

NOW Inc.
Form 10-Q
November 01, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934
Commission File Number 001-36325

NOW INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

46-4191184
(I.R.S. Employer
Identification No.)

7402 North Eldridge Parkway,

Houston, Texas 77041

(Address of principal executive offices)

(281) 823-4700

(Registrant's telephone number, including area code)

Edgar Filing: NOW Inc. - Form 10-Q

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

Indicate by check mark whether the registrant has submitted electronically 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 No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a small reporting company) Small reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of October 25, 2017 the registrant had 107,803,100 shares of common stock (excluding 1,884,067 unvested restricted shares), par value \$0.01 per share, outstanding.

NOW INC.

TABLE OF CONTENTS

Part I - Financial Information

| | |
|---|----|
| Item 1. <u>Financial Statements</u> | 3 |
| <u>Consolidated Balance Sheets as of September 30, 2017 (Unaudited) and December 31, 2016</u> | 3 |
| <u>Consolidated Statements of Operations (Unaudited) for the three and nine months ended September 30, 2017 and 2016</u> | 4 |
| <u>Consolidated Statements of Comprehensive Income (Loss) (Unaudited) for the three and nine months ended September 30, 2017 and 2016</u> | 5 |
| <u>Consolidated Statements of Cash Flows (Unaudited) for the nine months ended September 30, 2017 and 2016</u> | 6 |
| <u>Notes to Unaudited Consolidated Financial Statements</u> | 7 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 14 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 24 |
| Item 4. <u>Controls and Procedures</u> | 25 |
| <u>Part II - Other Information</u> | |
| Item 6. <u>Exhibits</u> | 26 |

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

NOW INC.

CONSOLIDATED BALANCE SHEETS

(In millions, except share data)

| | September 30, 2017 | December 31, 2016 |
|---|-----------------------|----------------------|
| | (Unaudited) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 99 | \$ 106 |
| Receivables, net | 466 | 354 |
| Inventories, net | 562 | 483 |
| Prepaid and other current assets | 22 | 16 |
| Total current assets | 1,149 | 959 |
| Property, plant and equipment, net | 126 | 143 |
| Deferred income taxes | 2 | 1 |
| Goodwill | 328 | 311 |
| Intangibles, net | 171 | 184 |
| Other assets | 4 | 5 |
| Total assets | \$ 1,780 | \$ 1,603 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 310 | \$ 246 |
| Accrued liabilities | 111 | 100 |
| Other current liabilities | 1 | 1 |
| Total current liabilities | 422 | 347 |
| Long-term debt | 163 | 65 |
| Deferred income taxes | 7 | 7 |
| Other long-term liabilities | 1 | 1 |
| Total liabilities | 593 | 420 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock—par value \$0.01; 20 million shares authorized; | | |
| no shares issued and outstanding | — | — |
| Common stock - par value \$0.01; 330 million shares authorized; | 1 | 1 |
| 107,803,100 and 107,474,904 shares issued and outstanding at September 30, 2017 | | |

| | | |
|--|----------|----------|
| and December 31, 2016, respectively | | |
| Additional paid-in capital | 2,017 | 2,002 |
| Accumulated deficit | (727) | (678) |
| Accumulated other comprehensive loss | (104) | (142) |
| Total stockholders' equity | 1,187 | 1,183 |
| Total liabilities and stockholders' equity | \$ 1,780 | \$ 1,603 |

See notes to unaudited consolidated financial statements.

NOW INC.

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In millions, except per share data)

| | Three Months Ended September 30, 2017 | | Nine Months Ended September 30, 2016 | |
|---|--|----------|---|-----------|
| | 2017 | 2016 | 2017 | 2016 |
| Revenue | \$697 | \$520 | \$1,979 | \$1,569 |
| Operating expenses: | | | | |
| Cost of products | 562 | 433 | 1,606 | 1,312 |
| Warehousing, selling and administrative | 141 | 140 | 414 | 432 |
| Operating loss | (6) | (53) | (41) | (175) |
| Other expense | (3) | (3) | (8) | (7) |
| Loss before income taxes | (9) | (56) | (49) | (182) |
| Income tax provision (benefit) | — | — | — | (19) |
| Net loss | \$(9) | \$(56) | \$(49) | \$(163) |
| Loss per share: | | | | |
| Basic loss per common share | \$(0.08) | \$(0.53) | \$(0.45) | \$(1.52) |
| Diluted loss per common share | \$(0.08) | \$(0.53) | \$(0.45) | \$(1.52) |
| Weighted-average common shares outstanding, basic | 108 | 107 | 108 | 107 |
| Weighted-average common shares outstanding, diluted | 108 | 107 | 108 | 107 |

See notes to unaudited consolidated financial statements.

