NATIONAL OILWELL VARCO INC
Form 10-K/A
February 17, 2006

FORM 10-K/A

Amendment No. 2

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark one)

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE YEAR ENDED DECEMBER 31, 2004
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 1-12317

NATIONAL-OILWELL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**76-0475815**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*

10000 Richmond Avenue
Houston, Texas
77042-4200

(Address of principal executive offices)
(713) 346-7500

(Registrant s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value $.01	**New York Stock Exchange**
(Title of Class)	*(Exchange on which registered)*

Securities registered pursuant to Section 12(g) of the Act: **None**

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 þ NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes þ No o

The aggregate market value of voting and non-voting common stock held by non-affiliates of the registrant as of June 30, 2004 was $2.7 billion. As of March 1, 2005, there were 86,187,403 shares of the Company s common stock ($0.01 par value) outstanding.

Documents Incorporated by Reference
None.

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SIGNATURES
Consent of Ernst & Young LLP
Certification pursuant to Rule 13a-14a
Certification pursuant to Rule 13a-14a
Certification pursuant to Section 906
Certification pursuant to Section 906

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Amendment No. 2 Overview

This Amendment No. 2 on Form 10-K/A is being filed to amend Parts II and IV of our previously filed Annual Report on Form 10-K for the year ended December 31, 2004, as filed on March 8, 2005 and amended on April 29, 2005 to include Part III information (the Original Form 10-K). This Amendment No. 2 is being filed to reflect the restatement of our consolidated financial statements resulting from errors in intercompany and related inventory accounts, as described in Note 1, under Restatement of Previously Issued Financial Statements, of the Consolidated Financial Statements included in this Form 10-K/A. This Amendment No. 2 also contains changes to Item 6, Item 7, and Item 9A of Part II to reflect changes resulting from this restatement. There are no other significant changes to the Original Form 10-K other than those outlined above. This Amendment No. 2 does not reflect events occurring after the filing of the Original Form 10-K, or modify or update disclosures therein in any way other than as required to reflect the amendment set forth below. Among other things, forward-looking statements made in the Original Form 10-K have not been revised to reflect events that occurred or facts that became known to us after the filing of the Original Form 10-K (other than the restatement), and such forward-looking statements should be read in their historical context. In addition, currently-dated certifications from our Chief Executive Officer and Chief Financial Officer have been included as exhibits to this Amendment No. 2.

We changed our name following the filing of the Original Form 10-K to National Oilwell Varco, Inc. We have used our former name throughout this Amendment No. 2 for consistency.

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Part II

Item 5. Market for Registrant s Common Equity and Related Stockholder Matters

Market Information

National Oilwell common stock is listed on the New York Stock Exchange (ticker symbol: NOI). The following table sets forth the stock price range during the past three years:

	2004		2003		2002	
Quarter	High	Low	High	Low	High	Low
First	$ 31.08	$ 21.66	$ 23.44	$ 19.36	$ 26.25	$ 16.43
Second	31.74	25.42	24.78	20.54	28.81	20.91
Third	33.55	31.24	21.80	17.86	21.29	15.19
Fourth	37.38	31.54	22.99	18.01	23.31	17.69

As of March 1, 2005, there were 478 holders of record of National Oilwell common stock. Many stockholders choose to own shares through brokerage accounts and other intermediaries rather than as holders of record so the actual number is unknown but significantly higher. National Oilwell has never paid cash dividends, and none are anticipated during 2005.

Item 6. Selected Financial Data

	Year Ended December 31,				
	2004 (Restated)	**2003 (Restated)**	**2002 (Restated)**	**2001 (Unaudited)**	**2000 (Unaudited)**
	(in millions of U.S. dollars, except per share amounts)(1)				
Operating Data:					
Revenues	$ 2,318.1	$ 2,004.9	$ 1,521.9	$ 1,747.5	$ 1,149.9
Operating income (3)	176.0	164.1	127.7	189.3	48.5
Income before taxes (3)	138.9	121.8	106.7	168.0	27.0
Net income (2)	115.2	79.7	67.1	104.1	13.1
Net income per share					
Basic (2)	1.34	0.94	0.83	1.29	0.17
Diluted (2)	1.33	0.94	0.82	1.27	0.16
Other Data:					
Depreciation and amortization	44.0	39.2	25.0	38.9	35.0
Capital expenditures	39.0	32.4	24.8	27.4	24.6
Balance Sheet Data:					
Working capital	711.0	763.0	734.8	631.3	480.3
Total assets	2,576.5	2,213.1	1,942.5	1,471.7	1,278.9
Long-term debt, less current maturities	350.0	594.0	594.6	300.0	222.5
Stockholders equity	1,270.2	1,059.2	899.3	839.4	739.1

(1)

We restated our consolidated financial statements for 2004, 2003 and 2002 as discussed in Note 1 to the consolidated financial statements. For periods prior to 2002, our internal investigation indicated that total assets and stockholder s equity were overstated by $28.1 million and we have adjusted these amounts based on information available at this time. However, we were not able to determine, with precision, the complete impact on the 2001 and 2000 consolidated financial statements without incurring unreasonable amounts of time, resources and expenses to allocate and consistently apply adjustments to these periods. Therefore, these periods have been labeled unaudited.

(2) We adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS 142), effective January 1, 2002. The effects of not amortizing goodwill and other intangible assets in periods prior to the adoption of SFAS 142 would have resulted in net income of $115.0 million and $23.1 million for the years ended December 31, 2001 and 2000, respectively; basic earnings per common share of $1.42 and $0.29 for the years ending December 31, 2001 and 2000, respectively; and diluted earnings per common share of $1.41 and $0.29 for the years ending December 31, 2001 and 2000, respectively.

(3) In connection with the IRI International Corporation merger in 2000, we recorded charges of $14.1 million related to direct merger costs, personnel reductions, and facility closures and inventory write-offs of $15.7 million due to product line rationalization.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations (Restated)

Restatement

We have restated our consolidated financial statements filed with this report as described in Note 1 of the consolidated financial statements filed with this Amendment No. 2.

General Overview

We design, manufacture and sell drilling systems, drilling equipment and downhole products as well as distribute maintenance, repair and operating products to the oil and gas industry. Our revenues and operating results are directly related to the level of worldwide oil and gas drilling and production activities and the profitability and cash flow of oil and gas companies and drilling contractors, which in turn are affected by current and anticipated prices of oil and gas. Oil and gas prices have been and are likely to continue to be volatile. See Risk Factors .

We conduct our operations through the following segments:

Products and Technology

Our Products and Technology segment designs and manufactures complete land drilling and workover rigs, and drilling related systems for offshore rigs. Technology has increased the desirability of one vendor assuming responsibility for the entire suite of components used in the drilling process, as mechanical and hydraulic components are replaced by or augmented with integrated computerized systems. In addition to traditional components such as drawworks, mud pumps, top drives, derricks, cranes, jacking and mooring systems, and other structural components, we provide automated pipehandling, control and electrical power systems. We have also developed new technology for drawworks and mud pumps applicable to the highly demanding offshore markets. We have made strategic acquisitions during the past several years in an effort to expand our product offering and our global manufacturing capabilities, including new operations in Norway, the United Kingdom and China. Product and Technology revenues are directly dependent on the levels of worldwide drilling activity.

Distribution Services

Our Distribution Services segment provides maintenance, repair and operating supplies and spare parts from our network of distribution service centers to drill site and production locations throughout North America and to offshore contractors worldwide. Products are purchased from numerous manufacturers and vendors, including our Products and Technology segment. We have expanded this business to locations outside North America, including Europe, the Middle East, Southeast Asia, and South America. We have made significant investments in systems, staffing and inventory in the international market and, using our information technology platforms and processes, we can provide complete procurement, inventory management, and logistics services to our customers.

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Results of Operations

Operating results by segment are as follows (in millions):

	Year Ended December 31,			
	2004 (Restated)	2003 (Restated)	2002 (Restated)	
Revenues:				
Revenues from backlog	$ 695.1	$ 623.1	$ 390.4	
Noncapital equipment	841.9	691.5	526.8	
Products and Technology	1,537.0	1,314.6	917.2	
Distribution Services	905.1	792.0	686.2	
Eliminations	(124.0)	(101.7)	(81.5)	
Total	$ 2,318.1	$ 2,004.9	$ 1,521.9	
Operating Income:				
Products and Technology	$ 164.8	$ 170.2	$ 120.4	
Distribution Services	29.6	6.5	18.1	
Corporate	(18.4)	(12.6)	(10.8)	
Total	$ 176.0	$ 164.1	$ 127.7	
Capital equipment backlog:				
Beginning of year	$ 338.9	$ 363.6	$ 384.9	
Add: Orders, net	961.3	598.4	199.1	
Less: Revenues	695.1	623.1	390.4	
End of year	$ 605.1	$ 338.9	$ 363.6	(1)

(1) Includes $170 million Hydralift backlog @ 12/31/02

Products and Technology

Year 2004 versus 2003

Products and Technology revenues in 2004 were $222.4 million (17%) higher than the previous year. Yearly average oil and gas prices in 2004 were $41.37 and $5.95, an increase of 34% and 8% over 2003. These higher oil and gas prices have encouraged many of our customers to order new capital equipment, or refurbish their existing equipment, generating additional capital equipment revenues in 2004 of $72 million. The number of worldwide rigs actively searching for oil and gas increased approximately 10% in 2004 to a yearly average of 2,395 rigs. This metric is a key driver of our noncapital equipment revenues which were $150 million higher in 2004. Drilling spare parts, expendable pumps and related parts, downhole motors and fishing tools, and service work all showed significant increases during 2004. Despite the higher revenues, operating income declined approximately $5 million (3%). Gross margins were negatively impacted by the increase of lower margin capital equipment revenues, higher steel prices during the first half of the year and higher agent commissions. Operating expenses increased primarily due to higher employee benefit costs.

One of our primary metrics is the capital equipment backlog. New orders are added to backlog only when we receive a firm customer purchase order for major drilling rig components or a signed contract related to a construction project. New orders received in 2004 for capital equipment totaled $961 million, far exceeding the previous year s record of $598 million. The capital equipment backlog was $605 million at December 31, 2004, $339 million at December 31, 2003 and $364 million at December 31, 2002. All of the current backlog will be delivered by the end of 2006.

Year 2003 versus 2002

Revenues in the Products and Technology segment in 2003 increased $397.4 million over the prior year, with virtually all of the increase attributable to our acquisitions of Hydralift and Monoflo. Major international construction projects are generally long-term contracts, thus less susceptible to changes in oil and gas prices or rig count movements. Our revenues from backlog increased $233 million, primarily resulting from the addition of the Hydralift operations. Sales and rentals of downhole motors and fishing tools increased approximately $32 million, primarily due to the resurging North American drilling rig count. Spare part and service revenues accounted for the remaining incremental revenues. Operating income in 2003 increased $49.8 million over 2002 and generated a flow-through percentage of 12.5%. We use flow-through percentage as a measure of operating leverage. The percentage, or ratio, is derived directly from the Company s financial statements. Incremental means the actual period to period changes in revenues and operating income. A flow-through percentage represents the incremental change in operating income over the incremental change in revenue. While we target a flow-through rate of 25% for this group, this was not expected in 2003 as the increased revenues came from acquisitions which in turn included large amounts of overhead and administrative costs. Operating expenses incurred to generate the margins resulting from the incremental sales volume were approximately $81 million higher than the prior year, due primarily to the addition of Hydralift and Monoflo.

The Products and Technology capital equipment backlog was $339 million at December 31, 2003, $364 million at December 31, 2002 and $385 million at December 31, 2001. Backlog at December 31, 2002 includes $170 million acquired in late December through the purchase of Hydralift ASA. Backlog from Hydralift is also contained in subsequent backlog totals but quantification is not possible due to the overlap with products from our other operations.

Distribution Services

Year 2004 versus 2003

Revenues in 2004 of $905.1 million for the Distribution Services segment established a new record, increasing $113 million (14%) over 2003. The number of drilling rigs actively searching for oil and gas is a key metric for this business. According to the Baker Hughes rig count report, the average number of rigs operating in the world in 2004 continued to climb to levels not seen since 1985. The average rig count in the United States in 2004 was up 15% over the prior year to 1,190 rigs with our U.S. revenues up $49 million (11%). While the Canadian rig count was virtually flat during 2004, our Canadian revenues were up $44 million (24%) primarily due to strong tubular sales and the inclusion of a late 2003 acquisition, Corlac Equipment Ltd., in our Canadian results for the full year. In the international market, our revenue increase of 11% linked favorably with the international rig count increase in 2004 of 8%. From a product perspective, maintenance, repair and operating supplies (MRO) products recorded the most growth, a $78 million increase over the prior year. Sales of our manufactured products increased $20 million and tubular products recorded a $15 million increase over 2003. Operating income increased $23.1 million in 2004 to $29.6 million. Excluding the non-recurring clearing account matter recorded in 2003, operating income increased $16.8 million. Margin on the incremental revenues was partially offset by higher distribution service center costs to handle the increased market activity.

