,595	1,178	3,893
Total Products	170,282	217,085	254,359
Services			
Technical Advisory	29,973	28,053	22,554
Reconditioning	10,985	8,846	13,049
Total Services (excluding rental tools)	40,958	36,899	35,603
Leasing	25,302	28,151	27,747
Total Services (including rental tools)	66,260	65,050	63,350
Intercompany	13,343	27,554	43,856
Eliminations	—	—	—
Total	\$249,885	\$309,689	\$361,565
Depreciation and amortization	\$23,314	\$30,441	\$21,396
Income (loss) before taxes	\$(29,823 )	\$(18,099 )	\$91,221
Eastern Hemisphere			
Revenues			
Products			
Standard Products	\$49,216	\$43,260	\$76,647
Percentage of Completion	22,503	26,404	30,215
Total Products	71,719	69,664	106,862
Services			
Technical Advisory	16,499	15,313	19,568
Reconditioning	3,188	1,958	4,116
Total Services (excluding rental tools)	19,687	17,271	23,684
Leasing	13,639	10,776	11,134
Total Services (including rental tools)	33,326	28,047	34,818
Intercompany	2,010	772	337
Eliminations	—	—	—
Total	\$107,055	\$98,483	\$142,017
Depreciation and amortization	\$4,578	\$4,096	\$4,965
Income before taxes	\$20,495	\$1,379	\$60,835

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Asia Pacific Hemisphere	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Revenues			
Products			
Standard Products	\$19,569	\$34,951	\$30,928
Percentage of Completion	3,482	29,432	40,863
Total Products	23,051	64,383	71,791
Services			
Technical Advisory	10,143	7,559	4,209
Reconditioning	1,626	216	598
Total Services (excluding rental tools)	11,769	7,775	4,807
Leasing	8,219	3,465	2,744
Total Services (including rental tools)	19,988	11,240	7,551
Intercompany	2,058	781	1,882
Eliminations	—	—	—
Total	\$45,097	\$76,404	\$81,224
Depreciation and amortization	\$4,785	\$4,063	\$4,436
Income (loss) before taxes	\$(3,123 )	\$4,928	\$12,779
Corporate			
Depreciation and amortization	\$2,635	\$2,374	\$1,060
Loss before taxes	\$(102,538 )	\$(53,852 )	\$(48,967 )
Consolidated			
Revenues			
Products			
Standard Products	\$204,472	\$294,118	\$358,041
Percentage of Completion	60,580	57,014	74,971
Total Products	265,052	351,132	433,012
Services			
Technical Advisory	56,615	50,925	46,331
Reconditioning	15,799	11,020	17,763
Total Services (excluding rental tools)	72,414	61,945	64,094
Leasing	47,160	42,392	41,625
Total Services (including rental tools)	119,574	104,337	105,719
Intercompany	17,411	29,107	46,075
Eliminations	(17,411 )	(29,107 )	(46,075 )
Total	\$384,626	\$455,469	\$538,731
Depreciation and amortization	\$35,312	\$40,974	\$31,857
Income (loss) before taxes	\$(114,989 )	\$(65,644 )	\$115,868



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	December 31,	
	2018	2017
	(In thousands)	
Total long-lived assets:		
Western Hemisphere	\$412,624	\$482,636
Eastern Hemisphere	256,899	264,828
Asia Pacific	65,944	58,606
Eliminations	(395,938 )	(414,814 )
Total	\$339,529	\$391,256

Total assets:		
Western Hemisphere	\$708,723	\$877,779
Eastern Hemisphere	788,171	752,967
Asia Pacific	154,298	185,229
Eliminations	(458,682 )	(416,170 )
Total	\$1,192,510	\$1,399,805

In 2018, BP and its affiliated companies accounted for approximately 13% of the Company's total revenues. In 2017 and 2016, Chevron and its affiliated companies accounted for approximately 14% and 16%, respectively, of the Company's total revenues. No other customer accounted for more than 10% of the Company's total revenues in 2018, 2017 or 2016.

