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

FORM 10-K

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

For the fiscal year ended December 31, 1998

Commission file number: 001-13439

Dril-Quip, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	74-2162088 (IRS Employer Identification No.)
13550 Hempstead Highway Houston, Texas (Address of principal executive offices)	77040 (Zip code)

Registrant's telephone number, including area code: (713) 939-7711
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, $.01 par value per share	New York Stock Exchange
Rights to purchase Series A Junior Participating Preferred Stock	New York Stock Exchange

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 [X] NO [_]

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

At March 24, 1999, the aggregate market value of the registrant's Common Stock held by non-affiliates of the registrant was approximately $113,106,638 based on the closing price of such stock on such date of $19 7/8.

At March 24, 1999, the number of shares outstanding of registrant's Common Stock was 17,245,000.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for its 1999 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A are incorporated by reference in Part III of this Form 10-K.

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FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K includes certain statements that may be deemed to be "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Statements contained in all parts of this document that are not historical facts are forward looking statements that involve risks and uncertainties that are beyond Dril-Quip's control. You can identify Dril-Quip's forward looking statements by the words "anticipate," "estimate," "expect," "may," "project," "believe" and similar expressions. These forward-looking statements include the following types of information and statements as they relate to Dril-Quip:

.scheduled, budgeted and other future capital expenditures;

.working capital requirements;

.the availability of expected sources of liquidity;

.the impact of the Year 2000 problem; and

.all statements regarding future operations, financial results, business plans and cash needs.

These statements are based upon certain assumptions and analyses made by management of Dril-Quip in light of its experience and its perception of historical trends, current conditions, expected future developments and other factors it believes are appropriate in the circumstances. Such statements are subject to a number of assumptions, risks and uncertainties, including but not limited to, those relating to the volatility of oil and natural gas prices and cyclicality of the oil and gas industry, Dril-Quip's international operations, operating risks, Dril-Quip's dependence on key employees, Dril-Quip's dependence on skilled machinists and technical personnel, Dril-Quip's reliance on product development and possible technological obsolescence, control by certain stockholders, the potential impact of governmental regulation and environmental matters, competition, reliance on significant customers, the risk factors discussed herein and other factors detailed in the Registration Statement on Form S-1 (Registration No. 333-33447) filed in connection with Dril-Quip's initial public offering, and Dril-Quip's other filings with the Securities and Exchange Commission. Prospective investors are cautioned that any such statements are not guarantees of future performance, and that, should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual outcomes may vary materially from those indicated.

PART I

Item 1. Business

General

Dril-Quip, Inc., a Delaware corporation ("Dril-Quip" or the "Company"), is one of the world's leading manufacturers of highly engineered offshore drilling and production equipment which is well suited for use in deepwater, harsh environment and severe service applications. The Company designs and manufactures subsea equipment, surface equipment and offshore rig equipment for use by major integrated, large independent and foreign national oil and gas companies in offshore areas throughout the world. The Company's principal products consist of subsea and surface wellheads, subsea and surface production trees, mudline hanger systems, specialty connectors and associated pipe, drilling and production riser systems, wellhead connectors and diverters. The Company also provides installation and reconditioning services and rents running tools for use in connection with the installation and retrieval of its products.

Dril-Quip has developed its broad line of subsea equipment, surface equipment and offshore rig equipment exclusively through its internal product development efforts. The Company believes that it has achieved significant market share and brand name recognition with respect to its established products due to the technological capabilities, reliability, cost effectiveness and operational timesaving features of these products. In particular, the Company's Quik-Thread(R) and Quik-Stab(R) specialty connectors, MS-15(R) mudline hanger systems and SS-10(R) and

SS-15(R) subsea wellheads are among the most widely used in the industry. Since 1991, the Company has introduced a number of new products, including diverters, wellhead connectors, dual-bore and single-bore subsea production trees, subsea and platform valves, platform wellheads, platform trees, drilling risers and Spar and TLP production risers.

Dril-Quip markets its products through its offices and sales representatives located in all of the major international energy markets throughout the world. In 1998, the Company generated approximately 62% of its revenues from foreign sales. The Company manufactures its products at its facilities located in Houston, Texas; Aberdeen, Scotland; and Singapore, and maintains additional facilities for fabrication and/or reconditioning in Norway, Denmark and Australia. Dril-Quip's manufacturing operations are vertically integrated, with the Company performing substantially all of its forging, heat treating, machining, fabrication, inspection, assembly and testing at its own facilities.

The Company was co-founded as a Texas corporation in 1981 by Larry E. Reimert, Gary D. Smith, J. Mike Walker and Gary W. Loveless. Together, Messrs. Reimert, Smith and Walker have over 75 years of combined experience in the oilfield equipment industry, essentially all of which has been with the Company and its major competitors. In addition, key department managers have been with the Company over 10 years, on average. The Company was reincorporated as a Delaware corporation on August 12, 1997.

On October 28, 1997, the Company sold 2,875,000 shares of common stock, par value $.01 per share ("Common Stock") in an initial public offering (the "Offering"). The net proceeds to the Company from the Offering were approximately $63.4 million. The Company repaid approximately $30 million of indebtedness with the proceeds from the Offering and has used the remaining proceeds to expand its manufacturing capacity, improve and expand facilities and manufacture additional running tools for rental.

Industry Overview

Both the market for offshore drilling and production equipment and services and the Company's business are substantially dependent on the condition of the oil and gas industry and, in particular, the willingness of oil and gas companies to make capital expenditures on exploration, drilling and production operations offshore. The level of capital expenditures is generally dependent upon the prevailing view of future oil and gas prices, which are influenced by numerous factors affecting the supply and demand for oil and gas, including worldwide economic activity, interest rates and the cost of capital, environmental regulation, tax policies, and the ability of OPEC and other producing nations to set and maintain production levels and prices. Capital expenditures are also dependent on the cost of exploring for and producing oil and gas, the sale and expiration dates of offshore leases in the United States and overseas, the discovery rate of new oil and gas reserves in offshore areas and technological advances. Oil and gas prices and the level of offshore drilling and production activity have historically been characterized by significant volatility.

Crude oil prices declined substantially in 1998, and these depressed prices may continue in 1999. During 1998, oil prices fell to 12-year lows as measured in absolute dollars, and 25-year lows as measured in inflation-adjusted dollars. As a result, worldwide offshore exploration and production activity declined, with the number of offshore rigs under contract in January 1999 at their lowest levels since the second quarter of 1995. Consequently, demand for Dril-Quip products, particularly those products used in drilling and producing economically marginal properties, has declined. As a result of continued depressed oil prices, virtually all major oil and gas companies have announced reduced exploratory capital spending budgets for 1999. Consequently, the Company may see a reduction in orders in 1999, which could adversely affect financial results.

Any further significant or prolonged decline in hydrocarbon prices would likely have a material adverse effect on the Company's results of operations. There can be no assurance that the current level of oil and gas exploration, drilling and production activity will increase or that demand for the Company's products and services will reflect such improvement, if any.

Products and Services

Product Group

Dril-Quip designs, manufactures, fabricates, inspects, assembles, tests and markets subsea equipment, surface equipment and offshore rig equipment. In 1998, the Company derived approximately 87.9% of its revenues from the sale of its products. The Company's products are used to explore for oil and gas on offshore drilling rigs, such as floating rigs and jack-ups, and for drilling and production of oil and gas wells on offshore platforms, TLPs, Spars and moored vessels such as FPSOs. TLPs are floating production platforms that are connected to the ocean floor via vertical mooring tethers (called tension legs). A Spar is a floating cylindrical structure approximately six or seven times longer than its diameter that is anchored in place (like a Spar buoy). FPSOs are floating production, storage and offloading monohull moored vessels. The Company believes that sales of its equipment in connection with TLPs, Spars and FPSOs are potentially important sources of future revenues.

Subsea Equipment. Subsea equipment is used in the drilling and production of offshore oil and gas wells around the world. Included in the subsea equipment product line are subsea wellheads, mudline hanger systems, specialty connectors and associated pipe, subsea production trees, valves and TLP and Spar well systems.

Subsea wellheads are pressure-containing forged and machined metal housings in which casing hangers are landed and sealed subsea to suspend casing (downhole pipe). As drilling depth increases, successively smaller diameter casing strings are installed, each suspended by an independent casing hanger. Subsea wellheads are utilized when drilling from floating drilling rigs, either semi-submersible or drillship types, and TLPs and Spars. The Company generally supplies subsea wellheads to customers from inventory.

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

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

A subsea production tree is an assembly composed of valves, a wellhead connector, control equipment and various other components installed on a subsea wellhead or a mudline hanger system and used to control the flow of oil and gas from a producing well. Subsea trees may be either stand alone satellite type or template mounted cluster arrangements. Both types typically produce via flowlines to a central control point located on a platform, TLP, Spar or FPSO. The use of subsea production trees has become an increasingly important method for producing wells located in hard-to-reach deepwater areas or economically marginal fields located in shallower waters. The Company is an established manufacturer of more complicated dual-bore production trees, which are used in severe service applications. In addition, Dril-Quip manufactures a patented single bore (SingleBore(TM)) subsea completion system which features a hydraulic mechanism instead of a wireline-installed mechanism that allows the operator to plug the tubing hanger annulus remotely from the surface via a hydraulic control line and subsequently unplug it when the well is put on production. This mechanism eliminates the need for an expensive multibore installation and workover riser, thereby saving both cost and installation time. The Company's subsea production trees are generally custom designed and manufactured to customer specifications.

