DRIL-QUIP INC
Form 10-Q
April 26, 2018

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

FORM 10-Q

(MARK ONE)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended March 31, 2018
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 001-13439

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

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

6401 N. ELDRIDGE PARKWAY
HOUSTON, TEXAS
77041
(Address of principal executive offices) (Zip Code)
(713) 939-7711
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨
	Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes ¨ No ý

As of April 25, 2018, the number of shares outstanding of the registrant’s common stock, par value $0.01 per share, was 38,143,019.

TABLE OF CONTENTS

Table of Contents

PART I—FINANCIAL INFORMATION
Item 1. Financial Statements
DRIL-QUIP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	March 31, 2018	December 31, 2017
	(In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$495,591	$493,180
Trade receivables, net	193,915	191,629
Inventories, net	276,005	291,087
Prepaids and other current assets	36,620	32,653
Total current assets	1,002,131	1,008,549
Property, plant and equipment, net	288,466	284,247
Deferred income taxes	5,471	5,364
Goodwill	47,818	47,624
Intangible assets	37,892	38,408
Other assets	16,084	15,613
Total assets	$1,397,862	$1,399,805
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$25,277	$33,480
Accrued income taxes	27,632	24,714
Customer prepayments	5,809	4,767
Accrued compensation	11,116	11,412
Other accrued liabilities	17,404	25,538
Total current liabilities	87,238	99,911
Deferred income taxes	3,514	3,432
Other long-term liabilities	2,001	2,001
Total liabilities	92,753	105,344
Commitments and contingencies (Note 11)		
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, 38,136,258 and 38,132,693 shares issued and outstanding at March 31, 2018 and December 31, 2017	381	372
Additional paid-in capital	23,964	20,083
Retained earnings	1,393,933	1,400,296
Accumulated other comprehensive losses	(113,169)	(126,290)
Total stockholders' equity	1,305,109	1,294,461
Total liabilities and stockholders' equity	$1,397,862	$1,399,805

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

Table of Contents

DRIL-QUIP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

	Three months ended March 31,	
	2018	2017
	(In thousands, except per share data)	
Revenues:		
Products	$71,045	$91,592
Services	28,128	27,636
Total revenues	99,173	119,228
Cost and expenses:		
Cost of sales:		
Products	52,175	66,462
Services	15,575	15,978
Total cost of sales	67,750	82,440
Selling, general and administrative	28,253	25,808
Engineering and product development	9,447	11,850
Total costs and expenses	105,450	120,098
Operating loss	(6,277)	(870)
Interest income	1,797	937
Interest expense	(2)	(15)
Income before income taxes	(4,482)	52
Income tax provision (benefit)	2,901	(42)
Net income (loss)	$(7,383)	$94
Earnings per common share:		
Basic	$(0.20)	$—
Diluted	$(0.20)	$—
Weighted average common shares outstanding:		
Basic	37,729	37,525
Diluted	37,729	37,693

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

Table of Contents

DRIL-QUIP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three months ended March 31,	
	2018	2017
	(In thousands)	
Net income (loss)	$(7,383)	$94
Other comprehensive loss, net of tax:		
Foreign currency translation adjustments	13,121	7,859
Total comprehensive income	$5,738	$7,953

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

Table of Contents

DRIL-QUIP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three months ended March 31, 2018 (In thousands)	2017
Operating activities		
Net income (loss)	$ (7,383)	$ 94
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	8,241	9,832
Stock-based compensation expense	3,974	3,216
Loss (gain) on sale of equipment	(22)	—
Deferred income taxes	(5)	(1,121)
Changes in operating assets and liabilities:		—
Trade receivables, net	1,195	7,044
Inventories, net	17,244	11,591
Prepaids and other assets	(4,076)	3,051
Accounts payable and accrued expenses	(7,403)	(22,231)
Other, net	(377)	—
Net cash (used in) provided by operating activities	11,388	11,476
Investing activities		
Purchase of property, plant and equipment	(10,571)	(4,847)
Proceeds from sale of equipment	71	439
Acquisition of business, net of cash acquired	—	(19,869)
Net cash used in investing activities	(10,500)	(24,277)
Financing activities		
Proceeds from exercise of stock options	52	403
Net cash provided by financing activities	52	403
Effect of exchange rate changes on cash	1,471	3,091

activities					
Increase (decrease) in cash and cash equivalents	2,411		(9,307		)
Cash and cash equivalents at beginning of period	493,180		423,497		
Cash and cash equivalents at end of period	$	495,591	$	414,190	

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

Table of Contents

DRIL-QUIP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Organization and Principles of Consolidation

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

The Company’s operations are organized into three geographic segments—Western Hemisphere (including North and South America; headquartered in Houston, Texas), Eastern Hemisphere (including Europe and Africa; headquartered in Aberdeen, Scotland) and Asia Pacific (including the Pacific Rim, Southeast Asia, Australia, India and the Middle East; headquartered in Singapore). Each of these segments sells similar products and services and the Company has major manufacturing facilities in all three of its regional headquarter locations as well as in Macae, Brazil. The Company’s major subsidiaries are Dril-Quip (Europe) Limited, located in Aberdeen with branches in Denmark, Norway and Holland; Dril-Quip Asia Pacific PTE Ltd., located in Singapore; and Dril-Quip do Brasil LTDA, located in Macae, Brazil. Other operating subsidiaries include TIW Corporation (TIW), located in Houston, Texas; DQ Holdings Pty. Ltd., located in Perth, Australia; 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, with branches in Shezhen and Beijing, China; and Dril-Quip Qatar LLC, located in Doha, Qatar; TIW de Mexico S.A. de C.V., located in Villahermosa, Mexico; TIW de Venezuela S.A., located in Anaco, Venezuela and with a registered branch located in Shushufindi, Ecuador; TIW (UK) Limited, located in Aberdeen, Scotland; TIW Hungary LLC, located in Szolnok, Hungary; and TIW International, LLC., with a registered branch located in Singapore.