During the fourth quarter of 2017, the Company pursued a restructuring of its entities to prepare it for potential increased activity in international markets. The main focus of the restructuring was to consolidate excess foreign cash held offshore and create an internal financing capability. The excess foreign cash is now held in a treasury concentration center in the Eastern Hemisphere where it is invested when not required to fund international operations. When required, these funds can be easily deployed to meet the working capital requirements of foreign operations. This structure was put in place as the Company expects that when the market rebounds, future work will come from international markets, especially Europe and Asia Pacific.

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 regional headquarter locations as well as in Macae, Brazil.

Eliminations of operating profits are related to intercompany inventory transfers that are deferred until shipment is made to third party customers.

#### 17. Stockholders' Equity

On November 24, 2008, the Board of Directors declared a dividend of one right (a "Right") for each outstanding share of the Company's common stock to stockholders of record at the close of business on December 5, 2008. Each Right entitled the registered holder to purchase from the Company a unit consisting of one one-hundredth of a share (a "Fractional Share") of Series A Junior Participating Preferred Stock, par value \$0.01 per share (the "Preferred Stock"), at a purchase price of \$100 per Fractional Share, subject to adjustment. The Rights were exercisable in the event any person or group acquired 15% or more of the Company's common stock, and until such time were inseparable from and traded with the Company's common stock. The related rights agreement was amended on February 26, 2018 to accelerate the expiration of the Rights from the close of business on November 24, 2018 to the close of business on February 26, 2018, and had the effect of terminating the rights agreement on that date. At the time of the termination of the rights agreement, all of the Rights distributed to holders of the Company's common stock pursuant to the rights

agreement expired.

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## 18. Stock-Based Compensation and Stock Awards

On May 13, 2004, the Company's stockholders approved the 2004 Incentive Plan of Dril-Quip, Inc. (as amended in 2012 and approved by the Company's stockholders on May 10, 2012, the "2004 Plan"), which reserved up to 2,696,294 shares of common stock to be used in connection with the 2004 Plan. Persons eligible for awards under the 2004 Plan are employees holding positions of responsibility with the Company or any of its subsidiaries and members of the Board of Directors.

On May 12, 2017, the Company's stockholders approved the 2017 Omnibus Incentive Plan of Dril-Quip, Inc. (the "2017 Plan"), which reserved up to 1,500,000 shares of common stock to be used in connection with the 2017 Plan. Persons eligible for awards under the 2017 Plan are employees with the Company or any of its subsidiaries and members of the Board of Directors.

## Stock Options

Options granted under the 2004 Plan have a term of ten years and become exercisable in cumulative annual increments of one-fourth of the total number of shares of common stock subject thereto, beginning on the first anniversary of the date of the grant. No stock options have been granted under the 2017 Plan.

The fair value of stock options granted was estimated on the grant date using the Black-Scholes option pricing model. The expected life was based on the Company's historical trends, and volatility is based on the historical volatility over the expected life of the options. The risk-free interest rate is based on U.S. Treasury yield curve at the grant date. The Company does not pay dividends and, therefore, there is no assumed dividend yield.

Option activity for the year ended December 31, 2018 was as follows:

	Number of Options	Weighted Average Price	Aggregate Intrinsic Value (in millions)	Weighted Average Remaining Contractual Life (in years)
Outstanding at December 31, 2017	280,212	\$ 59.84		
Granted	—	—		
Exercised	(35,375 )	31.59		
Forfeited	(20,750 )	67.71		
Outstanding at December 31, 2018	224,087	\$ 63.57	—	2.1
Exercisable at year-end	224,087	\$ 63.57	—	2.1

The total intrinsic value of stock options exercised in 2018, 2017 and 2016 was \$0.7 million, \$0.4 million and \$1.0 million, respectively. The income tax benefit realized from stock options exercised was \$157,442, \$153,759 and \$357,000 for the years ended December 31, 2018, 2017 and 2016, respectively. There were 6,180 anti-dilutive stock option shares on December 31, 2018.

Stock-based compensation is recognized as selling, general and administrative expense in the accompanying Consolidated Statements of Income. For the years ended December 31, 2018, 2017 and 2016, there was no stock-based compensation expense for stock option awards. No stock-based compensation expense was capitalized during 2018, 2017 and 2016.