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

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

After installation of a wellhead, a platform production tree, consisting of gate valves, a wellhead connector, controls, tree cap and associated equipment, is installed on the wellhead to control and regulate oil or gas production. Platform production trees are similar to subsea production trees but utilize less complex equipment and more manual, rather than hydraulically activated, valves and connectors. Platform wellheads and platform production trees and associated equipment are designed and manufactured in accordance with customer specifications.

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

Wellhead connectors and drilling and production riser systems are also used on both TLPs and Spars, which are being installed more frequently in deepwater applications. The Company has recently delivered its first drilling and production risers. The principal markets for offshore rig equipment are new rigs, rig upgrades, TLPs and Spars. Diverters, drilling and production risers and wellhead connectors are generally designed and manufactured to customer specifications.

Certain products of the Company are used in potentially hazardous drilling, completion and production applications that can cause personal injury, product liability and environmental claims. Litigation arising from a catastrophic occurrence at a location where the Company's equipment and/or services are used may in the future result in the Company being named as a defendant in lawsuits asserting potentially large claims. The Company maintains insurance coverage that it believes is customary in the industry. Such insurance does not, however, provide coverage for all liabilities (including liability for certain events involving pollution), and there is no assurance that its insurance coverage will be adequate to cover claims that may arise or that the Company will be able to maintain adequate insurance at rates it considers reasonable. The occurrence of an event not fully covered by insurance could have a material adverse effect on the financial condition and results of operations of the Company.

Service Group

Dril-Quip's Service Group provides field installation services, reconditioning of its products which are customer-owned, and rental running tools for installation and retrieval of its products. These services are provided from the Company's worldwide locations and represented approximately 12.1% of revenues in 1998.

Field Installation. Dril-Quip provides field installation services through the use of its technicians. These technicians assist in the onsite installation of Company products and are available on a 24-hour call out from the Company's facilities located in Houston, Texas; Aberdeen, Scotland; Stavanger, Norway; Esbjerg, Denmark; Singapore; and Perth, Australia.

Reconditioning. The Company provides reconditioning of its products at its facilities in Houston, Texas; Aberdeen, Scotland; Stavanger, Norway; and Singapore.

Rental. The Company rents running and installation tools for use in installing its products. These tools are used to install and retrieve Company products which are purchased by customers. Running tools are available from Dril-Quip's locations in Houston, Texas; Aberdeen, Scotland; Stavanger, Norway; Esbjerg, Denmark; Singapore; and Perth, Australia.

Manufacturing

Dril-Quip has major manufacturing facilities in Houston, Texas; Aberdeen, Scotland; and Singapore. Each location conducts a broad variety of processes, including machining, fabrication, inspection, assembly and testing. The Houston facility provides forged and heat treated products to all the major manufacturing facilities.

The Company's Houston and Aberdeen manufacturing plants are ISO 9001 and American Petroleum Institute certified. See "Properties--Major Manufacturing Facilities." Dril-Quip maintains its high standards of product quality through the use of quality assurance specialists who work with product manufacturing personnel throughout the manufacturing process by inspecting and documenting equipment as it is processed through the Company's manufacturing facilities. The Company has the capability to manufacture various products from each of its product lines at its major manufacturing facilities and believes that this localized manufacturing capability is essential in order to compete with the Company's major competitors.

The Company's manufacturing process is vertically integrated, producing, in house, approximately 80% of its forging requirements and essentially all of its heat treatment, machining, fabrication, inspection, assembly and testing. The Company's primary raw material is cast steel ingots, from which it produces steel shaped forgings at its forging and heat treatment facility. The Company routinely purchases steel ingots from approximately four suppliers on a purchase order basis and does not have any long-term supply contracts. The Company's Houston facility provides forgings and heat treatment for its Aberdeen and Singapore facilities. The Company's major competitors depend on outside sources for all or a substantial portion of their forging and heat treatment requirements. The Company has made significant capital investments in developing its vertically integrated manufacturing capability. Prolonged periods of low demand in the market for offshore drilling and production equipment could have a greater effect on the Company than on certain of its competitors that have not made large capital investments in facilities.

Dril-Quip's manufacturing facilities utilize state-of-the-art computer numerically controlled ("CNC") machine tools and equipment, which contribute to the Company's product quality and timely delivery. The Company has also developed a cost effective, in-house machine tool rebuild capability which produces "like new" machine upgrades with customized features to enhance the economic manufacture of its specialized products. The Company purchases quality used machine tools as they become available and stores them at its facilities to be rebuilt and upgraded as the need arises. Rebuilding used machine tools allows for greater customization suitable for manufacturing Dril-Quip proprietary product lines. This provides the added advantage of requiring only in-house expertise for repairs and maintenance of these machines. A significant portion of the Company's manufacturing capacity growth has been through the rebuild/upgrade of quality used machine tools, including the replacement of outdated control systems with state-of-the-art CNC controls.

Since 1996, the Company has been operating at close to full capacity. In 1997, in conjunction with its initial public offering, the Company announced a three-year, $50 million capital expansion program to increase its manufacturing capacity by approximately 90% by the end of 1999. During 1998 this expansion continued substantially on schedule and on budget as the Company increased its facilities at its Eldridge site in Houston, Texas from approximately 280,000 square feet at the end of 1997 to approximately 664,000 square feet at the end of 1998. Facility expansions included additions to the Company's rough-out machine shop, forge and heat treat building, blast and paint facilities, and fabrication building. Additionally, a new machine shop was erected which will allow for the 1999 consolidation of finish machine operations under one roof. A new riser tower and test pit and a new riser fabrication and assembly building were also added at the Eldridge site.

Customers

The Company's principal customers are major integrated oil and gas companies, large independent oil and gas companies and foreign national oil and gas companies. Offshore drilling contractors and engineering and construction companies also represent a minor customer base. The Company's customers are generally oil and gas companies that are well-known participants in offshore exploration and production.

The Company is not dependent on any one customer or group of customers. In 1998, the Company's top 15 customers represented approximately 74% of total revenues, with the Royal Dutch Shell Group of Companies (aggregating sales to all of its worldwide affiliates), accounting for approximately 13%, and Chevron USA Production Company accounting for approximately 11%, of revenues. The number and variety of the Company's products required in a given year by any one customer depends upon the amount of that customer's capital expenditure budget devoted to offshore exploration and production in any single year and on the results of competitive bids for major projects. Consequently, a customer that accounts for a significant portion of revenues in one fiscal year may represent an immaterial portion of revenues in subsequent years. While the Company is not dependent on any one customer or group of customers, the loss of one or more of its significant customers could, at least on a short-term basis, have an adverse effect on the Company's results of operations.

Marketing and Sales

Dril-Quip markets its products and services throughout the world directly through its sales personnel in two domestic and seven international locations. In addition, in certain foreign markets where the Company does not maintain offices, it utilizes independent sales representatives to enhance its marketing and sales efforts. Some of the locations in which Dril-Quip has sales representatives are the United Arab Emirates, Saudi Arabia, China, Canada, the Philippines, Brazil, Indonesia, Malaysia, Kuwait, Brunei, Oman, Qatar and West Africa. Although they do not have authority to contractually bind the Company, these representatives market the Company's products in their respective territories in return for sales commissions. The Company also places print advertising from time to time in trade and technical publications targeted to its customer base. It also participates in industry conferences and trade shows to enhance industry awareness of its products.

The Company's customers generally order products on a purchase order basis. Orders are typically filled within two weeks to three months after receipt of a purchase order, depending on the type of product and whether it is sold out of inventory or requires some customization. Contracts for certain of the Company's larger, more complex products, such as subsea production trees, drilling risers and equipment for TLPs and Spars can take a year or more to complete.

The primary factors influencing a customer's decision to purchase the Company's products are the quality, reliability and reputation of the product, price and technologically superior features. Timely delivery of equipment is also very important to customer operations and the Company maintains an experienced sales coordination staff to help assure such delivery. For large drilling and production system orders, project management teams coordinate customer needs with engineering, manufacturing and service organizations, as well as with subcontractors and vendors.

A portion of the Company's business consists of designing, manufacturing, selling and installing equipment for major projects pursuant to competitive bids, and the number of such projects in any year fluctuates. The Company's profitability on such projects is critically dependent on making accurate and cost effective bids and performing efficiently in accordance with bid specifications. Various factors can adversely affect the Company's performance on individual projects, with potential adverse effects on project profitability.