Year 2003 versus 2002

Revenues for the Distribution Services segment increased $105.8 million (15%) over the prior year. North American revenues recorded the largest gains, reflecting the increase in the number of operating rigs. According to the Baker Hughes rig count report, the average number of rigs operating in 2003 in the United

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States and Canada were 1,032, and 372 increases of 202 and 106 over the prior year. Canadian revenues were up $37 million, or 24%, while the U.S. revenues improved $51 million, or 14%. We expanded our presence in the international market as we recorded revenue gains of $18 million (12%) over the year 2002, primarily due to an alliance in Indonesia and our new operations in Mexico. Our base margin % remained flat as our customers remained sensitive to price changes, which had no significant effect on 2003 revenues. Substantially all of the 2003 revenue growth was in the maintenance, repair and operating supplies (MRO) products. Despite the revenue increase, operating income in 2003 fell $11.6 million to a disappointing $6.5 million. This reduction was primarily due to recording a $6.3 million pre-tax charge related to a clearing account problem uncovered in our purchasing system that had accumulated over a three year period. This amount relates to periods prior to 2003 and we have not restated prior periods as the impact is not considered material. A key financial metric for this low-margin business is % of operating expenses to revenue, which remained flat at 18% for 2003. In November 2003, we acquired Corlac Equipment Ltd., a Canadian pump distributor, and their 2003 revenues and operating income were not significant.

Corporate

Corporate charges represent the unallocated portion of centralized and executive management costs. Costs for 2004 totaled $18.4 million, an increase of $5.8 million from the prior year. The majority of this increase is due to expenses incurred in conjunction with our efforts to comply with the Sarbanes Oxley Act of 2002 and consulting fees incurred with various tax initiatives.

Interest Expense

Interest expense incurred in 2004 of $34.4 million is slightly below expense level incurred in the prior year. Our average borrowing cost for the year of 5.6 % was essentially the same as 2003. The $150 million 6 7/8% unsecured Senior Notes will mature on July 1, 2005. In addition, our $175 million unsecured North American revolving credit facility expires July 31, 2005. We plan to arrange financing at reasonable terms and conditions with our existing bank syndication, plus other banks as needed, or utilize surplus cash and certain discretionary credit facilities to refinance these expiring obligations. Interest expense should decline in 2005 due to this repayment.

Year 2003 interest expense of $35.5 million increased $11.4 million from the prior year. Annual interest due on the November 2002 issuance of senior notes accounted for $9.9 million of the increase. Borrowings in Norway attributable to the Hydralift operations incurred approximately $3 million in additional interest which was offset in part by lower borrowing rates on the U.S. revolving credit facility. Our average borrowing cost during 2003 of 5.6% reflected a decrease of 0.8 percentage points from the prior year due to the lower interest rates on the credit facilities.

Interest expense in 2002 totaled $24.1 million, an increase of $1.3 million from the prior year. All of this increase is a direct result of our mid-November 2002 sale of $200 million of 5.65% unsecured senior notes. Our average borrowing cost during 2002 of 6.4% remained the same as 2001.

Other Income (Expense)

The U.S. dollar continued its decline in 2004 against most of the currencies in countries where we operate, especially Canada, Norway and the United Kingdom. We recorded foreign exchange losses of $9.3 million in 2004 and $7.2 million in 2003, primarily related to cash balances and intercompany accounts held in U.S. dollars at these subsidiary locations. The remeasurement of these amounts into the local currency results in an income statement gain or loss, which is offset when the amount is translated back into U.S. currency for consolidation purposes by way of an increase or decrease to Other Comprehensive Income in the equity

section of the balance sheet. During 2004 we recorded a $2.7 million gain on the sale of certain non-strategic assets and a $10.7 million gain on the disposal of an equity investment.

Income Taxes

National Oilwell is subject to U.S. federal, state and foreign taxes and recorded a combined tax rate of 16% in 2004, 29% in 2003 and 36% in 2002. The reduction in the 2004 effective tax rate is primarily due to a non-recurring tax credit of $17 million resulting from the release of a valuation allowance related to the American Jobs Creation Act of 2004. We anticipate our effective tax rate for 2005 will approximate 32%.

The reduction in the 2003 effective tax rate was primarily due to the lower tax rate on increased foreign income and the benefit associated with export sales.

Liquidity and Capital Resources

At December 31, 2004, our working capital totaled $711 million, a decrease of $52 million from December 31, 2003. However, the general increase in market activity has increased our working capital needs. An increase of $19 million in receivables and $118 million in inventories has been offset by an increase in accounts payable of $187 million. Our capital equipment contracts have generated a net asset position of $195 million, an increase of $136 million from December 2003. We have recorded $150 million of our debt obligations to a current liability as the 6 7/8 unsecured senior notes will mature on July 1, 2005. Cash has increased $69 million during the year and our principal source of cash is from operations. Our ability to collect our customer receivables and obtain prepayments from our customers to help fund major projects are critical to our cash generation needs. Our primary cash uses include acquisitions, capital expenditures to enhance our existing operations, and repayment of debt obligations.

Total capital expenditures were $39 million during 2004, $32 million in 2003 and $24 million in 2002. The majority of these capital expenditures represent additions and enhancements to the downhole rental tool fleet and information management and inventory control systems. Capital expenditures are expected to approximate $43 million in 2005, slightly below our anticipated depreciation expense in that year, with continued emphasis on rental tools and information technology. We believe we have sufficient existing manufacturing capacity to meet currently anticipated demand through 2005 for our products and services.

At December 31, 2004, we had two committed credit facilities, a North American and a Norwegian facility, totaling $279 million. Both facilities are available for general corporate purposes and acquisitions, including letters of credit and performance bonds.

Our North American facility is a three-year unsecured $175 million revolving credit facility with availability up to $50 million for issuance of letters of credit that expires July 31, 2005. At December 31, 2004, there were no borrowings against this facility and there were $53 million in outstanding letters of credit.

Our Norwegian facility, which expires in 2006, has revolving credit facilities totaling $104 million, with $41 million available for letter of credit purposes. At December 31, 2004, there were no borrowings against this facility and there were $18 million in outstanding letters of credit.

We also have additional uncommitted credit facilities totaling $147 million that are used primarily for letters of credit, bid bonds and performance bonds. At December 31, 2004, there were no borrowings against these additional credit facilities and there were $49 million in outstanding letters of credit and performance bonds.

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In November 2002, we sold $200 million of 5.65% unsecured senior notes due November 15, 2012. Interest is payable on May 15 and November 15 of each year. In March 2001, we sold $150 million of 6.50% unsecured senior notes due March 15, 2011, with interest payable on March 15 and September 15 of each year. In June 1998, we sold $150 million of 6.875% unsecured senior notes due July 1, 2005, with interest payments due annually on January 1 and July 1.

The $150 million 6 7/8% unsecured senior notes will mature on July 1, 2005. In addition, our $175 million unsecured North American revolving credit facility expires July 31, 2005. We plan to arrange financing at reasonable terms and conditions with our existing bank syndication, plus other banks as needed, or utilize surplus cash and certain discretionary credit facilities to refinance these expiring obligations.

We believe cash generated from operations and amounts available under our existing credit facilities and from other sources of debt will be sufficient to fund operations, working capital needs, capital expenditure requirements and financing obligations. We also believe any significant increase in capital expenditures caused by any need to increase manufacturing capacity can be funded from operations or through debt financing.

The senior notes contain reporting covenants and the credit facilities contain financial covenants and ratios regarding maximum debt to capital and minimum interest coverage. We were in compliance with all covenants governing these facilities at December 31, 2004.

We have not entered into any transactions, arrangements, or relationships with unconsolidated entities or other persons which would materially affect liquidity, or the availability of or requirements for capital resources.

A summary of our outstanding contractual obligations and other commercial commitments at December 31, 2004 is as follows (in millions):

		Payments Due by Period			
Contractual Obligations	**Total**	**Less than 1 year**	**1-3 years**	**4-5 years**	**After 5 years**
Long Term Debt	$ 500.0	$ 150.0	$	$	$ 350.0
Operating Leases	76.4	21.3	40.9	6.5	7.7
Total contractual obligations	$ 576.4	$ 171.3	$ 40.9	$ 6.5	$ 357.7

		Amount of Commitment Expiration per Period			
Commercial Commitments	**Total**	**Less than 1 year**	**1-3 years**	**4-5 years**	**After 5 years**
Line of Credit	$ 279.1	$	$ 279.1	$	$
Standby Letters of Credit	120.5	97.5	19.2	3.8	
Total commercial commitments	$ 399.6	$ 97.5	$ 298.3	$ 3.8	$

We intend to pursue additional acquisition candidates, but the timing, size or success of any acquisition effort and the related potential capital commitments cannot be predicted. We expect to fund future cash acquisitions primarily with cash flow from operations and borrowings, including the unborrowed portion of the credit

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facility or new debt issuances, but may also issue additional equity either directly or in connection with acquisitions. There can be no assurance that acquisition funds will be available at terms acceptable to us.

Inflation has not had a significant impact on National Oilwell s operating results or financial condition in recent years.

Market Risk Disclosure

We are exposed to changes in foreign currency exchange rates and interest rates. Additional information concerning each of these matters follows:

Foreign Currency Exchange Rates

We have operations in foreign countries, including Canada, Norway and the United Kingdom, as well as operations in Latin America, China and other European countries. The net assets and liabilities of these operations are exposed to changes in foreign currency exchange rates, although such fluctuations generally do not affect income since their functional currency is the local currency. These operations also have net assets and liabilities not denominated in the local currency, which exposes us to changes in foreign currency exchange rates that do impact income. We recorded foreign exchange losses in our income statement of approximately $9.3 million in 2004 and $7.2 million in the prior year, primarily related to cash balances and intercompany accounts held in U.S. dollars at these subsidiary locations. The remeasurement of these amounts into the local currency results in an income statement gain or loss, which is offset when the amount is translated back into U.S. currency for consolidation purposes by way of an increase or decrease to Other Comprehensive Income in the equity section of the balance sheet.. We do not believe that a hypothetical 10% movement in these foreign currencies would have a material impact on our earnings.

Some of our revenues in foreign countries are denominated in US dollars, and therefore, changes in foreign currency exchange rates impact our earnings to the extent that costs associated with those US dollar revenues are denominated in the local currency. In order to mitigate that risk, we may utilize foreign currency forward contracts to better match the currency of our revenues and associated costs. We do not use foreign currency forward contracts for trading or speculative purposes. The counterparties to these contracts are major financial institutions, which minimizes counterparty credit risk.

Interest Rate Risk

Our long term borrowings consist of $150 million in 6.875% senior notes, $150 million in 6.5% senior notes and $200 million in 5.65% senior notes. We had no borrowings under our other facilities at December 31, 2004. Our revolving credit facilities may have borrowings during the year denominated in multiple currencies which could expose us to market risk with exchange rate movements. These instruments carry interest at a pre-agreed upon percentage point spread from either the prime interest rate, LIBOR, NIBOR or EURIBOR. Under our credit facilities, we may, at our option, fix the interest rate for certain borrowings based on a spread over LIBOR, NIBOR or EURIBOR for 30 days to 6 months. Our objective in maintaining a portion of our debt in variable rate borrowings is the flexibility obtained regarding early repayment without penalties and lower overall cost as compared with fixed-rate borrowings.

Critical Accounting Policies and Estimates

The preparation of our financial statements requires us to make certain estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Our estimation process generally relates to potential bad debts, obsolete and slow moving inventory, revenue recognition on long term contracts, value of intangible assets, and deferred income tax accounting. Note 1 to the consolidated financial

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statements contains the accounting policies governing each of these matters. Our estimates are based on historical experience and on our future expectations that we believe to be reasonable under the circumstances. The combination of these factors result in the amounts shown as carrying values of assets and liabilities in the financial statements and accompanying notes. Actual results could differ from our current estimates and those differences may be material.

We believe the following accounting policies are the most critical in the preparation of our consolidated financial statements:

We maintain an allowance for doubtful accounts for accounts receivables by providing for specifically identified accounts where collectibility is doubtful and a general allowance based on the aging of the receivables compared to past experience and current trends. A majority of our revenues come from drilling contractors, independent oil companies, international oil companies and government-owned or government-controlled oil companies, and we have receivables, some denominated in local currency, in many foreign countries. If, due to changes in worldwide oil and gas drilling activity or changes in economic conditions in certain foreign countries, our customers were unable to repay these receivables, additional allowances would be required.

