PECO II INC
Form CT ORDER
June 11, 2009

D> 731.6

Services

158.9 157.8 140.8

Total revenues

$844.3 $931.0 $872.4

Year Ended December 31, 2015 Compared to Year Ended December 31, 2014

Revenues. Revenues decreased by $86.7 million, or approximately 9.3%, to $844.3 million in 2015 from $931.0 million in 2014. The overall decrease in revenues was impacted by a 12.9% decrease in the average contracted offshore rig count (including floating and jack-up rigs) in 2015 as compared to 2014. Product revenues decreased by approximately $87.8 million for the year ended December 31, 2015 compared to the same period in 2014 as a result of decreased revenues of $77.5 million in subsea equipment, $9.6 million in surface equipment and $0.7 million in offshore rig equipment. Product revenues decreased in the Western Hemisphere by $98.1 million and in Asia-Pacific by $19.4 million, partially offset by a $29.7 million increase in the Eastern Hemisphere. 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 percentage-of-completion accounting method, market conditions and customer demand. Service revenues increased by approximately $1.1 million resulting from increased service revenues in the Western

Table of Contents

Hemisphere of $13.8 million, partially offset by decreases of $6.8 million in the Eastern Hemisphere and $5.9 million in Asia-Pacific. The majority of the increases in service revenues related to increased rental of the Company s running and installation tools, partially offset by a decrease in technical advisory assistance.

Cost of Sales. Cost of sales decreased by $54.2 million, or 10.6%, to $459.3 million for 2015 from $513.5 million for the same period in 2014. As a percentage of revenues, cost of sales were approximately 54.4% in 2015 and 55.2% in 2014. Cost of sales as a percentage of revenue decreased in 2015 primarily due to changes in the product mix and a reduction in unabsorbed manufacturing overhead expense.

Selling, General and Administrative Expenses. For 2015, selling, general and administrative expenses decreased by approximately $4.8 million, or 5.2%, to $88.0 million from $92.8 million in 2014. The decrease in selling, general and administrative expenses was primarily due to decreases in personnel and related expenses of $5.2 million coupled with foreign currency gains of $5.0 million in 2015 as compared to gains of $4.5 million in 2014. The decrease was offset by an increase in stock-based compensation of $1.2 million to $13.1 million in 2015 from $11.9 million in 2014. Selling, general and administrative expenses as a percentage of revenues were 10.5% in 2015 and 10.0% in 2014.

Engineering and Product Development Expenses. For 2015, engineering and product development expenses increased by approximately $2.2 million, or 4.8%, to $48.1 million from $45.9 million in 2014. Personnel and related expenses increased by $2.0 million. Engineering and product development expenses as a percentage of revenues increased to 5.7% in 2015 from 4.9% in 2014.

Income Tax Provision. Income tax expense for 2015 was $57.8 million on income before taxes of $249.8 million, resulting in an effective income tax rate of approximately 23.1%. Income tax expense in 2014 was $70.7 million on income before taxes of $279.4 million, resulting in an effective tax rate of approximately 25.3%. The decrease in effective income tax rate percentage primarily reflects the changes in taxable income among the Company s three geographic areas, which have different income tax rates, research and development credits, foreign intellectual property tax benefits and deductions related to domestic manufacturing activities.

Net Income. Net income was approximately $192.0 million in 2015 and $208.7 million in 2014 for the reasons set forth above.

Year Ended December 31, 2014 Compared to Year Ended December 31, 2013

Revenues. Revenues increased by $58.6 million, or approximately 6.7%, to $931.0 million in 2014 from $872.4 million in 2013. The overall increase in revenues was impacted by a 4.6% increase in the average contracted offshore rig count (including floating and jack-up rigs) in 2014 as compared to 2013. Product revenues increased by approximately $41.6 million for the year ended December 31, 2014 compared to the same period in 2013 as a result of increased revenues of $37.9 million in subsea equipment and an increase of $4.3 million in offshore rig equipment, partially offset by a decrease of $0.6 million in surface equipment. The increase in subsea equipment revenue was primarily due to increased revenues of $24.1 million in subsea equipment in the U.S. Gulf of Mexico as numerous subsea equipment orders were completed and shipped. Product revenues increased by $10.2 million in the Western Hemisphere, $19.1 million in the Eastern Hemisphere and $12.3 million in Asia-Pacific. Service revenues increased by approximately $17.0 million resulting from increased service revenues in the Western Hemisphere of $2.2 million, $13.1 million in the Eastern Hemisphere and $1.7 million in Asia-Pacific. The majority of the increases in service revenues related to increased technical advisory assistance services and rental of the Company s running and installation tools.

Cost of Sales. Cost of sales decreased by $0.4 million, or less than 1.0%, to $513.5 million for 2014 from $513.9 million for the same period in 2013. As a percentage of revenues, cost of sales were approximately 55.2% in 2014 and 58.9% in 2013. Cost of sales as a percentage of revenue decreased in 2014 primarily due to pricing increases and changes in the product mix.

Table of Contents

Selling, General and Administrative Expenses. For 2014, selling, general and administrative expenses decreased by approximately $2.0 million, or 2.1%, to $92.8 million from $94.8 million in 2013. The decrease in selling, general and administrative expenses was primarily due to foreign currency translation gains of $4.5 million in 2014 as compared to losses of $6.0 million in 2013. The gains were partially offset by an increase in stock-based compensation expense of $11.9 million in 2014 as compared to $8.9 million in 2013. Personnel and related expenses totaled $86.0 million for 2014 as compared to $79.3 million for 2013. Selling, general and administrative expenses as a percentage of revenues were 10.0% in 2014 and 10.9% in 2013.

Engineering and Product Development Expenses. For 2014, engineering and product development expenses increased by approximately $5.8 million, or 14.5%, to $45.9 million from $40.1 million in 2013. The increase was primarily due to additional personnel required to meet the demands of the backlog related to long-term projects. Engineering and product development expenses as a percentage of revenues increased to 4.9% in 2014 from 4.6% in 2013.

Income Tax Provision. Income tax expense for 2014 was $70.7 million on income before taxes of $279.4 million, resulting in an effective income tax rate of approximately 25.3%. Income tax expense in 2013 was $54.3 million on income before taxes of $224.1 million, resulting in an effective tax rate of approximately 24.2%. The increase in the effective income tax rate reflects the $1.2 million Research and Development tax credit from the American Taxpayer Relief Act of 2012 recognized on the 2012 U.S. income tax return, but not recorded until 2013 for financial statement purposes in accordance with accounting principles generally accepted in the United States of America. Also contributing to the increased tax rate is the difference in income tax rates between the Company s three geographic areas.

Net Income. Net income was approximately $208.7 million in 2014 and $169.8 million in 2013 for the reasons set forth above.