Product Development and Engineering

The technological demands of the oil and gas industry continue to increase as offshore exploration and drilling expand into more hostile environments. Conditions encountered in these environments include well pressures of up to 15,000 psi (pounds per square inch), mixed flows of oil and gas under high pressure that may also be highly corrosive and water depths in excess of 5,000 feet. Since its founding, Dril-Quip has actively engaged in continuing product development to generate new products and improve existing products. When developing new products, the Company typically seeks to design the most technologically advanced version for a particular application to establish its reputation and qualification in that product. Thereafter, the Company leverages its expertise in the more technologically advanced product to produce less costly and complex versions of the product for less demanding applications. The Company also focuses its activities on reducing the overall cost to the customer, which includes not only the initial capital cost but also operating costs associated with its products.

All of the Company's products have been developed from internally generated designs, and the Company has continually introduced new products and product enhancements since its founding in 1981. Product developments that began in 1991 have led to a series of new products, including diverters, wellhead connectors, SingleBore(TM) subsea trees, improved severe service dual bore subsea trees, subsea and platform valves, platform wellheads, platform trees, subsea tree workover riser systems, drilling risers and TLP and Spar production riser systems.

Dril-Quip's product development work is conducted at its facilities in Houston, Texas and Aberdeen, Scotland. In addition to the work of its product development staff, the Company's application engineering staff provides engineering services to customers in connection with the design and sales of its products. The Company's ability to develop new products and maintain technological advantages is important to its future success. There can be no assurance that the Company will be able to develop new products, successfully differentiate itself from its competitors or adapt to evolving markets and technologies.

The Company believes that the success of its business depends more on the technical competence, creativity and marketing abilities of its employees than on any individual patent, trademark or copyright. Nevertheless, as part of its ongoing product development and manufacturing activities, Dril-Quip's policy has been to seek patents when appropriate on inventions concerning new products and product improvements. All patent rights for products developed by employees are assigned to the Company and almost all of the Company's products have components that are covered by patents. The Company's existing patents expire at various times beginning in 2001.

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

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

Competition

Dril-Quip faces significant competition from other manufacturers of exploration and production equipment. Several of its primary competitors are diversified multinational companies with substantially larger operating staffs and greater capital resources than those of the Company and which, in many instances, have been engaged in the manufacturing business for a much longer time than the Company. The Company competes principally with ABB Vetco Gray Inc. (a subsidiary of Asea Brown Boveri, more commonly referred to as ABB), the petroleum production equipment segment of Cooper Cameron Corporation, the Petroleum Equipment Group of FMC Corporation and Kvaerner National Ltd. (a division of Kvaerner A.S.).

Because of their relative size and diversity of products, several of these companies have the ability to provide "turnkey" services for offshore drilling and production applications, which enables them to use their own products to the exclusion of Dril-Quip's products. The Company also competes to a lesser extent with a number of other companies in various products. The principal competitive factors in the petroleum drilling and production equipment markets are quality, reliability and reputation of the product, price, technology, service and timely delivery.

Employees

The total number of the Company's employees as of December 31, 1998 was 1,169. Of these, 756 were located in the United States. The Company's employees are not covered by collective bargaining agreements, and the Company considers its employee relations to be good.

The Company's operations depend in part on its ability to attract a skilled labor force. While the Company believes that its wage rates are competitive and that its relationship with its skilled labor force is good, a significant increase in the wages paid by competing employers could result in a reduction of the Company's skilled labor force, increases in the wage rates paid by the Company or both. If either of these events were to occur, in the near-term, the profits realized by the Company from work in progress would be reduced and, in the long-term, the production capacity and profitability of the Company could be diminished and the growth potential of the Company could be impaired.

Governmental Regulations

Many aspects of the Company's operations are affected by political developments and are subject to both domestic and foreign governmental regulations, including those relating to oilfield operations, worker safety and the protection of the environment. In addition, the Company depends on the demand for its services from the oil and gas industry and, therefore, is affected by changing taxes, price controls and other laws and regulations relating to the oil and gas industry generally, including those specifically directed to offshore operations. The adoption of laws and regulations curtailing exploration and development drilling for oil and gas for economic or other policy reasons could adversely affect the Company's operations by limiting demand for the Company's products.

In recent years, increased concern has been raised over the protection of the environment. Offshore drilling in certain areas has been opposed by environmental groups and, in certain areas, has been restricted. To the extent that new laws or other governmental actions prohibit or restrict offshore drilling or impose additional environmental protection requirements that result in increased costs to the oil and gas industry in general and the offshore drilling industry in particular, the business of the Company could be adversely affected. The Company cannot determine to what extent its future operations and earnings may be affected by new legislation, new regulations or changes in existing regulations.

The Company's operations are affected by numerous foreign, federal, state and local environmental laws and regulations. The technical requirements of these laws and regulations are becoming increasingly expensive, complex and stringent. These laws may provide for "strict liability" for damages to natural resources or threats to public health and safety, rendering a party liable for the environmental damage without regard to negligence or fault on the part of such party. Sanctions for noncompliance may include revocation of permits, corrective action orders, administrative or civil penalties and criminal prosecution. Certain environmental laws provide for joint and several strict liability for remediation of spills and releases of hazardous substances. In addition, companies may be subject to claims alleging personal injury or property damage as a result of alleged exposure to hazardous substances, as well as damage to natural resources. Such laws and regulations may also expose the Company to liability for the conduct of or conditions caused by others, or for acts of the Company that were in compliance with all applicable laws at the time such acts were performed. Compliance with environmental laws and regulations may require the Company to obtain permits or other authorizations for certain activities and to comply with various standards or procedural requirements. The Company believes that its facilities are in substantial compliance with current regulatory standards.

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

Item 2. Properties

Major Manufacturing Facilities

Location	Building Size (Approximate Square Feet)	Land (Approximate Acreage)	Owned or Leased
Houston, Texas			
--13550 Hempstead Highway....	175,000	15	Owned
	14,000	--	Leased (offices)
--6401 N. Eldridge Parkway...	664,000	218	Owned
Aberdeen, Scotland.............	137,000	14	Owned
	15,000	--	Leased (offices)
Singapore......................	24,000	2	Leased

Dril-Quip's manufacturing facilities in Houston and Aberdeen are capable of manufacturing each of its products, and the facility in Singapore is capable of manufacturing most of the Company's established products. Of the 664,000 square feet of buildings located at the Eldridge site in Houston, Texas, buildings consisting of approximately 215,000 square feet have been completed, but were not in service as of December 31, 1998.

Sales, Service and Reconditioning Facilities

Leased Location	Building Size (Approximate Square Feet)	Land (Approximate Acreage)	Activity
New Orleans, Louisiana..	2,300	--	Sales/Service
Beverwijk, Holland......	5,200	0.2	Sales/Warehouse
Perth, Australia........	5,400	0.2	Sales/Service/Reconditioning/Warehouse
Stavanger, Norway.......	15,700	2.4	Sales/Service/Reconditioning/ Warehouse/Fabrication
Esbjerg, Denmark........	19,400	1.2	Sales/Service/Reconditioning/Warehouse

The Company also performs sales, service and reconditioning activities at its facilities in Houston, Aberdeen and Singapore. As part of its capital expansion, the Company plans to expand its facilities in Stavanger to meet growing demands for its products and services.

Item 3. Legal Proceedings

The Company is not a party to, nor is any of its property the subject of, any pending legal proceedings, which, in the opinion of management, are expected to have a material adverse effect on the Company's consolidated results of operations or financial position.

Item 4. Submission of Matters to a Vote of Security Holders

The Company's Annual Meeting of Stockholders was held on May 14, 1998, to elect one Class I member of the Board of Directors and to approve the appointment of Ernst & Yount LLP as independent public accountants of the Company for 1998. The Class I director who was so elected was James M. Alexander, by 16,338,508 affirmative votes. 717,607 votes were withheld. The directors whose term of office continued after the Annual Meeting are J. Mike Walker, Gary W. Loveless, Larry E. Reimert and Gary D. Smith. In the matter of the approval of the appointment of the independent accountants, there were 16,518,283 affirmative votes 5,250 negative votes, 3,860 abstentations and 717,607 broker non-votes.

Item S-K 401(b). Executive Officers of the Registrant

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

The following table sets forth the names, ages (as of March 15, 1999) and positions of the Company's executive officers:

Name	Age	Position
Larry E. Reimert...	51	Co-Chairman of the Board and Co-Chief Executive Officer
Gary D. Smith......	56	Co-Chairman of the Board and Co-Chief Executive Officer
J. Mike Walker.....	55	Co-Chairman of the Board and Co-Chief Executive Officer
Jerry M. Brooks....	47	Chief Financial Officer

Larry E. Reimert is Co-Chairman of the Board and Co-Chief Executive Officer with principal responsibility for engineering, product development and finance. He has been the Director--Engineering, Product Development and Finance, as well as a member of the Board of Directors, since the Company's inception in 1981. Prior to that, he worked for Vetco Offshore, Inc. in various capacities, including Vice President of Technical Operations, Vice President of Engineering and Manager of Engineering. Mr. Reimert holds a BSME degree from the University of Houston and a MBA degree from Pepperdine University.

Gary D. Smith is Co-Chairman of the Board and Co-Chief Executive Officer with principal responsibility for sales, service, training and administration. He has been the Director--Sales, Service, Training and Administration, as well as a member of the Board of Directors, since the Company's inception in 1981. Prior to that, he worked for Vetco Offshore, Inc. in various capacities, including General Manager and Vice President of Sales and Service.