NOW INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

(In millions)

| | Three Months Ended September 30, 2017 | | Nine Months Ended September 30, 2016 | |
|--|--|--------|--|---------|
| Net loss | \$(9) | \$(56) | \$(49) | \$(163) |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustments | 16 | (3) | 38 | 12 |
| Comprehensive income (loss) | \$7 | \$(59) | \$(11) | \$(151) |

See notes to unaudited consolidated financial statements.

NOW INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In millions)

| | Nine Months Ended September 30, 2017 2016 | |
|---|--|---------|
| Cash flows from operating activities: | | |
| Net loss | \$(49) | \$(163) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 38 | 39 |
| Deferred income taxes | (1) | (24) |
| Stock-based compensation | 16 | 17 |
| Provision for doubtful accounts | 3 | 16 |
| Provision for inventory | 11 | 31 |
| Other, net | (1) | 1 |
| Change in operating assets and liabilities, net of acquisitions: | | |
| Receivables | (106) | 129 |
| Inventories | (81) | 152 |
| Prepaid and other current assets | (6) | 1 |
| Accounts payable and accrued liabilities | 70 | (38) |
| Income taxes receivable, net | (1) | 26 |
| Other assets / liabilities, net | — | (1) |
| Net cash provided by (used in) operating activities | (107) | 186 |
| Cash flows from investing activities: | | |
| Purchases of property, plant and equipment | (3) | (3) |
| Business acquisitions, net of cash acquired | (4) | (182) |
| Purchases of intangible assets | — | (7) |
| Other, net | 4 | 1 |
| Net cash used in investing activities | (3) | (191) |
| Cash flows from financing activities: | | |
| Borrowing under the revolving credit facility | 277 | 227 |
| Repayments under the revolving credit facility | (179) | (190) |
| Other | (1) | (4) |
| Net cash provided by financing activities | 97 | 33 |
| Effect of exchange rates on cash and cash equivalents | 6 | 13 |
| Net change in cash and cash equivalents | (7) | 41 |
| Cash and cash equivalents, beginning of period | 106 | 90 |
| Cash and cash equivalents, end of period | \$99 | \$131 |

See notes to unaudited consolidated financial statements.

NOW INC.

Notes to Unaudited Consolidated Financial Statements

1. Organization and Basis of Presentation

Nature of Operations

NOW Inc. (“NOW” or the “Company”) is a holding company headquartered in Houston, Texas that was incorporated in Delaware on November 22, 2013. NOW operates primarily under the DistributionNOW and Wilson Export brands. NOW is a global distributor of energy products as well as products for industrial applications through its locations in the U.S., Canada and internationally which are geographically positioned to serve the energy and industrial markets in over 80 countries. NOW’s energy product offerings are used in the oil and gas industry including upstream drilling and completion, exploration and production, midstream infrastructure development and downstream petroleum refining – as well as in other industries, such as chemical processing, power generation and industrial manufacturing operations. The industrial distribution portion of NOW’s business targets a diverse range of manufacturing and other facilities across numerous industries and end markets. NOW also provides supply chain management to drilling contractors, E&P operators, midstream operators, downstream energy and industrial manufacturing companies. NOW’s supplier network consists of thousands of vendors in approximately 40 countries.

Basis of Presentation

All significant intercompany transactions and accounts have been eliminated. The unaudited consolidated financial information included in this report has been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and Article 10 of SEC Regulation S-X. The principles for interim financial information do not require the inclusion of all the information and footnotes required by generally accepted accounting principles for complete financial statements. Therefore, these financial statements should be read in conjunction with the financial statements included in the Company’s most recent Annual Report on Form 10-K. In the opinion of the Company’s management, the consolidated financial statements include all adjustments, all of which are of a normal recurring nature, necessary for a fair presentation of the results for the interim periods. The results of operations for the three and nine months ended September 30, 2017 are not necessarily indicative of the results to be expected for the full year.

Use of Estimates

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

Reclassification

Certain amounts in the prior periods presented have been reclassified to conform to the current period financial statement presentation. These reclassifications have no effect on previously reported results of operations.

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, receivables and payables approximated fair value because of the relatively short maturity of these instruments. Cash equivalents include only those investments having a maturity date of three months or less at the time of purchase. See Note 11 “Derivative Financial Instruments” for the fair value of derivative financial instruments.

