OIL STATES INTERNATIONAL, INC
Form 10-Q
November 02, 2012

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

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2012

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ___________ to ___________

Commission file number: 001-16337

OIL STATES INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	76-0476605 (I.R.S. Employer Identification No.)
Three Allen Center, 333 Clay Street, Suite 4620, Houston, Texas (Address of principal executive offices)	77002 (Zip Code)

(713) 652-0582
(Registrant's telephone number, including area code)

None
(Former name, former address and former fiscal year, if changed since last report)

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) YES [X] NO [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "accelerated filer," "large accelerated filer" and "smaller reporting company in Rule 12b-2 of the Exchange Act.

(Check one):

Large Accelerated Filer [X]	Accelerated Filer [ ]
Non-Accelerated Filer [ ] (Do not check if a smaller reporting company)	Smaller Reporting Company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES [ ] NO [X]

The Registrant had 54,895,462 shares of common stock, par value $0.01, outstanding and 3,566,932 shares of treasury stock as of October 31, 2012.

OIL STATES INTERNATIONAL, INC.

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PART I -- FINANCIAL INFORMATION

ITEM 1. Financial Statements

OIL STATES INTERNATIONAL, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In Thousands, Except Per Share Amounts)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2012	2011	2012	2011
Revenues	$1,080,673	$902,621	$3,270,752	$2,483,379
Costs and expenses:				
Cost of sales and services	814,034	665,855	2,428,994	1,857,031
Selling, general and administrative expenses	51,308	45,430	147,901	131,902
Depreciation and amortization expense	59,440	46,929	164,323	137,318
Other operating (income) expense	1,566	(57)	1,703	2,724
	926,348	758,157	2,742,921	2,128,975
Operating income	154,325	144,464	527,831	354,404
Interest expense, net of capitalized interest	(15,736)	(16,760)	(51,617)	(39,541)
Interest income	440	174	979	1,422
Equity in earnings of unconsolidated affiliates	30	(204)	671	(151)
Other income	2,486	885	8,530	1,515
Income before income taxes	141,545	128,559	486,394	317,649
Income tax expense	(37,436)	(36,487)	(135,337)	(88,757)
Net income	104,109	92,072	351,057	228,892
Less: Net income attributable to noncontrolling interest	317	221	967	721
Net income attributable to Oil States International, Inc.	$103,792	$91,851	$350,090	$228,171
Net income per share attributable to Oil States International, Inc. common stockholders				
Basic	$1.92	$1.79	$6.69	$4.46
Diluted	$1.87	$1.67	$6.32	$4.15
Weighted average number of common shares outstanding:				
Basic	53,975	51,264	52,347	51,144
Diluted	55,365	54,960	55,391	55,028

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

OIL STATES INTERNATIONAL, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2012	2011	2012	2011
Net income	$104,109	$92,072	$351,057	$228,892
Other comprehensive income (loss):				
Foreign currency translation adjustment	43,564	(127,085)	40,527	(61,370)
Unrealized loss on forward contracts, net of tax	(434)	--	(434)	--
Total other comprehensive income (loss)	43,130	(127,085)	40,093	(61,370)
Comprehensive income (loss)	147,239	(35,013)	391,150	167,522
Comprehensive income attributable to noncontrolling interest	(357)	(148)	(996)	(685)
Comprehensive income (loss) attributable to Oil States International, Inc.	$146,882	$(35,161)	$390,154	$166,837

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

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OIL STATES INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In Thousands)

	SEPTEMBER 30, 2012 (UNAUDITED)	DECEMBER 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$163,551	$71,721
Accounts receivable, net	811,270	732,240
Inventories, net	807,317	653,698
Prepaid expenses and other current assets	18,853	32,000
Total current assets	1,800,991	1,489,659
Property, plant, and equipment, net	1,760,309	1,557,088
Goodwill, net	489,405	467,450
Other intangible assets, net	134,395	127,602
Other noncurrent assets	66,439	61,842
Total assets	$4,251,539	$3,703,641
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$328,029	$252,209
Accrued liabilities	113,291	96,748
Income taxes	31,688	10,395
Current portion of long-term debt and capitalized leases	32,605	34,435
Deferred revenue	65,158	75,497
Other current liabilities	1,761	5,665
Total current liabilities	572,532	474,949
Long-term debt and capitalized leases	1,154,167	1,142,505
Deferred income taxes	112,905	97,377
Other noncurrent liabilities	27,761	25,538
Total liabilities	1,867,365	1,740,369
Stockholders' equity:		
Oil States International, Inc. stockholders' equity:		
Common stock, $.01 par value, 200,000,000 shares authorized, 58,458,892 shares and 54,803,539 shares issued, respectively, and 54,893,645 shares and 51,288,750 shares outstanding, respectively	585	548
Additional paid-in capital	580,479	545,730
Retained earnings	1,800,676	1,450,586
Accumulated other comprehensive income	114,464	74,371
Treasury stock, at cost, 3,565,247 and 3,514,789 shares, respectively	(113,246)	(109,079)