Options granted to employees vest over four years and the Company recognizes compensation expense on a straight-line basis over the vesting period of the options. At December 31, 2018, there was no unrecognized compensation expense related to non-vested stock options as all outstanding options were fully vested.



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## Restricted Stock Awards

On October 28, 2018 and 2017, pursuant to the 2017 Plan and the 2004 Plan, respectively, the Company awarded officers, directors and key employees restricted stock awards (RSAs), which is an award of common stock subject to time vesting. The awards issued under both the 2017 Plan and the 2004 Plan are restricted as to transference, sale and other disposition. These RSAs vest ratably over a three-year period. The RSAs may also vest in case of a change of control. Upon termination, whether voluntary or involuntary, the RSAs that have not vested will be returned to the Company resulting in stock forfeitures. The fair market value of the stock on the date of grant is amortized and charged to selling, general and administrative expense over the stipulated time period over which the RSAs vest on a straight-line basis, net of estimated forfeitures.

The Company's RSA activity and related information is presented below:

	Restricted Stock	Weighted-average Grant Date Fair Value
Unvested at December 31, 2017	397,298	\$ 46.76
Granted	197,380	41.93
Vested	(169,434)	49.73
Forfeited	(22,065 )	46.17
Unvested at December 31, 2018	403,179	\$ 43.18

RSA compensation expense for the years ended December 31, 2018, 2017 and 2016 totaled \$8.8 million, \$8.4 million and \$7.2 million, respectively. For 2018, 2017 and 2016, the income tax benefit recognized in net income for RSAs was \$1.5 million, \$1.9 million and \$1.2 million, respectively. As of December 31, 2018, there was \$16.5 million of total unrecognized compensation cost related to nonvested RSAs, which is expected to be recognized over a weighted average period of 2.2 years. There were 239,952 anti-dilutive restricted shares on December 31, 2018.

## Performance Unit Awards

On October 28, 2018, 2017 and 2016, pursuant to the 2017 Plan and the 2004 Plan, the Company awarded performance unit awards (Performance Units) to officers and key employees. The Performance Units were valued based on a Monte Carlo simulation at \$54.62 for the 2018 grants, \$54.64 for the 2017 grants and \$53.46 for the 2016 grants, approximately 126.8%, 131.7% and 110.3%, respectively, of the grant date share price. Under the plans, participants may earn from 0% to 200% of their target award based upon the Company's relative total share return (TSR) in comparison to the 15 component companies of the Philadelphia Oil Service Index.

The TSR is calculated over a three-year period from October 1, 2016, 2017 and 2018 to September 30, 2019, 2020 and 2021, respectively, and assumes reinvestment of dividends for companies within the index that pay dividends, which Dril-Quip does not. Assumptions used in the Monte Carlo simulation are as follows:

	2018	2017	2016
Grant date	October 28, 2018	October 28, 2017	October 28, 2016
Performance period	October 1, 2018 to September 30, 2021	October 1, 2017 to September 30, 2020	October 1, 2016 to September 30, 2019
Volatility	32.6%	34.0%	32.5%
Risk-free interest rate	2.9%	1.7%	1.0%
Grant date price	\$43.09	\$41.50	\$48.45

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The Company's Performance Unit activity and related information is presented below:

	Number of Performance Units	Weighted Average Grant Date Fair Value Per Unit
Nonvested balance at December 31, 2017	264,274	\$ 59.97
Granted	88,179	54.62
Vested	(48,072 )	79.00
Forfeited	(16,288 )	79.00
Nonvested balance at December 31, 2018	288,093	\$ 54.22

Performance Unit compensation expense was \$4.2 million, \$5.4 million and \$4.6 million for the years ended December 31, 2018, 2017 and 2016, respectively. The income tax benefit recognized in net income for Performance Units was \$0.4 million, \$0.8 million and \$0.5 million, for the years ended December 31, 2018, 2017 and 2016, respectively. As of December 31, 2018, there was \$9.6 million of total unrecognized compensation expense related to nonvested Performance Units which is expected to be recognized over a weighted average period of 2.1 years. There were 169,354 anti-dilutive Performance Units at December 31, 2018.