Liquidity and Capital Resources

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

	Year Ended December 31,		
	2015	**2014**	**2013**
		(In thousands)	
Operating activities	$ 190,155	$ 149,313	$ 162,229
Investing activities	(26,655)	(41,571)	(41,873)
Financing activities	(73,565)	(186,827)	3,367
	89,935	(79,085)	123,723
Effect of exchange rate changes on cash activities	(7,304)	(6,566)	3,442
Increase (decrease) in cash and cash equivalents	$ 82,631	$ (85,651)	$ 127,165

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 and (ii) to fund working capital. The Company s principal source of funds is cash flows from operations.

Net cash provided by operating activities increased $40.8 million in 2015 compared to 2014, primarily due to increases in operating assets and liabilities of $57.1 million, offset by lower net income of $16.7 million. Net

36

Table of Contents

cash provided by operating activities decreased $12.9 million in 2014 compared to 2013, primarily due to decreases in operating assets and liabilities of $54.4 million, offset by higher net income of $38.9 million and non-cash income adjustments of $2.6 million.

Net income decreased by $16.7 million to $192.0 million in 2015 from $208.7 million in 2014. Net income increased by $38.9 million to $208.7 million in 2014 from $169.8 million in 2013. The reasons for the changes in net income are set forth in the Results of Operations section above.

The change in operating assets and liabilities of $42.1 million during 2015 primarily reflected a decrease in trade receivables of $36.7 million and a decrease in inventory of $28.5 million. Trade receivables decreased primarily due to increased collection efforts and an overall downward shift of market activities. Inventory decreased due to lower balances in finished goods and an increase in the allowance for excess and slow-moving inventory. Prepaids and other assets increased by $17.9 million mostly from advances to suppliers related to long-term projects. Accounts payable and accrued expenses were lower by approximately $89.4 million which included a decrease of $52.8 million in customer prepayments.

The change in operating assets and liabilities of $99.1 million during 2014 primarily reflected an increase in trade receivables of $102.7 million and an increase in inventory of $36.8 million. Trade receivables increased due to the growth of revenues in 2014 and an increase in unbilled revenues of $15.1 million related to long-term projects. Inventory increased due to higher balances in raw materials and finished goods to accommodate the backlog requirements related to long-term projects. Prepaids and other assets increased by $13.2 million mostly due from advances to suppliers related to long-term projects. Accounts payable and accrued expenses were higher by approximately $54.2 million which included an increase of $26.2 million in customer prepayments.

Capital expenditures by the Company were $27.1 million, $42.5 million and $42.6 million in 2015, 2014 and 2013, respectively. Capital expenditures in 2015, 2014 and 2013 included expanding worldwide manufacturing facilities as well as increased expenditures on machinery and equipment and running tools. The capital expenditures for 2015 were primarily $1.0 million for facilities, $12.7 million for machinery and equipment, $11.8 million for running tools and other expenditures of $1.6 million. Capital expenditures in 2014 were primarily $3.0 million for facilities, $27.0 million for machinery and equipment, $8.3 million for running tools and other expenditures of $4.2 million. Capital expenditures in 2013 were comprised of $7.2 million for facilities, $23.6 million for machinery and equipment, $7.7 million for running tools and other expenditures of $4.1 million.

The exercise of stock options generated cash to the Company of $2.2 million, $2.8 million and $10.5 million in 2015, 2014, and 2013 respectively. On February 26, 2015, the Company announced that its 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. The Company repurchased 1,184,700 shares under this plan in 2015 for a total of $75.8 million. Under a share repurchase plan approved by its Board of Directors in 2012, the Company repurchased 869,699 shares, at a total cost of $90.0 million during 2014. On June 12, 2014 the Company announced that its Board of Directors had authorized another stock repurchase plan under which the Company was authorized to repurchase up to $100 million of its common stock. The Company repurchased 1,151,603 shares under this plan in 2014 for a total of $100.0 million. All repurchased shares were subsequently cancelled.

The following table presents long-term contractual obligations of the Company and the related payments in total and by year as of December 31, 2015:

Contractual Obligations	Payments Due by Year 2016	2017	2018	2019	2020	After 2020	Total
	(In millions)						
Operating lease obligations	$ 3.2	$ 2.1	$ 1.8	$ 1.5	$ 1.3	$ 4.4	$ 14.3

37

Table of Contents

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. However, continued depressed or a significant future decline in hydrocarbon prices, catastrophic events or significant changes in regulations affecting the Company or its customers could have a material adverse effect on the Company s liquidity. Should market conditions result in unexpected cash requirements, the Company believes that borrowing from commercial lending institutions would be available and adequate to meet such requirements.

Backlog

Backlog consists of firm customer orders of Dril-Quip products for which a purchase order or signed contract 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 $685 million at December 31, 2015 and $1.2 billion at December 31, 2014. The backlog at the end of 2015 represents a decrease of approximately $515 million, or 43%, from the end of 2014. The Company s backlog balance during 2015 has been negatively impacted by purchase order cancellations and revisions totaling approximately $62 million and translation adjustments of approximately $35 million, due primarily to the strengthening of the U.S. dollar versus the Brazilian real. In addition, the current decline in hydrocarbon prices and resulting business environment has resulted in a significant decrease in new customer orders.

The Company expects to fill approximately 60% to 70% of the December 31, 2015 product backlog by December 31, 2016. The remaining backlog at December 31, 2015 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 million, net of Brazilian taxes, at exchange rates in effect at that time (approximately $340 million based on the December 31, 2015 exchange rate of 3.90 Brazilian real to 1.00 U.S. dollar) if all the equipment under the contract is ordered. Amounts are included in the Company s backlog as purchase orders under the contract are received. Revenues of approximately $106 million have been recognized on this contract through December 31, 2015. As of December 31, 2015, the Company s backlog included $47 million of purchase orders under this Petrobras contract. The Company has not yet recognized revenue of approximately $9 million as of December 31, 2015 for certain items of equipment that were completed but not 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. The Company is in ongoing discussions with Petrobras regarding this contract and does not expect that Petrobras will order all of the equipment under the contract during its current four-year term. 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.

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 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 Note 10 of Notes to Consolidated Financial Statements. Revenues of the Western Hemisphere are also influenced by its sale of products to the Eastern Hemisphere and Asia-Pacific segments. Accordingly, the operating incomes of each area are closely tied to third-party sales, and the operating income of the Western Hemisphere is also dependent upon its level of intercompany sales.

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. Because of this strategy, the Company does not anticipate such exposure to be material in the future. The Company had, net of income taxes, transaction gains of $3.9 million and $3.4 million in 2015 and 2014, respectively, and transaction losses of $4.6 million in 2013. There is no assurance that the Company will be able to protect itself against such fluctuations in the future.