Total Oil States International, Inc. stockholders’ equity	2,382,958	1,962,156
Noncontrolling interest	1,216	1,116
Total stockholders’ equity	2,384,174	1,963,272
Total liabilities and stockholders’ equity	$4,251,539	$3,703,641

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

OIL STATES INTERNATIONAL, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)

	NINE MONTHS ENDED SEPTEMBER 30, 2012	2011
Cash flows from operating activities:		
Net income	$351,057	$228,892
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	164,323	137,318
Deferred income tax provision	5,122	16,281
Excess tax benefits from share-based payment arrangements	(7,739)	(7,966)
Gains on disposals of assets	(7,131)	(1,650)
Non-cash compensation charge	13,934	10,829
Accretion of debt discount	4,106	5,787
Amortization of deferred financing costs	5,249	4,699
Other, net	(9)	(16)
Changes in operating assets and liabilities, net of effect from acquired businesses:		
Accounts receivable	(62,688)	(109,415)
Inventories	(140,408)	(104,421)
Accounts payable and accrued liabilities	84,449	28,137
Taxes payable	38,035	11,343
Other current assets and liabilities, net	(2,337)	3,256
Net cash flows provided by operating activities	445,963	223,074
Cash flows from investing activities:		
Capital expenditures, including capitalized interest	(331,750)	(371,165)
Acquisitions of businesses, net of cash acquired	(48,000)	(212)
Proceeds from disposition of property, plant and equipment	9,609	2,778
Other, net	(1,668)	(3,601)
Net cash flows used in investing activities	(371,809)	(372,200)
Cash flows from financing activities:		
Revolving credit borrowings and (repayments), net	201,837	(395,908)
6 1/2% senior notes issued	--	600,000
Payment of principal on 2 3/8% Notes conversion	(174,990)	--
Term loan repayments	(22,510)	(11,246)
Debt and capital lease repayments	(2,453)	(966)
Issuance of common stock from share-based payment arrangements	13,108	11,559
Purchase of treasury stock	--	(12,632)
Excess tax benefits from share-based payment arrangements	7,739	7,966
Payment of financing costs	(3,264)	(13,152)
Tax withholdings related to net share settlements of restricted stock	(4,167)	(2,540)
Other, net	3	(11)
Net cash flows provided by (used in) financing activities	15,303	183,070

Effect of exchange rate changes on cash	2,802	(11,325)
Net increase in cash and cash equivalents from continuing operations	92,259	22,619
Net cash used in discontinued operations – operating activities	(429)	(118)
Cash and cash equivalents, beginning of period	71,721	96,350
Cash and cash equivalents, end of period	$163,551	$118,851
Non-cash financing activities:		
Value of common stock issued in payment of 2 3/8% Notes conversion	$220,597	$--

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

OIL STATES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS

1. ORGANIZATION AND BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Oil States International, Inc. and its wholly-owned subsidiaries (referred to in this report as we or the Company) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the Commission) pertaining to interim financial information. Certain information in footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to these rules and regulations. The unaudited financial statements included in this report reflect all the adjustments, consisting of normal recurring adjustments, except for the out-of-period adjustments recorded in the third quarter of 2012 discussed below, which the Company considers necessary for a fair presentation of the results of operations for the interim periods covered and for the financial condition of the Company at the date of the interim balance sheet. Results for the interim periods are not necessarily indicative of results for the full year.