7

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 affects any entity using GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). This ASU will supersede the revenue recognition requirements in Revenue Recognition (Topic 605), and most industry-specific guidance. The ASU provides two transition methods: (i) retrospectively to each prior reporting period presented or (ii) retrospectively with the cumulative effect of initially applying this ASU recognized at the date of initial application. In August 2015, the FASB proposed the effective date to be the annual reporting periods beginning after December 15, 2017, and interim periods therein. In May 2016, the FASB issued ASU 2016-12, Narrow-Scope Improvements and Practical Expedients (Topic 606), which clarifies implementation guidance on assessing collectability, presentation of sales tax, noncash consideration and completed contracts and contract modifications at transition. The Company will adopt Topic 606 in the first quarter of fiscal year 2018 pursuant to the aforementioned adoption method (ii). The Company has substantially completed its assessment of the impact of the new standard on key contracts with customers. The Company’s contracts predominantly contain a single delivery element and revenue is recognized at a single point in time when ownership, risks and rewards transfer. These are largely unimpacted by the new standard. Based on this preliminary assessment, which is subject to change, the Company does not expect the cumulative adjustment to have a material impact on the consolidated financial statements as a result of the adoption of the new standard. The Company is currently updating its control processes and procedures to support revenue recognition and disclosure requirements under the new standard.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 requires lessees to recognize a lease liability and a right-to-use asset for all leases, including operating leases, with a term greater than twelve months on its balance sheet. ASU 2016-02 is effective for annual and interim periods in fiscal years beginning after December 15, 2018, with early adoption permitted, and requires a modified retrospective transition method. The Company is currently assessing the impact of ASU 2016-02 on its consolidated financial statements. The Company expects that most of its operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon the adoption of ASU 2016-02, which will increase the total assets and total liabilities that are reported relative to such amounts prior to adoption.

In June 2016, the FASB issued ASU 2016-13, Measurement of Credit Losses on Financial Instruments (Topic 326), which replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to determine credit loss estimates. ASU 2016-13 requires entities to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Entities will now use forward-looking information to better form their credit loss estimates. ASU 2016-13 is effective for annual and interim periods in fiscal years beginning after December 15, 2019, with early adoption permitted as of December 15, 2018, and requires modified retrospective transition method. The Company is currently assessing the impact of ASU 2016-13 on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (Topic 715). ASU 2017-07 requires the disaggregation of the service cost component from the other components of net periodic benefit cost and allows only the service cost component of net benefit cost to be eligible for capitalization. ASU 2017-07 is effective for annual and interim periods in fiscal years beginning after December 15, 2017. The Company sponsors two defined benefit plans in the UK under which accrual of pension benefits has ceased and there will not be a service cost component to the net periodic pension cost. Plan members benefits that have previously been accrued are indexed in line with inflation during the period up to retirement in order to protect their purchasing power. The Company plans to adopt this standard in the first quarter of fiscal year 2018 and does not expect a material effect on its consolidated financial statements.

Recently Adopted Accounting Standards

In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory (Topic 330). Under ASU 2015-11, inventory will be measured at the “lower of cost and net realizable value.” ASU 2015-11 defines net realizable value as the “estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation.” ASU 2015-11 is effective for annual and interim periods in fiscal years beginning after December 15, 2016. The Company adopted this standard as of January 1, 2017, with no material impact on its consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, Intra-Entity Transfers of Assets Other than Inventory (Topic 740), to recognize the income tax consequences of intra-entity transfers of an asset other than inventory when the transfer occurs. ASU 2016-16 is effective for annual and interim periods in fiscal years beginning after December 15, 2017 with early adoption permitted in the first interim period of fiscal year 2017. Upon adoption, any deferred charge established upon the intra-company transfer would be recorded as a cumulative-effect adjustment to retained earnings. The Company early adopted this standard in the first quarter of fiscal year 2017 and reversed a deferred charge of \$1 million previously recorded in prepaid and other current assets in the accompanying consolidated

balance sheets. However, due to the Company's full valuation allowance in the U.S., the deferred charge recorded as a cumulative-effect adjustment to accumulated deficit netted to zero.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment (Topic 350), which eliminates Step 2 from the goodwill impairment test. ASU 2017-04 is effective for annual and interim periods in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed after January 1, 2017 and should be applied prospectively. The Company early adopted this standard as of January 1, 2017, for use in its goodwill impairment testing.

2. Property, Plant and Equipment, net

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

| | Estimated Useful Lives | September 30, 2017 | December 31, 2016 |
|--------------------------------------|---------------------------|-----------------------|----------------------|
| Information technology assets | 1-7 Years | \$ 48 | \$ 47 |
| Operating equipment | 2-15 Years | 93 | 93 |
| Buildings and land ⁽¹⁾⁽²⁾ | 5-35 Years | 98 | 95 |
| Construction in progress | | 1 | 1 |
| Total property, plant and equipment | | 240 | 236 |
| Less: accumulated depreciation | | (114) | (93) |
| Property, plant and equipment, net | | \$ 126 | \$ 143 |

(1) Land has an indefinite life.

(2) As of September 30, 2017, the Company had classified assets from the U.S. segment related to a facility relocation as held for sale. The net carrying value of these properties was approximately \$2 million. The Company expects to complete the sale of these assets within one year.