Allowances for inventory obsolescence are determined based on our historical usage of inventory on-hand as well as our future expectations related to our substantial installed base and the development of new products. Changes in worldwide oil and gas drilling activity and the development of new technologies associated with the drilling industry could require additional allowances to reduce the value of inventory to the lower of its cost or net realizable value.

We recognize revenue on long-term construction contracts using the percentage of completion method and is an output based measure focused on engineering estimates and manufacturing progress. This method is used because we believe this is the most meaningful measurement of the extent of progress toward completion. This methodology requires us to make estimates regarding the total costs of the project, our progress against the project schedule and the estimated completion date, all of which impact the amount of revenue and gross margin we recognize in each reporting period. Changes in job performance, job conditions, and estimated profitability, including those arising from contract penalty provisions, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Profit incentives are included in revenues when their realization is reasonably assured. Provisions for anticipated losses on uncompleted contracts are recorded in full when such losses become evident.

We account for our defined benefit pension plans in accordance with Statement of Financial Accounting Standards No. 87, Employers Accounting for Pensions (FAS 87), which requires that amounts recognized in the financial statements be determined on an actuarial basis. Significant elements in determining our pension income or expense in accordance with FAS 87 are the discount rate assumption and the expected return on plan assets. The discount rate used approximates the weighted average rate of return on high-quality fixed income investments whose maturities match the expected payouts. The expected return on plan assets is based upon the geometric mean of historical returns of a number of different equities, including stocks, bonds and U.S. treasury bills. The assumed long-term rate of return on assets is applied to a calculated value of plan assets, which results in an estimated return on plan assets that is included in current year pension income or expense. The difference between this expected return and the actual return on plan assets is deferred and amortized against future pension income or expense. A substantial portion of our pension amounts relate to our defined benefit plans in the United States, Norway and the United Kingdom. Between the years 2000-2003, we assumed that the expected long-term rate of return on plan assets for these plans would be between 6.3% and 8.5%. Prior to 2001, our actual cumulative long-term rate of return on the pension assets of these plans was in excess of these amounts; however, these plans assets have recently earned substantially less than the assumed rates of return. The impact of our pension plans on our 2004 results of operations, cash flow and

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liquidity has been immaterial but recent actual returns of the plan assets may effect future contributions to the plans and our earnings. The amount of unrecognized losses on pension assets is $21.0 million.

Business acquisitions are accounted for using the purchase method of accounting. The cost of the acquired company is allocated to identifiable tangible and intangible assets based on estimated fair value, with the excess allocated to goodwill. On at least an annual basis, we assess whether goodwill is impaired. Our annual impairment tests are performed at the beginning of the 4th quarter of each year. If we determine that goodwill is impaired, we measure that impairment based on the amount by which the book value of goodwill exceeds its implied fair value. The implied fair value of goodwill is determined by deducting the fair value of a reporting unit s identifiable assets and liabilities from the fair value of that reporting unit as a whole. Additional impairment assessments may be performed on an interim basis if we encounter events or changes in circumstances that would indicate that, more likely than not, the carrying amount of goodwill has been impaired. The fair value of the reporting units is determined based on internal management estimates which consider multiple valuation techniques.

In accordance with the provisions of SFAS No. 109, *Accounting for Income Taxes*, we account for income taxes using the asset and liability method. In determining income (loss) for financial statement purposes, we must make certain estimates and judgments. These estimates and judgments affect the calculation of certain tax liabilities and the determination of the recoverability of certain of the deferred tax assets, which arise from temporary differences between the tax and financial statement recognition of revenue and expense. Deferred tax assets are also reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods. In evaluating our ability to recover our deferred tax assets we consider all available positive and negative evidence including our past operating results, the existence of cumulative losses in the most recent years and our forecast of future taxable income. In estimating future taxable income, we develop assumptions including the amount of future state, federal and international pretax operating income, reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates we are using to manage the underlying businesses.

We currently have recorded significant valuation allowances that we intend to maintain until it is more likely than not the deferred tax assets will be realized. Other than valuation allowances associated with tax attributes acquired through acquisitions, our income tax expense recorded in the future will be reduced to the extent of decreases in our valuation allowances. The realization of our remaining deferred tax assets is primarily dependent on future taxable income. Any reduction in future taxable income including but not limited to any future restructuring activities may require that we record an additional valuation allowance against our deferred tax assets. An increase in the valuation allowance would result in additional income tax expense in such period and could have a significant impact on our future earnings. If a change in a valuation allowance occurs, which was established in connection with an acquisition, such adjustment may impact goodwill rather than the income tax provision. In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations in a multitude of jurisdictions across our global operations. We recognize potential liabilities and record tax reserves for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional taxes will be due. These tax liabilities are reflected net of related tax loss carryforwards. We adjust these reserves in light of changing facts and circumstances; however, due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from our current estimate of the tax liabilities. If our estimate of tax liabilities proves to be less than the ultimate assessment, an additional charge to expense would result. If payment of these amounts ultimately proves to be less than the recorded amounts, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the reserves are no longer necessary. If the tax liabilities relate to tax uncertainties existing at the date of the acquisition of a business, the adjustment of such tax liabilities will result in an adjustment to the goodwill recorded at the date of acquisition.

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Recently Issued Accounting Standards

In May 2004, the FASB issued Staff Position No. 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (FSP 106-2). FSP 106-2 provides guidance on accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) for employers that sponsor postretirement health care plans that provide prescription drug benefits. FSP 106-2 is effective for the first interim or annual period beginning after June 15, 2004. The adoption of FSP 106-2 did not have a material effect on our financial position, results of operations or cash flows.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, Inventory Costs an amendment of ARB 43, Chapter 4 (SFAS 151). SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. Paragraph 5 of Accounting Research Bulletin (ARB) 43, Chapter 4 Inventory Pricing, previously stated that under certain circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current-period charges. SFAS 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal. In addition, SFAS 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for fiscal years beginning after June 15, 2005. We do not believe the implementation of SFAS 151 will have a material impact on our financial position, results of operations or cash flows.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123-Revised 2004 (Revised SFAS 123), Share-Based Payment. This is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes APB No. 25, Accounting for Stock Issued to Employees. Currently, we do not record compensation expense for stock-based compensation. Under Revised SFAS 123, we will be required to measure the cost of employee services received in exchange for stock based on the grant-date fair value (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). The fair value will be estimated using an option-pricing model. Excess tax benefits, as defined in Revised SFAS 123, will be recognized as an addition to paid-in capital. This is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. Revised SFAS 123 permits public companies to adopt its requirements using one of two methods: 1) a *modified prospective* method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Revised SFAS 123 for all share-based payments granted after the effective date and (b) based on the requirements of Revised SFAS 123 for all awards granted to employees prior to the effective date of Revised SFAS 123 that remain unvested on the effective date, or 2) a *modified retrospective* method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under Statement 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption. We are currently in the process of evaluating the impact of Revised SFAS 123 on our financial statements, including different option-pricing models. The pro forma table in Note 1 of the Notes to Consolidated Financial Statements illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004 (FSP 109-1) and FASB Staff Position No. FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004 (FSP 109-2). FSP 109-1 clarifies the guidance in FASB Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (Statement 109) that applies to the new deduction for qualified domestic production activities under the American Jobs Creation Act of 2004 (the Act). FSP 109-1 clarifies that the deduction should be accounted for as a special deduction under Statement 109, not as a tax-rate reduction, because the deduction is contingent on performing activities identified in the Act. As a result, companies qualifying for the special deduction will not have a one-time adjustment of deferred tax assets and liabilities in the period the Act is enacted. FSP 109-2 addresses the effect of the Act s one-time deduction for qualifying repatriations of foreign earnings. FSP 109-2 allows additional time for companies to determine whether any foreign earnings will be repatriated under the Act s one-time deduction for repatriated earnings and how the Act affects whether undistributed earnings continue to qualify for Statement 109 s exception from recognizing deferred tax liabilities. FSP 109-1 and FSP 109-2 were both effective upon issuance. We have implemented FSP 109-1 and FSP 109-2 in the quarter ended December 31, 2004 and have included the required disclosures in Note 10 of the Notes to Consolidated Financial Statements.

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Forward-Looking Statements

Some of the information in this document contains, or has incorporated by reference, forward-looking statements. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements typically are identified by use of terms such as may, will, expect, anticipate, estimate, and similar words, although some forward-looking statements are expressed differently. You should be aware that our actual results could differ materially from results anticipated in the forward-looking statements due to a number of factors, including but not limited to changes in oil and gas prices, customer demand for our products and worldwide economic activity. You should also consider carefully the statements under Risk Factors which address additional factors that could cause our actual results to differ from those set forth in the forward-looking statements. Given these uncertainties, current or prospective investors are cautioned not to place undue reliance on any such forward-looking statements. We undertake no obligation to update any such factors or forward-looking statements to reflect future events or developments.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Incorporated by reference to Item 7 above, Market Risk Disclosure.

Item 8. Financial Statement and Supplementary Data

Attached hereto and a part of this report are financial statements and supplementary data listed in Item 15.

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

None.

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Item 9A. Controls and Procedures

Evaluation of disclosure controls and procedures

Subsequent to the initial filing of this annual report on Form 10-K, the Company discovered unreconciled differences in materials-in-transit inventory accounts between its consolidated subsidiaries. The Company s investigation of inventory and related intercompany accounts discovered unreconciled differences related to materials-in-transit and intercompany account balances from December 31, 2001 through September 30, 2005. Upon evaluation of the results of this investigation, management of the Company determined that the Company had a deficiency in controls relating to materials-in-transit and intercompany accounts, and further concluded that such deficiency represented a material weakness in internal control over financial reporting as of December 31, 2004.

For the reasons stated above, our chief executive officer and chief financial officer, based on their evaluation of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) or 15d-15(e)), have revised the previous conclusions of management of the Company stated in the initial filing of this annual report on Form 10-K and concluded that our disclosure controls and procedures were ineffective as of the end of the period covered by this report.

Management s annual report on internal control over financial reporting

A revised annual report of management of the Company on internal control over financial reporting is included in Item 15 of this annual report on Form 10-K/A.

Attestation report of the registered public accounting firm.

A revised annual report of Ernst &Young LLP on internal control over financial reporting of the Company is included in Item 15 of this annual report on Form 10-K/A.

Changes in internal control over financial reporting

During 2005 the Company implemented the following steps, among others, to remediate and strengthen its internal controls over materials-in-transit inventory and intercompany account reconciliations:

1. The Company has changed its reconciliation process to require individual subsidiaries to reconcile all intercompany balances with counterparties on a monthly and transaction-by transaction basis in a timely manner;

2. The Company appointed a worldwide intercompany controller to monitor the effectiveness of intercompany controls; and

3. The Company has corrected errors and improved processes to develop detailed support for its outstanding materials-in-transit account balances.

As a result of these improvements, management of the Company believes that its internal controls relating to the materials-in-transit and intercompany accounts are functioning effectively.

There were no other changes in the Company s internal control over financial reporting that occurred during the Company s last fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

Part IV

Item 15. Exhibits, Financial Statement Schedules

a) Financial Statements and Exhibits

1. Financial Statements
The following financial statements are presented in response to Part II, Item 8:

	Page(s) in This Report
Consolidated Balance Sheets	21
Consolidated Statements of Operations	22
Consolidated Statements of Cash Flows	23
Consolidated Statements of Stockholders Equity	24
Notes to Consolidated Financial Statements	25-47

2. Financial Statement Schedule

Schedule II Valuation and Qualifying Accounts	48

All schedules, other than Schedule II, are omitted because they are not applicable, not required or the information is included in the financial statements or notes thereto.

3. Exhibits

2.1 Amended and Restated Agreement and Plan of Merger, effective as of August 11, between National-Oilwell, Inc. and Varco International, Inc. (4).

3.1 Amended and Restated Certificate of Incorporation of National-Oilwell, Inc. (Exhibit 3.1) (1).

3.2 By-laws of National-Oilwell, Inc. (Exhibit 3.2) (5).

10.1 Employment Agreement dated as of January 1, 2002 between Merrill A. Miller, Jr. and National Oilwell, with a similar agreement with Steven W. Krablin (Exhibit 10.1) (2).

10.2 Employment Agreement dated as of January 1, 2002 between Dwight W. Rettig and National Oilwell, with similar agreements with Robert L. Bloom, Howard E. Davis, Kevin A. Neveu, Mark A. Reese, Jeremy D. Thigpen and Robert R. Workman (Exhibit 10.2) (2).