In the third quarter of 2012, we recorded out-of-period adjustments, which decreased revenues by $3.1 million and increased cost of sales by $4.4 million (including a $0.7 million decrease in cost of sales which related to 2011). The total adjustment of $7.5 million, or $0.10 per diluted share after tax, related to corrections of accruals for customer credits and related returned inventory due to accounting and reporting system design and implementation issues, along with other adjustments of cost accruals in our tubular services segment. After evaluating the quantitative and qualitative aspects of these corrections, management has determined that our previously issued quarterly and annual consolidated financial statements were not materially misstated and that the out-of-period adjustments are immaterial to our estimated full year 2012 results and to our earnings' trends.

The preparation of condensed consolidated financial statements in conformity with GAAP requires the use of estimates and assumptions by management in determining the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. If the underlying estimates and assumptions, upon which the financial statements are based, change in future periods, actual amounts may differ from those included in the accompanying condensed consolidated financial statements.

The financial statements included in this report should be read in conjunction with the Company's audited financial statements and accompanying notes included in its Annual Report on Form 10-K for the year ended December 31, 2011 (the 2011 Form 10-K).

2. RECENT ACCOUNTING PRONOUNCEMENTS

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board (the FASB), which are adopted by the Company as of the specified effective date. Unless otherwise discussed, management believes that the impact of recently issued standards, which are not yet effective, will not have a material impact on the Company's consolidated financial statements upon adoption.

In June 2011, the FASB issued amendments to disclosure requirements for the presentation of comprehensive income. This guidance eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. The amendments were applied retrospectively. For public entities, the amendments were effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The amendments do not require any transition disclosures. In December 2011, the FASB issued an amendment deferring the effective date of the requirement to present reclassification adjustments out of accumulated other comprehensive income on the face of the consolidated statement of income. The Company adopted this standard in the Quarterly Report on Form 10-Q for the three month period ended March 31, 2012.

3. DETAILS OF SELECTED BALANCE SHEET ACCOUNTS

Additional information regarding selected balance sheet accounts is presented below (in thousands):

	SEPTEMBER 30, 2012	DECEMBER 31, 2011
Accounts receivable, net:		
Trade	$585,579	$553,481
Unbilled revenue	229,113	180,273
Other	1,460	2,449
Total accounts receivable	816,152	736,203
Allowance for doubtful accounts	(4,882)	(3,963)
	$811,270	$732,240

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OIL STATES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

	SEPTEMBER 30, 2012	DECEMBER 31, 2011
Inventories, net:		
Tubular goods	$523,718	$420,519
Other finished goods and purchased products	93,015	80,184
Work in process	84,807	76,353
Raw materials	118,511	86,672
Total inventories	820,051	663,728
Allowance for obsolescence	(12,734)	(10,030)
	$807,317	$653,698

	ESTIMATED USEFUL LIFE	SEPTEMBER 30, 2012	DECEMBER 31, 2011
Property, plant and equipment, net:			
Land		$ 54,725	$ 48,989
Accommodations assets (1)	2 - 15 years	1,378,366	1,160,661
Buildings and leasehold improvements (1)	1 - 40 years	174,606	154,233
Machinery and equipment	1 - 29 years	386,891	355,798
Rental tools	4 - 10 years	243,082	199,084
Office furniture and equipment	1 - 10 years	54,999	48,081
Vehicles	2 - 10 years	117,648	100,554
Construction in progress		179,076	166,371
Total property, plant and equipment		2,589,393	2,233,771
Accumulated depreciation		(829,084)	(676,683)
		$ 1,760,309	$ 1,557,088

	SEPTEMBER 30, 2012	DECEMBER 31, 2011
Accrued liabilities:		
Accrued compensation	$57,899	$61,394
Accrued interest	13,474	6,035
Insurance liabilities	13,078	12,396
Accrued taxes, other than income taxes	14,738	5,889
Liabilities related to discontinued operations	1,696	2,125
Other	12,406	8,909
	$113,291	$96,748

(1) As of December 31, 2011, we have reclassified $54.7 million in buildings and leasehold improvements to accommodations assets for comparability purposes.