Historically, the Company has not conducted business in countries that limit repatriation of earnings. However, as the Company expands its international operations, it may begin operating in countries that have such limitations. 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 recognized under the percentage-of-completion method; and

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

Table of Contents

Revenues recognized under the percentage-of-completion method

The Company uses the percentage-of-completion method on long-term 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; and
- product requirements cannot be filled directly from the Company s standard inventory.

For each project, the Company prepares a detailed analysis of estimated costs, profit margin, completion date and risk factors which include availability of material, production efficiencies and other factors that may impact the project. On a quarterly basis, management reviews the progress of each project, which may result in revisions of previous estimates, including revenue recognition. The Company calculates the percent complete and applies the percentage to determine the revenues earned and the appropriate portion of total estimated costs. Losses, if any, are recorded in full in the period they 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 percentage-of-completion method, billings do not always correlate directly to the revenue recognized. Based upon the terms of the specific contract, billings may be in excess of the revenue recognized, in which case the amounts are included in customer prepayments as a liability on the 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, 2015 and 2014, receivables included $70.8 million and $68.0 million of unbilled receivables, respectively. For the year ended December 31, 2015, there were 14 projects representing approximately 16% of the Company s total revenues and approximately 19% of its product revenues, and 17 projects during 2014 representing approximately 11% of the Company s total revenues and approximately 13% of its product revenues, which were accounted for using percentage-of-completion accounting.

Revenues not recognized under the percentage-of-completion method

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

Service revenues

The Company earns service revenues from three sources:

- technical advisory assistance;

rental of running tools; and

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

The Company does not install products for its customers, but it provides technical advisory assistance. At the time of delivery of the product, the customer is not obligated to buy or rent the Company s running tools and the Company is not obligated to perform any subsequent services relating to installation. Technical advisory assistance service revenue is recorded at the time the service is rendered. Service revenues associated with the rental of running and installation tools are recorded as earned. Rework and reconditioning service revenues are recorded when the refurbishment process is complete.

40

Table of Contents

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

Inventories. Inventory costs are determined principally by the use of the first-in, first-out (FIFO) costing method and are stated at the lower of cost or market. Company manufactured inventory is valued principally using standard costs, which are calculated based upon direct costs incurred and overhead allocations 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. The inventory values have been reduced by a reserve for excess and slow-moving inventories of $39.2 million and $34.6 million as of December 31, 2015 and 2014, respectively. If market conditions are less favorable than those projected by management, additional inventory reserves may be required.

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

In November 2015, the FASB issued ASU 2015-17 Income Taxes (Topic 740). In an effort to reduce complexity, the requirement to separate deferred income tax liabilities and assets into current and noncurrent amounts will no longer be necessary. In the future, all deferred income taxes will be considered noncurrent and will continue to be offset into a single amount within each country. The standard is effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years. The Company s financial statements will be revised to reflect this amendment beginning in the first quarter of 2017.

In July 2015, the FASB issued ASU 2015-11 Simplifying the Measurement of Inventory (Topic 330). This standard states that inventory within the scope of this update should be measured at the lower of cost and net realizable value. Net realizable value is defined as the estimated selling price in the normal course of business, less reasonably predictable costs of completion, disposal and transportation. The standard is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company is evaluating the impact of the new guidance on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606). The amendment applies a new five-step revenue recognition model to be used in recognizing revenues associated with customer contracts. The amendment requires disclosure sufficient to enable readers of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures, significant judgments and changes in judgments and assets recognized from the costs to obtain or fulfill the contract. The standard s effective date was originally for fiscal years beginning after December 15, 2016, including interim periods within that reporting period. On

41

Table of Contents

April 1, 2015, the FASB voted to defer the effective date by one year to December 15, 2017 and interim periods within annual reporting periods beginning after December 15, 2017. The Company is evaluating the impact of the new guidance on its consolidated financial statements.

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, 2014.

Foreign Currency Exchange Rate Risk

Through its subsidiaries, the Company conducts a portion of its business in currencies other than the United States dollar, principally the British pound sterling and the Brazilian real. The Company has not experienced significant transaction gains or losses associated with changes in currency exchange rates and does not anticipate such exposure to be material in the future. However, 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 for the British pound sterling and the Brazilian real 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 $35.5 million and a decrease in net income of approximately $13.5 million for 2015. 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.

Table of Contents

Item 8. ***Financial Statements and Supplementary Data***

43

Table of Contents

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, 2015.

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, and their report is set forth on page 45.

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of

Dril-Quip, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, comprehensive income, stockholders equity and cash flows present fairly, in all material respects, the financial position of Dril-Quip, Inc. and its subsidiaries at December 31, 2015 and December 31, 2014, and the results of their operations and their cash flows each of the two years in the period ended December 31, 2015 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements and financial statement schedule, 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 these financial statements, financial statement schedule, and on the Company s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. 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.

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 25, 2016

45

Table of Contents

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

Dril-Quip, Inc.

Houston, Texas

We have audited the accompanying consolidated statements of income, comprehensive income, stockholders equity, and cash flows of Dril-Quip, Inc. (the Company) for the year ended December 31, 2013. In connection with our audit of the consolidated financial statements, we have also audited the financial statement schedule for the year ended December 31, 2013 listed in the accompanying index. These consolidated financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of Dril-Quip, Inc. for the year ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

Also in our opinion, the financial statement schedule for the year ended December 31, 2013, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ BDO USA, LLP

Houston, Texas

February 26, 2014

Table of Contents

DRIL-QUIP, INC.

CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31, 2015	2014	2013
	(In thousands, except per share data)		
Revenues:			
Products	$ 685,364	$ 773,205	$ 731,617
Services	158,946	157,752	140,755
Total revenues	844,310	930,957	872,372
Cost and expenses:			
Cost of sales:			
Products	382,925	428,125	436,359
Services	76,361	85,402	77,547
Total cost of sales	459,286	513,527	513,906
Selling, general and administrative	88,044	92,762	94,806
Engineering and product development	48,145	45,920	40,115
Total costs and expenses	595,475	652,209	648,827
Operating income	248,835	278,748	223,545
Interest income	948	667	587
Interest expense	(12)	(35)	(35)
Income before income taxes	249,771	279,380	224,097
Income tax provision	57,763	70,668	54,270
Net income	$ 192,008	$ 208,712	$ 169,827
Earnings per common share:			
Basic	$ 5.00	$ 5.22	$ 4.18
Diluted	$ 4.98	$ 5.19	$ 4.16
Weighted average common shares outstanding:			
Basic	38,364	39,964	40,648
Diluted	38,531	40,190	40,865

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

47

Table of Contents

DRIL-QUIP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended December 31,		
	2015	2014	2013
		(In thousands)	
Net income	$ 192,008	$ 208,712	$ 169,827
Other comprehensive loss, net of tax:			
Foreign currency translation adjustments	(51,060)	(30,034)	(6,340)
Total comprehensive income	$ 140,948	$ 178,678	$ 163,487

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

48

Table of Contents

DRIL-QUIP, INC.

