

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

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended September 30, 2022

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
(State or other jurisdiction of
incorporation or organization)

74-2162088
(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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading symbol(s)	Name of each exchange on which registered
Common Stock, \$0.01 par value per share	DRQ	New York Stock Exchange

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark 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	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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

As of October 24, 2022, the number of shares outstanding of the registrant's common stock, par value \$0.01 per share, was 33,919,726.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

DRIL-QUIP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	September 30, 2022	December 31, 2021
(In thousands, except per share data)		
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 290,279	\$ 355,451
Short-term investments	25,287	-
Trade receivables, net	81,666	100,987
Unbilled receivables	138,533	102,597
Inventories, net	140,530	145,724
Prepays and other current assets	49,457	40,790
Assets held for sale	20,006	-
Total current assets	745,758	745,549
Operating lease right of use assets	4,932	5,258
Property, plant and equipment, net	181,359	216,200
Deferred income taxes	8,893	11,381
Intangible assets	23,868	26,446
Other assets	5,714	5,592
Total assets	\$ 970,524	\$ 1,010,426
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 46,484	\$ 35,232
Accrued income taxes	2,106	4,102
Contract liabilities	8,859	9,746
Accrued compensation	8,420	6,291
Operating lease liabilities	1,007	1,046
Other accrued liabilities	22,411	37,246
Total current liabilities	89,287	93,663
Deferred income taxes	3,918	3,925
Income tax payable	6,501	9,627
Operating lease liabilities, long-term	3,817	4,170
Other long-term liabilities	2,164	1,933
Total liabilities	105,687	113,318
Contingencies (Note 12)		
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, 33,919,726 and 34,774,156 shares issued and outstanding at September 30, 2022 and December 31, 2021	343	352
Additional paid-in capital	87,917	80,254
Retained earnings	952,991	973,087
Accumulated other comprehensive losses	(176,414)	(156,585)
Total stockholders' equity	864,837	897,108
Total liabilities and stockholders' equity	\$ 970,524	\$ 1,010,426

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2022	2021	2022	2021
	(In thousands, except per share data)			
Revenues:				
Products	\$ 58,508	\$ 53,622	\$ 176,129	\$ 165,066
Services	20,443	19,560	57,538	54,763
Leasing	9,190	9,815	31,589	25,204
Total revenues	88,141	82,997	265,256	245,033
Cost and expenses:				
Cost of sales:				
Products	49,714	48,120	151,932	133,243
Services	8,105	7,020	24,773	24,687
Leasing	7,891	7,694	22,663	23,229
Total cost of sales	65,710	62,834	199,368	181,159
Selling, general and administrative	22,431	25,265	67,322	84,416
Engineering and product development	2,645	3,510	9,041	11,270
Restructuring and other charges	2,180	-	7,977	26,020
Gain on sale of property, plant and equipment	(17,276)	(13)	(17,770)	(3,886)
Foreign currency transaction gains	(1,901)	(1,663)	(5,574)	(764)
Total costs and expenses	73,789	89,933	260,364	298,215
Operating income (loss)	14,352	(6,936)	4,892	(53,182)
Interest income	379	188	1,155	300
Interest expense	(131)	(94)	(284)	(592)
Income (loss) before income taxes	14,600	(6,842)	5,763	(53,474)
Income tax provision (benefit)	(610)	4,301	5,061	11,094
Net income (loss)	<u>\$ 15,210</u>	<u>\$ (11,143)</u>	<u>\$ 702</u>	<u>\$ (64,568)</u>
Income (loss) per common share:				
Basic	<u>\$ 0.45</u>	<u>\$ (0.31)</u>	<u>\$ 0.02</u>	<u>\$ (1.82)</u>
Diluted	<u>\$ 0.44</u>	<u>\$ (0.31)</u>	<u>\$ 0.02</u>	<u>\$ (1.82)</u>
Weighted average common shares outstanding:				
Basic	<u>33,948</u>	<u>35,387</u>	<u>34,304</u>	<u>35,386</u>
Diluted	<u>34,232</u>	<u>35,387</u>	<u>34,580</u>	<u>35,386</u>

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

DRIL-QUIP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2022	2021	2022	2021
	(In thousands)			
Net income (loss)	\$ 15,210	\$ (11,143)	\$ 702	\$ (64,568)
Other comprehensive loss, net of tax:				
Foreign currency translation adjustments	(10,487)	(6,548)	(19,829)	(5,592)
Total comprehensive income (loss)	<u>\$ 4,723</u>	<u>\$ (17,691)</u>	<u>\$ (19,127)</u>	<u>\$ (70,160)</u>

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

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

	Nine months ended	
	September 30,	
	2022	2021
	(In thousands)	
Operating activities		
Net income (loss)	\$ 702	\$ (64,568)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	22,352	22,658
Stock-based compensation expense	7,669	9,541
Restructuring and other charges	6,119	22,465
Gain on sale of property, plant and equipment	(17,770)	(3,886)
Deferred income taxes	1,538	(993)
Changes in operating assets and liabilities:		
Trade receivables, net	16,980	11,632
Unbilled receivables	(38,097)	25,961
Inventories, net	2,255	(6,680)
Prepays and other assets	(10,775)	14,706
Accounts payable and accrued expenses	(10,124)	2,902
Other, net	(16)	-
Net cash provided by (used in) operating activities	(19,167)	33,738
Investing activities		
Purchase of property, plant and equipment	(13,712)	(7,928)
Proceeds from sale of property, plant and equipment	18,535	5,967
Purchase of short-term investments	(25,287)	-
Net cash used in investing activities	(20,464)	(1,961)
Financing activities		
Repurchase of common shares	(20,807)	(1,132)
Other	(74)	(113)
Net cash used in financing activities	(20,881)	(1,245)
Effect of exchange rate changes on cash activities	(4,660)	(1,315)
Increase (decrease) in cash and cash equivalents	(65,172)	29,217
Cash and cash equivalents at beginning of period	355,451	345,955
Cash and cash equivalents at end of period	<u>\$ 290,279</u>	<u>\$ 375,172</u>

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

DRIL-QUIP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(UNAUDITED)

	<u>Common Stock</u>	<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Losses</u>	<u>Total</u>
	(In thousands, except shares)				
Balance at July 1, 2022	\$ 348	\$ 85,351	\$ 948,917	\$ (165,927)	\$ 868,689
Foreign currency translation adjustment	-	-	-	(10,487)	(10,487)
Net income	-	-	15,210	-	15,210
Comprehensive income	-	-	-	-	4,723
Repurchase of common shares (457,467 shares)	(5)	-	(11,145)	-	(11,150)
Stock-based compensation expense	-	2,569	-	-	2,569
Other	-	(3)	9	-	6
Balance at September 30, 2022	<u>\$ 343</u>	<u>\$ 87,917</u>	<u>\$ 952,991</u>	<u>\$ (176,414)</u>	<u>\$ 864,837</u>
Balance at January 1, 2022	\$ 352	\$ 80,254	\$ 973,087	\$ (156,585)	\$ 897,108
Foreign currency translation adjustment	-	-	-	(19,829)	(19,829)
Net income	-	-	702	-	702
Comprehensive loss	-	-	-	-	(19,127)
Repurchase of common shares (888,197 shares)	(9)	-	(20,798)	-	(20,807)
Stock-based compensation expense	-	7,669	-	-	7,669
Other	-	(6)	-	-	(6)
Balance at September 30, 2022	<u>\$ 343</u>	<u>\$ 87,917</u>	<u>\$ 952,991</u>	<u>\$ (176,414)</u>	<u>\$ 864,837</u>
	<u>Common Stock</u>	<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Losses</u>	<u>Total</u>
	(In thousands, except shares)				
Balance at July 1, 2021	\$ 363	\$ 71,878	\$ 1,071,838	\$ (148,755)	\$ 995,324
Foreign currency translation adjustment	-	-	-	(6,548)	(6,548)
Net loss	-	-	(11,143)	-	(11,143)
Comprehensive loss	-	-	-	-	(17,691)
Repurchase of common shares (45,225 shares)	-	-	(1,132)	-	(1,132)
Stock option expense	-	3,276	-	-	3,276
Balance at September 30, 2021	<u>\$ 363</u>	<u>\$ 75,154</u>	<u>\$ 1,059,563</u>	<u>\$ (155,303)</u>	<u>\$ 979,777</u>
Balance at January 1, 2021	\$ 363	\$ 65,613	\$ 1,125,263	\$ (149,711)	\$ 1,041,528
Foreign currency translation adjustment	-	-	-	(5,592)	(5,592)
Net loss	-	-	(64,568)	-	(64,568)
Comprehensive loss	-	-	-	-	(70,160)
Repurchase of common shares (45,225 shares)	-	-	(1,132)	-	(1,132)
Stock option expense	-	9,541	-	-	9,541
Balance at September 30, 2021	<u>\$ 363</u>	<u>\$ 75,154</u>	<u>\$ 1,059,563</u>	<u>\$ (155,303)</u>	<u>\$ 979,777</u>