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OIL STATES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS
(Continued)

4. EARNINGS PER SHARE

The calculation of earnings per share attributable to the Company is presented below (in thousands, except per share amounts):

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2012	2011	2012	2011
Basic earnings per share:				
Net income attributable to Oil States International, Inc.	$103,792	$91,851	$350,090	$228,171
Weighted average number of shares outstanding	53,975	51,264	52,347	51,144
Basic earnings per share	$1.92	$1.79	$6.69	$4.46
Diluted earnings per share:				
Net income attributable to Oil States International, Inc.	$103,792	$91,851	$350,090	$228,171
Weighted average number of shares outstanding	53,975	51,264	52,347	51,144
Effect of dilutive securities:				
Options on common stock	477	592	513	666
2 3/8% Contingent Convertible Senior Subordinated Notes	782	2,944	2,391	3,044
Restricted stock awards and other	131	160	140	174
Total shares and dilutive securities	55,365	54,960	55,391	55,028
Diluted earnings per share	$1.87	$1.67	$6.32	$4.15

Our calculation of diluted earnings per share for the three and nine months ended September 30, 2012 excludes 303,833 shares and 424,299 shares, respectively, issuable pursuant to outstanding stock options and restricted stock awards, due to their antidilutive effect. Our calculation of diluted earnings per share for the three and nine months ended September 30, 2011 excludes 184,529 shares and 179,977 shares, respectively, issuable pursuant to outstanding stock options and restricted stock awards due to their antidilutive effect.

See Note 6 to the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for a discussion of the conversion of out 2 3/8% Contigent Convertible Senior Subordinated Notes (2 3/8% Notes).

5. BUSINESS ACQUISITIONS AND GOODWILL

On July 2, 2012, we acquired Piper Valve Systems, Ltd (Piper). Headquartered in Oklahoma City, Oklahoma, Piper designs and manufactures high pressure valves and manifold components for oil and gas industry projects offshore (surface and subsea) and onshore. Piper's valve technology complements our offshore products segment, allowing us to integrate their valve products and services into our existing subsea products such as pipeline end manifolds and terminals, increasing our suite of global deepwater product and service offerings. Subject to customary post-closing adjustments, total transaction consideration was $48.0 million, funded from amounts available under the Company's U.S. revolving credit facility. The operations of Piper have been included in our offshore products segment since its date of acquisition.

OIL STATES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

Changes in the carrying amount of goodwill for the nine month period ended September 30, 2012 and the twelve month period ended December 31, 2011 are as follows (in thousands):

	Well Site Services						
	Rental Tools and Services	Drilling Services	Subtotal	Accommodations	Offshore Products	Tubular Services	Total
Balance as of December 31, 2010							
Goodwill	$170,034	$22,767	$192,801	$ 299,062	$100,654	$62,863	$655,380
Accumulated Impairment Losses	(94,528)	(22,767)	(117,295)	--	--	(62,863)	(180,158)
	75,506	--	75,506	299,062	100,654	--	475,222
Goodwill acquired and purchase price adjustments	--	--	--	(9,826)	315	--	(9,511)
Foreign currency translation and other changes	(323)	--	(323)	2,087	(25)	--	1,739
	75,183	--	75,183	291,323	100,944	--	467,450
Balance as of December 31, 2011							
Goodwill	169,711	22,767	192,478	291,323	100,944	62,863	647,608
Accumulated Impairment Losses	(94,528)	(22,767)	(117,295)	--	--	(62,863)	(180,158)
	75,183	--	75,183	291,323	100,944	--	467,450
Goodwill acquired	--	--	--	--	17,175	--	17,175
Foreign currency translation and other changes	482	--	482	4,094	204	--	4,780
	75,665	--	75,665	295,417	118,323	--	489,405
Balance as of September 30, 2012							
Goodwill	170,193	22,767	192,960	295,417	118,323	62,863	669,563
Accumulated Impairment Losses	(94,528)	(22,767)	(117,295)	--	--	(62,863)	(180,158)
	$75,665	$--	$75,665	$ 295,417	$118,323	$--	$489,405

6. DEBT

As of September 30, 2012 and December 31, 2011, long-term debt consisted of the following (in thousands):