CONSOLIDATED BALANCE SHEETS

	December 31, 2015	December 31, 2014
	(In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 381,336	$ 298,705
Trade receivables, net	319,780	373,993
Inventories, net	344,458	392,559
Deferred income taxes	24,613	23,569
Prepaids and other current assets	54,111	38,314
Total current assets	1,124,298	1,127,140
Property, plant and equipment, net	294,251	309,525
Other assets	9,701	12,586
Total assets	$ 1,428,250	$ 1,449,251
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 30,934	$ 53,837
Accrued income taxes	14,052	16,903
Customer prepayments	18,388	71,177
Accrued compensation	17,957	21,527
Other accrued liabilities	19,484	35,198
Total current liabilities	100,815	198,642
Deferred income taxes	2,977	5,417
Total liabilities	103,792	204,059
Commitments and contingencies (Note 9)		
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, 2015 and 2014, 37,951,223 and 38,932,508 issued and outstanding at December 31, 2015 and 2014	378	388
Additional paid-in capital		16,480
Retained earnings	1,425,344	1,278,528
Accumulated other comprehensive losses	(101,264)	(50,204)
Total stockholders equity	1,324,458	1,245,192

Total liabilities and stockholders equity	$ 1,428,250	$ 1,449,251

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

49

DRIL-QUIP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2015	2014	2013
		(In thousands)	
Operating activities			
Net income	$ 192,008	$ 208,712	$ 169,827
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	30,477	31,155	29,340
Stock-based compensation expense	13,125	11,856	8,900
Loss (gain) on sale of equipment	69	(146)	124
Deferred income taxes	(3,465)	(3,145)	(1,235)
Changes in operating assets and liabilities:			
Trade receivables, net	36,729	(102,696)	(17,250)
Inventories, net	28,539	(36,814)	(10,562)
Prepaids and other assets	(17,883)	(13,239)	6,161
Excess tax benefits of stock options and awards	(70)	(558)	(2,863)
Accounts payable and accrued expenses	(89,374)	54,188	(20,213)
Net cash provided by operating activities	190,155	149,313	162,229
Investing activities			
Purchase of property, plant and equipment	(27,079)	(42,549)	(42,633)
Proceeds from sale of equipment	424	978	760
Net cash used in investing activities	(26,655)	(41,571)	(41,873)
Financing activities			
Repurchase of common stock	(75,805)	(190,234)	(10,002)
Proceeds from exercise of stock options	2,170	2,849	10,506
Excess tax benefits of stock options and awards	70	558	2,863
Net cash provided by (used in) financing activities	(73,565)	(186,827)	3,367
Effect of exchange rate changes on cash activities	(7,304)	(6,566)	3,442
Increase (decrease) in cash and cash equivalents	82,631	(85,651)	127,165
Cash and cash equivalents at beginning of year	298,705	384,356	257,191
Cash and cash equivalents at end of year	$ 381,336	$ 298,705	$ 384,356

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

50

Table of Contents

DRIL-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, 2012	$ 405	$ 179,868	$ 899,989	$ (13,830)	$ 1,066,432
Foreign currency translation adjustment				(6,340)	(6,340)
Net income			169,827		169,827
Comprehensive income					163,487
Options exercised and awards vested (284,653 shares)	3	10,503			10,506
Stock-based compensation		8,900			8,900
Excess tax benefits stock options and awards		2,695			2,695
Treasury stock (85,840 shares)	(1)	(10,001)			(10,002)
Balance at December 31, 2013	407	191,965	1,069,816	(20,170)	1,242,018
Foreign currency translation adjustment				(30,034)	(30,034)
Net income			208,712		208,712
Comprehensive income					178,678
Options exercised and awards vested (48,523 shares)	1	2,848			2,849
Stock-based compensation		11,856			11,856
Excess tax benefits stock options and awards		25			25
Treasury stock (2,023,172 shares)	(20)	(190,214)			(190,234)
Balance at December 31, 2014	388	16,480	1,278,528	(50,204)	1,245,192
Foreign currency translation adjustment				(51,060)	(51,060)
Net income			192,008		192,008
Comprehensive income					140,948
		2,170			2,170

Options exercised and awards vested (168,268 shares)					
Stock-based compensation		13,125			13,125
Excess tax benefits stock options and awards		(1,172)			(1,172)
Treasury stock (1,184,700 shares)	(10)	(30,603)	(45,192)		(75,805)
Balance at December 31, 2015	$ 378	$	$ 1,425,344	$ (101,264)	$ 1,324,458

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

Table of Contents

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

The Company s operations are organized into three geographic segments Western Hemisphere (including North and South America; headquartered in Houston, Texas), Eastern Hemisphere (including Europe and Africa; headquartered in Aberdeen, Scotland) and Asia-Pacific (including the Pacific Rim, Southeast Asia, Australia, India and the Middle East; headquartered in Singapore). Each of these segments sells similar products and services and the Company has major manufacturing facilities in all three of its headquarter locations as well as 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; Dril-Quip do Brasil LTDA, located in Macae, Brazil; and DQ Holdings Pty. Ltd., located in Perth, Australia. Other subsidiaries include Dril-Quip (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 and Dril-Quip Qatar, LLC located in Doha, Qatar.

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.

52

Table of Contents

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.

Inventories

Inventory costs are determined principally by the use of the first-in, first-out (FIFO) costing method and are stated at the lower of cost or market. Company manufactured inventory is valued principally using standard costs, which are calculated based upon direct costs incurred and overhead allocations 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. The inventory values have been reduced by a reserve for excess and slow-moving inventories. Inventory reserves of $39.2 million and $34.6 million were recorded as of December 31, 2015 and 2014, 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.

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. No impairments of long-lived assets were recorded in 2015, 2014 or 2013.

Income Taxes

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

Revenue Recognition

Product revenues

The Company recognizes product revenues from two methods:

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

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

Table of Contents

Revenues recognized under the percentage-of-completion method

The Company uses the percentage-of-completion 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; and
- product requirements cannot be filled directly from the Company s standard inventory.

For each project, the Company prepares a detailed analysis of estimated costs, profit margin, completion date and risk factors which include availability of material, production efficiencies and other factors that may impact the project. On a quarterly basis, management reviews the progress of each project, which may result in revisions of previous estimates, including revenue recognition. The Company calculates the percent complete and applies the percentage to determine the revenues earned and the appropriate portion of total estimated costs. Losses, if any, are recorded in full in the period they 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 percentage-of-completion method, billings do not always correlate directly to the revenue recognized. Based upon the terms of the specific contract, billings may be in excess of the revenue recognized, in which case the amounts are included in customer prepayments as a liability on the 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, 2015 and 2014, receivables included $70.8 million and $68.0 million of unbilled receivables, respectively. For the year ended December 31, 2015, there were 14 projects representing approximately 16% of the Company s total revenues and approximately 19% of its product revenues, and 17 projects during 2014 representing approximately 11% of the Company s total revenues and approximately 13% of its product revenues, which were accounted for using percentage-of-completion accounting.