#### Director Stock Compensation Awards

In June 2014, the Board of Directors authorized a stock compensation program for the directors pursuant to the 2004 Plan. This program continues under the 2017 Plan. Under this program, the Directors may elect to receive all or a portion of their fees in the form of restricted stock awards (DSA) in an amount equal to 125% of the fees in lieu of cash. The awards are made quarterly on the first business day after the end of each calendar quarter and vest on January 1 on the second year after the grant date.

The Company's DSA activity for the year ended December 31, 2018 is presented below:

	DSA Number of Shares	Weighted Average Grant Date Fair Value Per Share
Non-vested balance at December 31, 2017	17,514	\$ 54.80
Granted	9,539	48.32
Vested	(8,174 )	58.47
Forfeited	—	—
Nonvested balance at December 31, 2018	18,879	\$ 49.93

Director stock compensation awards expense for 2018 was \$460,884 as compared to \$462,968 for 2017 and 405,000 for 2016. For 2018, 2017 and 2016, the income tax benefit recognized in net income for DSAs was \$81,879, \$115,002, and \$19,000, respectively. There was \$291,168 of unrecognized compensation expense related to nonvested DSAs, which is expected to be recognized over a weighted average period of one year. There were 9,291 anti-dilutive DSA shares on December 31, 2018.

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The following table summarizes information for equity compensation plans in effect as of December 31, 2018:

Plan category	Number of securities to be issued upon exercise of outstanding options (1)	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plan (excluding securities reflected in column (a))
(a)	(b)	(c)	(c)
Equity compensation plans approved by stockholders			
Stock options	224,087	\$ 63.57	1,279,330
Total	224,087	\$ 63.57	1,279,330

(1) Excludes 422,058 shares of unvested RSAs and DSAs and 288,093 of unvested Performance Units, which were granted pursuant to the 2017 Plan and the 2004 Plan, both of which were approved by the stockholders.

## 19. Earnings Per Share

The following is a reconciliation of the basic and diluted earnings per share computation.

	Year Ended December 31,		
	2018	2017	2016
	(In thousands, except per share amounts)		
Net income (loss)	\$(95,695)	\$(100,639)	\$93,221
Weighted average basic common shares outstanding	37,075	37,457	37,537
Effect of dilutive securities - stock options and awards	—	—	130
Total shares and dilutive securities	37,075	37,457	37,667
Basic earnings (loss) per common share	\$(2.58 )	\$(2.69 )	\$2.48
Diluted earnings (loss) per common share	\$(2.58 )	\$(2.69 )	\$2.47

For the years ended December 31, 2018, 2017 and 2016, the Company has excluded the following common stock options and awards because their impact on the loss per share is anti-dilutive (in thousands on a weighted average basis):

	Year Ended		
	December 31,		
	2018	2017	2016
	(In thousands)		
Director stock awards	9	8	2
Stock options	6	21	—
Performance share units	169	160	64
Restricted stock awards	240	186	110

## 20. Stock Repurchase Plan

On February 26, 2015, the Company announced that the Board of Directors had authorized a stock repurchase plan under which the Company was authorized to repurchase up to \$100 million of its common stock. As part of the

repurchase plan, the Company repurchased 400,500 shares under this plan for a total of \$24.2 million during 2016. All repurchased shares were subsequently cancelled.

On July 26, 2016, the Board of Directors authorized a stock repurchase plan under which the Company was authorized to repurchase up to \$100 million of its common stock. During the year ended December 31, 2018, the Company purchased 1,991,206 shares under the share repurchase plan for approximately \$100 million. The repurchase plan was completed on

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October 19, 2018. All repurchased shares have been cancelled as of December 31, 2018. Refer to Item 5. Market for Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities for further discussion.

No repurchases were made pursuant to this plan during 2017.