	September 30, 2012 (Unaudited)	December 31, 2011
U.S. revolving credit facility, which matures December 10, 2015, with available commitments up to $500 million and with a weighted average interest rate of 2.7% for the nine month period ended September 30, 2012	$276,320	$68,065
U.S. term loan, which matures December 10, 2015, of $200 million; 2.5% of aggregate principal repayable per quarter; weighted average interest rate of 2.4% for the nine month period ended September 30, 2012	175,000	190,000
Canadian revolving credit facility, which matures on December 10, 2015, with available commitments up to $250 million and with a weighted average interest rate of 4.3% for the nine month period ended September 30, 2012	--	--
Canadian term loan, which matures December 10, 2015, of $100 million; 2.5% of aggregate principal repayable per quarter; weighted average interest rate of 3.4% for the nine month period ended September 30, 2012	89,315	93,795
Australian revolving credit facility, which was replaced September 18, 2012, with available commitments up to AUD$150 million and with a weighted average interest rate of 6.2% for the nine month period ended September 30, 2012	--	43,050
Australian revolving credit facility, which matures December 10, 2015, with available commitments up to AUD$300 million and with a weighted average interest rate of 5.6% for the nine month period ended September 30, 2012	37,397	--
6 1/2% senior unsecured notes - due June 2019	600,000	600,000
2 3/8% contingent convertible senior subordinated notes, net	--	170,884
Subordinated unsecured notes payable to sellers of businesses, fixed interest rate of 6%, which mature in December 2012	2,000	4,000
Capital lease obligations and other debt	6,740	7,146
Total debt	1,186,772	1,176,940
Less: Current portion	32,605	34,435
Total long-term debt and capitalized leases	$1,154,167	$1,142,505

OIL STATES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS
(Continued)

On September 18, 2012, the Company's Australian accommodations subsidiary, The MAC Services Group Pty Limited (The MAC), entered into a AUD$300 million revolving loan facility governed by a Syndicated Facility Agreement (The MAC Group Facility Agreement), between The MAC, J.P. Morgan Australia Limited, as Australian agent and security trustee, JPMorgan Chase Bank, N.A., as U.S. agent, and the lenders party thereto, which is guaranteed by the Company and The MAC's subsidiaries. The maturity date of The MAC Group Facility Agreement is December 10, 2015. Under the terms of the MAC Group Facility Agreement, loans bear interest for a particular interest period at a rate per annum equal to the sum of the average interest rate paid by banks for loans of the equivalent period and an applicable percentage ranging from 2.00% to 3.00% based upon the Australian Borrower's leverage ratio. The MAC Group Facility Agreement contains representations, warranties and covenants that are customary for similar credit arrangements, including, among other things, covenants relating to financial reporting and notification, payment of obligations, and notification of certain events. Financial covenants in the MAC Group Facility Agreement also require The MAC not to permit: (i) the interest coverage ratio (the ratio of consolidated EBITDA to consolidated interest expense) to be less than 4.0 to 1.0 for any period of four consecutive fiscal quarters of The MAC; and (ii) the leverage ratio (the ratio of total debt to consolidated EBITDA) to be greater than 3.0 to 1.0 for any period of four consecutive fiscal quarters of The MAC. Each of the factors considered in the calculations of ratios are defined in The MAC Group Facility Agreement. The MAC Group Facility Agreement contains various customary restrictive covenants, subject to certain exceptions, that limit The MAC and its subsidiaries from, among other things, incurring additional indebtedness or guarantees, creating liens or other encumbrances on property, entering into a merger or similar transaction, selling or transferring certain property, making certain restricted payments and entering into transactions with affiliates. The MAC Group Facility Agreement replaced The MAC's previous AUD$150 million revolving loan facility. As of September 30, 2012, we had AUD$36 million outstanding under the Australian credit facility leaving AUD$264 million available to be drawn under this facility.

On June 1, 2011, the Company sold $600 million aggregate principal amount of 6 1/2% senior unsecured notes (6 1/2% Notes) due 2019 through a private placement to qualified institutional buyers. The 6 1/2% Notes are senior unsecured obligations of the Company, are guaranteed by our material U.S. subsidiaries (the Guarantors), bear interest at a rate of 6 1/2% per annum and mature on June 1, 2019. At any time prior to June 1, 2014, the Company may redeem up to 35% of the 6 1/2% Notes at a redemption price of 106.5% of the principal amount, plus accrued and unpaid interest to the redemption date, with the proceeds of certain equity offerings. Prior to June 1, 2014, the Company may redeem some or all of the 6 1/2% Notes for cash at a redemption price equal to 100% of their principal amount plus an applicable make-whole premium and accrued and unpaid interest to the redemption date. On and after June 1, 2014, the Company may redeem some or all of the 6 1/2% Notes at redemption prices (expressed as percentages of principal amount), plus accrued and unpaid interest to the redemption date. The optional redemption prices as a percentage of principal amount are as follows:

Twelve Month Period Beginning June 1,	% of Principal Amount	
2014	104.875	%
2015	103.250	%
2016	101.625	%
2017	100.000	%

The Company utilized approximately $515 million of the net proceeds from the 6 1/2% Note offering in June 2011 to repay borrowings outstanding under its U.S. and Canadian credit facilities. The remaining net proceeds of approximately $75 million were utilized for general corporate purposes.