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

DRIL-QUIP, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)****1. Organization and Basis of Presentation**

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, 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 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 Azerbaijan, Denmark, Norway and Holland; Dril-Quip Asia-Pacific PTE Ltd., located in Singapore; and Dril-Quip do Brasil LTDA, located in Macae, Brazil. Other operating subsidiaries include TIW Corporation (TIW) and Honing, Inc., both located in Houston, Texas; DQ Holdings Pty. Ltd., located in Perth, Australia; Dril-Quip Cross (Ghana) Ltd., located in Takoradi, Ghana; PT DQ Oilfield Services Indonesia, located in Jakarta, Indonesia; Dril-Quip Egypt for Petroleum Services S.A.E., located in Alexandria, Egypt; Dril-Quip TIW Saudi Arabia Limited, located in Dammam, Kingdom of Saudi Arabia; Dril-Quip Oilfield Services (Tianjin) Co. Ltd., located in Tianjin, China, with branches in Shenzhen and Beijing, China; Dril-Quip Qatar LLC, located in Doha, Qatar; Dril-Quip TIW Mexico S. de R.L.C.V., located in Villahermosa, Mexico; Dril-Quip Venezuela S.C.A., located in Anaco, Venezuela and with a registered branch located in Ecuador.

The condensed consolidated financial statements included herein are unaudited. The balance sheet at December 31, 2021 has been derived from the audited consolidated financial statements as of 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 September 30, 2022 and the results of operations and comprehensive income (loss) for the three and nine months ended September 30, 2022 and 2021 and cash flows for the nine months ended September 30, 2022 and 2021. 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. The results of operations and comprehensive income (loss) for the three and nine months ended September 30, 2022 and cash flows for the nine months ended September 30, 2022 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, 2021.

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 as of the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. Some of the Company’s more significant estimates are those affected by critical accounting policies for revenue recognition and asset recoverability tests and inventories.

Revenue Recognition

The Company generates revenues through the sale of products, the sale of services and the leasing of running 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.

Leasing Revenues

The Company earns leasing revenues from the rental of running tools. Revenues from rental of running tools are recognized on a day rate basis over the lease term, which is generally between one to three months.

On April 30, 2021, as a result of lower activity stemming from the COVID-19 pandemic, AFGlobal Corporation provided a 90-day written notice of termination of the lease agreement between the Company and AFGlobal in relation to the Company's forge facility and equipment at its Houston Eldridge campus. As a result of the lease termination, the Company had approximately \$2.3 million in unbilled revenue that was expensed in second quarter of 2021. Leasing revenue from renting this facility that was not recognized due to the termination of the lease agreement was approximately \$0.5 million and \$1.5 million for the three and nine months ended September 30, 2021, respectively. The Company has numerous other forging suppliers and, through the end of the third quarter of 2022, has not experienced any disruptions in forging supply as a result of the lease termination.

Short-term Investments

Short-term investments are comprised primarily of time deposits, certificates of deposit, commercial paper, bonds and notes, substantially all of which are denominated in U.S. dollars and are stated at cost plus accrued interest, which approximates fair value. The Company expects to hold all of its Short-term investments to maturity.

For purposes of the Consolidated Financial Statements, the Company does not consider Short-term investments to be cash equivalents.

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.

Impairment of Long-Lived Assets

Long-lived assets, including property, plant and equipment and definite-lived intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. We evaluate our property and equipment and definite-lived intangible assets for impairment whenever changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Should the review indicate that the carrying value is not fully recoverable, the amount of the impairment loss is determined by comparing the carrying value to the estimated fair value. We assess recoverability based on undiscounted future net cash flows. Estimating future net cash flows requires us to make judgements regarding long-term forecasts of future revenues and costs related to the assets subject to review. These forecasts are uncertain in that they require assumptions about our revenue growth, operating margins, capital expenditures, future market conditions and technological developments. If changes in these assumptions occur, our expectations regarding future net cash flows may change such that a material impairment could result.

Restructuring and Other Charges

During the third quarter of 2022, the Company incurred \$2.2 million of additional costs under the 2021 global strategic plan. These charges were primarily related to consulting and legal fees, office moves and site cleanup, and preparation costs. During the first half of 2021, the Company incurred additional costs under the former 2018 global strategic plan to realign manufacturing facilities globally. These charges were primarily related to the restructuring of our downhole tools business where we exited certain underperforming countries and markets and shifted from manufacturing in-house to a vendor sourcing model. The Company did not incur any additional costs in the third quarter of 2021. These charges are reflected as "Restructuring and other charges" in our condensed consolidated statements of income (loss).

Repurchase of Equity Securities

On February 22, 2022, the Board of Directors authorized an incremental \$100.0 million share repurchase plan. The repurchase plans have no set expiration date and any repurchased shares are expected to be cancelled. The manner, timing and amount of any purchase will be determined by management based on an evaluation of market conditions, stock price, liquidity and other factors. The program does not obligate the Company to acquire any amount of common stock and may be modified or superseded at any time at the Company's discretion.

For the three months ended September 30, 2022, the Company purchased 457,467 shares under the share repurchase plans at an average price of approximately \$24.35 per share totaling approximately \$11.1 million and has retired such shares. For the nine months ended September 30, 2022, the Company purchased 888,197 shares under the share repurchase plans at an average price of approximately \$23.41 per share totaling approximately \$20.8 million and has retired such shares.

For the three and nine months ended September 30, 2021, the Company purchased 45,225 shares under the share repurchase plan at an average price of approximately \$25.02 per share totaling approximately \$1.1 million and has retired such shares.

Earnings Per Share

Basic earnings per common share is computed by dividing net income (loss) 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 awards using the treasury stock method.

In each relevant period, the net income (loss) 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:

	Three months ended September 30,		Nine months ended September 30,	
	2022	2021	2022	2021
	(In thousands)			
Weighted average common shares outstanding – basic	33,948	35,387	34,304	35,386
Dilutive effect of common stock awards	284	-	276	-
Weighted average common shares outstanding – diluted	<u>34,232</u>	<u>35,387</u>	<u>34,580</u>	<u>35,386</u>

For the three and nine months ended September 30, 2022 and 2021, the Company has excluded the following common stock options and awards because their impact on the income/(loss) per share is anti-dilutive (in thousands on a weighted average basis):

	Three months ended September 30,		Nine months ended September 30,	
	2022	2021	2022	2021
	(In thousands)			
Director stock awards	1	63	-	60
Stock options	-	54	-	56
Performance share units	-	323	-	328
Restricted stock awards	2	477	1	479

3. Revenue Recognition

Revenues from contracts with customers (excludes leasing) consisted of the following:

	Three months ended September 30,							
	Western Hemisphere		Eastern Hemisphere		Asia-Pacific		Total	
	2022	2021	2022	2021	2022	2021	2022	2021
	(In thousands)							
Product Revenues	\$ 36,242	\$ 37,612	\$ 12,150	\$ 10,217	\$ 10,116	\$ 5,793	\$ 58,508	\$ 53,622
Service Revenues	14,416	12,872	3,980	2,458	2,047	4,230	20,443	19,560
Total	\$ 50,658	\$ 50,484	\$ 16,130	\$ 12,675	\$ 12,163	\$ 10,023	\$ 78,951	\$ 73,182

	Nine months ended September 30,							
	Western Hemisphere		Eastern Hemisphere		Asia-Pacific		Total	
	2022	2021	2022	2021	2022	2021	2022	2021
	(In thousands)							
Product Revenues	\$ 116,768	\$ 112,787	\$ 36,103	\$ 25,505	\$ 23,258	\$ 26,774	\$ 176,129	\$ 165,066
Service Revenues	39,067	33,813	10,507	7,748	7,964	13,202	57,538	54,763
Total	\$ 155,835	\$ 146,600	\$ 46,610	\$ 33,253	\$ 31,222	\$ 39,976	\$ 233,667	\$ 219,829

Contract Balances

Balances related to contracts with customers consisted of the following:

Contract Assets (amounts shown in thousands)

Contract Assets at December 31, 2021	\$ 97,716
Additions	108,136
Transfers to Trade Receivables, Net	(71,733)
Contract Assets at September 30, 2022	<u>\$ 134,119</u>

Contract Liabilities (amounts shown in thousands)

Contract Liabilities at December 31, 2021	\$ 9,222
Additions	1,698
Revenue Recognized	(3,411)
Contract Liabilities at September 30, 2022	<u>\$ 7,509</u>

Contract assets include unbilled accounts receivable associated with contracts accounted for under the over-time accounting method which were approximately \$90.8 million and \$58.7 million at September 30, 2022 and December 31, 2021, respectively. Unbilled contract assets are transferred to trade receivables, net, when the rights become unconditional. Contract liabilities primarily relate to advance payments from customers.