10.3 Employment Agreement dated as of June 28, 2000 between Gary W. Stratulate and IRI International, Inc., which has now merged into National Oilwell (Exhibit 10.3) (2).

10.4 Amended and Restated Stock Award and Long-Term Incentive Plan (Exhibit 10.1) (3)*.

10.4.1 Form of Stock Option Agreement (Exhibit 10.1) (6)

10.5 Loan Agreement dated July 30, 2002 (Exhibit 10.2) (3).

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21.1 Subsidiaries of the Company**.

23.1 Consent of Ernst & Young LLP

24.1 Power of Attorney (included on signature page hereto)**.

31.1 Certification pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended

31.2 Certification pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended

32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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* Compensatory plan or arrangement for management or others

** Previously filed

(1) Filed as an Exhibit to our Quarterly Report on Form 10-Q filed on August 11, 2000.

(2) Filed as an Exhibit to our Annual Report on Form 10-K filed on March 28, 2002.

(3) Filed as an Exhibit to our Quarterly Report on Form 10-Q filed on November 12, 2002.

(4) Filed as Annex A to our Registration Statement on Form S-4 filed on September 16, 2004.

(5) Filed as an Exhibit to our Annual Report on Form 10-K filed on March 7, 2003.

(6) Filed as an Exhibit to our Current Report on Form 8-K filed on February 10, 2005.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Amendment to the Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

National Oilwell Varco, Inc.
(formerly National-Oilwell, Inc.)

Date: **February 16, 2006**

By: ***/s/ Clay C. Williams***
Clay C. Williams
Senior Vice President and
Chief Financial Officer

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
National-Oilwell, Inc.

We have audited the accompanying consolidated balance sheets of National-Oilwell, Inc. and subsidiaries as of December 31, 2004 and 2003 and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedule listed in the index at Item 15(a). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of National-Oilwell, Inc. at December 31, 2004 and 2003, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, the consolidated financial statements have been restated.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of National-Oilwell, Inc. s internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 7, 2005, except for the effects of the material weakness described in the sixth paragraph of that report, as to which the date is February 16, 2006, expressed an unqualified opinion on management s assessment of and an adverse opinion on the effectiveness of internal control over financial reporting.

/s/ ERNST & YOUNG LLP

Houston, Texas
March 7, 2005, except for Note 1
as to which the date is February 16, 2006

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MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING (AS RESTATED)

National Oilwell s management is responsible for establishing and maintaining adequate internal control over financial reporting. National-Oilwell s internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management has used the framework set forth in the report entitled Internal Control Integrated Framework published by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission to evaluate the effectiveness of the Company s internal control over financial reporting. In the Company s 2004 Form 10-K filed on March 7, 2005, management concluded that our internal control over financial reporting was effective as of December 31, 2004. Subsequently, management concluded that a deficiency in controls relating to materials-in-transit inventory and intercompany accounts between consolidated subsidiaries existed as of December 31, 2004, and that such deficiency represented a material weakness in our internal control over financial reporting as of December 31, 2004. As a result of this material weakness, our management has revised its earlier assessment and concluded that our internal control over financial reporting was not effective as of December 31, 2004. This material weakness has caused us to amend our Annual Report on Form 10-K for the year ended December 31, 2004, in order to restate our consolidated financial statements as of December 31, 2004 and 2003, and for each of the three years in the period ended December 31, 2004.

Management s revised assessment of the effectiveness of internal control over financial reporting as of December 31, 2004, has been audited by Ernst & Young LLP, the independent registered public accounting firm who also has audited the Company s restated consolidated financial statements included in this Amendment.

/s/ Merrill A. Miller, Jr
Merrill A. Miller, Jr.
Chairman, President and Chief Executive Officer

/s/ Clay C. Williams
Clay C. Williams
Senior Vice President and
Chief Financial Officer

Houston, Texas

February 16, 2006

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors and Shareholders

National-Oilwell, Inc.

We have audited management s assessment, included in the accompanying Management s Report on Internal Control over Financial Reporting, that National-Oilwell, Inc. maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). National-Oilwell, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

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

In our report dated March 7, 2005, we expressed an unqualified opinion on management s previous assessment that the Company maintained effective internal control over financial reporting as of December 31, 2004 and an unqualified opinion that the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on the COSO criteria. Management has subsequently determined that a deficiency in controls relating to materials-in-transit and intercompany accounts between consolidated subsidiaries existed as of the previous assessment date, and has further concluded that such deficiency represented a material weakness as of December 31, 2004. As a result, management has revised its assessment, as presented in the accompanying Management s Report on Internal Control over Financial Reporting, to conclude that the Company s internal control over financial reporting was not effective as of December 31, 2004. Accordingly, our present opinion on the effectiveness of the Company s internal control over financial reporting as of December 31, 2004, as expressed herein, is different from that expressed in our previous report.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management s assessment: In its assessment as of

December 31, 2004, management identified a material weakness in the Company s controls over materials-in-transit and intercompany accounts between consolidated subsidiaries and, as a result, concluded the Company s previously reported financial statements had been misstated. The insufficient controls resulted in the restatement of the Company s consolidated financial statements as of December 31, 2004 and 2003, and for each of the three years in the period ended December 31, 2004. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2004 consolidated financial statements, and this report does not affect our report dated March 7, 2005, except for Note 1 as to which the date is February 16, 2006, on those consolidated financial statements (as restated).

In our opinion, management s assessment that the Company did not maintain effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the COSO control criteria. Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2004, based on the COSO control criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of National-Oilwell, Inc. as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2004 of National-Oilwell, Inc. and our report dated March 7, 2005, except for Note 1, as to which the date is February 16, 2006, expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Houston, Texas

March 7, 2005, except for the effects of the material
weakness described in the sixth paragraph above,
as to which the date is February 16, 2006

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NATIONAL-OILWELL, INC.
CONSOLIDATED BALANCE SHEETS
(In millions, except share data)
(Restated)

	December 31, 2004	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 142.7	$ 74.2
Receivables, net	480.1	460.9
Inventories	635.3	517.1
Costs in excess of billings	226.5	107.6
Deferred income taxes	15.6	15.4
Prepaid and other current assets	15.0	41.6
Total current assets	1,515.2	1,216.8
Property, plant and equipment, net	255.1	252.4
Deferred income taxes	55.1	52.4
Goodwill	639.0	587.3
Intangibles, net	91.0	79.3
Property held for sale	1.1	8.7
Other assets	20.0	16.2
	$ 2,576.5	$ 2,213.1
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt	150.0	14.9
Accounts payable	407.7	220.5
Customer prepayments	27.9	26.4
Accrued compensation	37.0	25.4
Billings in excess of costs	32.0	49.3
Accrued income taxes	37.0	26.3
Other accrued liabilities	112.6	91.0
Total current liabilities	804.2	453.8
Long-term debt	350.0	594.0
Deferred income taxes	102.8	52.4
Other liabilities	31.5	38.0
Total liabilities	1,288.5	1,138.2
Commitments and contingencies		
Minority interest	17.8	15.7

Stockholders equity:				
Common stock par value $.01; 85,995,266 and 85,124,979 shares issued and outstanding at December 31, 2004 and December 31, 2003		0.9		0.9
Additional paid-in capital		692.9		674.9
Accumulated other comprehensive gain (loss)		33.4		(44.4)
Retained earnings		543.0		427.8
		1,270.2		1,059.2
	$	2,576.5	$	2,213.1

The accompanying notes are an integral part of these statements.

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NATIONAL-OILWELL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except per share data)
(Restated)

	Year Ended December 31,		
	2004	2003	2002
Revenues	$ 2,318.1	$ 2,004.9	$ 1,521.9
Cost of products sold	1,814.3	1,535.6	1,166.7
Gross profit	503.8	469.3	355.2
Selling, general, and administrative	327.8	305.2	227.5
Operating income	176.0	164.1	127.7
Interest and financial costs	(38.4)	(38.9)	(27.3)
Interest income	3.5	2.3	2.6
Other income (expense), net	(2.2)	(5.7)	3.7
Income before income taxes and minority interest	138.9	121.8	106.7
Provision for income taxes	21.6	35.9	38.8
Income before minority interest	117.3	85.9	67.9
Minority interest in income of consolidated subsidiaries	(2.1)	(6.2)	(0.8)
Net income	$ 115.2	$ 79.7	$ 67.1
Net income per share:			
Basic	$ 1.34	$ 0.94	$ 0.83
Diluted	$ 1.33	$ 0.94	$ 0.82
Weighted average shares outstanding:			
Basic	85.8	84.5	81.0

Diluted	86.5	85.0	81.7

The accompanying notes are an integral part of these statements.

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NATIONAL-OILWELL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Restated)

	Year Ended December 31,		
	2004	2003	2002
Cash flow from operating activities:			
Net income	$ 115.2	$ 79.7	$ 67.1
Adjustments to reconcile net income to net cash provided (used) by operating activities:			
Depreciation and amortization	44.0	39.2	25.0
Provision for losses on receivables	4.0	5.7	3.6
Provision (benefit) for deferred income taxes	(6.7)	6.9	11.5
Gain on sale of assets	(18.4)	(5.8)	(4.5)
Foreign currency transaction losses, net	9.3	7.2	0.3
Tax benefit from exercise of nonqualified stock options	3.4	3.9	0.3
Changes in assets and liabilities, net of acquisitions:			
Receivables	(8.6)	(6.2)	59.0
Inventories	(105.8)	(56.4)	31.8
Costs in excess of billings	(106.4)	(53.8)	
Prepaid and other current assets	27.4	(13.9)	(3.0)
Accounts payable	174.3	53.4	(32.0)
Billings in excess of cost	(17.7)	(12.5)	
Other assets/liabilities, net	52.2	(16.4)	(54.7)
Net cash provided by operating activities	166.2	31.0	104.4
Cash flow from investing activities:			
Purchases of property, plant and equipment	(39.0)	(32.4)	(24.8)
Proceeds from sale of assets	35.8	7.9	12.5
Businesses acquired and investments in joint ventures, net of cash	(2.8)	(78.0)	(213.0)
Net cash used by investing activities	(6.0)	(102.5)	(225.3)
Cash flow from financing activities:			
Borrowings against lines of credit	521.6	454.6	303.2
Payments against lines of credit	(631.5)	(439.1)	(311.0)
Net proceeds from issuance of long-term debt			199.1
Proceeds from stock options exercised	14.6	9.7	2.0
Other			1.3
Net cash provided by financing activities	(95.3)	25.2	194.6
Effect of exchange rates on cash	3.6	2.2	1.4
Increase (decrease) in cash and equivalents	68.5	(44.1)	75.1

Cash and cash equivalents, beginning of year	74.2	118.3	43.2
Cash and cash equivalents, end of year	$ 142.7	$ 74.2	$ 118.3
Supplemental disclosures of cash flow information:			
Cash payments during the period for:			
Interest	$ 34.0	$ 35.1	$ 21.6
Income taxes	$ 21.4	$ 30.7	$ 45.6

The accompanying notes are an integral part of these statements.

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NATIONAL-OILWELL, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
(In millions, except share data)
(Restated)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total
Balance at December 31, 2001	$ 0.8	$ 592.5	$ (34.9)	$ 281.0	$ 839.4
Net income				67.1	67.1
Other comprehensive income					
Currency translation adjustments			2.5		2.5
Interest rate contract			0.9		0.9
Minimum liability of defined benefit plans			(12.9)		(12.9)
Comprehensive income					57.6
Stock options exercised	0.0	2.0			2.0
Tax benefit of options exercised		0.3			0.3
Balance at December 31, 2002	$ 0.8	$ 594.8	$ (44.4)	$ 348.1	$ 899.3
Net income				79.7	79.7
Other comprehensive income					
Currency translation adjustments			4.6		4.6
Interest rate contract			(0.1)		(0.1)
Minimum liability of defined benefit plans			(4.5)		(4.5)
Comprehensive income					79.7
Stock issued for acquisition	0.1	66.5			66.6
Stock options exercised	0.0	9.7			9.7
Tax benefit of options exercised		3.9			3.9
Balance at December 31, 2003	$ 0.9	$ 674.9	$ (44.4)	$ 427.8	$ 1,059.2
Net income				115.2	115.2
Other comprehensive income					
Currency translation adjustments			72.5		72.5
Interest rate contract			(0.1)		(0.1)
Minimum liability of defined benefit plans			5.4		5.4
Comprehensive income					193.0
Stock options exercised		14.6			14.6
Tax benefit of options exercised		3.4			3.4

Balance at December 31, 2004	$ 0.9	$ 692.9	$ 33.4	$ 543.0	$ 1,270.2

The accompanying notes are an integral part of these statements.