3. Accrued Liabilities

Accrued liabilities consist of (in millions):

| | September 30, 2017 | December 31, 2016 |
|---|-----------------------|----------------------|
| Compensation and other related expenses | \$ 36 | \$ 25 |
| Customer credits and prepayments | 27 | 27 |
| Taxes (non-income) | 17 | 17 |
| Other | 31 | 31 |

| | | |
|-------|--------|--------|
| Total | \$ 111 | \$ 100 |
|-------|--------|--------|

4. Debt

On January 20, 2016, the Company entered into an amendment (the “Amendment”) to its credit facility dated as of April 18, 2014 (the “Credit Agreement”). The Amendment, among other things, (i) suspends, until the Company elects otherwise, the Credit Agreement’s minimum interest coverage ratio effective as of December 30, 2015, (ii) adds a minimum asset coverage ratio (as defined in the Credit Agreement), which requires that the ratio of the value of the Company’s eligible assets (value of qualified cash, eligible inventory and eligible accounts receivable) to the amount of its outstanding obligations under the Credit Agreement is no less than 1.50 to 1.00, (iii) reduces the maximum capitalization ratio (as defined in the Credit Agreement) from 50% to 45%, (iv) increases the applicable interest margin on current borrowings by 75 basis points and the current commitment fee by 5 basis points and (v) reduces sub-facilities for standby letters of credit and swingline loans to \$40 million and \$25 million, respectively. In connection with the Amendment, the Company also entered into a Security Agreement dated as of January 20, 2016 (the “Security Agreement”) pursuant to which it granted the lenders under the Credit Agreement customary security interests in substantially all of the Company’s U.S. assets and in approximately 65% of the equity interests of the Company’s first-tier foreign subsidiaries.

As of September 30, 2017, the Company had borrowed \$163 million against its senior secured revolving credit facility, and had \$441 million in availability (as defined in the Credit Agreement) resulting in the excess availability (as defined in the Credit Agreement) of 72%, subject to certain restrictions. Borrowings that result in the excess availability dropping below 25% are conditioned upon compliance with or waiver of a minimum fixed charge ratio (as defined in the Credit Agreement). The Company was not obligated to pay back the borrowing against the senior secured revolving credit facility until the expiration date of April 18, 2019, as such the outstanding borrowing is classified as long term. As of September 30, 2017, the Company was in compliance with all financial

covenants in the credit facility. Total commitments under the amended credit facility remain at \$750 million and the amended credit facility includes a \$250 million accordion feature, subject to certain conditions.

At September 30, 2017, the Company issued \$5 million in letters of credit under its senior revolving credit facility primarily for casualty insurance expiring in July 2018.

5. Accumulated Other Comprehensive Income (Loss)

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

| | Foreign Currency Translation Adjustments |
|-------------------------------|---|
| Balance at December 31, 2016 | \$ (142) |
| Other comprehensive income | 38 |
| Balance at September 30, 2017 | \$ (104) |

The Company's reporting currency is the U.S. dollar. A majority of the Company's international entities in which there is a substantial investment have the local currency as their functional currency. As a result, foreign currency translation adjustments resulting from the process of translating the entities' financial statements into the reporting currency are reported in other comprehensive income (loss) in accordance with ASC Topic 830, "Foreign Currency Matters."

6. Business Segments

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------|--|-------|---------------------------------------|---------|
| | 2017 | 2016 | 2017 | 2016 |
| Revenue: | | | | |
| United States | \$506 | \$372 | \$1,426 | \$1,066 |
| Canada | 96 | 67 | 271 | 185 |
| International | 95 | 81 | 282 | 318 |
| Total revenue | \$697 | \$520 | \$1,979 | \$1,569 |
| Operating profit (loss): | | | | |

Edgar Filing: NOW Inc. - Form 10-Q

| | | | | |
|---------------------------------------|---------|---------|---------|----------|
| United States | \$(10) | \$(46) | \$(52) | \$(149) |
| Canada | 4 | (2) | 9 | (16) |
| International | — | (5) | 2 | (10) |
| Total operating loss | \$(6) | \$(53) | \$(41) | \$(175) |
| Operating profit (loss) % of revenue: | | | | |
| United States | (2.0%) | (12.4%) | (3.6 %) | (14.0 %) |
| Canada | 4.2 % | (3.0 %) | 3.3 % | (8.6 %) |
| International | 0.0 % | (6.2 %) | 0.7 % | (3.1 %) |
| Total operating loss % | (0.9%) | (10.2%) | (2.1 %) | (11.2 %) |