Obligations for returns and refunds were considered immaterial as of September 30, 2022.

Remaining Performance Obligations

The aggregate amount of the transaction price allocated to remaining performance obligations from our over-time product lines was \$63.2 million as of September 30, 2022. The Company expects to recognize revenue on approximately 92.7% of the remaining performance obligations over the next 12 months and the remaining 7.3% thereafter.

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

4. Stock-Based Compensation and Stock Awards

During the three and nine months ended September 30, 2022, the Company recognized approximately \$2.6 million and \$7.7 million of stock-based compensation expense. Stock-based compensation is included in "Selling, general and administrative" in our accompanying condensed consolidated statements of income (loss) and "Additional paid-in capital" in our accompanying condensed consolidated balance sheets. During the three and nine months ended September 30, 2021, the Company recognized approximately \$3.3 million and \$9.5 million of stock-based compensation expense.

5. Inventories, net

Inventories consist of the following:

	September 30, 2022	December 31, 2021
	(In thousands)	
Raw materials and supplies	\$ 25,778	\$ 27,398
Work in progress	30,814	28,361
Finished goods	173,197	218,946
	229,789	274,705
Less: allowance for slow moving and excess inventory	(89,259)	(128,981)
Total inventory	\$ 140,530	\$ 145,724

6. Assets Held for Sale

In the second quarter of 2022, the Company actively marketed for sale its corporate administrative building, forge facilities and aftermarket facilities in connection with the consolidation of its operations into a smaller footprint at its campus in Houston, Texas. In September 2022, we sold our forge facility for approximately \$18.9 million. The Company expects to sell the remaining two facilities within a year.

In accordance with the applicable accounting guidance, FASB ASC 360-10-45-9, the Company reclassified the buildings' net carrying amount from Property, plant and equipment, net, to Assets held for sale on the Condensed Consolidated Balance Sheets at September 30, 2022. Of the \$20.0 million classified as Assets Held for Sale, \$11.5 million was held in DQ Corporate and \$8.6 million in the Western Hemisphere. We wrote down approximately \$2.6 million in the nine months ended September 30, 2022 to reflect the net carrying amount of the corporate administrative building assets to their estimated fair value, less estimated costs to sell the building. The long-lived asset write-downs are included in the Restructuring and Other Charges line item of the Condensed Consolidated Statements of Income (Loss) for the nine months ended period ended September 30, 2022. No long-lived asset write downs were recorded in the three and nine-month period ended September 30, 2021.

7. Impairment, Restructuring and Other Charges

Restructuring and Other Charges

During the three and nine months ended September 30, 2022, the Company incurred additional costs of approximately \$2.2 million and \$8.0 million, respectively, under the 2021 global strategic plan. The year-to-date charges were primarily related to the write-downs of long-lived assets and other charges of approximately \$5.1 million and \$2.9 million, respectively. Other charges consisted of office moves, site cleanup, preparation costs, consulting and legal fees.

During the nine months ended September 30, 2021, the Company incurred additional costs under the former 2018 global strategic plan to realign manufacturing facilities globally. These charges were primarily related to the restructuring of our downhole tools business where we exited certain underperforming countries and markets and shifted from manufacturing in-house to a vendor sourcing model. The Company did not incur any additional costs during the three months ended September 30, 2021.

The following table summarizes the components of charges included in "Restructuring and other charges" in our condensed consolidated statements of income (loss) for the three and nine months ended September 30, 2022 and 2021 (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2022	2021	2022	2021
Inventory write-down	\$ -	\$ -	\$ -	\$ 19,251
Severance	-	-	32	2,745
Long-lived asset write-down	-	-	5,055	-
Other	2,180	-	2,890	4,024
	<u>\$ 2,180</u>	<u>\$ -</u>	<u>\$ 7,977</u>	<u>\$ 26,020</u>

The following table summarizes the changes to our accrued liability balance related to restructuring and other charges as of September 30, 2022 (in thousands):

	Total
Beginning balance at January 1, 2022	\$ 4,000
Additions for costs expensed	2,901
Reductions for payments	(3,347)
Other	4
Ending balance at September 30, 2022	<u>\$ 3,558</u>

8. Intangible Assets

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

September 30, 2022					
	Estimated Useful Lives	Gross Book Value	Accumulated Amortization	Foreign Currency Translation	Net Book Value
(In thousands)					
Trademarks	15 years	\$ 8,202	\$ (1,963)	\$ (107)	\$ 6,132
Patents	15 - 30 years	6,049	(3,587)	(1)	2,461
Customer relationships	5 - 15 years	26,002	(10,407)	(370)	15,225
Organizational costs	3 years	183	(112)	(21)	50
		<u>\$ 40,436</u>	<u>\$ (16,069)</u>	<u>\$ (499)</u>	<u>\$ 23,868</u>

December 31, 2021					
	Estimated Useful Lives	Gross Book Value	Accumulated Amortization	Foreign Currency Translation	Net Book Value
(In thousands)					
Trademarks	15 years	\$ 8,257	\$ (1,579)	\$ (23)	\$ 6,655
Patents	15 - 30 years	6,058	(3,285)	(1)	2,772
Customer relationships	5 - 15 years	26,078	(9,128)	(38)	16,912
Organizational costs	3 years	185	(76)	(2)	107
		<u>\$ 40,578</u>	<u>\$ (14,068)</u>	<u>\$ (64)</u>	<u>\$ 26,446</u>

9. Credit Facility

The Company's ABL Credit Facility, dated February 23, 2018, as amended, was terminated effective February 22, 2022. In addition, we opened a new cash collateral account with JPMorgan Chase Bank, N.A., in which cash was transferred to facilitate our existing letters of credit. As of September 30, 2022, the cash balance in that account was approximately \$5.4 million. The Company is required to maintain a balance equal to the outstanding letters of credit plus 5% at all times, which is considered as restricted cash and is included in "Cash and cash equivalents" in our condensed consolidated balance sheets as at September 30, 2022 and December 31, 2021. Withdrawals from this cash collateral account are only allowed at such point that a given letter of credit has expired or has been cancelled.

10. Geographic Areas

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 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.

	Three months ended September 30,									
	Western Hemisphere		Eastern Hemisphere		Asia-Pacific		DQ Corporate		Total	
	2022	2021	2022	2021	2022	2021	2022	2021	2022	2021
	(In thousands)									
Revenues										
Products										
Point in Time	\$ 17,355	\$ 22,692	\$ 3,992	\$ 6,276	\$ 4,628	\$ 3,953	\$ -	\$ -	\$ 25,975	\$ 32,921
Over-Time	18,887	14,920	8,158	3,941	5,488	1,840	-	-	32,533	20,701
Total Products	36,242	37,612	12,150	10,217	10,116	5,793	-	-	58,508	53,622
Services										
Technical Advisory	9,899	10,814	3,303	2,038	1,131	3,629	-	-	14,333	16,481
Reconditioning	4,517	2,058	677	420	916	601	-	-	6,110	3,079
Total Services (excluding rental tools)	14,416	12,872	3,980	2,458	2,047	4,230	-	-	20,443	19,560
Leasing	5,310	6,627	3,588	1,564	292	1,624	-	-	9,190	9,815
Total Services (including rental tools)	19,726	19,499	7,568	4,022	2,339	5,854	-	-	29,633	29,375
Intercompany	1,352	4,029	120	920	1,518	576	-	-	2,990	5,525
Eliminations	-	-	-	-	-	-	(2,990)	(5,525)	(2,990)	(5,525)
Total Revenues	\$ 57,320	\$ 61,140	\$ 19,838	\$ 15,159	\$ 13,973	\$ 12,223	\$ (2,990)	\$ (5,525)	\$ 88,141	\$ 82,997
Depreciation and amortization	\$ 4,257	\$ 4,736	\$ 997	\$ 1,044	\$ 965	\$ 1,194	\$ 904	\$ 925	\$ 7,123	\$ 7,899
Income (loss) before income taxes	\$ 25,135	\$ 8,417	\$ 5,578	\$ (1,273)	\$ (562)	\$ 2,002	\$ (15,551)	\$ (15,988)	\$ 14,600	\$ (6,842)

During the three months ended September 30, 2022, the Company incurred additional \$2.2 million costs under the 2021 global strategic plan. These charges were primarily related to office moves, site cleanup, preparation costs, consulting and legal fees at DQ Corporate. During the three months ended September 30, 2021, the Company did not incur any restructuring and other charges.