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NATIONAL-OILWELL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Restated)

1. Restatement and Summary of Significant Accounting Policies

Restatement of previously issued financial statements
On February 17, 2006 the Company announced that it was restating its previously issued Consolidated Financial Statements for each of 2004, 2003, and 2002 due to errors in intercompany and inventory accounts. The restatement had no impact on the reported net income of the Company for the nine-month period ended September 30, 2005, and resulted in an increase (decrease) to net income of $5.0 million, $2.9 million, and ($6.0 million) for the fiscal years ending December 31, 2004, 2003, and 2002, respectively. In addition, the restatement also reduced inventory and stockholders equity by $28.1 million as of December 31, 2001.
In late 2005, the Company discovered unreconciled differences related to materials-in-transit and intercompany accounts between consolidated subsidiaries. The Company s investigation of inventory and related intercompany accounts discovered misstatements of certain account balances from December 31, 2001 through September 30, 2005. The Company has made revisions to its intercompany and inventory controls to identify and prevent these issues from recurring in future periods. During 2005, the Company implemented the following steps, among others, to remeditate and strengthen its internal controls over materials-in-transit and intercompany account reconciliations: 1) The Company has changed its reconciliation process to require individual subsidiaries to reconcile all intercompany balances with counter parties on a monthly and transaction-by-transaction basis. 2) The Company appointed a worldwide intercompany controller to monitor the effectiveness of these controls. 3) The Company has corrected errors and improved processes to develop detailed support for its outstanding materials-in-transit account balances. As a result of these improvements, the Company believes that the financial controls over the materials-in-transit and intercompany accounts are functioning effectively.
The following tables compares the Company s reported and restated financial results for each of the years ended December 31, 2004, 2003, and 2002, respectively.
As originally reported (in millions; except per share data):

	Year Ended December 31,		
	2004	**2003**	**2002**
Stockholders Equity	$ 1,296.4	$ 1,090.4	$ 933.4
Income Before Income Taxes and Minority Interest	$ 131.5	$ 116.7	$ 113.3
Net Income	$ 110.2	$ 76.8	$ 73.1
Net Income per Diluted Share	$ 1.27	$ 0.90	$ 0.89

As restated (in millions; except per share data):

	Year Ended December 31,		
	2004	**2003**	**2002**
Stockholders Equity	$ 1,270.2	$ 1,059.2	$ 899.3
Income Before Income Taxes and Minority Interest	$ 138.9	$ 121.8	$ 106.7
Net Income	$ 115.2	$ 79.7	$ 67.1
Net Income per Diluted Share	$ 1.33	$ 0.94	$ 0.82

Difference (in millions; except per share data):

	Year Ended December 31,		
	2004	2003	2002
Stockholders Equity	$ (26.2)	$ (31.2)	$ (34.1)
Income Before Income Taxes and Minority Interest	$ 7.4	$ 5.1	$ (6.6)
Net Income	$ 5.0	$ 2.9	$ (6.0)
Net Income (Loss) per Diluted Share	$ 0.06	$ 0.04	$ (0.07)

Amounts for 2002 and prior periods have not been tax effected as the ability to obtain tax deductions is uncertain.

In addition, the restatement resulted in changes to the consolidated statement of cash flows and Notes 3, 10, 11 and 12.

Nature of Business

We design, construct, manufacture and sell comprehensive systems, components, and products used in oil and gas drilling and production, as well as distribute products and provide supply chain integration services to the upstream oil and gas industry. Our revenues and operating results are directly related to the level of worldwide oil and gas drilling and production activities and the profitability and cash flow of oil and gas companies and drilling contractors, which in turn are affected by current and anticipated prices of oil and gas. Oil and gas prices have been and are likely to continue to be volatile.

Summary of Significant Accounting Policies

Basis of Consolidation

The accompanying consolidated financial statements include the accounts of National-Oilwell, Inc. and its majority-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. Investments that are not wholly-owned, but where we exercise control, are fully consolidated with the equity held by minority owners and their portion of net income (loss) reflected as minority interest in the accompanying financial statements. Investments in unconsolidated affiliates, over which we exercise significant influence, but not control, are accounted for by the equity method. Investments in which we exercise no control or significant influence would be accounted for under the cost method. Certain reclassifications have been made to the 2003 and 2002 consolidated financial statements in order for them to conform with the 2004 presentation.

Fair Value of Financial Instruments

The carrying amounts of financial instruments including cash and cash equivalents, receivables, and payables approximated fair value because of the relatively short maturity of these instruments. Cash equivalents include only those investments having a maturity date of three months or less at the time of purchase. The carrying values of other financial instruments approximate their respective fair values.

Derivative Financial Instruments

We record all derivative financial instruments at their fair value in our consolidated balance sheet. All derivative financial instruments we hold are designated as cash flow hedges and are highly effective in offsetting movements in the underlying risks. Accordingly, gains and losses from changes in the fair value of derivative financial instruments are deferred and recognized in earnings as the underlying transactions occur. Because our derivative financial instruments are so closely related to the underlying transactions, hedge ineffectiveness is insignificant.

We use foreign currency forward contracts to mitigate our exposure to changes in foreign currency exchange rates on firm sale commitments to better match the local currency cost components of our fixed US dollar contracts. Such arrangements typically have terms between three months and one year, depending upon the customer s purchase order. We may also use interest rate contracts to mitigate our exposure to changes in interest rates on anticipated long-term debt issuances. These contracts are typically short term in nature. We do not use derivative financial instruments for trading or speculative purposes.

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Inventories

Inventories consist of oilfield products, manufactured equipment, specialized drilling products and downhole motors and spare parts for manufactured equipment and drilling products. Inventories are stated at the lower of cost or market using the first-in, first-out or average cost methods. Allowances for excess and obsolete inventories are determined based on our historical usage of inventory on-hand as well as our future expectations related to our substantial installed base and the development of new products. The allowance, which totaled $41.2 million and $45.3 million at December 31, 2004 and 2003, is the amount necessary to reduce the cost of the inventory to its estimated realizable value.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Expenditures for major improvements that extend the lives of property and equipment are capitalized while minor replacements, maintenance and repairs are charged to operations as incurred. Disposals are removed at cost less accumulated depreciation with any resulting gain or loss reflected in operations. Depreciation is provided using the straight-line method or declining balance method over the estimated useful lives of individual items. Depreciation expense was $41.6 million, $37.4 million and $25.0 million for the years ending December 31, 2004, 2003 and 2002.

Long-lived Assets

We record impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those assets. The carrying value of assets used in operations that is not recoverable is reduced to fair value if lower than carrying value. In determining the fair market value of the assets, we consider market trends and recent transactions involving sales of similar assets, or when not available, discounted cash flow analysis.

Assets Held for Sale

In the course of integrating acquisitions and streamlining operations, we have closed certain manufacturing facilities and non-strategic assets. Facilities that are available for immediate sale, under a formal plan that is probable of completion within one year, are classified as held for sale. When we designate an asset as held for sale, we adjust its carrying value to the lower of its current carrying amount or the estimated fair value less costs to sell and stop recording depreciation expense. Carrying values are adjusted to reflect any subsequent deterioration in fair value.

Intangible Assets

Beginning in 2002, we adopted FAS 142 Accounting for Goodwill and Other Intangible Assets and accordingly stopped amortizing goodwill that arose from acquisitions before June 30, 2001. On at least an annual basis, we assess whether goodwill is impaired. Our annual impairment tests are performed at the beginning of the 4th quarter of each year and have indicated no impairment. If we determine that goodwill is impaired, we measure that impairment based on the amount by which the book value of goodwill exceeds its implied fair value. The implied fair value of goodwill is determined by deducting the fair value of a reporting unit s identifiable assets and liabilities from the fair value of that reporting unit as a whole. Additional impairment assessments may be performed on an interim basis if we encounter events or changes in circumstances that would indicate that, more likely than not, the carrying amount of goodwill has been impaired. Fair value of the reporting units is determined based on internal management estimates.

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Goodwill is identified by segment as follows (in millions):

	Products and Technology	Distribution Service	Corporate/ Elimination	Total
Balance December 31, 2002	$ 490.9	$ 16.4	$ 4.9	$ 512.2
Additions to Goodwill	39.8	17.1	(0.3)	56.6
Translation Adjustments	15.9	2.3	0.3	18.5
Balance December 31, 2003	546.6	35.8	4.9	587.3
Additions to Goodwill	31.1	(2.2)	1.2	30.1
Translation Adjustments	20.0	1.5	0.1	21.6
Balance December 31, 2004	$ 597.7	$ 35.1	$ 6.2	$ 639.0

Identified intangible assets with determinable lives consist primarily of technical drawings acquired in the acquisitions of Hydralift, Mono and Corlac and are being amortized on a straight-line basis over the estimated useful lives of 15-20 years. The balance at December 31, 2004 and 2003 was $36 million and $28 million (net of accumulated amortization of $4 million and $2 million, respectively). Amortization expense of identified intangibles is expected to be approximately $2 million in each of the next five years.

Identified intangible assets with indefinite lives consist primarily of tradenames acquired in the acquisitions of Hydralift, Mono and Corlac. The balance at December 31, 2004 and 2003 was $55 million and $50 million. Indefinite lived intangible assets are not amortized, but are subject to an impairment test on at least an annual basis. An impairment charge would be recognized if the fair value were determined to be less than the carrying amount. Our annual impairment tests have indicated no impairment.

Deferred financing costs are amortized on a straight-line basis over the life of the related debt securities.

Foreign Currency

The functional currency for certain of our foreign operations is the local currency. The cumulative effects of translating the balance sheet accounts from the functional currency into the U.S. dollar at current exchange rates are included in accumulated other comprehensive income. Revenues and expenses are translated at average exchange rates in effect during the period. Certain other foreign operations use the U.S. dollar as the functional currency. Accordingly, financial statements of these foreign subsidiaries are remeasured to U.S. dollars for consolidation purposes using current rates of exchange for monetary assets and liabilities and historical rates of exchange for nonmonetary assets and related elements of expense. Revenue and other expense elements are remeasured at rates that approximate the rates in effect on the transaction dates. For all operations, gains or losses from remeasuring foreign currency transactions into the functional currency are included in income. Net foreign currency transaction losses were $9.3 million, $7.2 million and $0.3 million for the years ending December 31, 2004, December 31, 2003 and December 31, 2002, and are included in other income(expense) in the accompanying statement of operations. These losses are primarily related to cash balances and intercompany accounts held in U.S. dollars at these subsidiary locations. The remeasurement of these amounts into the local currency results in an income statement gain or loss, which is offset when the amount is translated back into U.S. currency for consolidation purposes by way of an increase or decrease to Other Comprehensive Income in the equity section of the balance sheet.

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Revenue Recognition

Product and service sales are recognized on purchase orders or contracts when product delivery has occurred or services have been rendered, pricing is fixed or determinable, and collection is reasonably assured. Our arrangements do not include right of return or other similar provisions or other significant post delivery obligations. Customer advances or deposits are deferred and recognized as revenue when we have completed all of our performance obligations related to the sale. The amounts billed for shipping and handling costs are included in revenue and related costs are included in costs of sales.

Contracts to design and construct complex rig packages to a customers specifications are recorded on the percentage-of-completion method using an output based measure focused on engineering estimates and manufacturing progress. This method is used because we believe this is the most meaningful measurement of the extent of progress toward completion. This methodology requires us to make estimates regarding the total costs of the project, our progress against the project schedule and the estimated completion date, all of which impact the amount of revenue and gross margin we recognize in each reporting period. Contract costs include all direct material, labor and subcontract costs. Changes in job performance, job conditions, and estimated profitability, including those arising from contract penalty provisions, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Profit incentives are included in revenues when their realization is reasonably assured. Provisions for anticipated losses on uncompleted contracts are recorded in full when such losses become evident.

The asset, Costs in excess of billings, represents revenues recognized in excess of amounts billed. The liability, Billings in excess of costs, represents billings in excess of revenues recognized.

Income Taxes

The liability method is used to account for income taxes. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to amounts which are more likely than not to be realized.

Concentration of Credit Risk

We grant credit to our customers, which operate primarily in the oil and gas industry. Concentrations of credit risk are limited because we have a large number of geographically diverse customers, thus spreading trade credit risk. We control credit risk thorough credit evaluations, credit limits and monitoring procedures. We perform periodic credit evaluations of our customers financial condition and generally do not require collateral, but may require letters of credit for certain international sales. Credit losses are provided for in the financial statements. We maintain an allowance for doubtful accounts for accounts receivables by providing for specifically identified accounts where collectibility is doubtful and an additional allowance based on the aging of the receivables compared to past experience and current trends. Accounts receivable are net of allowances for doubtful accounts of approximately $12.8 million and $18.3 million at December 31, 2004 and December 31, 2003, respectively.