Revenues not recognized under the percentage-of-completion method

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

Service revenues

The Company earns service revenues from three sources:

- technical advisory assistance;

- rental of running tools; and
- rework and reconditioning of customer-owned Dril-Quip products.

The Company does not install products for its customers, but it does provide technical advisory assistance. At the time of delivery of the product, the customer is not obligated to buy or rent the Company s running tools and the Company is not obligated to perform any subsequent services relating to installation. Technical advisory assistance service revenue is recorded at the time the service is rendered. Service revenues associated with the rental of running and installation tools are recorded as earned. Rework and reconditioning service revenues are recorded when the refurbishment process is complete.

54

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

Foreign Currency

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

Foreign currency exchange transactions are recorded using the exchange rate at the date of the settlement. The Company experienced exchange gains of approximately $3.9 million and $3.4 million in 2015 and 2014, respectively, and exchange losses of $4.6 million in 2013, 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 share are computed by dividing net income by the weighted average number of shares of common stock outstanding during the year. Diluted earnings per common share are computed considering the dilutive effect of stock options and awards using the treasury stock method.

3. New Accounting Standards

In November 2015, the FASB issued ASU 2015-17 Income Taxes (Topic 740). In an effort to reduce complexity the requirement to separate deferred income tax liabilities and assets into current and noncurrent amounts will no longer be necessary. In the future, all deferred income taxes will be considered noncurrent and will continue to be offset into a single amount within each country. The standard is effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years. The Company s financial statements will be revised to reflect this amendment beginning in the first quarter of 2017.

Table of Contents

In July 2015, the FASB issued ASU 2015-11 Simplifying the Measurement of Inventory (Topic 330). This standard states that inventory within the scope of this update should be measured at the lower of cost and net realizable value. Net realizable value is defined as the estimated selling price in the normal course of business, less reasonably predictable costs of completion, disposal and transportation. The standard is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company is evaluating the impact of the new guidance on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606). The amendment applies a new five-step revenue recognition model to be used in recognizing revenues associated with customer contracts. The amendment requires disclosure sufficient to enable readers of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures, significant judgments and changes in judgments and assets recognized from the costs to obtain or fulfill the contract. The standard s effective date was originally for fiscal years beginning after December 15, 2016, including interim periods within that reporting period. On April 1, 2015, the FASB voted to defer the effective date by one year to December 15, 2017 and interim periods within annual reporting periods beginning after December 15, 2017. The Company is evaluating the impact of the new guidance on its consolidated financial statements.

4. Inventories, net

Inventories consist of the following:

	December 31,	
	2015	2014
	(In thousands)	
Raw materials and supplies	$ 101,311	$ 107,357
Work in progress	104,102	112,514
Finished goods	178,292	207,295
	383,705	427,166
Less: allowance for obsolete and excess inventory	(39,247)	(34,607)
Total inventory	$ 344,458	$ 392,559

5. Property, Plant and Equipment, net

Property, plant and equipment consists of:

	Estimated	December 31,	
	Useful Lives	2015	2014
		(In thousands)	
Land and improvements	10-25 years	$ 27,753	$ 26,854
Buildings	15-40 years	188,420	194,587
Machinery, equipment and other	3-10 years	351,477	340,279

	567,650	561,720
Less accumulated depreciation	(273,399)	(252,195)
Total property, plant and equipment	$ 294,251	$ 309,525

Depreciation expense totaled $30.5 million, $31.2 million and $29.3 million for 2015, 2014 and 2013, respectively.

56

Table of Contents

6. Income Taxes

The Company is required to recognize the impact of a tax position that is more likely than not to be sustained upon examination based upon the technical merits of the position, including resolution of any appeals. Based on the Company s evaluation, the Company has concluded that there are no significant uncertain tax positions requiring recognition in the Company s financial statements. The evaluation was performed for the tax years which remain subject to examination by major tax jurisdictions as of December 31, 2015, which are the years ended December 31, 2008 through December 31, 2014. The Company has occasionally been assessed interest or penalties by major tax jurisdictions; these assessments historically have not materially impacted the Company s financial results. Interest expense assessed by tax jurisdictions is included with interest expense and assessed penalties are included in selling, general and administrative expenses.

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 no uncertain tax positions that required recognition in the consolidated financial statements at December 31, 2015 and 2014. If it is more likely than not that the related tax benefits will not be realized, a valuation allowance would be established to reduce deferred tax assets. As of December 31, 2015 and 2014, the Company determined that a valuation allowance was not necessary.

Income before income taxes consisted of the following:

	Year Ended December 31,		
	2015	**2014**	**2013**
		(In thousands)	
Domestic	$ 107,158	$ 124,571	$ 98,883
Foreign	142,613	154,809	125,214
Total	$ 249,771	$ 279,380	$ 224,097

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

	Year Ended December 31,		
	2015	**2014**	**2013**
		(In thousands)	
Current:			
Federal	$ 33,017	$ 43,652	$ 30,962
Foreign	28,229	30,022	24,543
Total current	61,246	73,674	55,505

Deferred:			
Federal	(1,611)	(5,916)	(1,299)
Foreign	(1,872)	2,910	64
Total deferred	(3,483)	(3,006)	(1,235)
Total	$ 57,763	$ 70,668	$ 54,270

57

Table of Contents

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:

	Year Ended December 31,		
	2015	2014	2013
Federal income tax statutory rate	35.0%	35.0%	35.0%
Foreign income tax rate differential	(7.3)	(6.0)	(6.0)
Foreign development tax incentive	(1.3)	(1.6)	(2.6)
Manufacturing benefit	(1.4)	(1.7)	(1.4)
Foreign intellectual property tax benefit	(0.8)	(0.0)	(0.0)
Other	(1.1)	(0.4)	(0.8)
Effective income tax rate	23.1%	25.3%	24.2%

As part of the United Kingdom s (U.K.) growth agenda, the patent box tax regime, effective April 1, 2013, was introduced to provide an additional incentive to develop, commercialize and retain innovative patented technology in the U.K. This foreign intellectual property tax benefit enables the Company s U.K. operations to begin to phase in a corporate tax rate of 10% on profits earned from qualifying products over four years beginning April 1, 2013. The full benefit of the patent box tax regime will become available in April 2017. The Company has recorded in December 2015 a total patent box benefit of approximately $2.0 million for the years ended December 31, 2013, 2014 and 2015. It is reasonably possible that the benefit could be reviewed by the U.K. taxing authority and the amount of benefit claimed could be adjusted. However, the Company believes that it is more likely than not that the tax positions taken by the Company, including resolution of any related appeals or litigation, will be sustained upon examination based on the technical merits of the positions and as such, no uncertain tax position has been recognized.