	Nine months ended September 30,									
	Western Hemisphere		Eastern Hemisphere		Asia-Pacific		DQ Corporate		Total	
	2022	2021	2022	2021	2022	2021	2022	2021	2022	2021
	(In thousands)									
Revenues										
Products										
Point in Time	\$ 57,861	\$ 76,927	\$ 11,089	\$ 17,086	\$ 15,746	\$ 19,420	\$ -	\$ -	\$ 84,696	\$ 113,433
Over-Time	58,907	35,860	25,014	8,419	7,512	7,354	-	-	91,433	51,633
Total Products	116,768	112,787	36,103	25,505	23,258	26,774	-	-	176,129	165,066
Services										
Technical Advisory	27,863	26,916	8,594	6,058	6,130	11,603	-	-	42,587	44,577
Reconditioning	11,204	6,897	1,913	1,690	1,834	1,599	-	-	14,951	10,186
Total Services (excluding rental tools)	39,067	33,813	10,507	7,748	7,964	13,202	-	-	57,538	54,763
Leasing	18,937	15,297	8,059	4,635	4,593	5,272	-	-	31,589	25,204
Total Services (including rental tools)	58,004	49,110	18,566	12,383	12,557	18,474	-	-	89,127	79,967
Intercompany	9,558	8,807	2,580	1,558	3,127	8,875	-	-	15,265	19,240
Eliminations	-	-	-	-	-	-	(15,265)	(19,240)	(15,265)	(19,240)
Total	\$ 184,330	\$ 170,704	\$ 57,249	\$ 39,446	\$ 38,942	\$ 54,123	\$ (15,265)	\$ (19,240)	\$ 265,256	\$ 245,033
Depreciation and amortization	\$ 13,486	\$ 13,291	\$ 3,072	\$ 3,021	\$ 3,064	\$ 3,576	\$ 2,730	\$ 2,770	\$ 22,352	\$ 22,658
Income (loss) before income taxes	\$ 47,780	\$ (13,136)	\$ 7,935	\$ (583)	\$ (739)	\$ 17,540	\$ (49,213)	\$ (57,295)	\$ 5,763	\$ (53,474)

During the nine months ended September 30, 2022, the Company incurred additional costs under the 2021 global strategic plan. These charges were primarily related to a \$2.6 million write down of our Houston corporate administrative building in DQ Corporate and other long-lived asset write downs of \$2.5 million in the Western Hemisphere. In addition, there were other charges of \$2.9 million primarily related to office moves, site cleanup, preparation costs, consulting and legal fees at DQ Corporate. During the nine months ended September 30, 2021, we recorded \$26.0 million of restructuring and other charges. These charges were related to non-cash inventory write downs, severance charges and other charges, primarily consisting of facilities restructuring exit costs and consulting fees. Of these charges, \$21.0 million was recorded in the Western Hemisphere, \$1.6 million in the Eastern Hemisphere and \$3.4 million at DQ Corporate.

	September 30, 2022	December 31, 2021
	(In thousands)	
<i>Total long-lived assets:</i>		
Western Hemisphere	\$ 304,501	\$ 335,760
Eastern Hemisphere	218,909	224,345
Asia-Pacific	55,302	58,308
Eliminations	(353,946)	(353,536)
Total	\$ 224,766	\$ 264,877
<i>Total assets:</i>		
Western Hemisphere	\$ 856,459	\$ 686,361
Eastern Hemisphere	794,465	805,574
Asia-Pacific	180,276	184,097
Eliminations	(860,676)	(665,606)
Total	\$ 970,524	\$ 1,010,426

As of September 30, 2022, the Company had recorded a \$2.6 million write down of our Houston corporate administrative building at DQ Corporate and other long-lived asset write downs of \$2.5 million in the Western Hemisphere. As of September 30, 2021, we had \$19.1 million of non-cash inventory write-downs in the Western Hemisphere and \$0.2 million in the Eastern Hemisphere as we shifted from the manufacturing of our downhole tools products business to a vendor outsourcing model.

11. Income Tax

The effective tax rate for the three and nine months ended September 30, 2022 was (4.2)% and 87.8% compared to (62.9)% and (20.7)%, respectively, for the same periods in 2021. The change in the effective tax rate between the periods resulted primarily due to the change in projected earnings mix by geography and tax jurisdiction as compared to the prior period, changes in valuation allowances in the United States, changes in uncertain tax positions, foreign inclusions, changes in nondeductible compensation, and the mix of earnings in jurisdictions with differing tax rates.

We have historically considered the majority of undistributed earnings of our foreign subsidiaries and equity investees to be indefinitely reinvested, and, accordingly, no deferred taxes had been provided on the indefinitely reinvested earnings. As of June 30, 2020, the Company reversed its indefinite reinvestment assertion. As a result, we recorded a deferred foreign tax liability, which had a balance of \$2.5 million as of September 30, 2022 and is primarily related to estimated foreign withholding tax associated with repatriating all non-U.S. earnings back to the United States.

The Company is subject to ongoing tax authority examinations in various jurisdictions in which it operates. The Company reviews its accrual for uncertain tax positions at each reporting period and updates positions based on available information. In October 2022, the Company completed and closed an examination. The Company expects to reflect a decrease in its accrual for unrecognized tax benefits resulting from the formal closure of the examination by the taxing authority of \$6.2 million in the fourth quarter of 2022. It is still reasonably possible that the Company's existing liabilities for unrecognized tax benefits could change within the next 12 months, due to the progression of other tax authority examinations and the expiration of statutes of limitation.

12. Contingencies

FMC Technologies Lawsuit

On October 5, 2020, FMC Technologies, Inc. (“FMC”) sued the Company alleging misappropriation of trade secrets and sought money damages and injunctive relief in the 127th District Court of Harris County in an action styled *FMC Technologies, Inc. v. Richard Murphy and Dril-Quip, Inc.*, Cause No. 2020-63081. FMC alleged that its former employee communicated FMC trade secrets to the Company and the Company used those trade secrets in its VXTe subsea tree systems. On April 29, 2021, the jury returned a verdict in favor of the Company. FMC filed a notice of appeal on August 20, 2021. The Company intends to continue its vigorous defense of this matter on appeal.

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 is dependent on the condition of the oil and gas industry. Additionally, certain of the Company’s products are used in potentially hazardous drilling, completion, and production applications that can cause personal injury, property damage and environmental claims. Although exposure to such risks has not resulted in any significant problems for the Company in the past, ongoing exposure to these risks and future developments could adversely impact the Company in the future.

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.

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

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 expressions, or by the Company’s discussion of strategies or trends. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, no assurance can be given that these expectations will prove to be correct. These forward-looking statements include the following types of information and statements as they relate to the Company:

- the impact of actions taken by the Organization of Petroleum Exporting Countries and the expanded alliance (OPEC+) with respect to their production levels and the effects thereof;
- the impact of the ongoing COVID-19 pandemic and the effects thereof;
- the impact of general economic conditions, including inflation, on economic activity and on our operations;
- future operating results and cash flow;
- scheduled, budgeted and other future capital expenditures;
- planned or estimated cost savings;
- working capital requirements;
- the need for and the availability of expected sources of liquidity;
- the introduction into the market of the Company’s future products;
- the Company’s ability to deliver its backlog in a timely fashion;
- the market for the Company’s existing and future products;
- the Company’s ability to develop new applications for its technologies;
- the exploration, development and production activities of the Company’s customers;
- compliance with present and future environmental regulations and costs associated with environmentally related penalties, capital expenditures, remedial actions and proceedings;
- effects of pending legal proceedings;
- changes in customers’ future product and service requirements that may not be cost effective or within the Company’s capabilities;
- future operations, financial results, business plans and cash needs; and
- the overall timing and level of transition of the global energy sector from fossil-based systems of energy production and consumption to more renewable energy sources.

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 II of this report, and “Item 1A. Risk Factors” in Part I of the Company’s Annual Report on Form 10-K for the year ended December 31, 2021.

Investors should note that Dril-Quip announces financial information in SEC filings, press releases and public conference calls. Dril-Quip may use the Investors section of its website (www.dril-quip.com) to communicate with investors. It is possible that the financial and other information posted there could be deemed to be material information. The information on Dril-Quip’s website is not part of this Form 10-Q.

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 (loss) 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 herein as well as the discussion under Part II – Item 1A, "Risk Factors," included herein and "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, 2021.

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, 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.

Business Environment

On August 16, 2022, President Biden signed into law the Inflation Reduction Act of 2022 (the "Inflation Reduction Act"). The Inflation Reduction Act contains a number of revisions to the Internal Revenue Code, including a 15% book-income corporate alternative minimum tax on any corporation that, along with the other members of its controlled group, if any, has average adjusted financial statement income over \$1.0 billion for any 3-tax-year period ending with January 1, 2022 or later and a 1% excise tax on the fair market value of stock that is repurchased by publicly traded U.S. corporations or their specified affiliates. The alternative minimum tax and the excise tax are effective in taxable years beginning after December 31, 2022. Currently, we are not subject to the corporate alternative minimum tax. The Company will evaluate any impact related to the excise tax on stock repurchases by the Company in future periods.