Stock-Based Compensation

We use the intrinsic value method in accounting for our stock-based employee compensation plans.

Assuming that we had accounted for our stock-based compensation using the alternative fair value method of accounting under FAS No. 123 and amortized the fair value to expense over the option s vesting period, our net income and net income per share would have been (in millions, except per share data):

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	Year Ended December 31,		
	2004	2003	2002

These pro forma results may not be indicative of future effects.

Environmental Liabilities

When environmental assessments or remediations are probable and the costs can be reasonably estimated, remediation liabilities are recorded on an undiscounted basis and are adjusted as further information develops or circumstances change.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect reported and contingent 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 from those estimates.

Net Income Per Share

The following table sets forth the computation of weighted average basic and diluted shares outstanding (in millions):

	Year Ended December 31,		
	2004	2003	2002
Denominator for basic earnings per share weighted average	85.8	84.5	81.0
Effect of dilutive securities:			
Employee stock options	0.7	0.5	0.7
Denominator for diluted earnings per share adjusted weighted average shares and assumed conversions	86.5	85.0	81.7

In addition, we had stock options outstanding that were anti-dilutive totaling 0.8 million at December 31, 2004, 2.3 million at December 31, 2003, and 1.6 million at December 31, 2002.

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Recently Issued Accounting Standards

In May 2004, the FASB issued Staff Position No. 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (FSP 106-2). FSP 106-2 provides guidance on accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) for employers that sponsor postretirement health care plans that provide prescription drug benefits. FSP 106-2 is effective for the first interim or annual period beginning after June 15, 2004. The adoption of FSP 106-2 did not have a material effect on our financial position, results of operations or cash flows.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, Inventory Costs an amendment of ARB 43, Chapter 4 (SFAS 151). SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. Paragraph 5 of Accounting Research Bulletin (ARB) 43, Chapter 4 Inventory Pricing, previously stated that under certain circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current-period charges. SFAS 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal. In addition, SFAS 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for fiscal years beginning after June 15, 2005. We do not believe the implementation of SFAS 151 will have a material impact on our financial position, results of operations or cash flows.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123-Revised 2004 (Revised SFAS 123), Share-Based Payment. This is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes APB No. 25, Accounting for Stock Issued to Employees. Currently, we do not record compensation expense for stock-based compensation. Under Revised SFAS 123, we will be required to measure the cost of employee services received in exchange for stock based on the grant-date fair value (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). The fair value will be estimated using an option-pricing model. Excess tax benefits, as defined in Revised SFAS 123, will be recognized as an addition to paid-in capital. This is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. Revised SFAS 123 permits public companies to adopt its requirements using one of two methods: 1) a *modified prospective* method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Revised SFAS 123 for all share-based payments granted after the effective date and (b) based on the requirements of Revised SFAS 123 for all awards granted to employees prior to the effective date of Revised SFAS 123 that remain unvested on the effective date, or 2) a *modified retrospective* method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under Statement 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption. We are currently in the process of evaluating the impact of Revised SFAS 123 on our financial statements, including different option-pricing models. The pro forma table in Note 1 of the Notes to Consolidated Financial Statements illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004 (FSP 109-1) and FASB Staff Position No. FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004 (FSP 109-2). FSP 109-1 clarifies the guidance in FASB Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (Statement 109) that applies to the new deduction for qualified domestic production activities under the American Jobs Creation Act of 2004 (the Act). FSP 109-1 clarifies that the deduction should be accounted for as a special deduction under Statement 109, not as a tax-rate reduction, because the deduction is contingent on performing activities identified in the Act. As a result, companies qualifying for the special deduction will not have a one-time adjustment of deferred tax assets and liabilities in the period the Act is enacted. FSP 109-2 addresses the effect of the Act s one-time deduction for qualifying repatriations of foreign earnings. FSP 109-2 allows additional time for companies to determine whether any foreign earnings will be repatriated under the Act s one-time deduction for repatriated earnings and how the Act affects whether undistributed earnings continue to qualify for Statement 109 s exception from recognizing deferred tax liabilities. FSP 109-1 and FSP 109-2 were both effective upon issuance. We have implemented FSP 109-1 and FSP 109-2 in the quarter ended December 31, 2004 and have included the required disclosures in Note 10 of the Notes to Consolidated Financial Statements.

2. Acquisitions

On August 11, 2004, we agreed to combine our businesses with Varco International, Inc. by merging Varco with and into National Oilwell, with National Oilwell continuing as the surviving corporation. Consummation of the merger requires approval by the stockholders of both companies and also approval from various regulatory agencies. We anticipate completion of the merger during March 2005.

Year 2004

We spent $2.8 million during 2004 acquiring assets or companies, with the largest being a distribution operation in Australia.

Year 2003

On January 16, 2003, we acquired the Mono pumping products business from Halliburton Energy Services for approximately $91 million, consisting of $24 million in cash and 3.2 million shares of our common stock valued at $67 million. During the remainder of 2003 we made eight other acquisitions representing cash outlays totaling $54 million primarily expanding our Distribution network.

Year 2002

On December 18, 2002, we completed a cash tender offer for 92% of the common shares of Hydralift ASA, a Norwegian based company specializing in the offshore drilling equipment industry. By December 31, 2002, we had substantially completed the acquisition of the remaining shares for a total purchase price, including the assumption of debt and net of cash acquired, of approximately $300 million. The results of Hydralift s operations have been included in our income statement since the acquisition date.

During 2002 we also acquired three other businesses, primarily within our Products and Technology segment, for approximately $17 million in cash.

3. Inventories

Inventories consist of (in millions):

	December 31, 2004 (restated)	December 31, 2003 (restated)
Raw materials and supplies	$ 62.6	$ 45.4
Work in process	104.2	107.7
Finished goods and purchased products	468.5	364.0
Total	$ 635.3	$ 517.1

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4. Property, Plant and Equipment

Property, plant and equipment consists of (in millions):

	Estimated Useful Lives	December 31, 2004	December 31, 2003
Land and improvements	2-20 Years	$ 20.8	$ 23.7
Buildings and improvements	5-31 Years	117.8	99.9
Machinery and equipment	5-12 Years	196.9	154.7
Computer and office equipment	3-10 Years	79.1	95.6
Rental equipment	1-7 Years	91.8	75.7
		506.4	449.6
Less accumulated depreciation		(251.3)	(197.2)
		$ 255.1	$ 252.4

5. Long-Term Debt

Long-term debt consists of (in millions):

	December 31, 2004	December 31, 2003
Credit facilities	$	$ 108.9
6.875% senior notes	150.0	150.0
6.50% senior notes	150.0	150.0
5.65% senior notes	200.0	200.0
	500.0	608.9
Less current portion	150.0	14.9
	$ 350.0	$ 594.0

At December 31, 2004, we had two committed credit facilities, a North American and a Norwegian facility, totaling $279 million. Both facilities are available for general corporate purposes and acquisitions, including letters of credit and performance bonds.

Our North American facility is a three-year unsecured $175 million revolving credit facility with availability up to $50 million for issuance of letters of credit that expires July 31, 2005. At December 31, 2004, there were no borrowings against this facility and there were $53 million in outstanding letters of credit.

Our Norwegian facility, which expires in 2006, has revolving credit facilities totaling $104 million, with $41 million available for letter of credit purposes. At December 31, 2004, there were no borrowings against this facility and there were $18 million in outstanding letters of credit.

We also have additional uncommitted credit facilities totaling $147 million that are used primarily for letters of credit, bid bonds and performance bonds. At December 31, 2004, there were no borrowings against these additional credit facilities and there were $49 million in outstanding letters of credit and performance bonds.

In November 2002, we sold $200 million of 5.65% unsecured senior notes due November 15, 2012. Interest is payable on May 15 and November 15 of each year. In March 2001, we sold $150 million of 6.50% unsecured senior notes due March 15, 2011, with interest payable on March 15 and September 15 of each year. In June 1998, we sold $150 million of 6.875% unsecured senior notes due July 1, 2005, with interest payments due annually on January 1 and July 1.

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The $150 million 6 7/8% unsecured senior notes will mature on July 1, 2005. In addition, our $175 million unsecured North American revolving credit facility expires July 31, 2005. We plan to arrange financing at reasonable terms and conditions with our existing bank syndication, plus other banks as needed, or utilize surplus cash and certain discretionary credit facilities to refinance these expiring obligations.

The senior notes contain reporting covenants and the credit facilities contain financial covenants and ratios regarding maximum debt to capital and minimum interest coverage. We were in compliance with all covenants governing these facilities at December 31, 2004.

6. Employee Benefit Plans

We have benefit plans covering substantially all of our employees. Defined-contribution benefit plans cover most of the U.S. and Canadian employees and benefits are based on years of service, a percentage of current earnings and matching of employee contributions. Employees in our Norwegian operations can elect to participate in a defined-contribution plan in lieu of a local defined benefit plan. For the years ended December 31, 2004, 2003 and 2002, expenses for defined-contribution plans were $14.2 million, $13.1 million and $9.1 million, and all funding is current.

Certain retired or terminated employees of predecessor or acquired companies participate in a defined benefit plan in the United States. None of the participants in this plan are eligible to accrue benefits. In addition, approximately 175 U.S. retirees and spouses participate in defined benefit health care plans of predecessor or acquired companies that provide postretirement medical and life insurance benefits. Active employees are ineligible to participate in any of these defined benefit plans. Our subsidiaries in the United Kingdom and Norway also have defined benefit pension plans covering virtually all of their employees.

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Net periodic benefit cost (credit) for our defined benefit pension plans in the United States, the United Kingdom and Norway was as follows (in millions):

	Pension benefits			Postretirement benefits		
For the year	2004	2003	2002	2004	2003	2002
Service cost benefits earned during the period	$ 2.9	$ 3.0	$ 0.4	$ 0.1	$ 0.0	$ 0.0
Interest cost on projected benefit obligation	8.6	7.5	3.3	0.5	0.5	0.5
Expected return on plan assets	(8.8)	(7.5)	(3.9)			
Net amortization and deferral	1.5	1.4	0.1	0.2	0.2	0.3
Net periodic benefit cost (credit)	$ 4.2	$ 4.4	$ (0.1)	$ 0.8	$ 0.7	$ 0.8

The change in benefit obligation, plan assets and the funded status of the defined benefit pension plans in the United States, United Kingdom, and Norway and defined postretirement plans in the United States, using a measurement date of September 30, 2004 or 2003, follows (in millions):

	Pension benefits		Postretirement benefits	
At year end	2004	2003	2004	2003
Benefit obligation at beginning of year	$ 142.2	$ 64.7	$ 8.0	$ 8.5
Service cost	2.9	3.0	0.1	
Interest cost	8.6	7.5	0.5	0.5
Actuarial (gain) loss	(2.0)	(9.5)	0.2	(0.5)
Benefits paid	(5.6)	(4.8)	(0.7)	(0.6)
Participant contributions	0.8	0.7		
Acquisitions		69.4		
Exchange rate gain	11.5	11.0		
Curtailments			(0.9)	
Other		0.2	0.1	0.1
Benefit obligation at end of year	$ 158.4	$ 142.2	$ 7.3	$ 8.0
Accumulated benefit obligation at end of year	$ 149.5	$ 133.0		
Fair value of plan assets at beginning of year	$ 120.4	$ 44.7	$	$
Actual return	7.2	8.8		
Benefits paid	(5.6)	(4.7)	(0.7)	(0.6)
Contributions	3.7	3.8	0.7	0.6
Acquisitions		58.7		

Exchange rate gain		9.6		9.3				
Other				(0.2)				
Fair value of plan assets at end of year	$	135.3	$	120.4	$		$	
Funded status	$	(21.5)	$	(21.4)	$	(7.2)	$	(7.9)
Unrecognized actuarial net loss		21.3		22.0		3.4		3.5
Prior service costs not yet recognized		0.2		0.3		0.1		0.2
Prepaid (accrued) benefit cost	$		$	0.9	$	(3.7)	$	(4.2)

Amounts recognized in the consolidated balance sheets consist of (in millions):

	Pension benefits				Postretirement benefits			
	2004		2003		2004		2003	
Prepaid benefit cost	$	(0.2)	$	2.2	$		$	
Accrued benefit cost		(31.9)		(28.1)		(3.7)		(4.2)
Intangible assets		0.2		0.3				
Accumulated other comprehensive income		31.9		26.5				
Net amount recognized	$		$	0.9	$	(3.7)	$	(4.2)

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Defined Benefit Pension Plans

Assumed long-term rates of return on plan assets, discount rates and rates of compensation increases vary for the different plans according to the local economic conditions.