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

The condensed consolidated financial statements included herein are unaudited. The balance sheet at December 31, 2017 has been derived from the audited consolidated financial statements at that date. In the opinion of management, the unaudited condensed consolidated interim financial statements include all normal recurring adjustments necessary for a fair statement of the financial position as of March 31, 2018 and the results of operations, comprehensive income and cash flows for the three-month periods ended March 31, 2018 and 2017. Certain information and footnote disclosures normally included in annual audited consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. Management believes the unaudited interim related disclosures in these condensed consolidated financial statements are adequate. The results of operations, comprehensive income and cash flows for the three-month period ended March 31, 2018 are not necessarily indicative of the results to be expected for the full year. The condensed consolidated financial statements included herein should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

2. Significant Accounting Policies

Principles of Consolidation

The condensed 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

Table of Contents

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.

Revenue Recognition

The Company generates revenues through the sale of products, the sale of services and the leasing of installation tools. The Company normally negotiates contracts for products, including those accounted for under the over time method, rental tools and services separately. Modifications to the scope and price of sales contracts may occur in the form of variations and change orders. 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 instead choose to use a third party or its own personnel.

Product and Service Revenues

Product and service revenues are recognized as the Company satisfies the performance obligation by transferring control of the promised good or service to the customer. Revenues are measured based on consideration specified in a contract with a customer and exclude sales incentives and amounts collected on behalf of third parties. In addition, some customers may impose contractually negotiated penalties for late delivery that are excluded from the transaction price.

Management has elected to utilize certain practical expedients allowed under Accounting Standards Codification 606, Revenue from Contracts with Customers (ASC 606). Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by the entity from a customer are excluded from the measurement of the transaction price. Shipping and handling activities that are performed after a customer obtains control of the good are accounted for as activities to fulfill the promise to transfer the good and thus are excluded from the transaction price.

Product revenues

The Company recognizes product revenues from two methods:

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

Revenues recognized under the over time method

The Company uses the over time method on long-term project contracts that have the following characteristics:

- the contracts call for products which are designed to customer specifications;
- the structural designs are unique and require significant engineering and manufacturing efforts generally requiring more than one year in duration;
- the contracts contain specific terms as to milestones, progress billings and delivery dates;
- product requirements cannot be filled directly from the Company's standard inventory; and
- The Company has an enforceable right to payment for any work completed to date and the enforceable payment includes a reasonable profit margin.

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

Under the over time method, billings may not correlate directly to the revenue recognized. Based upon the terms of the specific contract, billings may be in excess of the revenue recognized, in which case the amounts are included in customer prepayments as a liability on the Condensed Consolidated Balance Sheets. Likewise, revenue recognized may exceed customer billings in which case the amounts are reported in trade receivables. Unbilled revenues are expected to be billed and collected within one year. At March 31, 2018 and December 31, 2017, receivables included

$45.7 million and $41.0 million of unbilled receivables, respectively. For the quarter ended March 31, 2018, there were eight projects representing approximately 11% of the Company’s total revenues and approximately 16% of its product revenues that were accounted for using the over time

8

Table of Contents

method, compared to seven projects during the first quarter of 2017, which represented approximately 12% of the Company's total revenues and approximately 16% of its product revenues.

Revenues recognized under the point in time method

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

Service revenues

The Company recognizes service revenues from two sources:

- technical advisory assistance; and
- rework and reconditioning of customer-owned Dril-Quip products.

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

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

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

Lease revenues

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

Practical Expedients

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

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.

Earnings Per Share

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

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

Table of Contents

	Three months ended March 31, 2018	2017
	(In thousands)	
Weighted average common shares outstanding—basic	37,729	37,525
Dilutive effect of common stock options and awards	—	168
Weighted average common shares outstanding—diluted	37,729	37,693

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

	Three months ended March 31, 2018	2017
	(In thousands)	
Director stock awards	4	—
Stock options	11	—
Performance share units	78	14
Restricted stock awards	77	25

3. New Accounting Standards

In January 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2017-04, “Intangibles - Goodwill and Other (Topic 350).” The standard simplifies the subsequent measurement of goodwill by removing the second step of the two-step impairment test. The amendment requires an entity to perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The amendment should be applied on a prospective basis. The standard is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company has adopted this standard as of October 1, 2017.

In January 2017, the FASB issued ASU 2017-01, “Business Combinations: Clarifying the Definition of a Business (Topic 805).” This update clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. For public business entities, the amendments in this update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company has adopted this standard as of December 31, 2017.

In February 2016, the FASB issued ASU 2016-02 “Leases (Topic 842).” The new standard requires lessees to recognize lease assets (right of use) and lease obligations (lease liability) for leases previously classified as operating leases under generally accepted accounting principles on the balance sheet for leases with terms in excess of 12 months. The standard is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. The Company is evaluating the impact of the new standard on its consolidated financial statements.

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

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

We recognized the cumulative effect of the initial application of the new revenue standard as an increase to the opening balance of retained earnings at January 1, 2018 for $1.8 million. Therefore, the comparative information for prior periods has not been restated and continues to be reported under the accounting standards in effect for those periods.

A majority of the Company's revenues are not subject to the new revenue standard. The adoption of ASC 606 resulted in an increase of approximately $1.2 million in our results from operations for the three months ended March 31, 2018, and did

Table of Contents

not have a material impact on the Company's consolidated financial position, results of operations, equity or cash flows. A majority of our product revenues continues to be recognized when products are shipped from our facilities.