During the first quarter of 2022, Dril-Quip entered into a collaboration agreement with Aker Solutions ASA (Aker Solutions) to offer subsea injection systems for carbon capture, utilization and storage (CCUS) projects. Under the agreement, Dril-Quip will provide Aker Solutions with CO₂ injection Xmas trees and wellheads that will be fully integrated into a larger subsea injection system to provide customers with market-leading technology purposely designed for the injection and storage of CO₂. The arrangement will leverage on Aker Solution's position as an integrated supplier of CCUS systems along with its control systems and electrification components. We believe this collaboration agreement focuses on the strengths of both organizations, will deliver an optimum solution for carbon capture and storage, and is in line with each party's strategic goals of collaboration and partnerships to unlock value for customers.

In February 2022, Russia invaded Ukraine, resulting in wide-ranging sanctions imposed on Russia by certain members of the European Union, the United Kingdom and the United States, among others, higher oil prices and increased uncertainty in global markets. As Russia's invasion of Ukraine continues, there can be no certainty regarding whether such governments or other governments will impose additional sanctions, export-controls or other economic or military measures against Russia. Although we have minimal operational exposure in Russia and we do not intend to commit further capital towards projects in Russia, the full impact of the invasion of Ukraine, including economic sanctions and export controls or additional war or military conflict, as well as potential responses to them by Russia, is currently unknown and could adversely affect oil and gas companies, many of which are our customers, as well as the global supply chain. For more information on the risks associated with the invasion of Ukraine, see "Our business may also be affected by new sanctions and export controls targeting Russia and other responses to Russia's invasion of Ukraine." under "Item 1A. Risk Factors" in Part II of our Quarterly Report on Form 10-Q for the period ending March 31, 2022.

Crude oil prices increased in 2022, mainly driven by the Russian invasion of Ukraine, actions taken by OPEC+ to adjust their production levels and loosening of pandemic-related restrictions and the Company has seen an increase in drilling activity in the offshore market as a result of these continued price increases. In light of continued volatility in the crude oil market, global petroleum demand could be negatively impacted.

During the second quarter of 2021, Dril-Quip entered into a collaboration and supply agreement in which the Company will serve as a supplier of subsea wellheads, tubular goods, liner hangers and other related tools and services to a peer provider of subsea equipment and services. The arrangement provides a framework for bundling several of our products and services into an integrated engineering, procurement and construction offering by our peer for the subsea production system market. We believe this collaboration and supply agreement will lead to opportunities to participate in more subsea projects and bids as a subcontractor for this industry peer that we previously may not have had access to independently.

The Company has taken steps and adjusted its workforce to be in line with the current pandemic environment as we continue to monitor ongoing market conditions. The extent to which our future results are affected by these externalities will depend on various factors and circumstances beyond our control, such as the duration and scope of the pandemic, additional actions by businesses and governments in response to the pandemic, the speed and effectiveness of containing the virus and developments in the global oil markets. Similarly, we expect that the uncertainty in the sustainability of current oil prices will continue to have a negative impact on oil and gas activities. Further, Russia's military incursion into Ukraine has led to, and could continue to, give rise to regional instability and result in heightened economic sanctions by certain members of the European Union, the United Kingdom, the United States, and certain other members of the international community that, in turn, could increase uncertainty with respect to global financial markets and production output from OPEC+ and other crude oil producing nations. In addition to this, continued outbreaks of new COVID-19 variants could also aggravate the risk factors identified in our Annual Report on Form 10-K for the fiscal year ended December 31, 2021, and updated by our Quarterly Report on Form 10-Q for the period ending March 31, 2022, including leading to further material impairment charges.

The Company took advantage of the Payroll Tax Deferral provided by the CARES Act in 2020. This resulted in approximately \$2.9 million in FICA cash tax payments being deferred to 2021 and 2022. The CARES Act provided for the five-year carryback of Net Operating Losses ("NOLs") generated in the 2018, 2019 and 2020 taxable years. The Company filed returns to carryback its NOLs to generate a refund of \$46.0 million.

Oil and Gas Prices

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 Price per Barrel	Three months ended September 30,		Nine months ended September 30,	
	2022	2021	2022	2021
Low	\$ 82.55	\$ 65.51	\$ 78.25	\$ 50.37
High	121.80	78.85	133.18	78.85
Average	100.71	73.51	105.00	67.89
Closing	88.90	77.81	88.90	77.81

According to the October 2022 release of the Short-Term Energy Outlook published by the EIA, Brent Crude oil prices are projected to average approximately \$104.21 per barrel in 2022 and \$96.91 per barrel in 2023, compared with an average of \$70.89 per barrel in 2021. In its October 2022 Oil Market Report, the International Energy Agency projected global oil demand growth to reduce to 1.9 million barrels per day in 2022 and to 1.7 million barrels per day in 2023 and is now forecast to average 101.3 million barrels per day in 2023.

Although crude oil prices rebounded sharply in 2022, we have only recently seen an increase in activity from our customers as any recovery in the subsea market generally lags relative to the overall recovery in crude oil prices. If the Company experiences significant contract terminations, suspensions or scope adjustments to its contracts, then its financial condition, results of operations and cash flows may be adversely impacted.

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 nine months ended September 30, 2022 and 2021. 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.

	Nine months ended September 30,			
	2022		2021	
	Floating Rigs	Jack-up Rigs	Floating Rigs	Jack-up Rigs
Western Hemisphere	58	42	56	40
Eastern Hemisphere	49	62	45	58
Asia-Pacific	29	265	30	252
Total	136	369	131	350

Source: IHS—Petrodata RigBase – September 30, 2022 and 2021

According to IHS-Petrodata RigBase, as of September 30, 2022, there were 519 contracted rigs for the Company's geographic regions (140 floating rigs and 379 jack-up rigs), an increase of 8.1% from the rig count of 480 rigs (133 floating rigs and 347 jack-up rigs) as of September 30, 2021.

Regulation

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

In March 2018, the President of the United States issued a proclamation imposing a 25 percent global tariff on imports of certain steel products, effective March 23, 2018. The President subsequently proposed an additional 25 percent tariff on approximately \$50 billion worth of imports from China, and the government of China responded with a proposal of an additional 25 percent tariff on U.S. goods with a value of \$50 billion. In the following months, the United States and China placed additional, competing tariffs on imported goods until the two countries entered a phase one trade deal, which included an agreement to reduce certain tariffs. Negotiations for a phase two trade deal with China had begun prior to the outbreak of the global COVID-19 pandemic and if continued could lead to additional changes to the tariff rates in the phase one trade deal. President Biden has indicated that these tariffs will likely remain in place while the new administration assesses the United States' current posture, including a review of the phase one trade deal with China.

The imposition of any additional tariffs or initiation of trade restrictions by or against the United States could cause our cost of raw materials to increase or affect the markets for our products. However, given the uncertainty regarding the scope and duration of these trade actions by the United States and other countries, their ultimate impact on our business and operations remains uncertain.

The United Kingdom (U.K.) officially withdrew from the E.U. on January 31, 2020. (Brexit). Brexit and the terms of a subsequent trade and cooperation agreement (TCA) brought to an end the U.K.'s automatic access to the E.U. single market, resulting in the U.K. no longer benefitting from the free movement of goods and services between the E.U. and the U.K. The rights of people to freely move between the E.U. and the U.K. have also been restricted. For more information on the risks associated with Brexit and the TCA, see "Our international operations require us to comply with a number of U.S. and foreign regulations governing the international trade of goods, services and technology, which expose us to compliance risks" under "Item 1A. Risk Factors" in Part II of this report and "Item 1A. Risk Factors" in Part I of the Company's Annual Report on Form 10-K for the year ended December 31, 2021.

The Company believes that its backlog should help mitigate the impact of negative market conditions; however, slow recovery in 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 September 30, 2022 was approximately \$211.8 million, compared to approximately \$208.6 million at June 30, 2022, \$220.9 million at March 31, 2022 and \$210.1 million at December 31, 2021.

The following table represents the change in backlog for the three months ended September 30, 2022, June 30, 2022, March 31, 2022, and December 31, 2021.

	Three months ended			
	September 30, 2022	June 30, 2022	March 31, 2022	December 31, 2021
	(In thousands)			
Beginning Backlog	\$ 208,586	\$ 220,934	\$ 210,119	\$ 179,012
Bookings:				
Product (1)	74,945	56,780	63,155	83,105
Service	20,443	19,596	22,578	19,380
Leasing	9,190	12,403	9,996	9,837
Cancellation/Revision adjustments	(12,521)	(7,879)	(2,011)	(3,336)
Translation adjustments	(735)	730	234	33
Total Bookings	91,322	81,630	93,952	109,019
Revenues:				
Product	58,508	61,979	55,642	48,695
Service	20,443	19,596	17,499	19,380
Leasing	9,190	12,403	9,996	9,837
Total Revenue	88,141	93,978	83,137	77,912
Ending Backlog	<u>\$ 211,767</u>	<u>\$ 208,586</u>	<u>\$ 220,934</u>	<u>\$ 210,119</u>

⁽¹⁾ The backlog data shown above includes all bookings as of September 30, 2022, 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 a result, this table will not agree to the disclosed performance obligations of \$63.2 million as of September 30, 2022 within "Revenue Recognition", Note 3 to the Notes to Condensed Consolidated Financial Statements.