7. Income Taxes

On May 1, 2014, the National Oilwell Varco, Inc. (“NOV”) Board of Directors approved the Spin-Off (the “Spin-Off” or “Separation”) of its distribution business into an independent, publicly traded company named NOW Inc. In connection with the Separation, the Company and NOV entered into a Tax Matters Agreement, dated as of May 29, 2014 (the “Tax Matters Agreement”). The Tax Matters Agreement sets forth the Company and NOV’s rights and obligations related to the allocation of federal, state, local and foreign taxes for periods before and after the Spin-Off, as well as taxes attributable to the Spin-Off, and related matters such as the filing of tax returns and the conduct of IRS and other audits. Pursuant to the Tax Matters Agreement, NOV has prepared and filed the consolidated federal income tax return, and any other tax returns that include both NOV and the Company for all the liability periods ended on or prior to May 30, 2014. The income tax provision (benefit) for periods prior to the Separation has been computed as if NOW were a stand-alone company. NOV will indemnify and hold harmless the Company for any income tax liability for periods

before the Separation date. The Company will prepare and file all tax returns that include solely the Company for all taxable periods ending after that date. Settlements of tax payments between NOV and the Company were generally treated as contributions from or distributions to NOV in periods prior to the Separation date.

The effective tax rates for the three and nine months ended September 30, 2017 were (1.6%) and 0.6%, compared to (0.2%) and 10.3% for the same periods in 2016. Compared to the U.S. statutory rate, the effective tax rate was impacted by recurring items, such as lower tax rates on income earned in foreign jurisdictions that is permanently reinvested, offset by nondeductible expenses, state income taxes and the change in valuation allowance recorded against deferred tax assets. Due to the continuing uncertainty in our industry and thus our outlook, the Company continues to utilize the method of recording income taxes on a year-to-date effective tax rate for the three and nine months ended September 30, 2017. The Company will evaluate its use of this method each quarter until such time as a return to the annualized estimated effective tax rate method is deemed appropriate.

During the second quarter of 2016, the Company acquired Power Service and recorded a deferred tax liability of \$19 million related to basis differences between U.S. GAAP and U.S. Tax associated with the acquisition and step-up to fair value of certain assets, primarily intangible assets. The step up in basis resulted in higher future taxable temporary differences and a corresponding reduction in the valuation allowance recorded against deferred tax assets in the U.S.

To the extent penalties and interest would be assessed on any underpayment of income tax, such accrued amounts would be classified as a component of income tax provision (benefit) in the financial statements consistent with the Company's policy.

The Company is subject to taxation in the United States, various states and foreign jurisdictions. The Company has significant operations in the United States and Canada and to a lesser extent in various other international jurisdictions. Tax years that remain subject to examination by major tax jurisdictions vary by legal entity, but are generally open in the U.S. for the tax years ending after 2013 and outside the U.S. for the tax years ending after 2011. The Company is indemnified for any income tax exposures related to the periods prior to the Separation under the Tax Matters Agreement with NOV.

8. Loss Per Share ("EPS")

For the three and nine months ended September 30, 2017 and 2016, 8,141,971 and 8,038,097, 7,430,510 and 7,264,566, respectively, of potentially dilutive shares were excluded from the computation of diluted loss per share due to the Company recognizing a net loss for the period.

Basic and diluted loss per share follows (in millions, except share data):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|----------|------------------------------------|-----------|
| | 2017 | 2016 | 2017 | 2016 |
| Numerator: | | | | |
| Net loss attributable to the Company's stockholders | \$ (9 |) \$ (56 |) \$ (49 |) \$ (163 |
| Denominator: | | | | |

Edgar Filing: NOW Inc. - Form 10-Q

| | | | | |
|--|-------------|-------------|-------------|-------------|
| Weighted average basic common shares outstanding | 107,752,427 | 107,473,952 | 107,695,277 | 107,396,681 |
| Effect of dilutive securities | — | — | — | — |
| Weighted average diluted common shares outstanding | 107,752,427 | 107,473,952 | 107,695,277 | 107,396,681 |
| Loss per share attributable to the Company's stockholders: | | | | |
| Basic | \$(0.08) | \$(0.53) | \$(0.45) | \$(1.52) |
| Diluted | \$(0.08) | \$(0.53) | \$(0.45) | \$(1.52) |

ASC Topic 260, "Earnings Per Share," requires companies with unvested participating securities to utilize a two-class method for the computation of net income attributable to the Company per share. The two-class method requires a portion of net income attributable to the Company to be allocated to participating securities, which are unvested awards of share-based payments with non-forfeitable rights to receive dividends or dividend equivalents, if declared. Net losses are not allocated to nonvested shares in periods that the Company determines that those shares are not obligated to participate in losses.

9. Stock-based Compensation and Outstanding Awards

In connection with the Separation, the Company and NOV entered into the Employee Matters Agreement which governs the Company and NOV's compensation and employee benefit obligations with respect to current and former employees of each company, and generally allocates liabilities and responsibilities relating to employee compensation and benefit plans and programs. Such agreement provided the adjustment mechanisms applied as a result of the Spin-Off to convert outstanding NOV equity awards held by Company employees to Company awards.