J. Mike Walker is Co-Chairman of the Board and Co-Chief Executive Officer with principal responsibility for manufacturing, purchasing and facilities. He has been the Director--Manufacturing, Purchasing and Facilities, as well as a member of the Board of Directors, since the Company's inception in 1981. Prior to that, he served as the Director of Engineering, Manager of Engineering and Manager of Research and Development with Vetco Offshore, Inc. Mr. Walker holds a BSME degree from Texas A&M University, a MSME degree from the University of Texas at Austin and a Ph.D. in mechanical engineering from Texas A&M University.

Jerry M. Brooks has been Chief Financial Officer since March 1999. Prior to that, he served as Chief Accounting Officer since joining the Company in 1992. From 1980 to 1991, he held various positions with Chiles Offshore Corporation, most recently as Chief Financial Officer, Secretary and Treasurer. Mr. Brooks holds a BBA in Accounting and an MBA from the University of Texas at Austin.

PART II

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

(a) The Company's Common Stock has been publicly traded on the New York Stock Exchange under the symbol DRQ since the Offering on October 22, 1997. The following table sets forth the quarterly high and low sales prices for the indicated quarters of fiscal 1997 and 1998:

Quarter Ended	High	Low
December 31, 1997	$40 7/16	$27 1/2
March 31, 1998	35	22 3/8
June 30, 1998	37	26 1/4
September 30, 1998	26 1/2	11 3/4
December 31, 1998	22 1/2	13 1/8

There were approximately 85 stockholders of record of the Company's Common Stock as of March 24, 1999. This number does not include the number of security holders for whom shares are held in a "nominee" or "street" name.

The Company currently intends to retain any earnings for the future operation and development of its business and does not currently anticipate paying any dividends in the foreseeable future. The Board of Directors will review this policy on a regular basis in light of the Company's earnings, financial condition and market opportunities.

(b) Use of Proceeds.

In October 1997, Dril-Quip sold 2,875,000 shares of Common Stock in the Offering. The net proceeds to the Company from the Offering were $63.4 million. As of December 31, 1998, the Company had used such net proceeds as follows: (i) to repay $30 million of indebtedness outstanding under the Company's credit facilities and term loans, which constitutes repayment of such facilities in full and (ii) $33.4 million for the purchase of property, plant and equipment. None of such payments was a direct or indirect payment to directors or officers of the Company or their associates, to persons owning 10% or more of any class of equity securities of the Company or to affiliates of the Company.

Item 6. Selected Financial Data

The information set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and Notes thereto included elsewhere in this Report.

	Year Ended December 31,				
	1994	1995	1996	1997	1998
	(In Thousands, Except Per Share Amount)				
Statement of Operations Data:					
Revenues	$80,548	$108,390	$115,864	$146,823	$177,642
Cost of sales	58,604	76,471	77,863	99,800	118,923
Selling, general and administrative expenses	11,673	13,597	15,031	16,313	21,293
Engineering and product development expenses	6,069	5,769	6,971	9,158	11,968
	76,346	95,837	99,865	125,271	152,184
Operating income	4,202	12,553	15,999	21,552	25,458
Interest expense (income)	2,273	2,944	2,647	2,027	(1,197)
Income before income taxes	1,929	9,609	13,352	19,525	26,655
Income tax provision	635	3,023	4,234	6,587	9,228
Net income	$ 1,294	$ 6,586	$ 9,118	$ 12,938	$ 17,427
Diluted earnings per share	$ .09	$ .46	$ .63	$ .87	$ 1.01
Weighted average shares outstanding	14,370	14,370	14,370	14,895	17,275
Statement of Cash Flows Data:					
Net cash provided by operating activities	$ 2,422	$ 6,466	$ 5,185	$ 10,325	$ 9,118
Net cash used in investing activities	(4,524)	(5,659)	(7,006)	(10,240)	(29,450)
Net cash provided by financing activities	2,668	560	1,261	31,386	(203)
Other Data:					
EBITDA(1)	$ 8,069	$ 17,201	$ 20,387	$ 26,541	$ 32,305
Depreciation and amortization	3,867	4,648	4,388	4,989	5,650
Capital expenditures	4,614	6,184	7,228	10,375	29,642

	As of December 31,				
	1994	1995	1996	1997	1998
	(In Thousands)				
Balance Sheet Data:					
Working capital	$34,099	$ 40,682	$ 49,524	$ 89,373	$ 83,595
Total assets	79,208	93,186	114,777	152,921	177,246
Total debt	30,416	31,052	32,536	518	315
Total stockholders' equity	32,903	39,501	50,882	124,161	141,912

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(1) EBITDA, or "earnings from continuing operations before interest expense, interest income, income taxes, depreciation and amortization," is not a generally accepted accounting principle measure, but is a supplemental financial measurement used by the Company in the evaluation of its business. EBITDA should not be construed as an alternative to net income or to cash flow from operations or any other measure of performance in accordance with generally accepted accounting principles, and is presented solely as a supplemental disclosure.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is management's discussion and analysis of certain significant factors that have affected certain aspects of the Company's financial position and results of operations during the periods included in the accompanying consolidated financial statements. This discussion should be read in conjunction with the Company's Consolidated Financial Statements and Notes thereto presented elsewhere in this Report.

Overview

Dril-Quip manufactures highly engineered offshore drilling and production equipment which is well suited for use in deepwater, harsh environment and severe service applications. The Company designs and manufactures subsea equipment, surface equipment and offshore rig equipment for use by major integrated, large independent and foreign national oil and gas companies in offshore areas throughout the world. The Company's principal products consist of subsea and surface wellheads, subsea and surface production trees, mudline hanger systems, specialty connectors and associated pipe, drilling and production riser systems, wellhead connectors and diverters. Dril-Quip also provides installation and reconditioning services and rents running tools for use in connection with the installation and retrieval of its products.

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

Crude oil prices declined substantially in 1998, and these depressed prices may continue in 1999. During 1998, oil prices fell to 12-year lows as measured in absolute dollars, and 25-year lows as measured in inflation-adjusted dollars. As a result, worldwide offshore exploration and production activity also declined, with the number of offshore rigs under contract in January 1999 at their lowest levels since the second quarter of 1995. Consequently, demand for Dril-Quip products, particularly those products used in drilling and producing economically marginal properties, has declined. As a result of continued depressed oil prices, virtually all major oil and gas companies have announced reduced exploratory capital spending budgets for 1999. Consequently, the Company may see a reduction in orders in 1999, which could adversely affect financial results.

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

Dril-Quip's revenues are generated by its two operating groups: the Product Group and the Service Group. The Product Group manufactures offshore drilling and production equipment, and the Service Group provides installation and reconditioning services as well as rental running tools for installation and retrieval of its products. In 1998, the Company derived 87.9% of its revenues from the sale of its products and 12.1% of its revenues from services. Revenues from the Service Group generally correlate to revenues from product sales, because increased product sales generate increased revenues from installation services and rental running tools. The Company has substantial international operations, with approximately 70%, 68%, 60% and 62% of its revenues derived from foreign sales in 1995, 1996, 1997 and 1998, respectively. During the same years, approximately 70% of all products sold were manufactured in the United States. The Company operates its business and markets its products and services in all of the significant oil and gas producing areas in the world and is, therefore, subject to the risks customarily attendant to international operations and investments in foreign countries.

Historically, Drip-Quip recognized revenues upon the delivery of a completed product. Beginning in 1997, the Company began receiving orders relating to larger and more complex projects that have longer manufacturing time frames. The Company accounts for such projects on a percentage of completion basis and revenues are generally recognized on the ratio of costs incurred to the total estimated costs. Accordingly, price and cost estimates are reviewed periodically as the work progresses, and adjustments proportionate to the percentage of completion are reflected in the period when such estimates are revised.

The principal elements of cost of sales are labor, raw materials and manufacturing overhead. Variable costs, such as labor, raw materials, supplies and energy, generally account for approximately two-thirds of the Company's cost of sales. The Company has experienced increased labor costs over the past few years due to the limited supply of skilled workers. Fixed costs, such as the fixed portion of manufacturing overhead, constitute the remainder of the Company's cost of sales. The Company continually seeks to improve its efficiency and cost position. Cost of sales as a percentage of revenues is also influenced by the product mix sold in any particular quarter and market conditions. The Company's costs related to its foreign operations do not significantly differ from its domestic costs.

Results of Operations

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

	Year Ended December 31,		
	1996	1997	1998
Revenues:			
Product Group	82.1%	86.1%	87.9%
Service Group	17.9	13.9	12.1
Total	100.0	100.0	100.0
Cost of sales	67.2	68.0	66.9
Selling, general and administrative expenses	13.0	11.1	12.0
Engineering and product development expenses	6.0	6.2	6.7
Operating income	13.8	14.7	14.3
Interest expense (income)	2.3	1.4	(0.7)
Income before income taxes	11.5	13.3	15.0
Income tax provision	3.6	4.5	5.2
Net income	7.9%	8.8%	9.8%

Year Ended December 31, 1998 Compared to Year Ended December 31, 1997

Revenues. Revenues increased by $30.8 million, or approximately 21%, to $177.6 million in 1998 from $146.8 million in 1997. This increase relates to increased sales in the United States area of $34.4 million, decreased revenues of $1.2 million in the European area and decreased sales of $2.4 million in the Asia-Pacific area. Domestic sales in the United States area increased by $8.8 million, or 15%, while export sales in the United States area increased by $25.6 million, or 343%. These increases were mainly due to increased manufacturing capacity and increased sales of new products related to larger and longer-term projects.