4. Revenue Recognition (Adoption of ASC 606)

Revenues from contracts with customers consisted of the following:

	Three months ended March 31, 2018				
	Western Hemisphere	Eastern Hemisphere	Asia-Pacific	Intercompany	Total
	(In thousands)				
Product Revenues	$42,436	$ 19,865	$ 8,744	$ —	$71,045
Service Revenues	9,082	5,973	2,406	—	17,461
Total	$51,518	$ 25,838	$ 11,150	$ —	$88,506

Contract Balances

Balances related to contracts with customers consisted of the following:

Contract Assets (amounts shown in thousands)	
Contract Assets at December 31, 2017	$41,825
Additions	48,676
Transfer to Accounts Receivable	(34,169)
Contract Assets at March 31, 2018	$56,332

Contract Liabilities (amounts shown in thousands)	
Contract Liabilities at December 31, 2017	$4,767
Additions	4,969
Revenue Recognized	(3,986)
Contract Liabilities at March 31, 2018	$5,750

Receivables, which are included in trade receivables, net, were $120.2 million and $133.4 million for the three months ended March 31, 2018 and 2017, respectively. The amount of revenues from performance obligations satisfied (or partially satisfied) in previous periods was $7.1 million. The contract liabilities primarily relate to advance payments from customers and are included within "Customer prepayments" in our accompanying consolidated balance sheets. The contract assets primarily relate to unbilled amounts typically resulting from sales under contracts when the over time method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer and is included in "Prepaids and other current assets" in our accompanying consolidated balance sheets. Contract assets are transferred to the receivables when the rights become unconditional.

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

Remaining Performance Obligations

The aggregate amount of the transaction price allocated to remaining performance obligations from our reconditioning services and over time product lines was $27.2 million as of March 31, 2018. The Company expects to recognize revenue on approximately 84% and 16% of the remaining performance obligations over the next 12 and 24 months, respectively, with the remainder recognized thereafter.

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

5. Stock-Based Compensation and Stock Awards

During the three months ended March 31, 2018 and 2017, the Company recognized approximately $4.0 million and $3.2 million, respectively, of stock-based compensation expense, which is included in the selling, general and administrative

Table of Contents

expense line on the Condensed Consolidated Statements of Income. No stock-based compensation expense was capitalized during the three months ended March 31, 2018 or 2017.

6. Inventories, net

Inventories consist of the following:

	March 31, 2018	December 31, 2017
	(In thousands)	
Raw materials and supplies	$65,540	$70,188
Work in progress	66,686	65,382
Finished goods	227,429	239,083
	359,655	374,653
Less: allowance for obsolete and excess inventory	(83,650)	(83,566)
Net inventory	$276,005	$291,087

7. Goodwill

The changes in the carrying amount of goodwill by reporting unit during the three months ended March 31, 2018 were as follows:

	Carrying Value			Carrying Value
	January 1, 2018	Acquisitions	Foreign Currency Translation	March 31, 2018
	(In thousands)			
Western Hemisphere	$39,158	$ —	$ 16	$39,174
Eastern Hemisphere	8,466	—	178	8,644
Asia Pacific	—	—	—	—
Total	$47,624	$ —	$ 194	$47,818

The Company performs its annual impairment tests of goodwill as of October 1 or when there is an indication an impairment may have occurred.

Table of Contents

8. Intangible Assets

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

		March 31, 2018			
	Estimated Useful Lives	Gross Book Value	Accumulated Amortization	Foreign Currency Translation	Net Book Value
		(In thousands)			
Trademarks	indefinite	$8,416	$ —	$ 62	$8,478
Patents	15 - 30 years	5,946	(1,049)	11	4,908
Customer relationships	5 - 15 years	26,503	(2,465)	368	24,406
Non-compete agreements	3 years	171	(71)	—	100
		$41,036	$ (3,585)	$ 441	$37,892

		December 31, 2017			
	Estimated Useful Lives	Gross Book Value	Accumulated Amortization	Foreign Currency Translation	Net Book Value
		(In thousands)			
Trademarks	indefinite	$8,416	$ —	$ 56	$8,472
Patents	15 - 30 years	5,946	(968)	80	5,058
Customer relationships	5 - 15 years	26,503	(1,675)	(64)	24,764
Non-compete agreements	3 years	171	(57)	—	114
		$41,036	$ (2,700)	$ 72	$38,408

Amortization expense for each of the three months ended March 31, 2018 and 2017 was $0.7 million.

9. Asset Backed Loan (ABL) Credit Facility

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

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

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

13

Table of Contents

commitments under the ABL Credit Facility could be terminated and any outstanding borrowings under the ABL Credit Facility may be declared immediately due and payable. The ABL Credit Facility also contains cross default provisions that apply to the Company's other indebtedness. The Company is in compliance with the related covenants as of April 26, 2018.

As of March 31, 2018, the Company had no borrowings or letters of credit outstanding under the ABL Credit Facility and availability of $64.0 million.

10. Geographic Areas

	Western Hemisphere		Eastern Hemisphere		Asia Pacific		DQ Corporate		Total	
	Three months ended March 31,									
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
	(In thousands)									
Revenues:										
Products										
Standard Products	$35,952	$65,012	$17,461	$7,041	$6,505	$4,946	$—	$—	$59,918	$76,999
Over Time Contracts	6,484	275	2,404	6,886	2,239	7,432	—	—	11,127	14,593
Total Products	42,436	65,287	19,865	13,927	8,744	12,378	—	—	71,045	91,592
Services										
Technical Advisory	6,241	7,320	5,101	2,934	1,365	1,977	—	—	12,707	12,231
Reconditioning	2,841	1,919	872	341	1,041	44	—	—	4,754	2,304
Total Services (excluding rental tools)	9,082	9,239	5,973	3,275	2,406	2,021	—	—	17,461	14,535
Rental Tools	5,535	9,223	4,205	3,000	927	878	—	—	10,667	13,101
Total Services (including rental tools)	14,617	18,462	10,178	6,275	3,333	2,899	—	—	28,128	27,636
Intercompany	3,073	5,903	186	31	165	66	—	—	3,424	6,000
Eliminations	—	—	—	—	—	—	(3,424)	(6,000)	(3,424)	(6,000)
Total Revenues	$60,126	$89,652	$30,229	$20,233	$12,242	$15,343	$(3,424)	$(6,000)	$99,173	$119,228
Depreciation	$5,492	$7,137	$1,211	$1,080	$975	$1,017	$563	$599	$8,241	$9,833
Income before income taxes	$721	$7,472	$5,659	$3,491	$256	$1,844	$(11,118)	$(12,755)	$(4,482)	$52

	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017
	(In thousands)									
Long-Lived Assets	$480,882	$482,636	$135,436	$264,828	$62,655	$58,606	$(283,242)	$(414,814)	$395,731	$391,256
Total Assets	$856,227	$877,779	$635,387	$752,967	$188,610	$185,229	$(282,362)	$(416,170)	$1,397,862	$1,399,805

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

Table of Contents

of these segments sells similar products and services and the Company has major manufacturing facilities in all three of its regional headquarter locations as well as in Macae, Brazil.