The Company has a stock-based compensation plan known as the NOW Inc. Long-Term Incentive Plan (the "Plan"). Under the Plan, the Company's employees are eligible to be granted stock options, restricted stock awards ("RSAs"), restricted stock units ("RSUs"), and performance stock awards ("PSAs").

For the nine months ended September 30, 2017, the Company granted 915,037 stock options with a weighted average fair value of \$7.07 per share and 194,183 shares of RSAs and RSUs with a weighted average fair value of \$19.92 per share. In addition, the Company granted PSAs to senior management employees with potential payouts varying from zero to 169,346 shares. These options vest over a three-year period from the grant date on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in-substance, multiple awards. The RSAs and RSUs vest on the first and third anniversary of the date of grant. The PSAs can be earned based on performance against established metrics over a three-year performance period. The PSAs are divided into three equal, independent parts that are subject to three separate performance metrics: (i) one-third of the PSAs have a Total Shareholder Return (TSR) metric, (ii) one-third of the PSAs have an EBITDA metric, and (iii) one-third of the PSAs have a Working Capital (WC) metric.

Performance against the TSR metric is determined by comparing the performance of the Company's TSR with the TSR performance of designated peer companies for the three-year performance period. Performance against the EBITDA metric is determined by comparing the performance of the Company's actual EBITDA average for each of the three-years of the performance period against the EBITDA metrics set by the Company's Compensation Committee of the Board of Directors. Performance against the WC metric is determined by comparing the performance of the Company's actual WC average for each of the three-years of the performance period against the WC metrics set by the Company's Compensation Committee of the Board of Directors.

Stock-based compensation expense totaled \$5 million and \$16 million for the three and nine months ended September 30, 2017, respectively, and \$5 million and \$17 million for the same periods in 2016, respectively.

10. Commitments and Contingencies

In connection with the Spin-Off, the Company and NOV entered into a Separation and Distribution Agreement which contains the key provisions related to the separation from NOV and the distribution of the Company's common stock to NOV shareholders. The Separation and Distribution Agreement separated the assets related to the Company's business from NOV, along with liabilities related to such assets, which now reside with the Company. In general, the Company agrees to indemnify NOV from liabilities arising from the Company's business and assets, and NOV agrees to indemnify the Company from liabilities arising from NOV's business and assets (that remained with NOV), except as otherwise provided in such agreement.

The Company is involved in various claims, regulatory agency audits and pending or threatened legal actions involving a variety of matters. The Company has also assessed the potential for additional losses above the amounts accrued as well as potential losses for matters that are not probable, but are reasonably possible. The total potential

loss on these matters cannot be determined; however, in the Company's opinion, any ultimate liability, to the extent not otherwise recorded or accrued for, will not materially affect the Company's financial position, cash flow or results of operations. These estimated liabilities are based on the Company's assessment of the nature of these matters, their progress toward resolution, the advice of legal counsel and outside experts as well as management's intention and experience.

The Company's business is affected both directly and indirectly by governmental laws and regulations relating to the oilfield service industry in general, as well as by environmental and safety regulations that specifically apply to the Company's business. Although the Company has not incurred material costs in connection with its compliance with such laws, there can be no assurance that other developments, such as new environmental laws, regulations and enforcement policies hereunder may not result in additional, presently unquantifiable, costs or liabilities to the Company.

The Company does not accrue for contingent losses that, in its judgment, are considered to be reasonably possible, but not probable. Estimating reasonably possible losses also requires the analysis of multiple possible outcomes that often depend on judgments about potential actions by third parties. NOW's management currently estimates a range of loss for reasonably possible losses for which an estimate can be made is between zero and \$15 million in the international segment primarily attributable to accounts receivable with

one customer. The Company has accrued its best estimate for loss as of September 30, 2017. Factors underlying this estimated range of loss may change from time to time, and actual results may vary significantly from this estimate.

The Company maintains credit arrangements with several banks providing for short-term borrowing capacity, overdraft protection and other bonding requirements. As of September 30, 2017, these credit arrangements totaled approximately \$35 million, of which the Company was contingently liable for approximately \$10 million of outstanding standby letters of credit, including bid and performance related bonds and surety bonds. The Company does not believe, based on historical experience and information currently available, that it is probable that any amounts will be required to be paid.

11. Derivative Financial Instruments

The Company is exposed to certain risks relating to its ongoing business operations. The primary risk managed by using derivative instruments is foreign currency exchange rate risk. The Company has entered into certain financial derivative instruments to manage this risk.

The derivative financial instruments the Company has entered into are forward exchange contracts which have terms of less than one year to economically hedge foreign currency exchange rate risk on recognized non-functional currency monetary accounts. The purpose of the Company's foreign currency economic hedging activities is to economically hedge the Company's risk from changes in the fair value of non-functional currency denominated monetary accounts.