Cost of Sales. Cost of sales increased by $19.1 million, or 19%, to $118.9 million for the twelve months ended December 31, 1998 from $99.8 million for the same period in 1997. As a percentage of revenues, cost of sales decreased from 68% in 1997 to 67% in 1998. This decrease in cost of sales as a percentage of revenues was primarily due to strong market demand for new products related to larger and longer-term projects.

Selling, General and Administrative Expenses. For the twelve months ended December 31, 1998, selling, general and administrative expenses increased by $5 million, or 31%, to $21.3 million from $16.3 million in the 1997 period. This increase was due to an increased number of personnel needed to support higher sales volumes and increased labor costs. Selling, general and administrative expenses increased as a percentage of revenues from 11% in 1997 to approximately 12% in 1998.

Engineering and Product Development Expenses. During the year ended December 31, 1998, engineering and product development expenses increased by $2.8 million, or 31%, to $12 million from $9.2 million during the same period in 1997. This increase primarily reflects an increased number of personnel, and to a lesser extent, increased development testing related to new products. As a percentage of revenues, engineering and product development expenses increased from 6.2% in 1997 to approximately 6.7% in 1998.

Interest Expense/Income. Interest income for 1998 was $1.2 million, compared to interest expense of $2.0 million for the prior year. This change was primarily due to the repayment of substantially all of the Company's bank debt during the fourth quarter of 1997 and interest income earned on cash generated by the Offering.

Net Income. Net income increased by $4.5 million, or 35%, from $12.9 million in 1997 to $17.4 million in 1998 for the reasons set forth above.

Year Ended December 31, 1997 Compared to Year Ended December 31, 1996

Revenues. Revenues increased by $30.9 million, or approximately 27%, to $146.8 million in 1997 from $115.9 million in 1996. This increase relates to increased domestic sales in the United States area of $21.4 million, increased revenues of $7.0 million in the European area and increased sales of $3.2 million in the Asia-Pacific area. These increases were mainly due to strong market demand, along with increased manufacturing capacity, price increases and an increase in project related sales of new products.

Cost of Sales. Cost of sales increased by $21.9 million, or 28%, to $99.8 million for the twelve months ended December 31, 1997 from $77.9 million for the same period in 1996. As a percentage of revenues, cost of sales increased from 67% in 1996 to 68% in 1997. This increase in cost of sales as a percentage of revenues was primarily due to sales of new products, which tend to initially have lower margins, and higher labor costs, which factors were partially offset by improved pricing.

Selling, General and Administrative Expenses. For the twelve months ended December 31, 1997, selling, general and administrative expenses increased by $1.3 million, or 9%, to $16.3 million from $15.0 million in the 1996 period. This increase was due to an increased number of personnel needed to support higher sales volumes and increased labor costs. Selling, general and administrative expenses decreased as a percentage of revenues from 13% in 1996 to approximately 11% in 1997.

Engineering and Product Development Expenses. During the year ended December 31, 1997, engineering and product development expenses increased by $2.2 million, or 31%, to $9.2 million from $7.0 million during the same period in 1996. This increase primarily reflects an increased number of personnel, and to a lesser extent, increased development testing related to new products. As a percentage of revenues, engineering and product development expenses remained essentially unchanged at approximately 6% in both 1997 and 1996.

Interest Expense. Interest expense for 1997 was $2.0 million, a decrease of approximately $600,000, or approximately 23%, from interest expense of $2.6 million for the prior year. This decrease was primarily due to the repayment of a substantial portion of the Company's bank debt during the fourth quarter of 1997 which resulted, on average, in lower outstanding debt balances in 1997 as compared to 1996.

Net Income. Net income increased by $3.8 million, or 42%, from $9.1 million in 1996 to $12.9 million in 1997 for the reasons set forth above.

Liquidity and Capital Resources

The primary liquidity needs of the Company are (i) to fund capital expenditures to increase manufacturing capacity, improve and expand facilities and manufacture additional rental running tools and (ii) to fund working capital. Historically, the Company's principal sources of funds have been cash flow from operations and bank indebtedness. However, as a result of the Offering, all of the Company's bank indebtedness was repaid in 1997.

Net cash provided by operating activities was $5.2 million in 1996, $10.3 million in 1997 and $9.1 million in 1998. Improvements in cash flow from operating activities in 1997 were principally the result of improved operating results, offset by increased working capital requirements attributable to increases in accounts receivable and inventory due to increased sales. The decrease in cash flow from operating activities in 1998 was the result of a substantial increase in accounts receivable, offset by improved operating results. Accounts receivable at December 31, 1998 increased 63% over December 31, 1997 levels compared to a 21% increase in revenues for the year. The disproportionate increase in accounts receivable was due to timing of cash receipts and billings related to long-term projects.

Capital expenditures by the Company were $7.2 million, $10.4 million and $29.6 million in 1996, 1997 and 1998, respectively. Principal payments on long-term debt were $3.2 million, $36.3 million and $200,000 in 1996, 1997 and 1998, respectively.

In October 1997, the Offering provided the Company with proceeds of approximately $63.4 million, net of expenses. The Company repaid approximately $30 million of indebtedness with the proceeds from the Offering and has used the remaining proceeds to expand its manufacturing capacity, improve and expand facilities and manufacture additional running tools for rental. The Company believes that cash on hand plus cash generated from operations will be sufficient to fund operations, working capital needs and anticipated capital expenditure requirements. Should unexpected cash requirements arise, however, the Company believes that borrowing from commercial lending institutions would be readily available and more than adequate to meet such requirements.

Backlog

Backlog consists of firm customer orders for which a purchase order has been received, satisfactory credit or financing arrangements exist and delivery is scheduled. The Company's backlog was approximately $125 million at December 31, 1997 and was approximately $130 million at December 31, 1998. This increase in backlog was primarily attributable to certain larger and longer term projects, including such products as drilling and production risers. The Company expects to fill approximately 60% of the December 31, 1998 backlog by December 31, 1999. The remaining backlog at December 31, 1998 consists of longer-term projects that will be designed and manufactured to customer specifications rather than sold out of inventory. The Company can give no assurance that backlog will remain at current levels. Sales of the Company's products are affected by prices for oil and natural gas, which declined significantly during 1998. Any further significant or prolonged decline in oil and natural gas prices could reduce new customer orders, which would cause the Company's backlog to decline. All of the Company's projects currently included in its backlog are subject to change and/or termination at the option of the customer. In the case of a change or termination, the customer is required to pay the Company for work performed and other costs necessarily incurred as a result of the change or termination.

Geographic Areas

The Company's operations are divided into three geographic areas based upon the locations of its manufacturing facilities: the United States (Houston, Texas); Europe, Middle East and Africa (Aberdeen, Scotland) and Asia-Pacific (Singapore). The United States area includes sales to both North and South America. The area of Europe, Middle East and Africa includes primarily sales to the North Sea with lesser sales to the Middle East and Africa. The Asia-Pacific area includes sales primarily to Australia, Thailand, Malaysia and Indonesia.

Revenues for each of these areas are dependent upon the ultimate sale of products and services to the Company's customers. For information on revenues by geographic area, see note 10 "Notes to Consolidated Financial Statements and Supplementary Data" on page 29. Revenues of the United States area are also influenced by its sale of products to the European and Asia-Pacific subsidiaries. Accordingly, the operating incomes of each area are closely tied to third-party sales, and the operating income of the United States area is also dependent upon its level of intercompany sales.

Currency Risk

Through its subsidiaries, the Company conducts a portion of business in currencies other than the United States dollar, principally the British pound sterling and the Norwegian kroner. The Company generally attempts to minimize its currency exchange risk by seeking international contracts payable in local currency in amounts equal to the Company's estimated operating costs payable in local currency and in U.S. dollars for the balance of the contract and by contractual purchase price adjustments based on an exchange rate formula related to U.S. dollars. Because of this strategy, the Company has not experienced significant transaction gains or losses associated with changes in currency exchange rates and does not anticipate such exposure to be material in the future. In 1996 and 1997, the Company had exchange gains, net of income taxes, of approximately $163,000 and $1 million, respectively. In 1998, the Company had a loss of approximately $296,000. The gain in 1997 was primarily related to debt which was repaid in 1997. There is no assurance that the Company will be able to protect itself against such fluctuations in the future. Historically, the Company has not conducted business in countries that limit repatriation of earnings. However, as the Company expands its international operations, it may begin operating in countries that have such limitations. Further, there can be no assurance that the countries in which the Company currently operates will not adopt policies limiting repatriation of earnings in the future. The Company also has significant investments in countries other than the United States, principally its manufacturing operations in Aberdeen, Scotland and, to a lesser extent, Singapore. The functional currency of these foreign operations is the local currency and, accordingly, financial statement assets and liabilities are translated at current exchange rates. Resulting translation adjustments are reflected as a separate component of stockholders' equity and have no current effect on earnings or cash flow.