The assumption rates used for benefit obligations are as follows:

	Year ending December 31, 2004	2003
Discount rate:		
United States plan	6.00%	6.25%
International plans	6.00%	6.00%
Salary increase:		
United States plan	n/a	n/a
International plans	2.50-2.75%	2.50%

The assumption rates used for net periodic benefit costs are as follows:

	Year ending December 31, 2004	2003	2002
Discount rate:			
United States plan	6.25%	6.50%	6.87%
International plans	6.00%	5.75-6.00%	5.75%
Salary increase:			
United States plan	n/a	n/a	n/a
International plans	2.50%	2.50-4.00%	4.00%
Expected return on assets:			
United States plan	8.50%	8.50%	8.50%
International plans	6.50-7.75%	6.50-7.75%	6.25%

In determining the overall expected long-term rate of return for plan assets, the Company takes into consideration the historical experience as well as future expectations of the asset mix involved. As different investments yield different returns, each asset category must be reviewed individually and then weighted for significance in relation to the total portfolio.

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The weighted-average asset allocations at December 31, 2004 and 2003, by asset category are as follows:

	2004		2003	
	United States	International	United States	International
Equity securities	59.4%	56.5%	60.5%	56.9%
Fixed income	39.7%		38.0%	
Debt securities		28.7%		29.7%
Real estate		1.8%		1.7%
Other	0.9%	13.0%	1.5%	11.7%
Total	100.0%	100.0%	100.0%	100.0%

In the U.S., our investment strategy includes a balanced approach with target allocation percentages of 55-65% equity investments and 35-45% fixed income investments. Our target allocation percentages in the United Kingdom plans are 80% equity securities, 15% debt securities and 5% real estate. The Norwegian target investment allocation percentage is 100% insurance contracts. Our pension investment strategy worldwide prohibits a direct investment in our own stock.

Information for Pension Plans with Projected and Accumulated Benefit Obligations in Excess of Plan Assets (in millions):

	FYE December 31, 2004		FYE December 31, 2003	
	United States	International	United States	International
Projected benefit obligation	$ 18.6	$ 60.4	$ 17.5	$ 51.4
Accumulated benefit obligation	18.6	58.8	17.5	50.4
Fair value of assets	12.8	45.8	12.3	39.5

Additional Information for Defined Benefit Plans (in millions):

	FYE December 31, 2004		FYE December 31, 2003	
	United States	International	United States	International
Accumulated benefit obligation	$ 18.6	$ 58.8	$ 17.5	$ 50.4
Change in minimum liability included in other comprehensive income	0.9	4.5	(0.6)	(6.2)

In 2005, the Company expects to contribute $1.0 million in the U.S. and $4.6 million internationally to its pension plans and $0.6 million to its other postretirement benefit plans.

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In addition, the following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in millions):

	United States plan	International plans
2005	$1.4	$ 4.3
2006	1.4	4.6
2007	1.4	4.4
2008	1.4	4.6
2009	1.4	4.7
subsequent five years	6.7	28.4

Defined Benefit Healthcare Plans

Fiscal Period January 1 to December 31 **Disclosure Assumptions**	FYE 2004	FYE 2003
For determining benefit obligations at year-end:		
Discount rate	6.00%	6.25%
Salary increase	5.00%	5.00%
For determining net periodic cost for year:		
Discount rate	6.25%	6.50%
Salary increase	5.00%	5.00%
Expected return on assets	n/a	n/a
Measurement date	9/30/2004	9/30/2003
Effect of 1% annual increase in health care cost trend rate:		
Aggregate of the Service Cost and Interest Cost Dollar change	$ 0.040	$ 0.043
APBO Dollar change	$ 0.625	$ 0.729
Effect of 1% annual decrease in health care cost trend rate:		
Aggregate of the Service Cost and Interest Cost Dollar change	$ (0.035)	$ (0.036)
APBO Dollar change	$ (0.526)	$ (0.622)
Cash Flows:		
Employer contribution (expected during fiscal year beginning in 2005)	$ 0.568	

Estimated future benefit payments during fiscal year ending in:	*After* *Medicare subsidy*	*Before* *Medicare subsidy*
2005	$ 0.568	$ 0.568
2006	$ 0.526	$ 0.552
2007	$ 0.501	$ 0.533
2008	$ 0.503	$ 0.541
2009	$ 0.488	$ 0.523
subsequent five years	$ 2.541	$ 2.727

The assumed weighted-average annual rate of increase in the per capita cost of covered benefits is 10.5% for 2005 and is assumed to decrease gradually to 5.0% for 2009 and remain at that level thereafter. The health care cost trend rate assumption has a significant effect on the amounts reported.

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7. Accumulated Other Comprehensive Income / (Loss)

The components of other comprehensive income (loss) are as follows (in millions):

	Change in Minimum Pension Liability	Cumulative Currency Translation Adjustment	Interest Rate Contract	**Total**
Balance at December 31, 2001	$	$ (34.9)	$	$ (34.9)
Current period activity	(19.7)	2.5	1.4	(15.8)
Tax effect	6.8		(0.5)	6.3
Balance at December 31, 2002	(12.9)	(32.4)	0.9	(44.4)
Current period activity	(6.8)	4.6	(0.1)	(2.3)
Tax effect	2.3			2.3
Balance at December 31, 2003	(17.4)	(27.8)	0.8	(44.4)
Current period activity	8.0	72.5	(0.1)	80.4
Tax effect	(2.6)			(2.6)
Balance at December 31, 2004	$ (12.0)	$ 44.7	$ 0.7	$ 33.4

8. Commitments and Contingencies

We lease land, buildings, storage facilities, vehicles, data processing equipment and software under operating leases expiring in various years through 2011. Rent expense for the years ended December 31, 2004, 2003 and 2002 was $22.4 million, $24.6 million and $21.2 million. Our minimum rental commitments for operating leases at December 31, 2004 were as follows: 2005 $21.3 million; 2006 $16.9 million; 2007 $13.4 million; 2008 $10.6 million; 2009 $6.5 million and subsequent to 2009 $7.7 million.

We are involved in various claims, regulatory agency audits and pending or threatened legal actions involving a variety of matters. The total liability on these matters at December 31, 2004 cannot be determined; however, in our opinion, any ultimate liability, to the extent not otherwise provided for, should not materially affect our financial position, liquidity or results of operations.

Our business is affected both directly and indirectly by governmental laws and regulations relating to the oilfield service industry in general, as well as by environmental and safety regulations that specifically apply to our business. Although we have not incurred material costs in connection with our compliance with such laws, there can be no assurance that other developments, such as stricter environmental laws, regulations and enforcement policies thereunder could not result in additional, presently unquantifiable, costs or liabilities to us.

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9. Common Stock

National Oilwell has authorized 150 million shares of $.01 par value common stock. We also have authorized 10 million shares of $.01 par value preferred stock, none of which is issued or outstanding.

Under the terms of National Oilwell s Stock Award and Long-Term Incentive Plan, as amended, 8.4 million shares of common stock are authorized for the grant of options to officers, key employees, non-employee directors and other persons. Options granted under our stock option plan generally vest over a three-year period starting one year from the date of grant and expire five or ten years from the date of grant. The purchase price of options granted may not be less than the market price of National Oilwell common stock on the date of grant. At December 31, 2004, approximately 2.4 million shares were available for future grants.

We also have inactive stock option plans that were acquired in connection with the acquisitions of Dreco Energy Services, Ltd. in 1997 and IRI International Corporation in 2000. We converted the outstanding stock options under these plans to options to acquire our common stock and no further options are being issued under these plans. Stock option information summarized below includes amounts for the National Oilwell Stock Award and Long-Term Incentive Plan and stock plans of acquired companies.

Options outstanding at December 31, 2004 under the stock option plans have exercise prices between $5.62 and $40.50 per share, and expire at various dates from January 19, 2005 to May 26, 2014.

The following summarizes options activity:

	Years Ended December 31,					
	2004		2003		2002	
	Number of shares	Average Exercise Price	Number of shares	Average Exercise Price	Number of shares	Average Exercise Price
Shares under option at beginning of year	3,610,571	$ 23.83	3,790,496	$ 21.99	3,094,160	$ 22.95
Granted	1,142,500	28.22	1,035,000	20.05	977,500	18.53
Cancelled	(96,570)	27.91	(304,659)	28.01	(133,465)	28.54
Exercised	(924,185)	17.28	(910,266)	10.47	(147,699)	13.52
Shares under option at end of year	3,732,316	$ 26.69	3,610,571	$ 23.83	3,790,496	$ 21.99
Exercisable at end of year	1,657,162	$ 29.66	1,713,647	$ 25.47	2,119,692	$ 18.71

The following summarizes information about stock options outstanding as of December 31, 2004:

		Options Outstanding		Options Exercisable	
Range of Exercise Price	Weighted-Avg. Remaining Contractual Life	Shares	Weighted-Avg. Exercise Price	Shares	Weighted-Avg. Exercise Price
\$5.62 to \$19.39	6.96	658,016	\$ 17.86	332,068	\$ 17.21
\$20.14 to \$28.22	8.13	2,277,098	24.57	527,892	21.84
\$30.30 to \$40.50	6.03	797,202	40.03	797,202	40.03
Totals	7.48	3,732,316	\$ 26.69	1,657,162	\$ 29.66

The weighted average fair value of options granted during 2004, 2003 and 2002 was approximately \$13.19, \$8.88, and \$8.95 per share, as determined using the Black-Scholes option-pricing model.

The assumptions used in the Black-Scholes option-pricing model were:

Assumptions	2004	2003	2002
Risk-free interest rate	2.7%	2.6%	2.4%
Expected dividend			
Expected option life (years)	5	5	5
Expected volatility	51%	48%	54%

On February 7, 2005, we issued 1,145,000 stock options at an exercise price of \$37.60.

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10. Income Taxes

The domestic and foreign components of income before income taxes were as follows (in millions):

	December 31, 2004 (Restated)	December 31, 2003 (Restated)	December 31, 2002 (Restated)
Domestic	$ 51.5	$ 24.2	$ 39.1
Foreign	87.4	97.6	67.6
	$ 138.9	$ 121.8	$ 106.7

The components of the provision for income taxes consisted of (in millions):

	December 31, 2004 (Restated)	December 31, 2003 (Restated)	December 31, 2002 (Restated)
Current:			
Federal	$ 9.8	$ 5.5	$ 10.7
State	(3.3)	0.9	0.9
Foreign	21.8	22.6	15.7
	28.3	29.0	27.3
Deferred:			
Federal	(12.8)	1.7	4.9
State	2.2	0.7	1.2
Foreign	3.9	4.5	5.4
	(6.7)	6.9	11.5
	$ 21.6	$ 35.9	$ 38.8

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

	December 31, 2004 (Restated)	December 31, 2003 (Restated)	December 31, 2002 (Restated)
Federal income tax at statutory rate	$ 48.6	$ 42.6	$ 37.4
Foreign income tax rate differential	(2.3)	(7.9)	(3.3)

State income tax, net of federal benefit	1.0	0.6	0.6
Tax benefit of foreign sales income	(3.1)	(3.0)	(1.6)
Nondeductible expenses	1.3	1.7	1.0
Tax benefit of capital loss carryovers		(0.8)	
Foreign dividends net of FTCs	3.2	(2.7)	1.2
Net operating loss carryforwards		(0.7)	
Change in deferred tax valuation allowance	(20.1)	6.9	0.4
Prior year taxes	(7.2)	(0.8)	2.8
Other	0.2		0.3
	$ 21.6	$ 35.9	$ 38.8

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Significant components of our deferred tax assets and liabilities were as follows (in millions):

	December 31, 2004	December 31, 2003
Deferred tax assets:		
Allowances and operating liabilities	$ 19.6	$ 30.3
Net operating loss carryforwards	18.6	29.4
Foreign tax credit carryforwards	21.1	21.9
Capital loss carryforward	3.8	4.9
Other	24.3	18.2
Total deferred tax assets	87.4	104.7
Valuation allowance for deferred tax assets	(16.8)	(36.9)
	70.6	67.8
Deferred tax liabilities:		
Tax over book depreciation	29.6	30.0
Operating and other assets	58.7	10.6
Other	14.5	11.8
Total deferred tax liabilities	102.8	52.4
Net deferred tax asset (liability)	$ (32.2)	$ 15.4

In the United States, the Company has $14.4 million of net operating loss carryforwards as of December 31, 2004, which expire at various dates through 2018. The potential benefit of $5.2 million has been recorded with no valuation allowance. Future income tax payments will be reduced when the Company ultimately realizes the benefit of these net operating losses.