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

11. Commitments and Contingencies

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. 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, which were 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 filed a similar appeal in the judicial system with regard to the January 2011 assessment and was required to deposit with the court approximately $5.7 million in December 2016. 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

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

The following is management's discussion and analysis of certain significant factors that have affected aspects of the Company's financial position, results of operations, comprehensive income and cash flows during the periods included in the accompanying unaudited condensed consolidated financial statements. This discussion should be read in conjunction with the Company's unaudited condensed consolidated financial statements and notes thereto presented elsewhere in this report as well as the discussion under "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Overview

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

Oil and Gas Prices

Both the market for drilling and production equipment and services and the Company's business are substantially dependent on the condition of the oil and gas industry and, in particular, the willingness of oil and gas companies to make capital expenditures on exploration, drilling and production operations. Oil and gas prices and the level of drilling and production activity have historically been characterized by significant volatility.

According to the Energy Information Administration (EIA) of the U.S. Department of Energy, Brent Crude oil prices per barrel are listed below for the periods covered by this report:

	Brent Crude Oil Prices Three months ended March 31,	
	2018	2017
High	$71.08	$56.34
Low	61.94	49.56
Average	66.86	53.69
Closing March 31	$69.02	$52.20

According to the April 2018 release of the Short-Term Energy Outlook published by the EIA, Brent Crude oil prices are projected to average approximately $63 per barrel in both 2018 and 2019. In its March 2018 Oil Market Report, the International Energy Agency projected the 2018 global oil demand will increase to 99.3 million barrels per day, a 1.5 million barrels per day decrease from 2017.

Offshore Rig Count

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

Table of Contents

	Three months ended March 31,			
	2018		2017	
	Floating Rigs	Jack-up Rigs	Floating Rigs	Jack-up Rigs
Western Hemisphere	59	39	65	39
Eastern Hemisphere	55	59	54	57
Asia-Pacific	33	223	31	212
Total	147	321	150	308

Source: IHS—Petrodata RigBase – March 31, 2018 and 2017

According to IHS-Petrodata RigBase, as of March 31, 2018, there were 466 rigs contracted for the Company's geographic regions (145 floating rigs and 321 jack-up rigs), which represents a 2.4% increase from the rig count of 455 rigs (148 floating rigs and 307 jack-up rigs) as of March 31, 2017.

The Company believes that the number of rigs (semi-submersibles, drillships and jack-up rigs) under construction impacts its backlog and resulting revenues because in certain cases, its customers order some of the Company's products during the construction of such rigs. As a result, an increase in rig construction activity tends to favorably impact the Company's backlog while a decrease in rig construction activity tends to negatively impact the Company's backlog. According to IHS-Petrodata RigBase, as of March 31, 2018 and 2017, there were 132 and 149 rigs, respectively, under construction, which represents an approximate 11.4% decline in rigs under construction. The expected delivery dates for the rigs under construction at March 31, 2018 are as follows:

	Floating Rigs	Jack-Up Rigs	Total
2018	17	57	74
2019	13	26	39
2020	11	7	18
2021	1	—	1
2022	—	—	—
After 2022 or unspecified delivery date	—	—	—
Total	42	90	132

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

Regulation

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

Business Environment

Oil and gas prices and the level of drilling and production activity have been characterized by significant volatility in recent years. Worldwide military, political, economic and other events have contributed to oil and natural gas price volatility and are likely to continue to do so in the future. Sustained low crude oil and natural gas prices have resulted in a trend of customers seeking to renegotiate contract terms with the Company, including reductions in the prices of its products and services, extensions of delivery terms and, in some instances, contract cancellations or revisions. In some cases, a customer may already hold an inventory of the Company's equipment, which may delay the placement of new orders. In addition, some of the Company's customers could experience liquidity or solvency issues or could otherwise be unable or unwilling to perform under a contract, which could ultimately lead a customer to enter bankruptcy or otherwise encourage a customer to seek to repudiate, cancel or renegotiate a contract. An extended period of reduced crude oil and natural gas prices may accelerate these trends. If the Company experiences significant contract terminations, suspensions or scope adjustments to its contracts, then its financial condition, results of operations and cash flows may be adverseley impacted.

17

Table of Contents

The Company expects continued volatility in both crude oil and natural gas prices, as well as in the level of drilling and production related activities. Even during periods of increasing prices for oil and natural gas, companies exploring for oil and gas may cancel or curtail programs, seek to renegotiate contract terms, including the price of products and services, or reduce their levels of capital expenditures for exploration and production for a variety of reasons. Continued low hydrocarbon prices have had and are expected to continue to have a material adverse effect on the Company's results of operations.

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

The Company's product backlog at March 31, 2018 was approximately $266.7 million, compared to approximately $207.3 million at December 31, 2017 and approximately $295.5 million at March 31, 2017.