The Company records all derivative financial instruments at their fair value in its consolidated balance sheets. None of the derivative financial instruments that the Company holds are designated as either a fair value hedge or cash flow hedge and the gain or loss on the derivative instrument is recorded in earnings. The Company has determined that the fair value of its derivative financial instruments are computed using level 2 inputs (inputs other than quoted prices in active markets for identical assets and liabilities that are observable either directly or indirectly for substantially the full term of the asset or liability) in the fair value hierarchy as the fair value is based on publicly available foreign exchange rates at each financial reporting date.

The table below provides data about the fair value of the derivative instruments that are recorded in the consolidated balance sheets (in millions):

| | September 30, 2017 | | December 31, 2016 | |
|---|-----------------------|-------------|----------------------|-------------|
| | Assets | Liabilities | Assets | Liabilities |
| Derivatives not designated as hedging instruments: | | | | |
| Foreign exchange forward contracts ⁽¹⁾ | \$ — | \$ 1 | \$ 1 | \$ — |

⁽¹⁾Included in other current liabilities and other current assets in the consolidated balance sheets. The total notional amount of the forward foreign exchange contracts was approximately \$26 million and \$76 million at September 30, 2017 and December 31, 2016, respectively.

The table below provides the gains (losses) recognized in other income in the accompanying consolidated statements of operations related to the Company's derivative instruments (in millions):

| | Three Months Ended September 30, 2017 | | Nine Months Ended September 30, 2016 | |
|---|--|------|---|-------|
| Derivatives not designated as hedging instruments: | | | | |
| Foreign exchange forward contracts | \$ — | \$ — | \$ 2 | \$ 10 |

As of September 30, 2017, the Company's financial instruments do not contain any credit-risk-related or other contingent features that could cause accelerated payments when the Company's financial instruments are in net liability positions. The Company does not use derivative financial instruments for trading or speculative purposes.

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

Forward-Looking Statements

Some of the information in this document contains, or has incorporated by reference, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements typically are identified by use of terms such as “may,” “believe,” “anticipate,” “expect,” “plan,” “predict,” “estimate,” “will be” or other similar words and phrases, although forward-looking statements are expressed differently. You should be aware that our actual results could differ materially from results anticipated in the forward-looking statements due to a number of factors, including, but not limited to, changes in oil and gas prices, changes in the energy markets, customer demand for our products, significant changes in the size of our customers, difficulties encountered in integrating mergers and acquisitions, general volatility in the capital markets, changes in applicable government regulations, increased borrowing costs, competition between us and our former parent company, NOV, the triggering of rights and obligations by the Spin-Off or any litigation arising out of or related to the Separation, impairments in goodwill or other intangible assets and worldwide economic activity. You should also consider carefully the statements under “Risk Factors,” as disclosed in our Form 10-K, which address additional factors that could cause our actual results to differ from those set forth in the forward-looking statements. Given these uncertainties, current or prospective investors are cautioned not to place undue reliance on any such forward-looking statements. We undertake no obligation to update any such factors or forward-looking statements to reflect future events or developments.

Company Overview

We are a global distributor to the oil and gas and industrial markets with a legacy of over 150 years. We operate primarily under the DistributionNOW and Wilson Export brands. Through our network of approximately 300 locations and approximately 4,600 employees worldwide, we stock and sell a comprehensive offering of energy products as well as an extensive selection of products for industrial applications. Our energy product offering is consumed throughout all sectors of the oil and gas industry – from upstream drilling and completion, exploration and production (“E&P”), midstream infrastructure development to downstream petroleum refining – as well as in other industries, such as chemical processing, mining, utilities and industrial manufacturing operations. The industrial distribution end markets include manufacturing, aerospace, automotive, refineries and engineering and construction. We also provide supply chain management solutions to drilling contractors, E&P operators, midstream operators and downstream energy and industrial manufacturing companies around the world.

Our global product offering includes consumable maintenance, repair and operating (“MRO”) supplies, pipe, valves, fittings, flanges, gaskets, fasteners, electrical, instrumentation, artificial lift, pumping solutions, valve actuation and modular process, measurement and control equipment. We also offer warehouse and inventory management solutions as part of our supply chain and materials management offering. Through focused effort, we have developed expertise in providing application systems and parts integration, optimization solutions and after-sales support.

Our solutions include outsourcing the functions of procurement, inventory and warehouse management, logistics, point of issue technology, project management, business process and performance metrics reporting. These solutions allow us to leverage the infrastructure of our SAP™ Enterprise Resource Planning (“ERP”) system and other technologies to streamline our customers’ purchasing process, from requisition to procurement to payment, by digitally managing workflow, improving approval routing and providing robust reporting functionality.