Year 2000 Readiness Disclosure

Historically, certain computerized systems have used two digits rather than four digits to define the applicable year, which could result in recognizing the date using "00" as the year 1900 rather than the year 2000. This could result in major failures or miscalculations and is generally referred to as the Year 2000 problem.

The Company has undertaken a Year 2000 readiness program that encompasses a comprehensive review of three distinct areas that are susceptible to the Year 2000 problem:

- information systems;
- automated production systems; and
- third parties.

Information systems include communications and traditional software and hardware in the Company network and desktop environments. Automated production systems include all automation and embedded chips used in production and manufacturing. Third parties include any party that supplies goods or services to the Company. The Company does not anticipate any material year 2000 exposure arising out of the sale of its products to third party customers because the Company's products are mechanical and structural in nature and do not include integrated circuitry.

The Year 2000 problem is being addressed within the Company and progress is regularly reported to management and the Board of Directors. In implementing the Year 2000 program, the Company has prioritized its readiness efforts into two categories: "mission critical" and "non-mission critical." Systems and third parties which are considered mission critical are those of which a Year 2000 failure could cause any of the following to occur:

- the inability of the Company to meet its product delivery obligations;
- a reduction or cessation of the Company's manufacturing capacity or capabilities;
- the inability of the Company to meet its financial obligations; or

.any other major interruption to Company operations.

Mission critical systems and third parties are addressed on a priority basis over non-mission critical systems and third parties.

The Company's Year 2000 program is made up of three phases: assessment, remediation and testing. As of March 1, 1999 the Company had completed assessment and remediation of all mission critical information systems and automated production systems. Testing of mission critical systems is already underway and will be completed by July 1, 1999. As of March 1, 1999, the Company had completed assessment and remediation of approximately 50% of all non-mission critical information systems and automated production systems. Assessment and remediation of all non-mission critical systems will be completed by July 1, 1999 and testing will be completed by August 1, 1999.

As of March 1, 1999, the Company had contacted substantially all of its mission critical third party suppliers and vendors about their Year 2000 readiness. The Company has received responses from a majority of those third parties contacted. By July 1, 1999, the Company plans to have contacted all of its mission critical third parties and substantially all of its non-mission critical third parties.

Although the Company is taking affirmative steps to determine the readiness of third parties, there can be no assurance that the systems and processes of such third parties will remain functional. Year 2000 failures among mission critical third parties could possibly cause shutdowns or other significant business interruptions that could result in a material effect on the operations, liquidity or capital resources of the Company. At this time, the Company cannot quantify the potential impact of these failures. The Company is currently developing contingency plans to address issues within its control. The program minimizes, but does not eliminate, the issues of third parties.

The total cost of the Company's Year 2000 program is not expected to be material to the Company's operations, liquidity or capital resources. Costs are being handled within the current information systems budget, and no special allocations have been made. The total estimated cost for the Company's Year 2000 program is expected to be less than $200,000. This includes costs for the replacement, repair or upgrade of existing non-ready systems.

This disclosure is provided pursuant to Securities Exchange Act Release No. 34-40277. As such, it is protected as a forward-looking statement under the Private Securities Litigation Reform Act of 1995. See "Forward-Looking Statements" on page 1. This disclosure is also subject to protection under the Year 2000 Information and Readiness Disclosure Act of 1998, Public Law 105-271, as a "Year 2000 Statement" and "Year 2000 Readiness Disclosure" as defined therein.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 8. Financial Statements and Supplementary Data

REPORT OF INDEPENDENT AUDITORS

Board of Directors and Stockholders
Dril-Quip, Inc.

We have audited the accompanying consolidated balance sheets of Dril-Quip, Inc., as of December 31, 1998 and 1997, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Dril-Quip, Inc., at December 31, 1998 and 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

Ernst & Young LLP

Houston, Texas
February 15, 1999

DRIL-QUIP, INC.

CONSOLIDATED STATEMENTS OF INCOME

	Year ended December 31		
	1996	1997	1998
	(In Thousands, Except Share Amounts)		
Revenues	$ 115,864	$ 146,823	$ 177,642
Cost and expenses:			
Cost of sales	77,863	99,800	118,923
Selling, general, and administrative	15,031	16,313	21,293
Engineering and product development	6,971	9,158	11,968
	99,865	125,271	152,184
Operating income	15,999	21,552	25,458
Interest expense (income)	2,647	2,027	(1,197)
Income before income taxes	13,352	19,525	26,655
Income tax provision	4,234	6,587	9,228
Net income	$ 9,118	$ 12,938	$ 17,427
Earnings per share:			
Basic	$ .63	$ .87	$ 1.01
Fully diluted	$ .63	$ .87	$ 1.01
Weighted average shares			
Basic	14,370,000	14,881,986	17,245,000
Fully diluted	14,370,000	14,895,222	17,275,222

The accompanying notes are an integral part of these statements.

DRIL-QUIP, INC.

CONSOLIDATED BALANCE SHEETS

ASSETS	December 31 1997	1998
	(In Thousands)	
Current assets:		
Cash and cash equivalents	$ 32,612	$ 11,869
Trade receivables	27,336	44,527
Inventories	52,436	55,536
Deferred taxes	3,694	3,883
Prepaids and other current assets	657	1,387
Total current assets	116,735	117,202
Property, plant, and equipment, net	35,814	59,753
Other assets	372	291
Total assets	$152,921	$177,246

LIABILITIES AND STOCKHOLDERS' EQUITY

	1997	1998
Current liabilities:		
Accounts payable	$ 15,354	$ 16,712
Current maturities of long-term debt	210	165
Accrued income taxes	1,176	1,637
Customer prepayments	4,324	9,039
Accrued compensation	3,098	3,742
Other accrued liabilities	3,200	2,312
Total current liabilities	27,362	33,607
Long-term debt	308	150
Deferred taxes	1,090	1,577
Total liabilities	28,760	35,334
Stockholders' equity:		
Preferred stock, 10,000,000 shares authorized at $0.01 par value (none issued)	--	--
Common stock: 50,000,000 shares authorized at $0.01 par value, 17,245,000 issued and outstanding	172	172
Additional paid-in capital	63,291	63,291
Retained earnings	62,590	80,017
Foreign currency translation adjustment	(1,892)	(1,568)
Total stockholders' equity	124,161	141,912
Total liabilities and stockholders' equity	$152,921	$177,246

The accompanying notes are an integral part of these statements.

DRIL-QUIP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31		
	1996	1997	1998
	(In Thousands)		
Operating activities			
Net income	$ 9,118	$ 12,938	$ 17,427
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	4,388	4,989	5,650
Gain on sale of equipment	(82)	(9)	(6)
Deferred income taxes	(505)	(189)	299
Changes in operating assets and liabilities:			
Trade receivables	(4,553)	(2,822)	(16,994)
Inventories	(10,815)	(2,763)	(2,743)
Prepaids and other assets	(144)	133	(641)
Trade accounts payable and accrued expenses	7,778	(1,952)	6,126
Net cash provided by operating activities	5,185	10,325	9,118
Investing activities			
Purchase of property, plant, and equipment	(7,228)	(10,375)	(29,642)
Proceeds from sale of equipment	222	135	192
Net cash used in investing activities	(7,006)	(10,240)	(29,450)
Financing activities			
Proceeds from revolving line of credit and long-term borrowings	4,564	4,373	0
Principal payments on long-term debt	(3,203)	(36,307)	(203)
Dividends paid	(100)	--	--
Proceeds from sale of stock	--	63,320	0
Net cash provided by (used in) financing activities	1,261	31,386	(203)
Effect of exchange rate changes on cash activities	(658)	(220)	(208)
Increase (decrease) in cash	(1,218)	31,251	(20,743)
Cash at beginning of period	2,579	1,361	32,612
Cash at end of period	$ 1,361	$ 32,612	$ 11,869

The accompanying notes are an integral part of these statements.

DRIL-QUIP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock	Paid-In Capital	Retained Earnings	Unrealized Translation Adjustment	Total
			(In Thousands)		
Balance at December 31, 1995......	$144	$ --	$40,634	$(1,277)	$ 39,501
Translation adjustment..........	--	--	--	2,363	2,363
Net income.....................	--	--	9,118	--	9,118
Comprehensive income............	--	--	--	--	11,481
Dividends ($.007 per share).....	--	--	(100)	--	(100)
Balance at December 31, 1996......	144	--	49,652	1,086	50,882
Translation adjustment..........	--	--	--	(2,978)	(2,978)
Net income.....................	--	--	12,938	--	12,938
Comprehensive income............	--	--	--	--	9,960
Common stock offering...........	28	63,291	--	--	63,319
Balance at December 31, 1997......	172	63,291	62,590	(1,892)	124,161
Translation adjustment..........	--	--	--	324	324
Net income.....................	--	--	17,427	--	17,427
Comprehensive income............	--	--	--	--	17,751
Balance at December 31, 1998......	$172	$63,291	$80,017	$(1,568)	$141,912

The accompanying notes are an integral part of these statements.