On May 17, 2012, the Company gave notice of the redemption of all of its outstanding 2 3/8% Notes due 2025, totaling $174,990,000 at a redemption price equal to 100% of the principal amount thereof plus accrued interest. In July 2012, rather than having their 2 3/8% Notes redeemed, on or prior to July 5, 2012, holders of $174,990,000 aggregate principal amount of the 2 3/8% Notes converted their 2 3/8% Notes and received cash up to the principal amount and 3,012,380 shares of the Company’s common stock valued at $220.6 million.

OIL STATES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS
(Continued)

The carrying amount of our 2 3/8% Notes as of December 31, 2011 in our condensed consolidated balance sheets was (in thousands):

		December 31, 2011
Carrying amount of the equity component in additional paid-in capital	$	28,434
Principal amount of the liability component	$	174,990
Less: Unamortized discount		4,106
Net carrying amount of the liability component	$	170,884

An effective interest rate of 7.17% was applied as of the issuance date for our 2 3/8% Notes in accordance with ASC 470-20 – Debt with Conversion and Other Options. Interest expense on the 2 3/8% Notes, excluding amortization of debt issue costs, was as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Interest expense	$--	$3,003	$6,185	$8,904

As of September 30, 2012, the Company had approximately $163.6 million of cash and cash equivalents and $437.7 million of the Company's U.S. and Canadian credit facilities available for future financing needs. The Company also had availability totaling AUD$264 million under its Australian credit facility. As of September 30, 2012, we had $40.0 million of outstanding letters of credit which reduced amounts available under our credit facilities.

Interest expense on the condensed consolidated statements of income is net of capitalized interest of $0.7 million and $3.2 million, respectively, for the three and nine months ended September 30, 2012 and $1.6 million and $4.0 million, respectively, for the same periods in 2011.

7. FAIR VALUE MEASUREMENTS

The Company's financial instruments consist of cash and cash equivalents, investments, receivables, payables, debt instruments and foreign currency forward contracts. The Company believes that the carrying values of these instruments, other than our 2 3/8% Notes and our 6 1/2% Notes, on the accompanying consolidated balance sheets approximate their fair values.

The fair values of our 2 3/8% and 6 1/2 % Notes are estimated based on quoted prices and analysis of similar instruments (Level 2 fair value measurements). The Company changed from a Level 1 fair value measurement standard to a Level 2 fair value measurement standard in the second quarter of 2012 in consideration of the relatively low daily trading volume of our debt instruments. The carrying values and fair values of these notes are as follows (in thousands):

	September 30, 2012		December 31, 2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
2 3/8% Notes				
Principal amount	$-	$-	$174,990	$411,396
Less: unamortized discount	-	-	4,106	-
Net value	$-	$-	$170,884	$411,396
6 1/2% Notes				
Principal amount due 2019	$600,000	$639,000	$600,000	$625,128

See Note 8 to the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for a discussion of the fair values of the Company’s foreign currency forward contracts.

As of September 30, 2012, the carrying value of the Company's debt outstanding under its credit facilities was estimated to be at fair value.

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8. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company conducts business in various foreign countries and, therefore, settles transactions in foreign currencies. The Company, from time to time, will utilize foreign currency forward contracts to offset the risk associated with the effects of certain foreign currency exposure. These derivative contracts are consistent with the Company's strategy for managing financial risks. In July 2012, the Company entered into foreign currency forward contracts, which have been designated and qualify as cash flow hedges, to reduce the Company's exposure to foreign currency fluctuations on a revenue contract denominated in a foreign currency. The Company initially reports any gain or loss on the effective portion of a cash flow hedge as a component of other comprehensive income and subsequently reclassifies any gain or loss to net sales when the hedged revenues are recorded. The portion of these instruments that do not qualify for cash flow hedge treatment are re-measured at fair value on each balance sheet date and resulting gains or losses are recognized in net income. As of September 30, 2012, the total notional amount of the derivative contracts was $12.4 million (€10.0 million). As of September 30, 2012, all of the Company's derivative contracts were designated as hedges. The Company had no derivative contracts outstanding as of December 31, 2011.