## 21. Quarterly Results of Operations (Unaudited):

	Quarter Ended			
	March 31	June 30	September 30	December 31
	(In thousands, except per share data)			
	Unaudited			
2018				
Revenues	\$99,173	\$94,861	\$93,257	\$97,335
Cost of sales	67,750	69,444	65,630	68,675
Gross profit	31,423	25,417	27,627	28,660
Operating income (loss)	(6,277)	(3,551)	(14,084)	(98,826)
Net income (loss)	(7,383)	(3,042)	(10,358)	(74,912)
Earnings (loss) per share:				
Basic (1)	\$(0.20)	\$(0.08)	\$(0.28)	\$(2.09)
Diluted (1)	\$(0.20)	\$(0.08)	\$(0.28)	\$(2.09)
2017				
Revenues	\$119,228	\$127,922	\$100,346	\$107,973
Cost of sales	82,440	87,549	63,050	72,355
Gross profit	36,788	40,373	37,296	35,618
Operating income (loss)	(870)	(1,114)	(62,045)	(5,107)
Net income (loss)	94	15	(29,260)	(71,488)
Earnings (loss) per share:				
Basic (1)	\$—	\$—	\$(0.78)	\$0.03
Diluted (1)	\$—	\$—	\$(0.78)	\$0.03

(1) The sum of the quarterly per share amounts may not equal the annual amount reported, as per share amounts are computed independently for each quarter and for the full year.

## 22. Subsequent Events

On February 26, 2019, the Company announced that the Board of Directors had authorized a new stock repurchase program under which the Company is authorized to repurchase up to \$100 million of its common stock. The repurchase program has no set expiration date. Repurchases under the program will be made through open market purchases, privately negotiated transactions or plans, instructions or contracts established under Rule 10b5-1 under the Exchange Act. The manner, timing and amount of any purchase will be determined by management based on an evaluation of market conditions, stock price, liquidity and other factors. The program does not obligate the Company to acquire any particular amount of common stock and may be modified or superseded at any time at the Company's discretion. Any repurchased shares are expected to be cancelled. No repurchases have been made pursuant to this program at the time of this filing.

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Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure  
None.

Item 9A. 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 Chief Executive Officer 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 Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2018 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 Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure.

"Management's Annual Report on Internal Control over Financial Reporting" appears on page 48 of this Annual Report on Form 10-K.

There has been no change in the Company's internal controls over financial reporting that occurred during the three months ended December 31, 2018 that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item is set forth under the captions "Election of Directors," "Corporate Governance Matters" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's definitive Proxy Statement (the "2019 Proxy Statement") for its annual meeting of stockholders to be held on May 14, 2019, which sections are incorporated herein by reference.

Pursuant to Item 401(b) of Regulation S-K, the information required by this item with respect to executive officers of the Company is set forth in Part I of this report.

Item 11. Executive Compensation

The information required by this item is set forth in the sections entitled "Director Compensation," "Executive Compensation" and "Corporate Governance Matters" in the 2019 Proxy Statement, which sections are incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item is set forth in the sections entitled "Security Ownership of Certain Beneficial Owners and Management" and "Executive Compensation—Equity Compensation Plan Information" in the 2019 Proxy Statement, which sections are incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item is set forth in the section entitled "Corporate Governance Matters" in the 2019 Proxy Statement, which section is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information required by this item is set forth in the sections entitled "Approval of Appointment of Independent Registered Public Accounting Firm—Fees Paid to PwC" and "—Audit Committee Pre-Approval Policy for Audit and Non-Audit Services" in the 2019 Proxy Statement, which sections are incorporated herein by reference.

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## PART IV

## Item 15. Exhibits and Financial Statement Schedules

## (a)(1) Financial Statements

All financial statements of the registrant are set forth under Item 8 of this Annual Report on Form 10-K.

## (a)(2) Financial Statement Schedule

## Schedule II—Valuation and Qualifying Accounts

Description	Balance at beginning of period (In thousands)	Charges to costs and expenses	Recoveries and write offs	Balance at end of period
Allowance for doubtful trade receivables				
December 31, 2018	\$4,519	\$ 3,794	\$ (2,647 )	\$5,666
December 31, 2017	5,570	1,709	(2,760 )	4,519
December 31, 2016	\$7,739	\$ 1,259	\$ (3,428 )	\$5,570
Allowance for excess and slow moving inventory				
December 31, 2018	\$83,566	\$ 34,155	\$ (9,154 )	\$108,567
December 31, 2017	45,648	32,204	5,714	83,566
December 31, 2016	\$39,247	\$ 5,748	\$ 653	\$45,648

All other financial schedules are omitted because of the absence of conditions under which they are required or because the required information is presented in the financial statements or notes thereto.