Table of Contents

The following table represents the change in backlog for the three months ended March 31, 2018, December 31, 2017 and March 31, 2017:

	Three months ended		
	March 31, 2018	December 31, 2017	March 31, 2017
	(In thousands)		
Beginning Backlog	$207,305	$ 216,495	317,579
Bookings:			
Product	132,538	74,513	71,054
Service	28,128	26,409	27,636
Cancellation/Revision adjustments	(2,508)	(1,260)	(3,500)
Translation adjustments	385	(879)	1,993
Total Bookings	158,543	98,783	97,183
Revenues:			
Product	71,045	81,564	91,592
Service	28,128	26,409	27,636
Total Revenue	99,173	107,973	119,228
Ending Backlog (1)	$266,675	$ 207,305	295,534

(1) The backlog data shown above includes all bookings as of March 31, 2018, including contract awards and signed purchase orders for which the contracts would not be considered enforceable or qualify for the practical expedient under ASC 606. As of March 31, 2018, approximately $84 million related to contract awards is included in our backlog. As a result, this table above will not agree to the disclosed performance obligations of $27 million within Note 4, Revenue Recognition.

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

In August 2012, the Company's Brazilian subsidiary, Dril-Quip do Brasil LTDA, was awarded a four-year contract by Petroleo Brasileiro S.A. (Petrobras), Brazil's national oil company, which was amended in 2016 to extend the term of the contract through July 2020. As of March 31, 2018, the Company's backlog included $28 million of purchase orders under this Petrobras contract. The Company has not yet recognized revenue of approximately $16 million as of March 31, 2018 for certain items of equipment that were completed but not yet accepted for delivery by Petrobras. If Petrobras does not ultimately accept these items for delivery or if they refuse to accept these or similar items completed in the future, the Company's results of operations may be adversely affected. As part of the amendment to extend the term of the contract, Petrobras agreed to issue purchase orders totaling a minimum of approximately $29 million (based on current exchange rates) before 2019. As of March 31, 2018, approximately $12 million of the purchase orders have been issued. The Company cannot provide assurance that Petrobras will order all of the equipment under the contract.

As of March 31, 2017, the total number of the Company's employees was 2,146, of which 1,214 were located in the United States. The total number of the Company's employees as of December 31, 2017 was 2,019, of which 1,095 were located in the United States. As a result of natural attrition, the total number of employees as of March 31, 2018 was 1,964, of which 1,028 were located in the United States.

The Company operates its business and markets its products and services in most of the significant oil and gas producing areas in the world and is, therefore, subject to the risks customarily attendant to international operations and investments in foreign countries. These risks include nationalization, expropriation, war, acts of terrorism and civil disturbance, restrictive action by local governments, limitation on repatriation of earnings, change in foreign tax laws and change in currency exchange rates, any of which could have an adverse effect on either the Company's ability to manufacture its products in its facilities abroad or the demand in certain regions for the Company's products or both. To date, the Company has not experienced any significant problems in foreign countries arising from local government actions or political instability, but there is no assurance that such problems will not arise in the future.

Interruption of the Company’s international operations could have a material adverse effect on its overall operations.

Table of Contents

The June 23, 2016 referendum by British voters to exit the European Union (Brexit) adversely impacted global markets, including currencies, and resulted in a decline in the value of the British pound sterling, as compared to the U.S. dollar and other currencies. Volatility in exchange rates could be expected to continue in the short term as the United Kingdom (U.K.) negotiates its exit from the European Union. A weaker British pound sterling compared to the U.S. dollar during a reporting period would cause local currency results of the Company's U.K. operations to be translated into fewer U.S. dollars. Continued adverse consequences such as deterioration in economic conditions and volatility in currency exchange rates could have a negative impact on the Company's financial position and results of operations. See “Item 1A - Risk Factors Our international operations expose us to instability and changes in economic and political conditions and other risks inherent to international business, which could have a material adverse effect on our results of operations, financial position or cash flows.”

Revenues. Dril-Quip’s revenues are generated from two sources: products and services. Product revenues are derived from the sale of drilling and production equipment. Service revenues are earned when the Company provides technical advisory assistance and rental tools during installation and retrieval of the Company’s products. Additionally, the Company earns service revenues when rework and reconditioning services are provided. For the three months ended March 31, 2018 and 2017, the Company derived 72% and 77%, respectively, of its revenues from the sale of its products and 28% and 23%, respectively, of its revenues from services. Service revenues generally correlate to revenues from product sales because increased product sales typically generate increased demand for technical advisory assistance services during installation and rental of running tools during installation. The Company has substantial international operations, with approximately 52% and 48% of its revenues derived from foreign sales for the three months ended March 31, 2018 and 2017, respectively. The majority of the Company’s domestic revenue relates to operations in the U.S. Gulf of Mexico. Domestic revenue approximated 48% and 52% of the Company’s total revenues for the three months ended March 31, 2018 and 2017, respectively.

Product contracts are typically negotiated and sold separately from service contracts. In addition, service contracts are not typically included in the product contracts or related sales orders and are not offered to the customer as a condition of the sale of the Company’s products. The demand for products and services is generally based on worldwide economic conditions in the oil and gas industry, and is not based on a specific relationship between the two types of contracts. Substantially all of the Company’s sales are made on a purchase order basis. Purchase orders are subject to change and/or termination at the option of the customer. In case of a change or termination, the customer is required to pay the Company for work performed and other costs necessarily incurred as a result of the change or termination.

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

The Company accounts for larger and more complex projects that have relatively longer manufacturing time frames on an over time basis. For the quarter ended March 31, 2018, there were eight projects representing approximately 11% of the Company’s total revenues and approximately 16% of its product revenues that were accounted for using the over time method of accounting, compared to seven projects during the first quarter of 2017, which represented approximately 12% of the Company’s total revenues and approximately 16% of its product revenues. These percentages may fluctuate in the future. Revenues accounted for in this manner are generally recognized based upon a calculation of the percentage complete, which is used to determine the revenue earned and the appropriate portion of total estimated cost of sales to be recognized. Accordingly, price and cost estimates are reviewed periodically as the work progresses, and adjustments proportionate to the percentage complete are reflected in the period when such estimates are revised. Losses, if any, are recorded in full in the period they become known. Amounts received from customers in excess of revenues recognized are classified as a current liability.