Revenues. Dril-Quip's revenues are generated from three sources: products, services and leasing. Product revenues are derived from the sale of drilling and production equipment. Service revenues are earned when the Company provides technical advisory assistance and rework and reconditioning services. Leasing revenues are derived from rental tools used during installation and retrieval of the Company's products. For the three months ended September 30, 2022 and 2021, the Company derived 66.4% and 64.6%, respectively, of its revenues from the sale of its products, 23.2% and 23.6%, respectively, of its revenue from services, and 10.4% and 11.8%, respectively, of its revenues from leasing. For the nine months ended September 30, 2022 and 2021, the Company derived 66.4% and 67.4%, respectively, of its revenues from the sale of its products, 21.7% and 22.3%, respectively, of its revenue from services, and 11.9% and 10.3%, respectively, of its revenues from leasing. Service and leasing revenues generally correlate to revenues from product sales because increased product sales typically generate increased demand for technical advisory assistance services and rental of running tools during installation. The Company has substantial international operations, with approximately 64.3% and 64.5% of its revenues derived from foreign sales for the nine months ended September 30, 2022 and 2021, respectively. The majority of the Company's domestic revenue relates to operations in the U.S. Gulf of Mexico. Domestic revenue approximated 35.7% and 35.5% of the Company's total revenues for the nine months ended September 30, 2022 and 2021, respectively.

Product contracts are generally 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 due to 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, preservation of market share, the introduction of new products and overall market conditions.

The Company accounts for more complex, customer specific projects that have relatively longer manufacturing time frames on an over-time basis. For the three months ended September 30, 2022, there were 58 projects representing approximately 36.9% of the Company's total revenues and approximately 55.6% of its product revenues that were accounted for using over-time accounting, compared to 29 projects for the three months ended September 30, 2021, which represented approximately 24.9% of the Company's total revenues and approximately 38.6% of its product revenues. For the nine months ended September 30, 2022, there were 66 projects representing approximately 34.5% of the Company's total revenues and approximately 51.9% of its product revenues that were accounted for using over-time accounting, compared to 45 projects for the nine months ended September 30, 2021, which represented approximately 21.1% of the Company's total revenues and approximately 31.3% 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, manufacturing overhead, and application engineering expenses related to customized products. 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 and other related administrative functions.

Engineering and Product Development Expenses. Engineering and product development expenses consist of new product development and testing.

Impairments. We evaluate our property and equipment for impairment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable, and we could incur additional impairment charges related to the carrying value of our long-lived assets. There were no impairment charges recorded for the three months ended September 30, 2022.

Restructuring and Other Charges. During the three and nine months ended September 30, 2022, the Company incurred additional costs of approximately \$2.5 million and \$8.0 million, respectively, under the 2021 global strategic plan. The year-to-date charges were primarily related to the write-downs of long-lived assets and other charges of approximately \$5.1 million and \$2.9 million, respectively. Other charges consisted of office moves, site cleanup, preparation costs, consulting and legal fees.

(Gain) Loss on Sale of Property, Plant and Equipment. Gain or loss on sale of property, plant and equipment consists of sales of certain property, plant and equipment.

Foreign Currency Transaction (Gains) and Losses. Foreign currency transaction (gains) and losses result from a change in exchange rates between the functional currency and the currency in which a foreign currency transaction is denominated.

Income Tax Provision (Benefit). The Company's effective income tax rate fluctuates from the U.S. statutory tax rate based on, among other factors, changes in earnings mix by geography and tax jurisdiction, impact of valuation allowances, changes in tax legislation, and other permanent differences related to the recognition of income and expense between U.S. GAAP and applicable tax rules.

Results of Operations

The following table sets forth, for the periods indicated, certain condensed consolidated statements of income (loss) data expressed as a percentage of revenues:

	Three months ended September 30,		Nine months ended September 30,	
	2022	2021	2022	2021
Revenues:				
Products	66.4%	64.6%	66.4%	67.4%
Services	23.2	23.6	21.7	22.3
Leasing	10.4	11.8	11.9	10.3
Total revenues	100.0	100.0	100.0	100.0
Cost of sales:				
Products	56.4	58.0	57.3	54.4
Services	9.2	8.5	9.3	10.1
Leasing	9.0	9.3	8.5	9.5
Total cost of sales	74.6	75.8	75.1	74.0
Selling, general and administrative	25.4	30.4	25.4	34.5
Engineering and product development	3.0	4.2	3.4	4.6
Restructuring and other charges	2.5	-	3.0	10.6
Gain on sale of property, plant and equipment	(19.6)	-	(6.7)	(1.6)
Foreign currency transaction gains	(2.2)	(2.0)	(2.1)	(0.3)
Operating income (loss)	16.3	(8.4)	1.9	(21.8)
Interest income	0.4	0.2	0.4	0.1
Interest expense	(0.1)	(0.1)	(0.1)	(0.2)
Income (loss) before income taxes	16.6	(8.3)	2.2	(21.9)
Income tax provision (benefit)	(0.7)	5.2	1.9	4.5
Net income (loss)	17.3%	(13.5)%	0.3%	(26.4)%

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

	Three months ended September 30,		Nine months ended September 30,	
	2022	2021	2022	2021
(In millions)				
Revenues:				
Products:				
Subsea equipment	\$ 48.5	\$ 41.4	\$ 144.2	\$ 129.9
Downhole tools	10.0	12.2	31.9	35.2
Total products	58.5	53.6	176.1	165.1
Services:				
Subsea equipment	15.8	15.6	43.8	43.4
Downhole tools	4.6	4.0	13.8	11.3
Total services	20.4	19.6	57.6	54.7
Leasing				
Subsea equipment	6.8	7.8	25.9	20.4
Downhole tools	2.4	2.0	5.7	4.8
Total leasing	9.2	9.8	31.6	25.2
Total revenues	\$ 88.1	\$ 83.0	\$ 265.3	\$ 245.0

Three Months Ended September 30, 2022 Compared to Three Months Ended September 30, 2021

Revenues. Revenues increased by \$5.1 million, or approximately 6.2%, to \$88.1 million for the three months ended September 30, 2022 from \$83.0 million for the three months ended September 30, 2021. Within product revenues, subsea equipment increased by \$7.1 million, partially offset by decrease in downhole tools revenue by \$2.2 million. Product revenues in the Asia-Pacific region and the Eastern Hemisphere increased by \$4.3 million and \$1.9 million, respectively, partially offset by decreased product revenues of \$1.3 million in the Western Hemisphere. As crude oil prices have continued to rise, the Company has seen an increase in drilling activity in the offshore market. Further, our revenues were favorably impacted by an increase in global demand and increased activity from customer drilling schedules. 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, our product mix and completion status of the projects accounted for under the over-time accounting method, market conditions and customer demand.

Service revenues increased by approximately \$0.9 million resulting mainly from an increase in the Western Hemisphere and the Eastern Hemisphere of \$1.6 million and \$1.5 million, respectively, partially offset by a decrease in the Asia-Pacific region of \$2.2 million. Increase in service revenues in the Western Hemisphere and the Eastern Hemisphere is mainly due to customer specific increases in technical advisory services and maintenance requests tied to drilling schedules. Lower service revenues in the Asia-Pacific region is primarily due to standby rates that the customers paid as a result of travel restrictions and increase in rig mobilization activities in 2021 as companies resumed their well completion activities.

Leasing revenues decreased by approximately \$0.6 million resulting mainly from decreased leasing revenues in the Western Hemisphere and the Asia-Pacific region of \$1.3 million and \$1.3 million, respectively, partially offset by increased leasing revenues in the Eastern Hemisphere of \$2.0 million. The majority of changes in all regions were a result of subsea rental tool utilization due to timing of customer drilling activity.

Cost of Sales. Cost of sales increased by \$2.9 million, or approximately 4.6%, to \$65.7 million for the three months ended September 30, 2022 from \$62.8 million for the same period in 2021. Cost of sales as a percentage of revenue decreased to 74.6% from 75.8% for the three months ended September 30, 2022 and 2021, respectively, primarily due to favorable product mix.

Selling, General and Administrative Expenses. For the three months ended September 30, 2022, selling, general and administrative expenses decreased by \$2.8 million, or 11.2% to \$22.4 million from \$25.3 million for the same period in 2021. This decrease was attributable mainly to lower legal expenses in the current period related to costs incurred in the second quarter of 2021 in connection with the FMC Technologies, Inc. lawsuit and administrative costs associated with the importation tax settlement under the Brazilian tax amnesty program.

Engineering and Product Development Expenses. For the three months ended September 30, 2022, engineering and product development expenses decreased by approximately \$0.9 million, or 24.6%, to \$2.6 million from \$3.5 million for the same period in 2021. This decrease was attributable mainly to lower spend on research and development activities as we completed certain strategic projects.