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(a)(3) Exhibits

Dril-Quip will furnish any exhibit to a stockholder upon payment by the stockholder of the Company's reasonable expenses to furnish the exhibit.

Exhibit No. Description

<u>*2.1</u>	Stock Purchase Agreement, dated as of October 14, 2016, by and between Pearce Industries, Inc. and the Company (incorporated herein by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on October 17, 2016, File No. 001-13439).
<u>*3.1</u>	Restated Certificate of Incorporation of the Company (incorporated herein by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, File No. 001-13439).
<u>*3.2</u>	Certificate of Elimination of Series A Junior Participating Preferred Stock of the Company (incorporated herein by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, File No. 001-13439).
<u>*3.3</u>	Amended and Restated Bylaws of the Company (incorporated herein by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed on May 20, 2014, File No. 001-13439).
<u>*4.1</u>	Form of certificate representing Common Stock (incorporated herein by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2018, File No. 001-13439).
<u>*4.2</u>	Rights Agreement, dated as of November 24, 2008 by and between the Company 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, File No. 001-13439).
<u>*4.3</u>	Amendment No. 1 to Rights Agreement, dated as of February 26, 2018, by and between the Company and Computershare Inc., as successor-in-interest to Computershare Shareowner Services LLC (f/k/a Mellon Investor Services LLC), as Rights Agent (incorporated herein by reference to Exhibit 4.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, File No. 001-13439).
<u>*+10.1</u>	Employment Agreement, dated as of December 8, 2011, between the Company and Mr. DeBerry (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K/A filed on December 12, 2011, File No. 001-13439).
<u>*+10.2</u>	Employment Agreement, dated as of December 8, 2011, between the Company and Mr. Gariepy (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K/A filed on December 12, 2011, File No. 001-13439).
<u>*+10.3</u>	Employment Agreement, dated as of December 8, 2011, between the Company and Mr. Webster (incorporated herein by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K/A filed on December 12, 2011, File No. 001-13439).
<u>*+10.4</u>	Employment Agreement, dated as of March 7, 2017, between the Company and Mr. Bird (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 9, 2017, File No. 001-13439).

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\*+10.5 Employment Agreement, dated as of March 7, 2017, between the Company and Mr. Brooks  
—(incorporated herein by reference to Exhibit 10.3 to the Company’s Current Report on Form 8-K filed on  
March 9, 2017).

\*+10.6 Amended and Restated 2004 Incentive Plan of Dril-Quip, Inc. (incorporated herein by reference to  
—Exhibit A to the Company’s Proxy Statement filed on April 6, 2012, File No. 001-13439).

\*+10.7 Short-Term Incentive Plan of Dril-Quip, Inc. (incorporated herein by reference to Exhibit B to the  
—Company’s Proxy Statement filed on April 6, 2012, File No. 001-13439).

\*+10.8 2017 Omnibus Incentive Plan of Dril-Quip, Inc. (incorporated herein by reference to Exhibit A to the  
—Company’s Proxy Statement filed on March 31, 2017, File No. 001-13439).