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. Based upon existing market conditions and the Company s earnings prospects, it is anticipated that all deferred tax assets will be realized in future years. Significant components of the Company s net deferred tax assets (liabilities) are as follows:

	December 31,	
	2015	2014
	(In thousands)	
Net current deferred tax assets:		
Inventory	$ 11,062	$ 10,835
Inventory reserve	8,926	8,535
Allowance for doubtful accounts	1,578	1,022
Reserve for accrued liabilities	1,205	510
Other	1,842	2,667
Net current deferred tax assets	24,613	23,569
Net non-current deferred tax liability:		
Property, plant and equipment	(10,583)	(11,295)
Stock options	6,898	5,735

Other	708	143
Net non-current deferred tax liabilities	(2,977)	(5,417)
Net deferred tax asset	$ 21,636	$ 18,152

Undistributed earnings of the Company s foreign subsidiaries are considered to be indefinitely reinvested and, accordingly, no provision for U.S. federal income taxes has been provided thereon. The estimate of

58

Table of Contents

undistributed earnings of the Company s foreign subsidiaries amounted to $784 million as of December 31, 2015. Upon distribution of those earnings in the form of dividends or otherwise, the Company may be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to the various foreign countries. Determination of the amount of unrecognized deferred U.S. income tax liability is not practicable.

The Company paid $61.7 million, $69.9 million and $41.0 million in income taxes in 2015, 2014 and 2013, respectively.

7. Other Accrued Liabilities

Other accrued liabilities consist of the following:

	December 31,	
	2015	2014
	(In thousands)	
Payroll taxes	$ 2,639	$ 3,354
Property, sales and other taxes	7,059	12,702
Commissions payable	1,925	3,917
Accrued vendor costs	3,134	10,162
Other	4,727	5,063
Total	$ 19,484	$ 35,198

8. 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 $5.7 million, $5.9 million and $4.9 million in 2015, 2014 and 2013, respectively.

9. Commitments and Contingencies

The Company leases certain offices, shop and warehouse facilities, automobiles and equipment. Total lease expense incurred was $5.1 million, $4.2 million and $3.5 million in 2015, 2014 and 2013, respectively. Future annual minimum lease commitments at December 31, 2015 are as follows: 2016 $3.2 million; 2017 $2.1 million; 2018 $1.8 million; 2019 $1.5 million; 2020 $1.3 million; and thereafter $4.4 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 August 2007, the State of Rio de Janeiro served the Company s Brazilian subsidiary with assessments to collect a state tax on the importation of goods through the State of Espirito Santo from 2002 to 2007 claiming that these taxes were due and payable to it under applicable law. The Company settled these assessments with payments to the State of Rio de Janeiro of $12.2 million in March 2010 and $3.9 million in December 2010.

59

Table of Contents

Approximately $7.8 million of these settlement payments were attributable to penalties, interest and amounts that had expired under the statute of limitations so that amount was recorded as an expense. The remainder of the settlement payments generated credits (recorded as a long-term prepaid tax) to be used to offset future state taxes on sales to customers in the State of Rio de Janeiro, subject to certification by the tax authorities. During the second quarter of 2015, the tax authorities certified approximately $8.3 million of those credits paid in 2010 and granted an additional $2.3 million in inflation-related credits. The additional amount of credits granted by the tax authorities increased long-term prepaid taxes and decreased selling, general and administrative expenses by $2.3 million.

In December 2010 and January 2011, the Company s Brazilian subsidiary was served with two additional 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 Santo Credits are not related to the credits described above. 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. With regard to the December 2010 assessment, the Company s Brazilian subsidiary filed an appeal with a State of Rio de Janeiro judicial court to annul the tax assessment following a ruling against the Company by the tax administration s highest council. In connection with that appeal, the Company was required to deposit with the court approximately $3.1 million in December 2014 as the full amount of the assessment with penalties and interest. The Company intends to file a similar appeal in the judicial system with regard to the January 2011 assessment as a result of a recent ruling against the Company by the tax administration s highest council once that ruling is finalized. 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, 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.

Table of Contents

10. Geographic Segments

	Year ended December 31, 2015	2014 (In thousands)	2013
Revenues:			
Western Hemisphere			
Products	$ 332,452	$ 430,597	$ 420,439
Services	88,376	74,544	72,328
Intercompany	53,429	55,094	51,767
Total	$ 474,257	$ 560,235	$ 544,534
Eastern Hemisphere			
Products	$ 234,853	$ 205,185	$ 186,074
Services	52,963	59,794	46,653
Intercompany	5,799	10,719	1,254
Total	$ 293,615	$ 275,698	$ 233,981
Asia-Pacific			
Products	$ 118,059	$ 137,423	$ 125,104
Services	17,607	23,414	21,774
Intercompany	5,124	3,165	9,155
Total	$ 140,790	$ 164,002	$ 156,033
Summary			
Products	$ 685,364	$ 773,205	$ 731,617
Services	158,946	157,752	140,755
Intercompany	64,352	68,978	62,176
Eliminations	(64,352)	(68,978)	(62,176)
Total	$ 844,310	$ 930,957	$ 872,372
Income before income taxes:			
Western Hemisphere	$ 112,499	$ 143,206	$ 111,498
Eastern Hemisphere	89,349	79,146	49,672
Asia-Pacific	38,155	54,302	55,136
Eliminations	9,768	2,726	7,791
Total	$ 249,771	$ 279,380	$ 224,097
Total Long-Lived Assets:			
Western Hemisphere	$ 208,408	$ 221,597	$ 216,104
Eastern Hemisphere	43,449	45,517	43,430

Asia-Pacific	55,021	57,923	59,192
Eliminations	(2,926)	(2,926)	(2,927)
Total	$ 303,952	$ 322,111	$ 315,799
Total Assets:			
Western Hemisphere	$ 677,460	$ 731,448	$ 805,399
Eastern Hemisphere	391,672	375,781	316,473
Asia-Pacific	372,823	354,329	292,463
Eliminations	(13,705)	(12,307)	(17,530)
Total	$ 1,428,250	$ 1,449,251	$ 1,396,805

Table of Contents

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

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

In 2015, Chevron and its affiliated companies accounted for approximately 12% of the Company s total revenues. In 2014, Chevron and its affiliated companies accounted for approximately 10% of the Company s total revenues and in 2013, Petrobras and its affiliated companies accounted for approximately 11% of the Company s total revenues. No other customer accounted for more than 10% of the Company s total revenues in 2015, 2014 or 2013.