Restructuring and Other Charges. For the three months ended September 30, 2022, the Company incurred additional costs of approximately \$2.2 million under the 2021 global strategic plan. These charges were primarily related to office moves, site cleanup, preparation costs, consulting and legal fees. During the three months ended September 30, 2021, the Company did not incur any additional costs.

Gain on Sale of Property, Plant and Equipment. For the three months ended September 30, 2022, the gain on sale of property, plant and equipment was \$17.3 million, primarily related to the sale of our Houston forge facility building. For the three months ended September 30, 2021, gain on sale of property, plant and equipment was deemed immaterial.

Foreign Currency Transaction Gains. Foreign exchange gain for the three months ended September 30, 2022, was \$1.9 million as compared to a gain of \$1.7 million for the same period in 2021.

Income Tax Provision (Benefit). Income tax benefit for the three months ended September 30, 2022 was \$0.6 million on an income before taxes of \$14.6 million, resulting in an effective tax rate of (4.2)%. Income tax expense was different than the U.S federal statutory income tax rate of 21% primarily due to change in projected earnings mix by geography and tax jurisdiction, changes in uncertain tax positions, nondeductible compensation and the change in valuation allowances in the United States and in various foreign countries. Income tax provision for the three months ended September 30, 2021 was \$4.3 million on a loss before taxes of \$6.8 million, resulting in an effective income tax rate of approximately (62.9)%. Income tax expense was different than the U.S federal statutory income tax rate of 21% primarily due to changes in pre-tax income or loss in foreign jurisdictions, nondeductible compensation and the change in valuation allowances in the United States and in various foreign countries.

Net Income (Loss). Net income was approximately \$15.2 million for the three months ended September 30, 2022 as compared to a net loss of \$11.1 million for the same period in 2021 for the reasons set forth above.

Nine Months Ended September 30, 2022 Compared to Nine Months Ended September 30, 2021

Revenues. Revenues increased by \$20.2 million, or approximately 8.3% to \$265.3 million for the nine months ended September 30, 2022 from \$245.0 million for the nine months ended September 30, 2021. Within product revenues, subsea equipment increased by \$14.3 million, partially offset by decreased downhole tools revenues of \$3.3 million. Product revenues in the Eastern Hemisphere and the Western Hemisphere increased by \$10.6 million and \$3.9 million, respectively, partially offset by decreased product revenues of \$3.5 million in the Asia-Pacific region. As crude oil prices have continued to rise, the Company has seen an increase in drilling activity in the offshore market. Further, our revenues were favorably impacted by an increase in global demand and increased activity from customer drilling schedules. 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, our product mix and completion status of the projects accounted for under the over-time accounting method, market conditions and customer demand.

Service revenues increased by approximately \$2.8 million resulting mainly from an increase in the Western Hemisphere and the Eastern Hemisphere of \$5.2 million and \$2.8 million, respectively, partially offset by a decrease in the Asia-Pacific region of \$5.2 million. Increase in service revenues in the Western Hemisphere and the Eastern Hemisphere is mainly due to customer specific increases in technical advisory services and maintenance requests tied to drilling schedules. Lower service revenues in the Asia-Pacific region resulted primarily due to standby rates that the customers paid as a result of travel restrictions and increase in rig mobilization activities in 2021 as companies resumed their well completion activities.

Leasing revenues increased by approximately \$6.4 million resulting from increased leasing revenues in the Western Hemisphere and the Eastern Hemisphere of \$3.7 million, and \$3.4 million, respectively, partially offset by a decrease in leasing revenues in the Asia-Pacific region of \$0.7 million. The majority of changes in all regions were a result of subsea rental tool utilization due to timing of customer drilling activity.

Cost of Sales. Cost of sales increased by \$18.2 million, or approximately 10.1%, to \$199.4 million for the nine months ended September 30, 2022 from \$181.2 million for the same period in 2021. Cost of sales as a percentage of revenue increased to 75.1% from 74.0% for the nine months ended September 30, 2022 and 2021, respectively, primarily due to unfavorable product mix and inflationary pressures resulting in an increase in the cost of raw materials.

Selling, General and Administrative Expenses. For the nine months ended September 30, 2022, selling, general and administrative expenses decreased by \$17.1 million, or 20.2% to \$67.3 million from \$84.4 million for the same period in 2021. This decrease was attributable mainly to lower legal expenses in the current period related to costs incurred in 2021 in connection with the FMC Technologies, Inc. lawsuit and administrative costs associated with the importation tax settlement under the Brazilian tax amnesty program.

Engineering and Product Development Expenses. For the nine months ended September 30, 2022, engineering and product development expenses decreased by approximately \$2.2 million, or 19.8%, to \$9.0 million from \$11.3 million for the same period in 2021. This decrease was attributable mainly to lower spend on research and development activities as we completed certain strategic projects. We are in the process of reprioritizing new research and development initiatives.

Restructuring and Other Charges. For the nine months ended September 30, 2022, the Company incurred additional costs of approximately \$8.0 million under the 2021 global strategic plan. These charges were primarily related to the write-downs of long-lived assets and other charges of approximately \$5.1 million and \$2.9 million, respectively. Other charges consisted of office moves, site cleanup, preparation costs, consulting and legal fees. During the nine months ended September 30, 2021, the Company incurred \$26.0 million additional costs under the 2018 global strategic plan to realign manufacturing facilities globally. These charges were primarily related to the restructuring of our downhole tools business where we exited certain underperforming countries and markets and shifted from manufacturing in-house to a vendor sourcing model which resulted in non-cash inventory write downs of \$19.3 million, severance charges of \$2.7 million and other charges of \$4.0 million, consisting of facilities-related market exit costs and consulting fees.

Gain on Sale of Property, Plant and Equipment. For the nine months ended September 30, 2022, the gain on sale of property, plant and equipment was approximately \$17.8 million, primarily related to the sale of our Houston forge facility building. For the nine months ended September 30, 2021, gain on sale of assets was approximately \$3.9 million, primarily related to the sale of two of our buildings in Singapore.

Foreign Currency Transaction Gains. Foreign exchange gain for the nine months ended September 30, 2022, was \$5.6 million as compared to a gain of \$0.8 million for the same period in 2021.

Income Tax Provision. Income tax provision for the nine months ended September 30, 2022 was \$5.1 million on an income before taxes of \$5.8 million, resulting in an effective tax rate of 87.8%. Income tax expense was different than the U.S federal statutory income tax rate of 21% primarily due to change in projected earnings mix by geography and tax jurisdiction, changes in uncertain tax positions, nondeductible compensation and the change in valuation allowances in the United States and in various foreign countries. Income tax provision for the nine months ended September 30, 2021 was \$11.1 million on a loss before taxes of \$53.5 million, resulting in an effective income tax rate of approximately (20.7)%. Income tax expense was different than the U.S federal statutory income tax rate of 21% primarily due to changes in pre-tax income or loss in foreign jurisdictions, nondeductible compensation and the change in valuation allowances in the United States and in various foreign countries.

Net Income (Loss). Net income was approximately \$0.7 million for the nine months ended September 30, 2022 as compared to a net loss of \$64.6 million for the same period in 2021 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 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 condensed consolidated statements of income (loss) 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:

	Three months ended September 30,		Nine months ended September 30,	
	2022	2021	2022	2021
	(In thousands)			
Net income (loss)	\$ 15,210	\$ (11,143)	\$ 702	\$ (64,568)
Add:				
Interest (income) expense, net	(248)	(94)	(871)	292
Income tax provision (benefit)	(610)	4,301	5,061	11,094
Depreciation and amortization expense	7,123	7,899	22,352	22,658
Restructuring and other charges ⁽²⁾	2,180	1,400	7,977	38,470
Gain on sale of property, plant and equipment	(17,276)	(13)	(17,770)	(3,886)
Foreign currency transaction gains	(1,901)	(1,663)	(5,574)	(764)
Stock compensation expense	2,569	3,276	7,669	9,541
Brazilian amnesty settlement	-	-	-	1,787
Adjusted EBITDA ⁽¹⁾	\$ 7,047	\$ 3,963	\$ 19,546	\$ 14,624

⁽¹⁾ 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.

⁽²⁾ Restructuring and other charges include legal expenses related to the FMC Technologies, Inc. lawsuit. These legal expenses are included in "Selling, general and administrative" in our condensed consolidated statements of income (loss) for the three and nine months ended September 30, 2021 (in thousands).

Liquidity and Capital Resources*Cash Flows*

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

	Nine months ended September 30,	
	2022	2021
	(In thousands)	
Operating activities	\$ (19,167)	\$ 33,738
Investing activities	(20,464)	(1,961)
Financing activities	(20,881)	(1,245)
	(60,512)	30,532
Effect of exchange rate changes on cash activities	(4,660)	(1,315)
Increase (decrease) in cash and cash equivalents	<u>\$ (65,172)</u>	<u>\$ 29,217</u>

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.