We support land and offshore operations for all the major oil and gas producing regions around the world through our network of locations. Our key markets, beyond North America, include Latin America, the North Sea, the Middle East, Asia Pacific and the Former Soviet Union (“FSU”). Products sold through our locations support greenfield expansion upstream capital projects, midstream infrastructure and transmission and MRO consumables used in

day-to-day production. We provide downstream energy and industrial products for petroleum refining, chemical processing, LNG terminals, power generation utilities and industrial manufacturing operations and customer on-site locations.

We stock or sell more than 300,000 stock keeping units (“SKUs”) through our branch network. Our supplier network consists of thousands of vendors in approximately 40 countries. From our operations in over 20 countries we sell to customers operating in approximately 80 countries. The supplies and equipment stocked by each of our branches is customized to meet varied and changing local customer demands. The breadth and scale of our offering enhances our value proposition to our customers, suppliers and shareholders.

We employ advanced information technologies, including a common ERP platform across most of our business, to provide complete procurement, materials management and logistics coordination to our customers around the globe. Having a common ERP platform allows immediate visibility into the Company’s financials and operations worldwide, enhancing decision making and efficiency.

Demand for our products is driven primarily by the level of oil and gas drilling, servicing and production, transmission, refining and petrochemical and industrial manufacturing activities. It is also influenced by the global economy in general and by government policies. Several factors drive spending, such as investment in energy infrastructure, the North American conventional and shale plays, market expectations of future developments in the oil, natural gas, liquids, refined products, petrochemical, plant maintenance and other industrial, manufacturing and energy sectors.

We have expanded globally, through acquisitions and organic investments, into Australia, Azerbaijan, Brazil, Canada, China, Colombia, Egypt, England, India, Indonesia, Kazakhstan, Kuwait, Mexico, Netherlands, Norway, Oman, Peru, the Philippines, Russia, Saudi Arabia, Scotland, Singapore, the United Arab Emirates and the United States.

Summary of Reportable Segments

We operate through three reportable segments: United States (“U.S.”), Canada and International. The segment data included in our Management’s Discussion and Analysis (“MD&A”) are presented on a basis consistent with our internal management reporting. Segment information appearing in Note 6 “Business Segments” of the notes to the unaudited consolidated financial statements (Part I, Item 1 of this Form 10-Q) is also presented on this basis.

United States

We have approximately 200 locations in the U.S., which are geographically positioned to best serve the upstream, midstream and downstream energy and industrial markets.

We offer higher value solutions in key product lines in the U.S. which broaden and deepen our customer relationships and related product line value. Examples of these include artificial lift, pumps, valves and valve actuation, process equipment, fluid transfer products, measurement and controls, along with many other products required by our customers, which enable them to focus on their core business while we manage their supply chain. We also provide additional value to our customers through the design, assembly, fabrication and optimization of products and equipment essential to the safe and efficient production, transportation and processing of oil and gas and industrial manufacturing.

Canada

We have a network of approximately 55 locations in the Canadian oilfield, predominantly in the oil rich provinces of Alberta and Saskatchewan in Western Canada. Our Canada segment primarily serves the energy exploration, production, mining and drilling business, offering customers many of the same products and value-added solutions that we perform in the U.S. In Canada, we also provide training for, and supervise the installation of, jointed and spoolable composite pipe. This product line is supported by inventory and product and installation expertise to serve our customers.

International

We operate in approximately 20 countries and serve the needs of our international customers from approximately 35 locations outside of the U.S. and Canada, which are strategically located in major oil and gas development areas. Our approach in these markets is similar to our approach in the U.S., as our customers turn to us to provide inventory and support closer to their drilling and exploration activities. Our long legacy of operating in many international regions, combined with significant expansion into several key markets, provides a competitive advantage as few of our competitors have a presence in most of the global energy producing regions.

Basis of Presentation

All significant intercompany transactions and accounts have been eliminated. The unaudited consolidated financial information included in this report has been prepared in accordance with GAAP for interim financial information and Article 10 of SEC Regulation S-X. The principles for interim financial information do not require the inclusion of all the information and footnotes required by generally accepted accounting principles for complete financial statements. Therefore, these financial statements should be read in conjunction with the financial statements included in the Company's most recent Annual Report on Form 10-K. In the opinion of our management, the consolidated financial statements include all adjustments, all of which are of a normal recurring nature, necessary for a fair presentation of the results for the interim periods. The results of operations for the three and nine months ended September 30, 2017 are not necessarily indicative of the results to be expected for the full year.

Operating Environment Overview

Our results are dependent on, among other things, the level of worldwide oil and gas drilling, well remediation activity, crude oil and natural gas prices, capital spending by oilfield service companies and drilling contractors, and worldwide oil and gas inventory levels. Key industry indicators for the third quarter of 2017 and 2016 and the second quarter of 2017 include the following:

%