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

Selling, General and Administrative Expenses. Selling, general and administrative expenses include the costs associated with sales and marketing, general corporate overhead, business development expenses, compensation expense, stock-based compensation expense, legal expenses, foreign currency transaction gains and losses and other related administrative functions.
Engineering and Product Development Expenses. Engineering and product development expenses consist of new product development and testing, as well as application engineering related to customized products.
Income Tax Provision. The Company's effective income tax rate has historically been lower than the statutory rate primarily due to foreign income tax rate differentials and research and development credits; however, the 2018 income tax expense has been negatively impacted by the valuation allowances in the US and Asia-Pacific regions.

Table of Contents

Results of Operations

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

	Three months ended March 31, 2018	2017
Revenues:		
Products	71.6 %	76.8 %
Services	28.4	23.2
Total revenues:	100.0	100.0
Cost of sales:		
Products	52.6	55.7
Services	15.7	13.4
Total cost of sales:	68.3	69.1
Selling, general and administrative expenses	28.5	21.7
Engineering and product development expenses	9.5	9.9
Operating income	(6.3)	(0.7)
Interest income	1.8	0.8
Income before income taxes	(4.5)	0.1
Income tax provision	2.9	—
Net income	(7.4)%	0.1 %

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

	Three months ended March 31, 2018	2017
	(In millions)	
Revenues:		
Products:		
Subsea equipment	$54.9	$74.3
Downhole tools	9.9	11.3
Surface equipment	5.1	0.9
Offshore rig equipment	1.2	5.1
Total products	71.1	91.6
Services	28.1	27.6
Total revenues	$99.2	$119.2

Three Months Ended March 31, 2018 Compared to Three Months Ended March 31, 2017

Revenues. Revenues decreased by $20.1 million, or approximately 16.8%, to $99.2 million in the three months ended March 31, 2018 from $119.2 million in the three months ended March 31, 2017, primarily due to a decrease in demand for exploration and production equipment. Product revenues decreased by approximately $20.5 million for the three months ended March 31, 2018 compared to the same period in 2017 as a result of decreased revenues of $19.4 million in subsea equipment, $3.9 million in offshore rig equipment and $1.4 million in downhole tools, partially offset by an increase in surface equipment of $4.2 million. Product revenues decreased in the Western and Asia-Pacific Hemispheres by $22.9 million and $3.6 million, respectively, partially offset by increases in the Eastern Hemisphere of $5.9 million, largely due to low oil and gas prices resulting in decreases in the demand for exploration and production equipment, especially subsea equipment. In any given time period, the revenues recognized between the various product lines and geographic areas will vary depending upon the timing of

21

Table of Contents

shipments to customers, completion status of the projects accounted for under the over time accounting method, market conditions and customer demand. Service revenues increased by approximately $0.5 million resulting from increased service revenues in the Eastern and Asia-Pacific Hemispheres of $3.9 million and $0.4 million, respectively, partially offset by decreased service revenues in the Western Hemisphere of $3.8 million. The majority of the increases in service revenues related to increased technical advisory assistance.

Cost of Sales. Cost of sales decreased by $14.7 million, or approximately 17.8%, to $67.8 million for the three months ended March 31, 2018 from $82.4 million for the same period in 2017 as a result of lower revenues. As a percentage of revenues, cost of sales decreased to 68.3% from 69.1% in the three months ended March 31, 2018 as compared to the same period in 2017, primarily as a result of product mix, pricing concessions and unabsorbed manufacturing costs.

Selling, General and Administrative Expenses. For the three months ended March 31, 2018, selling, general and administrative expenses increased by approximately $2.4 million, or 9.5%, to $28.3 million from $25.8 million for the same period in 2017, primarily due to the Company experiencing a pre-tax foreign currency transaction loss of $1.3 million in the first quarter of 2018 compared to a gain of $0.1 million in the first quarter of 2017, and increased professional service expenses related to certain entity restructuring costs and the implementation of ASC 606 of approximately $1.9 million, partially offset by other costs of $0.9 million. Selling, general and administrative expenses as a percentage of revenues increased to 28.5% in the first quarter of 2018 from 21.7% in the first quarter of 2017.

Engineering and Product Development Expenses. For the three months ended March 31, 2018, engineering and product development expenses totaled $9.4 million compared to $11.9 million for the same period in 2017, a decrease of $2.4 million, or 20.3%. The majority of the decrease was due to lower revenues related to projects during 2018. Engineering and product development expenses as a percentage of revenues decreased to 9.5% in the first quarter of 2018 from 9.9% in the first quarter of 2017.

Income Tax Provision. Income tax expense for the three months ended March 31, 2018 was $2.9 million on a loss before taxes of $4.5 million, resulting in an effective tax rate of -54.7%. Income tax benefit for the three months ended March 31, 2017 was $42,000 on income before taxes of $52,000, resulting in an effective income tax rate of approximately 80.8%. Historically, the change in the 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. The 2018 income tax expense has been negatively impacted by the valuation allowances in the US and Asia-Pacific regions.

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act ("Tax Reform"). The Act amends the Internal Revenue Code to reduce tax rates and modify policies, credits and deductions for individuals and businesses. For businesses, Tax Reform reduced the corporate federal tax rate from a maximum of 35% to 21% and transitions from a worldwide tax system to a modified territorial tax system. Tax Reform also adds many new provisions including changes to bonus depreciation, the deduction for executive compensation and interest expense, a tax on global intangible low-taxed income (GILTI), the base erosion anti-abuse tax (BEAT) and a deduction for foreign-derived intangible income (FDII). Given the amount and complexity of the changes in tax law, we are in the process of finalizing our accounting for the income tax effects stemming from Tax Reform. As such, certain provisional amounts were taken as estimates to account for the impact of Tax Reform. The actual impact of Tax Reform may differ from this estimate during the one-year measurement period due to, among other things, further refinement of our calculations, changes in interpretations and assumptions we have made, guidance that may be issued and actions we may take as a result of the tax legislation.

Net Income (Loss). Net loss was approximately $7.4 million for the three months ended March 31, 2018 and net income was $0.1 million for the same period in 2017 for the reasons set forth above.