We believe our business model, our current cash and short-term investment reserves and the ongoing business restructuring and facility realignment will strengthen our balance sheet and leave us well-positioned to manage our business. We continue to review potential scenarios in connection with the potential impact of any new COVID-19 variant outbreaks on the global economy and the oil and gas industry. Based on our analysis, we believe our existing balances of cash and cash equivalents and our currently anticipated operating cash flows will be sufficient to meet our cash needs arising in the ordinary course of business for the next twelve months.

Net cash used in operating activities for the nine months ended September 30, 2022 was \$19.2 million as compared to net cash provided by operating activities of \$33.7 million for the nine months ended September 30, 2021. The \$52.9 million net change is primarily due to decreased cash flow resulting from changes in operating assets and liabilities of \$88.3 million and \$29.9 million of non-cash movements which includes decreases in items such as restructuring and other charges, gain on sale of property, plant and equipment, stock-based compensation, deferred income taxes, depreciation and amortization. This was partially offset by a decrease in net loss of \$65.3 million.

The change in operating assets and liabilities for the nine months ended September 30, 2022 resulted in a \$88.3 million decrease in cash as compared to the change in operating assets and liabilities for the nine months ended September 30, 2021. The \$64.1 million decrease in cash due to changes in unbilled receivables was mainly due to a significant increase in projects that are accounted for on an over-time basis and the completion timelines of some of our major projects. The \$25.5 million decrease in cash due to changes in prepaids and other assets was primarily due to an increase in advances to vendors related to projects accounted for on an over-time basis and receipt of tax receivables and the reimbursement of the security amounts deposited with the Brazilian courts related to the tax amnesty program in 2021. The decrease due to changes in accounts payable and accrued expenses of \$13.0 million was mainly related to the payout of our short-term incentive bonuses, payment of our agent fees in the Middle East and the payment of certain property taxes. These decreases in cash were partially offset by a decrease in inventory of \$8.9 million mainly related to our continued focus on inventory management and consumption during the year and decrease in trade receivables by \$5.4 million primarily due to a decrease in billing activity related to our ongoing projects.

The change in investing cash flows for the nine months ended September 30, 2022 resulted in a \$20.5 million decrease in cash primarily due to purchase of short-term investments of \$25.3 million and \$13.7 million capital expenditure spend by the Company, partially offset by the proceeds from the sale of property, plant and equipment totaling \$18.5 million. Capital expenditures by the Company were \$13.7 million and \$7.9 million for the nine months ended September 30, 2022 and 2021, respectively. Capital expenditures for the nine months ended September 30, 2022 were \$7.2 million for rental tools to support our developed products, \$5.5 million for machinery and equipment related to our global strategic program which includes consolidation of our manufacturing facilities from the Eastern Hemisphere to the Western Hemisphere, \$0.9 million for other capital expenditures and \$0.1 million for buildings. Capital expenditures for the nine months ended September 30, 2021 were \$3.7 million for machinery and equipment related to our global strategic program which included consolidation of our manufacturing facilities from the Eastern Hemisphere to the Western Hemisphere, \$2.8 million for rental tools to support our developed products and \$1.4 million for other capital expenditures. We constantly review capital expenditure needs to ensure these are justified expenditures.

Credit Facility

The Company's ABL Credit Facility, dated February 23, 2018, as amended, was terminated effective February 22, 2022. In addition, we opened a new cash collateral account with JPMorgan Chase Bank, N.A., in which cash was transferred to facilitate our existing letters of credit. As of September 30, 2022, the cash balance in that account was approximately \$5.4 million. The Company is required to maintain a balance equal to the outstanding letters of credit plus 5% at all times which is considered as restricted cash and is included in "Cash and cash equivalents" in our condensed consolidated balance sheets as at September 30, 2022 and December 31, 2021. Withdrawals from this cash collateral account are only allowed at such point a given letter of credit has expired or has been cancelled.

Repurchase of Equity Securities

On February 22, 2022, the Board of Directors authorized an incremental \$100.0 million share repurchase plan. The repurchase plans have no set expiration date and any repurchased shares are expected to be cancelled. The manner, timing and amount of any purchase will be determined by management based on an evaluation of market conditions, stock price, liquidity and other factors. The program does not obligate the Company to acquire any amount of common stock and may be modified or superseded at any time at the Company's discretion.

For the three months ended September 30, 2022, the Company purchased 457,467 shares under the share repurchase plans at an average price of approximately \$24.35 per share totaling approximately \$11.1 million and has retired such shares. For the nine months ended September 30, 2022, the Company purchased 888,197 shares under the share repurchase plans at an average price of approximately \$23.41 per share totaling approximately \$20.8 million and has retired such shares.

For the three and nine months ended September 30, 2021, the Company purchased 45,225 shares under the share repurchase plan at an average price of approximately \$25.02 per share totaling approximately \$1.1 million and has retired such shares.

The Company currently 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 circumstances, including, among others, the Company's credit ratings, industry conditions, general economic conditions and market conditions.

Critical Accounting Estimates

During the nine months ended September 30, 2022, there were no material changes in our judgments and assumptions associated with the development of our critical accounting policies. Refer to our Annual Report on Form 10-K for the year ended December 31, 2021 for a discussion of our critical accounting policies.

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, 2021.

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 gain of approximately \$1.9 million and a pre-tax gain \$5.6 million, during the three and nine months ended September 30, 2022, respectively. The Company experienced a foreign currency pre-tax gain of approximately \$1.7 million and \$0.8 million during the three and nine months ended September 30, 2021, respectively.

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 September 30, 2022 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 control over financial reporting that occurred during the three months ended September 30, 2022 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II—OTHER INFORMATION**Item 1. Legal Proceedings**

For a description of the Company’s legal proceedings, see “Contingencies,” Note 12 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, 2021 and updated in our Quarterly Report on Form 10-Q for the period ending March 31, 2022.

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

The following table summarizes the repurchase and cancellation of our common stock during the nine months ended September 30, 2022.

	Nine months ended September 30, 2022			
	Total Number of Shares Purchased	Average Price paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Dollar Value (in millions) of Shares that May Yet be Purchased Under the Plans or Programs
January 1 - 31, 2022	273,629	\$ 21.20	273,629	\$ 18.5
February 1 - 28, 2022	-	-	-	118.5
March 1 - 31, 2022	-	-	-	118.5
April 1 - 30, 2022	-	-	-	118.5
May 1 - 31, 2022	-	-	-	118.5
June 1 - 30, 2022	157,101	24.49	157,101	114.6
July 1 - 31, 2022	-	-	-	114.6
August 1 - 31, 2022	-	-	-	114.6
September 1 - 30, 2022	457,467	24.35	457,467	103.5
	<u>888,197</u>	<u>\$ 23.41</u>	<u>888,197</u>	<u>\$ 103.5</u>

⁽¹⁾ On February 22, 2022, the Board of Directors authorized an incremental \$100.0 million share repurchase plan. The repurchase plans have no set expiration date and any repurchased shares are expected to be cancelled.

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 (incorporated herein by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2018, File No. 001-13439).
31.1	— Rule 13a-14(a)/15d-14(a) Certification of Jeffrey J. Bird.
31.2	— Rule 13a-14(a)/15d-14(a) Certification of Kyle F. McClure.
32.1	— Section 1350 Certification of Jeffrey J. Bird.
32.2	— Section 1350 Certification of Kyle F. McClure.
101.INS	— Inline XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH	— Inline XBRL Taxonomy Extension Schema Document.
101.CAL	— Inline XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	— Inline XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	— Inline XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	— Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	— Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101).

* Incorporated herein by reference as indicated.

RULE 13a-14(a)/15d-14(a) CERTIFICATION

I, Jeffrey J. Bird, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Dril-Quip, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 27, 2022

/s/ Jeffrey J. Bird

Jeffrey J. Bird

Chief Executive Officer and Director (Principal Executive Officer)

RULE 13a-14(a)/15d-14(a) CERTIFICATION

I, Kyle F. McClure, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Dril-Quip, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 27, 2022

/s/ Kyle F. McClure

Kyle F. McClure

Vice President – Chief Financial Officer

(Principal Financial Officer and Duly Authorized Signatory)

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Dril-Quip, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2022 (the "Report"), as filed with the Securities and Exchange Commission on the date hereof, I, Jeffrey J. Bird, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 27, 2022

/s/ Jeffrey J. Bird

Jeffrey J. Bird

President, Chief Executive Officer and Director (Principal Executive Officer)

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Dril-Quip, Inc. (the “Company”) on Form 10-Q for the period ended September 30, 2022 (the “Report”), as filed with the Securities and Exchange Commission on the date hereof, I, Kyle F. McClure, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 27, 2022

/s/ Kyle F. McClure

Kyle F. McClure

*Vice President - Chief Financial Officer
(Principal Financial Officer and Duly Authorized Signatory)*