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- \*+10.9 —Form of Standard Non-Qualified Stock Option Agreement under 2004 Incentive Plan of Dril-Quip, Inc. (incorporated herein by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on December 19, 2008, File No. 001-13439).
- \*+10.10 —Form of Restricted Stock Award Agreement under 2004 Incentive Plan of Dril-Quip, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 12, 2011, File No. 001-13439).
- \*+10.11 —Form of Restricted Stock Award Agreement for Directors under 2004 Incentive Plan of Dril-Quip, Inc. (incorporated herein by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, File No. 001-13439).
- \*+10.12 —Form of Restricted Stock Award Agreement under 2017 Omnibus Incentive Plan of Dril-Quip, Inc. (incorporated herein by reference to Exhibit 10.13 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, File No. 001-13439).
- \*+10.13 —2012 Performance Unit Award Agreement under 2004 Incentive Plan of Dril-Quip, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 19, 2012, File No. 001-13439).
- \*+10.14 —2013 Performance Unit Award Agreement under 2004 Incentive Plan of Dril-Quip, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 22, 2013, File No. 001-13439).
- \*+10.15 —2017 Performance Unit Award Agreement under 2017 Omnibus Incentive Plan of Dril-Quip, Inc. (incorporated herein by reference to Exhibit 10.16 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, File No. 001-13439).
- \*+10.16 —Stock Compensation Program for Directors under 2004 Incentive Plan of Dril-Quip, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, File No. 001-13439).
- \*+10.17 —Form of Indemnification Agreement (incorporated herein by reference to the Company's Current Report on Form 8-K filed on October 17, 2005, File No. 001-13439).
- \*10.18 —Contract for Goods and Services dated August 20, 2012 between Petroleo Brasileiro S.A. and Dril-Quip do Brasil LTDA (English translation) (incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, File No. 001-13439).
- \*10.19 —Amendment to Contract #4600368806 dated as of July 29, 2016, between Petroleo Brasileiro S.A., the Company, and Dril-Quip do Brasil LTDA (English translation) (incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2016, File No. 001-13439).
- \*10.20 —Extrajudicial Agreement, dated as of October 17, 2016, between Petróleo Brasileiro S.A., the Company and Dril-Quip do Brazil LTDA (English translation) (incorporated herein by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2016, File No. 001-13439).

\*10.21 — Credit Agreement, dated as of February 23, 2018, among the Company, as borrower, the guarantors party thereto, the lenders party thereto and JPMorgan Chase Bank, N.A., as administrative agent, an issuing bank and swingline lender (incorporated herein by reference to Exhibit 10.23 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, File No. 001-13439).

\*10.22 — Pledge and Security Agreement, dated as of February 23, 2018, among the Company, TIW Corporation and Honing, Inc., as grantors, and JPMorgan Chase Bank, N.A., as administrative agent (incorporated herein by reference to Exhibit 10.24 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017, File No. 001-13439).

\*\*21.1 —Subsidiaries of the Registrant.

\*\*23.1 —Consent of PricewaterhouseCoopers LLP.

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\*\*31.1 —Rule 13a-14(a)/15d-14(a) Certification of Blake T. DeBerry.

\*\*31.2 —Rule 13a-14(a)/15d-14(a) Certification of Jeffrey J. Bird.

\*\*32.1 —Section 1350 Certification of Blake T. DeBerry.

\*\*32.2 —Section 1350 Certification of Jeffrey J. Bird.

\*\*101.INS —XBRL Instance Document

\*\*101.SCH —XBRL Schema Document

\*\*101.CAL —XBRL Calculation Document

\*\*101.DEF —XBRL Definition Linkbase Document

\*\*101.LAB —XBRL Label Linkbase Document

\*\*101.PRE —XBRL Presentation Linkbase Document

\* Incorporated herein by reference as indicated.

\*\* Filed with this report.

+ Management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K.



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Item 16. Form 10-K Summary  
Not applicable.

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on February 27, 2019.

DRIL-QUIP, INC.

By: /S/ BLAKE T. DEBERRY

Blake T. DeBerry

President and Chief Executive Officer

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name	Capacity	Date
/S/ JOHN V. LOVOI JOHN V. LOVOI	Chairman of the Board	February 27, 2019
/S/ BLAKE T. DEBERRY BLAKE T. DEBERRY	President, Chief Executive Officer and Director (Principal Executive Officer)	February 27, 2019
/S/ JEFFREY J. BIRD JEFFREY J. BIRD	Vice President and Chief Financial Officer (Principal Financial and Accounting Officer and Duly Authorized Signatory)	February 27, 2019
/S/ A.P. SHUKIS A.P. SHUKIS	Director	February 27, 2019
/S/ TERENCE B. JUPP TERENCE B. JUPP	Director	February 27, 2019
/S/ STEVEN L. NEWMAN STEVEN L. NEWMAN	Director	February 27, 2019