Non-GAAP Financial Measures

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

Adjusted EBITDA

We calculate Adjusted EBITDA as one of the indicators to evaluate and compare the results of our operations from period to period by removing the effect of our capital structure from our operating structure. This measurement is used in concert with net income and cash flows from operations, which measures actual cash generated in the period. In addition, we believe that

Table of Contents

Adjusted EBITDA is a supplemental measurement tool used by analysts and investors to help evaluate overall operating performance, ability to pursue and service possible debt opportunities and analyze possible future capital expenditures. Adjusted EBITDA does not represent funds available for our discretionary use and is not intended to represent or to be used as a substitute for net income, as measured under U.S. generally accepted accounting principles. The items excluded from Adjusted EBITDA, but included in the calculation of reported net income, are significant components of the consolidated statements of income and must be considered in performing a comprehensive assessment of overall financial performance. Our calculation of Adjusted EBITDA may not be consistent with calculations of Adjusted EBITDA used by other companies.

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

Adjusted EBITDA:	Three months ended March 31,	
	2018	2017
	(In thousands)	
Net Income (Loss)	$(7,383)	$94
Add:		
Interest (income) expense	(1,795)	(922)
Income tax expense (benefit)	2,901	(42)
Depreciation and amortization expense	8,241	9,832
Restructuring costs	600	—
Foreign currency loss (gain)	1,304	(104)
Severance costs	—	1,572
Stock compensation expense	3,974	3,216
Adjusted EBITDA	$7,842	$13,646

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

Liquidity and Capital Resources

Cash Flows

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

	Three months ended March 31,	
	2018	2017
	(In thousands)	
Operating activities	$11,388	$11,476
Investing activities	(10,500)	(24,277)
Financing activities	52	403
	940	(12,398)
Effect of exchange rate changes on cash activities	1,471	3,091
Increase (decrease) in cash and cash equivalents	$2,411	$(9,307)

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

The primary liquidity needs of the Company are (i) to fund capital expenditures to improve and expand facilities and manufacture additional running tools and (ii) to fund working capital. The Company’s principal source of funds is cash flows from operations. As of April 26, 2018, the Company had availability of $64 million under the ABL Credit Facility.

Net cash provided by operating activities for the first quarter of 2018 was $11.4 million as compared to $11.5 million in the first quarter of 2017. The net neutral effect is primarily driven by increases in operating assets and liabilities of $7.1 million and other increases of $0.3 million, offset by the change to a net loss for the first quarter of 2018 of $7.5

million.

Table of Contents

The change in operating assets and liabilities for the three months ended March 31, 2018 resulted in a $7.1 million increase in cash. Trade receivables increased $1.2 million as a result of increased revenue accruals related to reconditioning revenue in March 2018. The decrease in inventory resulted in increased cash flow of $17.2 million. Prepaids and other assets decreased operating cash flow by $4.1 million due to increases in vendor prepayments. Accounts payable and accrued expenses decreased by approximately $7.4 million primarily due to a reduction in accounts payable of $7.8 million, partially offset by increased accrued expenses of $0.8 million.

The change in operating assets and liabilities for the three months ended March 31, 2017 resulted in a $0.5 million decrease in cash. Trade receivables decreased $7.0 million primarily due to an increase in customer collection efforts. Inventory decreased by $11.6 million. Prepaids and other assets decreased by $3.1 million due to decreases in vendor prepayments. Accounts payable and accrued expenses decreased by approximately $22.2 million primarily due to a reduction in accounts payable of $11.2 million and customer prepayments of $5.3 million.

The change in investing cash flows for the three months ended March 31, 2018 resulted in a $10.5 million increase to cash. Capital expenditures by the Company were $10.6 million and $4.8 million for the three months ended March 31, 2018 and 2017, respectively. The capital expenditures for the first quarter of 2018 were $6.0 million for buildings, $2.2 million for machinery and equipment, $2.0 million for rental tools and $0.4 million for other expenditures. The capital expenditures for the first quarter of 2017 were $2.7 million for machinery and equipment and other expenditures of $2.1 million. The remaining change to investing cash flows was the acquisition of OPT during the first quarter of 2017, which impacted the March 31, 2017 investing cash flows by approximately $19.8 million, compared to no acquisition occurring during the first quarter of 2018, and minor sales of equipment.

The exercise of stock options generated cash to the Company of $52,000 in the first quarter of 2018 as compared to $403,000 in the same period of 2017.

Repurchase of Equity Securities

On July 26, 2016, the Board of Directors authorized a stock repurchase plan under which the Company can repurchase up to $100 million of its common stock. The repurchase plan has no set expiration date and any repurchased shares are expected to be cancelled. No repurchases have been made pursuant to this plan as of March 31, 2018.

Asset Backed Loan (ABL) Credit Facility

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

As of March 31, 2018, the Company had no borrowings or letters of credit outstanding under the ABL Credit Facility and availability of $64.0 million. For additioanl information on the ABL Credit Facility, see "Asset Backed Loan (ABL) Credit Facility," Note 9 to the Notes to Condensed Consolidated Financial Statements.

Off-Balance Sheet Arrangements

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

Other Matters

From time to time, the Company enters into discussions or negotiations to acquire other businesses or enter into joint ventures. The timing, size or success of any such efforts and the associated potential capital commitments are unpredictable and dependent on market conditions and opportunities existing at the time. The Company may seek to fund all or part of any such efforts with proceeds from debt or equity issuances. Debt or equity financing may not, however, be available at that time due to a variety of events, including, among others, the Company's credit ratings, industry conditions, general economic conditions and market conditions.

Critical Accounting Policies

Refer to our Annual Report on Form 10-K for the year ended December 31, 2017 for a discussion of our critical accounting policies. During the three months ended March 31, 2018, there were no material changes in our judgments and assumptions associated with the development of our critical accounting policies.

24

Table of Contents

Item 3. 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 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 since December 31, 2017.