Also in the United States, the Company has $9.8 million of capital loss carryforwards as of December 31, 2004, which expire in 2005. The related potential benefit of $3.8 million has been recorded with a full valuation allowance of $3.8 million. These capital losses are not available to reduce future operating income but if realized will reduce future capital gains and will result in a reduction of future tax expense. The Company has $21.1 million of excess foreign tax credits as of December 31, 2004, which expire at various dates through 2014. These credits have not been allotted a valuation allowance and would be realized as a reduction of future income tax payments.

Outside the United States, the company has $46.0 million of net operating loss carryforwards as of December 31, 2004. Of this amount, $45.2 million will expire at various dates through 2014 and $0.8 million is available indefinitely. The related potential benefit available of $13.3 million has been recorded with a valuation allowance of $12.0 million. If the Company ultimately realizes the benefit of these net operating losses, $11.0 million would reduce goodwill and other intangible assets and $1.0 million would reduce income tax expense.

Also outside the United States, the company has $0.5 million of capital loss carryforwards as of December 31, 2004, which can be carried forward indefinitely. The related potential benefit of $0.2 million has been recorded with a full valuation allowance of $0.2 million. These capital losses are not available to reduce future operating income but if realized will reduce future capital gains and will result in a reduction of future income tax expense.

The deferred tax valuation allowance decreased $20.1 million for the period ending December 31, 2004 and increased $6.9 million for the period ending December 31, 2003. The decrease was reflected as a reduction of tax expense in 2004 and resulted primarily from completion of certain acquisition financing transactions and the enactment of the American Jobs Creation Act of 2004, which extended the carryforward period of excess foreign tax credits in the United States. The increase in 2003 resulted primarily from the recognition of additional excess foreign tax credits and capital loss carryforwards that may not be realized in the future. National-Oilwell s deferred tax assets are expected to be realized principally through future earnings.

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Undistributed earnings of the Company s foreign subsidiaries amounted to $299.9 million and $238.6 million at December 31, 2004 and 2003. Those earnings are considered to be permanently reinvested and no provision for U.S. federal and state income taxes has been made. Distribution of these earnings in the form of dividends or otherwise could result in either U.S. federal taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable in various foreign countries. Determination of the amount of unrecognized deferred U.S. income tax liability is not practical; however, unrecognized foreign tax credit carryforwards would be available to reduce some portion of the U.S. liability. Withholding taxes of approximately $30.5 million would be payable upon remittance of all previously unremitted earnings at December 31, 2004 . The Company has not reevaluated its position with respect to the indefinite reinvestment of foreign earnings to take into account the possible election of the repatriation provisions contained in the American Jobs Creation Act of 2004

Because of the number of tax jurisdictions in which the Company operates, its effective tax rate can fluctuate as operations and the local country tax rates fluctuate. The Company is also subject to audits by federal, state and foreign jurisdictions which may result in proposed assessments. The Company s future tax provision will reflect any favorable or unfavorable adjustments to its estimated tax liabilities when resolved. The Company is unable to predict the outcome of these matters, however, we believe that none of these matters will have a material adverse effect on the results of operations or financial condition of the Company.

In October 2004, the American Jobs Creation Act of 2004 (the Jobs Act) was signed into law which introduced a special one-time dividends received deduction on the repatriation of foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. The Act provides for a special one-time deduction of 85 percent of certain foreign earnings that are repatriated in either the Company s last tax year that began before the enactment date, or the first tax year that begins during the one-year period beginning on the date of enactment. The maximum amount of the Company s foreign earnings that qualify for temporary deduction is $286.4 million.

The Company is in the process of evaluating whether it will repatriate foreign earnings under the repatriation provisions of the Jobs Act, and if so, the amount that will be repatriated. The range of reasonably possible amounts that the Company is considering for repatriation, which would be eligible for the temporary deduction, is zero to $286.4 million. The Company is awaiting the issuance of further regulatory guidance and passage of statutory technical corrections with respect to certain provisions in the Jobs Act prior to determining the amounts it will repatriate. The Company expects to determine the amounts and sources of foreign earnings to be repatriated, if any, in 2005.

The Company is not yet in a position to determine the impact of a qualifying repatriation, should it choose to make one, on its income tax expense for 2005, the amount of its indefinitely reinvested foreign earnings, the range of income tax effects or the amount of its deferred tax liability with respect to foreign earnings.

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11. Business Segments and Geographic Areas

National Oilwell s operations consist of two segments: Products and Technology and Distribution Services. The Products and Technology segment designs and manufactures a variety of oilfield equipment for use in oil and gas drilling, completion and production activities. The Distribution Services segment distributes an extensive line of oilfield supplies and equipment. Intersegment sales and transfers are accounted for at commercial prices and are eliminated in consolidation. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies of the Company. The Company evaluates performance of each reportable segment based upon its operating income, excluding non-recurring items.

No single customer accounted for 10% or more of consolidated revenues during the three years ended December 31, 2004.

Summarized financial information is as follows (in millions):

Geographic Areas:

	United States	Canada	Norway	United Kingdom	Other	Eliminations	Total
December 31,2004							
Revenues from:							
Unaffiliated customers	$ 1,303.6	$ 403.1	$ 274.1	$ 99.7	$ 237.6	$	$ 2,318.1
Interarea sales	231.5	86.0	45.1	13.5	17.2	(393.3)	
Total revenues	1,535.1	489.1	319.2	113.2	254.8	(393.3)	2,318.1
Long-lived assets	126.1	33.2	33.1	24.4	38.3		255.1
December 31,2003							
Revenues from:							
Unaffiliated customers	$ 1,086.7	$ 332.9	$ 260.2	$ 95.9	$ 229.2	$	$ 2,004.9
Interarea sales	138.5	55.6	41.1	5.4	5.5	(246.1)	
Total revenues	1,225.2	388.5	301.3	101.3	234.7	(246.1)	2,004.9
Long-lived assets	133.9	32.4	29.5	22.8	33.8		252.4
December 31,2002							
Revenues from:							
Unaffiliated customers	$ 1,055.0	$ 254.3	$ 86.2	$ 44.7	$ 81.7	$	$ 1,521.9
Interarea sales	108.1	59.4	18.5	7.4	1.2	(194.6)	
Total revenues	1,163.1	313.7	104.7	52.1	82.9	(194.6)	1,521.9
Long-lived assets	138.5	26.0	18.3	6.1	19.5		208.4

Business Segments

	Products and Technology	Distribution Services	Corporate/ Eliminations	Total
December 31, 2004 (Restated)				
Revenues from:				
Unaffiliated customers	$ 1,424.5	$ 893.6	$	$ 2,318.1
Intersegment sales	112.5	11.5	(124.0)	
Total revenues	1,537.0	905.1	(124.0)	2,318.1
Operating income (loss)	164.8	29.6	(18.4)	176.0
Capital expenditures	34.8	2.3	1.9	39.0
Depreciation and amortization	34.7	6.8	2.5	44.0
Goodwill	597.7	35.1	6.2	639.0
Total assets	2,049.9	386.5	140.1	2,576.5
December 31, 2003 (Restated)				
Revenues from:				
Unaffiliated customers	$ 1,215.9	$ 789.0	$	$ 2,004.9
Intersegment sales	98.7	3.0	(101.7)	
Total revenues	1,314.6	792.0	(101.7)	2,004.9
Operating income (loss)	170.2	6.5(a)	(12.6)	164.1
Capital expenditures	25.5	3.8	3.1	32.4
Depreciation and amortization	30.1	5.8	3.3	39.2
Goodwill	546.6	35.8	4.9	587.3
Total assets	1,763.1	363.7	86.3	2,213.1
December 31, 2002 (Restated)				
Revenues from:				
Unaffiliated customers	$ 837.7	$ 684.2	$	$ 1,521.9
Intersegment sales	79.5	2.0	(81.5)	
Total revenues	917.2	686.2	(81.5)	1,521.9
Operating income (loss)	120.4	18.1	(10.8)	127.7
Capital expenditures	19.8	3.6	1.4	24.8
Depreciation and amortization	19.3	4.9	0.8	25.0
Goodwill	490.9	16.4	4.9	512.2
Total assets	1,605.5	266.7	70.3	1,942.5

(a) Includes a $6.3 million pre-tax charge related to the accumulated clearing account problem within the purchasing system.

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12. Quarterly Financial Data (Unaudited)

As discussed in Note 1, we have restated our financial statements and other financial information, including the unaudited quarterly information presented below. Summarized quarterly results, were as follows (in millions, except per share data):

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
Year ended December 31, 2004 (Restated)					
Revenues	$ 496.2	$ 533.5	$ 618.9	$ 669.5	$ 2,318.1
Gross Profit	104.4	119.5	133.0	146.9	503.8
Income before taxes	16.7	32.4	40.2	49.6	138.9
Minority interest	(0.2)	(0.3)	(0.7)	(0.9)	(2.1)
Net income	$ 11.6	$ 22.6	$ 28.4	$ 52.6	$ 115.2
Net income per basic share	0.14	0.26	0.33	0.61	1.34
Net income per diluted share	0.14	0.26	0.33	0.61	1.33
Year ended December 31, 2003 (Restated)					
Revenues	$ 500.6	$ 475.4	$ 498.6	$ 530.3	$ 2,004.9
Gross Profit	117.2	104.2	117.1	130.8	469.3
Income before taxes	28.2	25.6	31.1	36.9	121.8
Minority interest	(2.0)	(1.1)	(1.0)	(2.1)	(6.2)
Net income	$ 14.6	$ 19.8	$ 15.3	$ 30.0(a)	$ 79.7
Net income per basic share	0.17	0.23	0.18	0.35	0.94
Net income per diluted share	0.17	0.23	0.18	0.35	0.94

(a) Reflects an income tax benefit of $2.7 million related to a revision of the annual effective tax rate to 29%.

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Schedule II

National-Oilwell, Inc.

Valuation and Qualifying Accounts

Years ended December 31, 2004, 2003 and 2002

	Balance beginning of year	Additions (Deductions) charged to costs and expenses	Charge offs and other	Balance end of year
		(in millions)		
Allowance for doubtful accounts:				
2004	$ 18.3	$ 4.0	$ (9.5)	$ 12.8
2003	12.6	5.7	0.0	18.3
2002	9.1	3.6	(0.1)	12.6
Valuation allowance for deferred tax assets:				
2004	$ 36.9	$ (20.3)	$ 0.2	$ 16.8
2003	29.9	7.0		36.9
2002	29.5	0.4		29.9

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EXHIBIT INDEX

2.1	Amended and Restated Agreement and Plan of Merger, effective as of August 11, between National-Oilwell, Inc. and Varco International, Inc. (4).
3.1	Amended and Restated Certificate of Incorporation of National-Oilwell, Inc. (Exhibit 3.1) (1).
3.2	By-laws of National-Oilwell, Inc. (Exhibit 3.2) (5).
10.1	Employment Agreement dated as of January 1, 2002 between Merrill A. Miller, Jr. and National Oilwell, with a similar agreement with Steven W. Krablin (Exhibit 10.1) (2).
10.2	Employment Agreement dated as of January 1, 2002 between Dwight W. Rettig and National Oilwell, with similar agreements with Robert L. Bloom, Howard E. Davis, Kevin A. Neveu, Mark A. Reese, Jeremy D. Thigpen and Robert R. Workman (Exhibit 10.2) (2).
10.3	Employment Agreement dated as of June 28, 2000 between Gary W. Stratulate and IRI International, Inc., which has now merged into National Oilwell (Exhibit 10.3) (2).
10.4	Amended and Restated Stock Award and Long-Term Incentive Plan (Exhibit 10.1) (3)*.
10.4.1	Form of Stock Option Agreement (Exhibit 10.1) (6)
10.5	Loan Agreement dated July 30, 2002 (Exhibit 10.2) (3).
21.1	Subsidiaries of the Company**.
23.1	Consent of Ernst & Young LLP
24.1	Power of Attorney (included on signature page hereto)**.
31.1	Certification pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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* Compensatory plan or arrangement for management or others

** Previously filed

(1) Filed as an Exhibit to our Quarterly Report on Form 10-Q filed on August 11, 2000.

(2) Filed as an Exhibit to our Annual Report on Form 10-K filed on March 28, 2002.

(3) Filed as an Exhibit to our Quarterly Report on Form 10-Q filed on November 12, 2002.

(4) Filed as Annex A to our Registration Statement on Form S-4 filed on September 16, 2004.

(5) Filed as an Exhibit to our Annual Report on Form 10-K filed on March 7, 2003.

(6) Filed as an Exhibit to our Current Report on Form 8-K filed on February 10, 2005.