For each derivative contract entered into in which the Company seeks to obtain cash flow hedge accounting treatment, the Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking the hedge transaction, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed prospectively and retrospectively, and a description of the method of measuring ineffectiveness. This process includes linking all derivatives to specific firm commitments or forecasted transactions and designating the derivatives as cash flow hedges. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative contracts that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. The effective portion of these hedged items is reflected in other comprehensive income. If it is determined that a derivative contract is not highly effective, or that it has ceased to be a highly effective hedge, the Company will be required to discontinue hedge accounting with respect to that derivative contract prospectively.

At September 30, 2012, the Company's foreign currency forward contracts had remaining maturities ranging from 4 to 25 months.

The balance sheet location and the fair values of derivative instruments are (in thousands):

Foreign Currency Forward Contracts	September 30, 2012
Assets	
Derivatives designated as hedging instruments	
Other current assets	$-
Derivatives not designated as hedging instruments	
Other current assets	-
Total assets	$-
Liabilities	
Derivatives designated as hedging instruments	
Other current liabilities	$612

Derivatives not designated as hedging instruments	
Other current liabilities	-
Total liabilities	$612

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The amounts of the gains and losses related to the Company's derivative contracts designated as hedging instruments for the three and nine months ended September 30, 2012 and September 30, 2011 are (in thousands):

	Pretax Gain (Loss) Recognized in Other Comprehensive Income on Effective Portion of Derivative			
	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Derivatives in Cash Flow Hedging Relationships:				
Foreign currency forward contracts	$(696)	$-	$(696)	$-

		Pretax Gain (Loss) Recognized in Income on Effective Portion of Derivative as a Result of Reclassification from Accumulated Other Comprehensive Income			
		Three months ended September 30,		Nine months ended September 30,	
	Location	2012	2011	2012	2011
Derivatives in Cash Flow Hedging Relationships:					
Foreign currency forward contracts	Net sales	$(4)	$-	$(4)	$-

		Gain (Loss) on Ineffective Portion of Derivative Recognized in Income			
		Three months ended September 30,		Nine months ended September 30,	
	Location	2012	2011	2012	2011
Derivatives in Cash Flow Hedging Relationships:					
Foreign currency forward contracts	Net sales	$(22)	$-	$(22)	$-

At September 30, 2012, there is $0.7 million of unrealized pretax loss on outstanding derivatives accumulated in other comprehensive loss, a majority of which is expected to be reclassified to net sales within the next 24 months as a result of underlying hedged transactions also being recorded in net sales.

For the three and nine months ended September 30, 2012 and September 30, 2011, the gains and losses from our derivative contracts not designated as hedging instruments recognized in net sales were zero.

9. CHANGES IN COMMON STOCK OUTSTANDING

Shares of common stock outstanding – January 1, 2012	51,288,750
Shares issued upon conversion of 2 3/8% Notes	3,012,380
	644,075

Shares issued upon exercise of stock options and vesting of restricted stock awards	
Shares withheld for taxes on vesting of restricted stock awards and transferred to treasury	(51,560)
Shares of common stock outstanding – September 30, 2012	54,893,645

10. STOCK BASED COMPENSATION

During the first nine months of 2012, we granted restricted stock awards totaling 301,119 shares valued at a total of $25.0 million. Of the restricted stock awards granted in the first nine months of 2012, a total of 217,000 awards vest in four equal annual installments beginning in February 2013, 47,625 awards are performance based awards that may vest in February 2015 in an amount that will depend on the Company's achievement of specified performance objectives, 23,625 awards vest 100% in February 2016 and 12,464 awards vest 100% in May 2013. The performance based awards have a performance criteria that will be measured based upon the Company's achievement levels of average after-tax annual return on invested capital for the three year period commencing January 1, 2012 and ending December 31, 2014. During the nine months ended September 30, 2012, the Company also granted 54,950 units of phantom shares under the newly created Canadian Long-Term Incentive Plan, which provides for the granting of units of phantom shares to key Canadian employees. These awards vest in three equal annual installments beginning in February 2013 and are accounted for as a liability. Participants granted units of phantom shares are entitled to a lump sum cash payment equal to the fair market value of a share of the Company's common stock on the vesting date. A total of 155,250 stock options with a ten-year term were awarded in the nine months ended September 30, 2012 with an average exercise price of $84.52 that will vest in four equal annual installments starting in February 2013.