DRIL-QUIP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1998

1. Organization

Dril-Quip, Inc. (the "Company"), manufactures offshore drilling and production equipment, which is well suited for use in deepwater, harsh environment and severe service applications. The Company's principal products consist of subsea and surface wellheads, subsea and surface production trees, mudline hanger systems, specialty connectors and associated pipe, drilling and production riser systems, wellhead connector and diverters for use by major integrated, large independent and foreign national oil and gas companies in offshore areas throughout the world. Dril-Quip also provides installation and reconditioning services and rents running tools for use in connection with the installation and retrieval of its products. The Company has three subsidiaries that manufacture and market the Company's products abroad. Dril-Quip (Europe) Limited is located in Aberdeen, Scotland, with branches in Norway, Holland, and Denmark. Dril-Quip Asia Pacific PTE Ltd. is located in Singapore. DQ Holdings PTY Ltd. is located in Perth, Australia.

2. Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All material intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents

Short term investments that have a maturity of three months or less from the date of purchase are classified as cash equivalents. At December 31, 1997 and 1998, cash and cash equivalents include $30,235,000 and $10,075,000, respectively, invested in United States Treasury money market funds.

Inventories

The Company's inventories are reported at the lower of cost (first-in, first-out method) or market.

Property, Plant, and Equipment

Property, plant, and equipment are carried at cost, with depreciation provided on a straight-line basis over their estimated useful lives.

Income Taxes

The Company accounts for income taxes using the liability method. Deferred income taxes are provided on income and expenses which are reported in different periods for income tax and financial reporting purposes.

Revenue Recognition

The Company delivers most of its products on an as-needed basis by its customers and records revenues as the products are shipped. Certain revenues are derived from long-term contracts which generally require more than one year to fulfill. Revenues and profits on long-term contracts are recognized under the percentage-of-completion method based on a cost-incurred basis. Losses, if any, on contracts are recognized when they become known. Contracts for long-term projects contain provisions for customer progress payments. Payments in excess of revenues recognized are included as a customer prepayment liability. At December 31, 1998 and 1997, trade receivables included $11,032,000 and $1,900,000, respectively, in unbilled revenue, and inventories have been reduced by $22,571,000 and $3,700,000, respectively, for activities relating to long-term contracts.

Foreign Currency

The financial statements of foreign subsidiaries are translated into U.S. dollars at current exchange rates except for revenues and expenses, which are translated at average rates during each reporting period. Translation adjustments are reflected as a separate component of stockholders' equity and have no current effect on earnings or cash flows. These adjustments amounted to a gain of $2,363,000 in 1996, a loss of $2,978,000 in 1997 and, a gain of $324,000 in 1998, net of allocated income taxes of $458,000, $772,000 and $316,000, respectively.

Foreign currency exchange transactions are recorded using the exchange rate at the date of the settlement. Exchange gains (losses) were approximately $163,000 in 1996, $1,080,000 in 1997 and ($296,000) in 1998, net of income taxes. These amounts are included in the consolidated statements of income.

Stock-Based Compensation

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123. "Accounting For Stock Based Compensation" ("SFAS No. 123"). Accordingly, no compensation cost has been recognized for stock options granted under the Company's incentive plan.

Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and cash equivalents, receivables, payables, and debt instruments. The carrying values of these financial instruments approximate their respective fair values.

Concentration of Credit Risk

Financial instruments which subject the Company to concentrations of credit risk consist principally of trade receivables. The Company grants credit to its customers which operate primarily in the oil and gas industry. The Company performs periodic credit evaluations of its customer's financial condition and generally does not require collateral. The Company maintains reserves for potential losses and such losses have historically been within management's expectations.

Comprehensive Income

Effective January 1, 1998, the Company adopted Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income (SFAS No. 130). The adoption of SFAS No. 130 had no impact on the Company's net income or stockholders' equity. SFAS No. 130 requires the reporting of comprehensive income, which includes net income plus unrealized foreign currency translation gains and losses. Comprehensive income has been reported in the Consolidated Statements of Changes in Stockholders' Equity.

3. Inventories

Inventories consist of the following:

	December 31 1997	December 31 1998
	(In Thousands)	
Raw materials and supplies	$13,178	$13,114
Work in progress	14,766	18,114
Finished goods and purchased supplies	24,492	24,308
	$52,436	$55,536

4. Property, Plant, and Equipment

Property, plant, and equipment consist of:

	Estimated Useful Lives	December 31 1997	December 31 1998
		(In Thousands)	
Land and improvements	10-25 years	$ 6,826	$ 8,513
Buildings	15-40 years	15,987	27,063
Machinery and equipment	3-10 years	46,236	62,777
		69,049	98,353
Less accumulated depreciation		33,235	38,600
		$35,814	$59,753

5. Long-Term Debt

Long-term debt consists of the following:

	December 31 1997	December 31 1998
	(In Thousands)	
Equipment financing agreements	$ 518	$ 315
Less current portion	210	165
	$ 308	$ 150

Interest paid on long-term debt for the years ended December 31, 1996, 1997, and 1998 was $2,695,000, $2,562,681, and $44,000 respectively. Scheduled maturities of long-term debt are as follows: 1999--$165,000; 2000--$89,000; 2001--$49,000; 2002--$12,000; 2003 and thereafter--$-0-.

6. Income Taxes

Income before income taxes consisted of the following:

	1996	1997	1998
	(In Thousands)		
Domestic	$ 9,068	$13,547	$26,404
Foreign	4,284	5,978	251
Total	$13,352	$19,525	$26,655

The income tax provision consists of the following:

	1996	1997	1998
	(In Thousands)		
Current:			
Federal	$3,408	$4,640	$8,894
Foreign	1,331	2,258	36
Total current	4,739	6,898	8,930
Deferred:			
Federal	(505)	55	(16)
Foreign	--	(366)	314
Total deferred	(505)	(311)	298
	$4,234	$6,587	$9,228

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

	1996	1997	1998
Federal income tax statutory rate	34.0%	35.0%	35.0%
Benefit of foreign sales corporation	(1.8)	(1.2)	(1.7)
Other	(.5)	(.1)	1.3
Effective tax rate	31.7%	33.7%	34.6%

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

	December 31	
	1997	1998
	(In Thousands)	
Deferred tax liability:		
Property, plant and equipment	$1,090	$1,577
Deferred tax assets:		
Deferred profit on intercompany sales	2,704	2,815
Other--net	990	1,068
Total deferred tax assets	3,694	3,883
Net deferred tax asset	$2,604	$2,306

Undistributed earnings of the Company's foreign subsidiaries are considered to be indefinitely reinvested and, accordingly, no provision for U.S. federal income taxes has been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, the Company would be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to the various foreign countries. Determination of the amount of unrecognized deferred U.S. income tax liability is not practicable.

The Company paid approximately $4,314,000, $7,143,000 and $8,813,000 in income taxes in 1996, 1997 and 1998, respectively.

7. Employee Benefit Plans

The Company has a defined-contribution 401(k) plan covering domestic employees and a defined-contribution pension plan covering certain foreign employees. The Company generally makes contributions to the plans equal to each participant's eligible contributions for the plan year up to a specified percentage of the participant's annual compensation. The Company's contribution expense was $548,000, $601,000 and $652,000 in 1996, 1997 and 1998, respectively.

8. Commitments and Contingencies

The Company leases certain office, shop, and warehouse facilities; automobiles; and equipment, and expenses all lease payments when incurred. Total lease expense incurred was $853,000, $771,000 and $1,167,000 in 1996, 1997 and 1998, respectively. Annual minimum lease commitments at December 31, 1998 are as follows: 1999--$662,000; 2000--$299,000; 2001--$131,000; and 2002 and thereafter--$-0-.

The Company operates its business and markets its products and services in most of the significant oil and gas producing areas in the world and is, therefore, subject to the risk customarily attendant to international operations and dependency on the condition of the oil and gas industry. Additionally, products of the Company are used in potentially hazardous drilling, completion, and production applications that can cause personal injury, product liability, and environmental claims. Although exposure to such risk has not resulted in any significant problems in the past, there can be no assurance that future developments will not adversely impact the Company.

9. Stockholders' Equity

In October 1997, the Company completed its initial public offering of 5,750,000 shares of its common stock (the "Offering") at a public offering price of $24.00 per share. Of the 5,750,000 shares, 2,875,000 shares were sold by the Company and 2,875,000 shares were sold by certain selling stockholders of the Company. The Offering provided the Company with proceeds of approximately $63 million, net of expenses.

Under a Stockholder Rights Plan adopted by the Board of Directors in 1997, each share of common stock includes one Right to purchase from the Company a unit consisting of one one-hundredth of a share (a "Fractional Share") of Series A Junior Participating Preferred Stock at a specified purchase price per Fractional Share, subject to adjustment in certain events. The Rights will cause substantial dilution to any person or group that attempts to acquire the Company without the approval of the Company's Board of Directors.