11. Stockholders Equity

Under a Stockholder Rights Plan adopted by the Board of Directors on November 24, 2008, each share of common stock includes one right 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 at a specific purchase price per Fractional Share, subject to adjustment in certain events. The rights will cause substantial dilution to any person or group that attempts to acquire the Company without the approval of the Company s Board of Directors.

12. Stock-Based Compensation and Stock Awards

Stock Options

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. 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.

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, 2015 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, 2014	459,247		55.86			
Granted						
Exercised	(38,500)		56.37			
Forfeited	(5,625)		68.23			
Outstanding at December 31, 2015	415,122	$	55.64	$	3.4	4.2
Exercisable at December 31, 2015	415,122	$	55.64	$	3.4	4.2

62

The total intrinsic value of stock options exercised in 2015, 2014 and 2013 was $751,000, $2.0 million and $10.7 million, respectively. The income tax benefit realized from stock options exercised was $263,000, $718,000 and $3.7 million for the years ended December 31, 2015, 2014 and 2013, respectively. There were no anti-dilutive stock option shares on December 31, 2015.

Stock-based compensation is recognized as selling, general and administrative expense in the accompanying Consolidated Statements of Income. During the years ended December 31, 2015, 2014 and 2013, stock-based compensation expense for stock option awards totaled $1.1 million, $2.5 million and $3.4 million, respectively. No stock-based compensation expense was capitalized during 2015, 2014 or 2013.

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, 2015, there was no unrecognized compensation expense related to nonvested stock options.

Restricted Stock Awards

On October 28, 2015 and 2014, pursuant to the 2004 Plan, the Company awarded officers, directors and key employees restricted stock awards (RSA), which is an award of common stock subject to time vesting. In May 2012, the Board of Directors amended the 2004 Plan to include non-employee directors as eligible for RSAs. The awards issued under 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:

	RSA Number of Shares	Weighted Average Grant Date Fair Value Per Share
Nonvested balance at December 31, 2014	160,154	$ 93.78
Granted	123,224	66.02
Vested	(79,797)	89.10
Forfeited	(9,985)	96.29
Nonvested balance at December 31, 2015	193,596	$ 77.91

Restricted stock awards compensation expense for the year ended December 31, 2015 totaled $7.2 million and $6.3 million for 2014 and $3.9 million for 2013. For 2015, 2014 and 2013, the income tax benefit recognized in net income for RSAs was $1.8 million, $2.2 million and $2.0 million, respectively. As of December 31, 2015, there was $14.0 million of total unrecognized compensation cost related to nonvested RSAs, which is expected to be recognized over a weighted average period of 1.6 years. There were 96,100 anti-dilutive restricted shares on December 31, 2015.

Performance Unit Awards

On October 28, 2015 and 2014, the Company awarded 67,346 and 45,729 performance unit awards (Performance Units), respectively, pursuant to the 2004 Plan to officers and key employees. The Performance Units were valued based on a Monte Carlo simulation at $79.00 for 2015 grants and $126.84 for the 2014 grants, approximately 120.2% and 139.4%, respectively, of the grant share price. Under the plan, 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

63

Table of Contents

three year period from October 1, 2014 and 2015 to September 30, 2017 and 2018 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:

	2014	2015
Grant date	October 28, 2014	October 28, 2015
Performance period	October 1, 2014 to September 30, 2017	October 1, 2015 to September 30, 2018
Volatility	27.8%	29.5%
Risk-free interest rate	0.8081%	0.9795%
Grant date price	$91.02	$65.72

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, 2014	123,786	$ 113.98
Granted	67,346	79.25
Vested	(48,086)	84.66
Forfeited	(3,478)	114.50
Nonvested balance at December 31, 2015	139,568	$ 107.31

Performance Unit compensation expense was $4.5 million for the year ended December 31, 2015, $3.1 million for 2014 and $1.6 million for 2013. For 2015, 2014 and 2013, the income tax benefit recognized in net income for Performance Units was $1.1 million, none and none, respectively. As of December 31, 2015, there was $9.3 million of total unrecognized compensation expense related to nonvested Performance Units which is to be recognized over a weighted average period of 1.6 years. There were 57,200 anti-dilutive Performance Units at December 31, 2015.

Director Stock Compensation Awards

In June 2014, the Board of Directors authorized a stock compensation program for the directors pursuant to the 2004 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 DSA activity for December 31, 2015 is presented below:

	DSA Number of Shares	Weighted Average

		Grant Date Fair Value Per Share
Nonvested balance at December 31, 2014	1,204	$ 89.40
Granted	6,843	68.73
Vested	(1,885)	72.00
Forfeited		
Nonvested balance at December 31, 2015	6,162	$ 71.77

Director stock compensation awards expense for 2015 was $328,000 as compared to $21,600 for 2014. For 2015 and 2014, the income tax benefit recognized in net income for DSAs was $41,000 and none, respectively. There was $225,000 of unrecognized compensation expense related to nonvested DSAs, which is expected to be recognized over a weighted average period of one year. There were 450 anti-diluted DSA shares on December 31, 2015.

64

Table of Contents

The following table summarizes information for equity compensation plans in effect as of December 31, 2015:

Plan category	Number of securities to be issued upon exercise of outstanding options(1) (a)	Weighted-average exercise price of outstanding options (b)	Number of securities remaining available for future issuance under equity compensation plan (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by stockholders			
Stock options	415,122	$ 55.64	441,914
Equity compensation plans not approved by stockholders			
Total	415,122	$ 55.64	441,914

(1) Excludes 199,758 shares of unvested RSAs and DSAs and 139,568 of unvested Performance Units, which were granted pursuant to the 2004 Plan approved by the stockholders.

13. Earnings Per Share

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

	Year Ended December 31, 2015	2014	2013
	(In thousands, except per share amounts)		
Net income	$ 192,008	$ 208,712	$ 169,827
Weighted average basic common shares outstanding	38,364	39,964	40,648
Effect of dilutive securities stock options and awards	167	226	217
Total shares and dilutive securities	38,531	40,190	40,865
Basic earnings per common share	$ 5.00	$ 5.22	$ 4.18
Diluted earnings per common share	$ 4.98	$ 5.19	$ 4.16

14. Stock Repurchase Plan

On February 26, 2015, the Company announced that its Board of Directors authorized a stock repurchase plan under which the Company is authorized to repurchase up to $100 million of its common stock. As of December 31, 2015, the Company had repurchased and cancelled 1,184,700 shares at an average cost of $63.98 per share for a total cost of $75.8 million.