Stock based compensation pre-tax expense recognized in the nine month periods ended September 30, 2012 and 2011 totaled $13.9 million and $10.8 million, or $0.19 and $0.15 per diluted share after tax, respectively. Stock based compensation pre-tax expense recognized in the three month periods ended September 30, 2012 and 2011 totaled $4.7 million and $3.6 million, or $0.06 and $0.05 per diluted share after tax, respectively. The total fair value of restricted stock awards that vested during the nine months ended September 30, 2012 and 2011 was $15.9 million and $12.9 million, respectively. At September 30, 2012, $40.8 million of compensation cost related to unvested stock options and restricted stock awards attributable to future performance had not yet been recognized.

11. INCOME TAXES

Income tax expense for interim periods is based on estimates of the effective tax rate for the entire fiscal year. The Company's income tax provision for the three and nine months ended September 30, 2012 totaled $37.4 million, or 26.4% of pretax income, and $135.3 million, or 27.8% of pretax income, respectively, compared to $36.5 million, or 28.4% of pretax income, and $88.8 million, or 27.9% of pretax income, respectively, for the three and nine months ended September 30, 2011. The decrease in the effective tax rate from the prior year was largely the result of higher foreign earnings as a percentage of total earnings. Our foreign earnings are taxed at a lower rate than our domestic earnings.

12. SEGMENT AND RELATED INFORMATION

In accordance with current accounting standards regarding disclosures about segments of an enterprise and related information, the Company has identified the following reportable segments: well site services, accommodations, offshore products and tubular services. The Company's reportable segments represent strategic business units that offer different products and services. They are managed separately because each business requires different technologies and marketing strategies. Most of the businesses were initially acquired as a unit, and the management at the time of the acquisition was retained. Subsequent acquisitions have been direct extensions to our business segments. Separate business lines within the well site services segment have been disclosed to provide additional detail for that segment. Results of a portion of our accommodations segment supporting traditional oil and natural gas drilling activities are impacted by seasonally higher activity during the Canadian winter drilling season occurring in the first calendar quarter.

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Financial information by business segment for each of the three and nine months ended September 30, 2012 and 2011 is summarized in the following table (in thousands):

	Revenues from unaffiliated customers	Depreciation and amortization	Operating income (loss)	Equity in earnings (loss) of unconsolidated affiliates	Capital expenditures	Total assets
Three months ended September 30, 2012						
Well site services –						
Rental tools and services	$ 130,752	$ 12,746	$ 32,218	$ --	$ 27,251	$ 521,756
Drilling services	50,995	5,793	9,943	--	10,102	136,278
Total well site services	181,747	18,539	42,161	--	37,353	658,034
Accommodations	273,315	36,246	85,132	--	82,046	2,055,964
Offshore products	189,450	3,807	28,026	(103)	9,846	781,483
Tubular services	436,161	569	10,515	133	2,423	718,350
Corporate and eliminations	--	279	(11,509)	--	98	37,708
Total	$ 1,080,673	$ 59,440	$ 154,325	$ 30	$ 131,766	$ 4,251,539

	Revenues from unaffiliated customers	Depreciation and amortization	Operating income (loss)	Equity in earnings (loss) of unconsolidated affiliates	Capital expenditures	Total assets
Three months ended September 30, 2011						
Well site services –						
Rental tools and services	$ 127,217	$ 10,364	$ 32,939	$ --	$ 24,155	$ 435,281
Drilling services	45,550	5,033	7,973	--	8,890	124,610
Total well site services	172,767	15,397	40,912	--	33,045	559,891
Accommodations	227,783	27,395	71,727	--	101,604	1,662,776
Offshore products	139,525	3,421	24,854	(487)	4,416	602,636
Tubular services	362,546	515	17,934	283	1,709	527,964
Corporate and eliminations	--	201	(10,963)	--	138	83,745
Total	$ 902,621	$ 46,929	$ 144,464	$ (204)	$ 140,912	$ 3,437,012

Revenues from unaffiliated customers	Depreciation and amortization	Operating income (loss)