10. Geographic Areas

	1996	1997	1998
	(In Thousands)		
Revenues			
United States:			
Domestic	$ 36,759	$ 58,169	$ 67,021
Export	7,561	7,447	33,016
Intercompany	28,188	22,260	22,738
Total United States	72,508	87,876	122,775
Europe, Middle East, and Africa	54,728	61,742	60,352
Asia-Pacific	16,944	20,119	17,718
Eliminations	(28,316)	(22,914)	(23,203)
Total	$115,864	$146,823	$177,642
Operating Income			
United States	$ 13,693	$ 13,656	$ 24,266
Europe, Middle East, and Africa	3,309	5,026	(653)
Asia-Pacific	1,825	2,610	2,163
Eliminations	(2,828)	260	(318)
Total	$ 15,999	$ 21,552	$ 25,458
Identifiable Assets			
United States	$ 50,664	$ 93,259	$117,237
Europe, Middle East, and Africa	59,564	51,904	55,768
Asia-Pacific	9,700	12,779	9,468
Eliminations	(5,151)	(5,021)	(5,227)
Total	$114,777	$152,921	$177,246

Export sales from the United States to unaffiliated customers consist of worldwide sales outside the territorial waters of the United States. Europe sales are primarily to the North Sea, with lesser sales to Africa and the Middle East, while Asia-Pacific's sales are primarily to Australia, Thailand, Malaysia, and Indonesia.

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

One of the Company's customers, the Royal Dutch Shell Group of Companies, accounted for approximately 19%, 11% and 13% of consolidated sales in 1996, 1997 and 1998, respectively. In 1998 Chevron USA Production Company accounted for approximately 11% of consolidated sales.

11. Employee Stock Option Plan and Awards

On September 19, 1997, the Company adopted the Dril-Quip, Inc. 1997 Incentive Plan. The Company reserved 1,700,000 shares of Common Stock for use in connection with the Incentive Plan. Persons eligible for awards under the Incentive Plan are employees holding positions of responsibility with the Company or any of its subsidiaries. On the date of the Offering, options under the Incentive Plan were granted to certain employees of the Company to purchase a total of 411,250 shares of Common Stock at an exercise price per share of $24.00 which was equal to the Offering price per share. In October 1998, 261,596 additional options were granted to certain employees at an exercise price of $19.8125 per share, the mean between the highest and lowest sale price per share of Common Stock on The New York Stock Exchange on the date of the grant. All options have a term of ten years and become exercisable in cumulative annual increments of one-fourth of the total number of shares of Common Stock subject thereto, beginning on the first anniversary of the date of the grant. To date, no options have been exercised or cancelled. At December 31, 1998, 102,813 options are exercisable at a price of $24.00 per share.

Under SFAS No. 123, pro forma information is required to reflect the estimated effect on net income and earnings per share as if the Company had accounted for the stock options and other awards granted using the fair value method described in that Statement. The fair value was estimated at the date of each grant using a Black-Scholes option pricing model with the following assumptions: a risk free rate of 6%, a volatility factor of the expected market price of the Company's common stock of .350; and an expected life of the options of 5 years. These assumptions resulted in a grant date fair value for the options of $9.83 per share for the options granted in October, 1997 and $8.11 per share for the options granted in October, 1998. For purposes of the pro forma disclosures, the estimated fair value is amortized to expense over the awards' vesting period. The amortization of this expense would have approximately a 4% and a 1% effect on net income and earnings per share in 1998 and 1997, respectively.

12. Quarterly Results of Operations: (unaudited)

	Quarter Ended			
	March 31	June 30	Sept. 30	Dec. 31
	(In Thousands, Except Share Amounts)			
1998				
Revenues	$40,816	$44,888	$47,125	$44,813
Operating income	5,926	6,508	6,629	6,395
Net income	4,129	4,474	4,543	4,281
Earnings per share:				
Basic	0.24	0.26	0.26	0.25
Diluted	0.24	0.26	0.26	0.25
1997				
Revenues	$34,216	$34,454	$38,003	$40,150
Operating income	3,988	5,008	5,960	6,596
Net income	2,256	2,857	3,520	4,306
Earnings per share:				
Basic(1)	0.16	0.20	0.24	0.26
Diluted(1)	0.16	0.20	0.24	0.26

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

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

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information required by this item is set forth under the captions "Election of Directors" and "--Compliance with Section 16(a) of the Exchange Act" in the Company's definitive Proxy Statement (the "1999 Proxy Statement") for its annual meeting of stockholders to be held on May 13, 1999, which sections are incorporated herein by reference.

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

Item 11. Executive Compensation

The information required by this item is set forth in the sections entitled "Election of Directors--Director Compensation" and "--Executive Compensation" in the 1999 Proxy Statement, which sections are incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The information required by this item is set forth in the section entitled "Security Ownership of Certain Beneficial Owners and Management" in the 1999 Proxy Statement, which section is incorporated herein by reference.

Item 13. Certain Relationships and Related Party Transactions

The information required by this item is set forth in the section entitled "Election of Directors--Certain Transactions" in the 1999 Proxy Statement, which section is incorporated herein by reference.

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a)(1) Financial Statements

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

(a)(2) Financial Statement Schedules

All schedules and other statements for which provision is made in the applicable regulations of the Commission have been omitted because they are not required under the relevant instructions or are inapplicable.

(a)(3) Exhibits

Exhibit No.	Description
*2.1	--Agreement and Plan of Merger by and Between Dril-Quip, Inc., a Texas corporation, and Dril-Quip, Inc., a Delaware corporation (Incorporated herein by reference to Exhibit 2.1 to the Company's Registration Statement on Form S-1 (Registration No. 333-33447)).
*3.1	--Restated Certificate of Incorporation of the Company (Incorporated herein by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (Registration No. 333-33447)).
*3.2	--Bylaws of the Company (Incorporated herein by reference to Exhibit 3.3 to the Company's Registration Statement on Form S-1 (Registration No. 333-33447)).
*3.3	--Certificate of Designations for Series A Junior Participating Preferred Stock (Incorporated herein by reference to Exhibit 3.3 to the Company's Report on Form 10-Q for the Quarter ended September 30, 1997).
*4.1	--Form of certificate representing Common Stock (Incorporated herein by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 (Registration No. 333-33447)).
*4.2	--Registration Rights Agreement among Dril-Quip, Inc. and certain stockholders (Incorporated herein by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-1 (Registration No. 333-33447)).
*4.3	--Rights Agreement between Dril-Quip, Inc. and ChaseMellon Shareholder Services, L.L.C., as rights agent (Incorporated herein by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-1 (Registration No. 333-33447)).
+*10.1	--Form of Employment Agreement between Dril-Quip, Inc. and each of Messrs. Reimert, Smith and Walker (Incorporated herein by reference to Exhibit 10.12 to the Company's Registration Statement on Form S-1 (Registration No. 333-33447)).
+*10.2	--Dril-Quip, Inc. 1997 Incentive Plan (Incorporated herein by reference to Exhibit 10.13 to the Company's Registration Statement on Form S-1 (Registration No. 333-33447)).
21.1	--Subsidiaries of the Registrant.
23.1	--Consent of Ernst & Young LLP.
27.1	--Financial Data Schedule.

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* Incorporated herein by reference as indicated.
+ Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to the requirements of Item 14(c) of Form 10-K.

(b) Reports on Form 8-K

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on March 29, 1999.

DRIL-QUIP, INC.

By: /s/ Larry E. Reimert
Larry E. Reimert
Co-Chairman of the Board of Directors

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

Name	Capacity	Date
/s/ J. Mike Walker J. Mike Walker	Co-Chairman of the Board and Director (Co-Principal Executive Officer)	March 29, 1999
/s/ Larry E. Reimert Larry E. Reimert	Co-Chairman of the Board and Director (Co-Principal Executive Officer)	March 29, 1999
/s/ Gary D. Smith Gary D. Smith	Co-Chairman of the Board and Director (Co-Principal Executive Officer)	March 29, 1999
/s/ Jerry M. Brooks Jerry M. Brooks	Chief Financial Officer (Principal Financial and Accounting Officer)	March 29, 1999
/s/ Gary W. Loveless Gary W. Loveless	Director	March 29, 1999
/s/ James M. Alexander James M. Alexander	Director	March 29, 1999

EXHIBIT 21.1

SUBSIDIARIES OF THE COMPANY

Dril-Quip (Europe) Limited, a private limited company.
Dril-Quip Asia Pacific PTE Ltd., a private limited company.
DQ Holdings PTY Ltd., a private limited company.

EXHIBIT 23.1

CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statement (Form S-8 No. 333-47453) pertaining to the 1997 Incentive Plan of Dril-Quip, Inc. of our report dated February 15, 1999, with respect to the consolidated financial statements of Dril-Quip, Inc. included in the Annual Report (Form 10-K) for the year ended December 31, 1998.

ERNST & YOUNG LLP

Houston, Texas
March 27, 1999

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YEAR
DEC-31-1998
JAN-01-1998
DEC-31-1998
11,869
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