Table of Contents

15. Quarterly Results of Operations (Unaudited):

	Quarter Ended			
	March 31	June 30	Sept. 30	Dec. 31
	(In thousands, except per share data) (Unaudited)			
2015				
Revenues	$ 226,002	$ 215,276	$ 201,402	$ 201,630
Cost of sales	125,138	117,664	108,132	108,352
Gross profit	100,864	97,612	93,270	93,278
Operating income	71,693	52,579	64,255	60,308
Net income	53,664	39,213	50,777	48,354
Earnings per share:				
Basic(1)	$ 1.38	$ 1.01	$ 1.32	$ 1.28
Diluted(1)	1.38	1.01	1.32	1.28
2014				
Revenues	$ 204,073	$ 230,315	$ 241,750	$ 254,819
Cost of sales	110,787	124,993	135,250	142,497
Gross profit	93,286	105,322	106,500	112,322
Operating income	58,567	68,954	72,992	78,235
Net income	42,618	51,324	55,683	59,087
Earnings per share:				
Basic(1)	$ 1.05	$ 1.27	$ 1.41	$ 1.51
Diluted(1)	1.04	1.27	1.40	1.50

(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.

Item 9. ***Changes in and Disagreements With Accountants on Accounting and Financial Disclosure***

On May 28, 2014, our Audit Committee dismissed BDO USA, LLP (BDO), and appointed PricewaterhouseCoopers LLP (PwC), as Dril-Quip s independent registered public accounting firm for 2014. The reports of BDO on the Company s consolidated financial statements as of and for the years ended December 31, 2013 and 2012 did not contain an adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principles.

During the years ended December 31, 2013 and 2012 and the subsequent interim period through May 28, 2014, there were no disagreements with BDO on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of BDO, would have caused BDO to make reference thereto in their reports on the financial statements for such years. In addition, none of the reportable events described in Item 304 of Regulation S-K occurred with respect to the Company during the years ended December 31, 2013 and 2012 and the subsequent interim period through May 28, 2014.

During the years ended December 31, 2013 and 2012 and the subsequent interim period through May 28, 2014, neither the Company nor anyone acting on our behalf consulted PwC regarding (1) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on Dril-Quip s financial statements; or (2) any matter that was either the subject of a disagreement as defined in Item 304 of Regulation S-K or a reportable event as described in Item 304 of Regulation S-K.

Table of Contents

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, 2015 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 44 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, 2015 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 2016 Proxy Statement) for its annual meeting of stockholders to be held on May 13, 2016, 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 2016 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 2016 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 2016 Proxy Statement, which section is incorporated herein by reference.

Table of Contents

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 Public Accounting Firm Fees and Audit Committee Pre-Approval Policy for Audit and Non-Audit Services in the 2016 Proxy Statement, which sections are incorporated herein by reference.

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	Charges to costs and expenses	Recoveries and write offs	Balance at end of period
		(In thousands)		
Allowance for doubtful trade receivables				
December 31, 2015	$ 6,241	$ 5,741	$ (4,243)	$ 7,739
December 31, 2014	2,364	4,832	(955)	6,241
December 31, 2013	2,113	910	(659)	2,364
Allowance for excess and slow moving inventory				
December 31, 2015	$ 34,607	$ 8,512	$ (3,872)	$ 39,247
December 31, 2014	33,216	3,951	(2,560)	34,607
December 31, 2013	30,426	3,554	(764)	33,216

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.

(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
*3.1	Restated Certificate of Incorporation of the Company (incorporated herein by reference to Exhibit 3.1 to the Company s Current Report on Form 8-K filed on May 20, 2014).
*3.2	

	Certificate of Designations of Series A Junior Participating Preferred Stock of the Company (incorporated herein by reference to Exhibit 3.1 to the Company s Current Report on Form 8-K filed on November 25, 2008).
*3.3	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).
*4.1	Form of certificate representing Common Stock (incorporated herein by reference to Exhibit 4.2 to the Company s Registration Statement on Form S-1 (Registration No. 333-33447)).
*4.2	Rights Agreement dated as of November 24, 2008 between Dril-Quip, Inc. and Mellon Investor Services LLC, as Rights Agent (incorporated herein by reference to Exhibit 4.1 to the Company s Current Report on Form 8-K filed on November 25, 2008).

Table of Contents

Exhibit No.	Description
*+10.1	Employment Agreement between the Company and Mr. DeBerry (incorporated herein by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on December 12, 2011).
*+10.2	Employment Agreement between the Company and Mr. Gariepy (incorporated herein by reference to Exhibit 10.2 to the Company s Current Report on Form 8-K filed on December 12, 2011).
*+10.3	Employment Agreement 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 December 12, 2011).
*+10.4	Employment Agreement between the Company and Mr. Webster (incorporated herein by reference to Exhibit 10.4 to the Company s Current Report on Form 8-K filed on December 12, 2011).
*+10.5	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).
*+10.6	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).
*+10.7	Form of Standard Non-Qualified Stock Option Agreement (incorporated herein by reference to Exhibit 10.4 to the Company s Current Report on Form 8-K filed on December 19, 2008).
*+10.8	Form of Restricted Stock Award Agreement (incorporated herein by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on December 12, 2011).
*+10.9	Form of Restricted Stock Award Agreement for Directors (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).
**+10.10	Summary of Executive Officer and Non-employee Director Compensation.
*10.11	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).
*+10.12	2012 Performance Unit Award Agreement (incorporated herein by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on October 19, 2012).
*+10.13	Form of Indemnification Agreement (incorporated herein by reference to the Company s Current Report on Form 8-K/A filed on January 18, 2012).
*+10.14	2013 Performance Unit Award Agreement (incorporated herein by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on October 22, 2013).
*+10.15	Stock Compensation Program for Directors (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).
*+10.16	Form of Indemnification Agreement (incorporated herein by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on August 12, 2015).
**21.1	Subsidiaries of the Registrant.

**23.1	Consent of PricewaterhouseCoopers LLP.
**23.2	Consent of BDO USA, LLP.

Table of Contents

Exhibit No.	Description
**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 Jerry M. Brooks.
**32.1	Section 1350 Certification of Blake T. DeBerry.
**32.2	Section 1350 Certification of Jerry M. Brooks.
**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.

70

Table of Contents

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 25, 2016.

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 25, 2016
/s/ Blake T. DeBerry **BLAKE T. DEBERRY**	President, Chief Executive Officer and Director (Principal Executive Officer)	February 25, 2016
/s/ Jerry M. Brooks **JERRY M. BROOKS**	Vice President Finance and Chief Financial Officer (Principal Financial and Accounting Officer)	February 25, 2016
/s/ A.P. Shukis **A.P. SHUKIS**	Director	February 25, 2016
/s/ Terence B. Jupp **TERENCE B. JUPP**	Director	February 25, 2016
/s/ Steven L. Newman **STEVEN L. NEWMAN**	Director	February 25, 2016