Foreign Exchange Rate Risk

The Company has operations in various countries around the world and conducts business in a number of different currencies. 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 experienced a foreign currency pre-tax loss of approximately $1.3 million during the three-month period ended March 31, 2018 and a pre-tax gain of $0.1 million in the same period of 2017. These losses and gains were primarily due to the exchange rate fluctuations between the U.S. dollar and various currencies within the foreign regions where we do business.

The Company does not engage in any material hedging transactions, forward contracts or currency trading which could mitigate the effects and risks inherent in such transactions. Additionally, there is no assurance that the Company will be able to protect itself against currency fluctuations in the future.

Item 4. Controls and Procedures

In accordance with Exchange Act Rules 13a-15 and 15d-15, the Company carried out an evaluation, under the supervision and with the participation of management, including the Company’s 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 March 31, 2018 to provide reasonable assurance that information required to be disclosed in the Company’s reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and such information is accumulated and communicated to management, including the Company’s Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure.

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

Table of Contents

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

For a description of the Company's legal proceedings, see "Commitments and Contingencies," Note 11 to the Notes to Condensed Consolidated Financial Statements.

Item 1A. Risk Factors

There have been no material changes from the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Table of Contents

FORWARD LOOKING STATEMENTS

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

- future operating results and cash flow;
- scheduled, budgeted and other future capital expenditures;
- working capital requirements;
- the need for and the availability of expected sources of liquidity;
- the introduction into the market of the Company's future products;
- the market for the Company's existing and future products;
- the Company's ability to develop new applications for its technologies;
- the exploration, development and production activities of the Company's customers;
- compliance with present and future environmental regulations and costs associated with environmentally related penalties, capital expenditures, remedial actions and proceedings;
- effects of pending legal proceedings;
- changes in customers' future product and service requirements that may not be cost effective or within the Company's capabilities; and
- future operations, financial results, business plans and cash needs.

These statements are based on assumptions and analysis in light of the Company's experience and perception of historical trends, current conditions, expected future developments and other factors the Company believes were appropriate in the circumstances when the statements were made. Forward-looking statements by their nature involve substantial risks and uncertainties that could significantly impact expected results, and actual future results could differ materially from those described in such statements. While it is not possible to identify all factors, the Company continues to face many risks and uncertainties. Among the factors that could cause actual future results to differ materially are the risks and uncertainties discussed under "Item 1A. Risk Factors" in Part I of the Company's Annual Report on Form 10-K for the year ended December 31, 2017 and the following:

- the volatility of oil and natural gas prices;
- the cyclical nature of the oil and gas industry;
- uncertainties associated with the United States and worldwide economies;
- uncertainties regarding political tensions in the Middle East, South America, Africa and elsewhere;
- current and potential governmental regulatory actions in the United States and regulatory actions and political unrest in other countries;
- uncertainties regarding future oil and gas exploration and production activities, including new regulations, customs requirements and product testing requirements;
- operating interruptions (including explosions, fires, weather-related incidents, mechanical failure, unscheduled downtime, labor difficulties, transportation interruptions, spills and releases and other environmental risks);
- project terminations, suspensions or scope adjustments to contracts reflected in the Company's backlog;
- the Company's reliance on product development;
- technological developments;
- the Company's reliance on third-party technologies;

Table of Contents

- acquisition and merger activities involving the Company or its competitors;
- the Company’s dependence on key employees and skilled machinists, fabricators and technical personnel;
- the Company’s reliance on sources of raw materials, including any increase in steel costs or decreases in steel supply as a result of the President's March 2018 proclamation imposing a 25% global tariff on certain imported steel mill products;
- impact of environmental matters, including future environmental regulations;
- competitive products and pricing pressures;
- fluctuations in foreign currency, including those attributable to the Brexit;
- the ability of the Organization of Petroleum Exporting Countries to set and maintain production levels and pricing;
- the Company’s reliance on significant customers;
- creditworthiness of the Company’s customers;
- fixed-price contracts;
- changes in general economic, market or business conditions;
- access to capital markets;
- negative outcome of litigation, threatened litigation or government proceedings;
- terrorist threats or acts, war and civil disturbances; and
- changes to, and differing interpretations of, tax laws with respect to our operations and subsidiaries.

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

Table of Contents

Item 6.
(a) Exhibits
The following exhibits are filed herewith:

Exhibit No.	Description
*3.1	Restated Certificate of Incorporation of the Company (incorporated herein by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017).
*3.2	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
*4.2	Amendment No. 1 to Rights Agreement, dated as of February 26, 2018, by and between the Company and Computershare Inc., as successor-in-interest to Computershare Shareowner Services LLC (f/k/a Mellon Investor Services LLC), as Rights Agent (incorporated herein by reference to Exhibit 4.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017).
*10.1	Credit Agreement, dated as of February 23, 2018, among the Company, as borrower, the guarantors party thereto, the lenders party thereto and JPMorgan Chase Bank, N.A., as administrative agent, an issuing bank and swingline lender (incorporated herein by reference to Exhibit 10.23 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017).
*10.2	Pledge and Security Agreement, dated as of February 23, 2018, among the Company, TIW Corporation and Honing, Inc., as grantors, and JPMorgan Chase Bank, N.A., as administrative agent. (incorporated herein by reference to Exhibit 10.24 to the Company's Annual Report on Form 10-K for the year ended December 31, 2017).
31.1	Rule 13a-14(a)/15d-14(a) Certification of Blake T. DeBerry.
31.2	Rule 13a-14(a)/15d-14(a) Certification of Jeffrey J. Bird.
32.1	Section 1350 Certification of Blake T. DeBerry.
32.2	Section 1350 Certification of Jeffrey J. Bird.
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Document
101.DEF	XBRL Definition Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

* Incorporated herein by reference as indicated.

Table of Contents

SIGNATURE

Pursuant to the requirements 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.

	DRIL-QUIP, INC.
Date: April 26, 2018	BY: /s/ Jeffrey J. Bird
	Jeffrey J. Bird, Vice President and Chief Financial Officer (Principal Accounting Officer and Duly Authorized Signatory)