**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****FOR THE TRANSITION PERIOD FROM \_\_\_\_\_\_\_ TO \_\_\_\_\_\_\_** |
|  |  |
|  |  |

**Commission file number: 001-35479**

**MRC Global Inc.**
(Exact name of registrant as specified in its charter)

|  |  |
| --- | --- |
| **Delaware** | **20-5956993** |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. EmployerIdentification No.) |
|  |  |
| Fulbright Tower1301 McKinney Street, Suite 2300Houston, Texas  | **77010** |
| (Address of Principal Executive Offices) | (Zip Code) |

(877) 294-7574
(Registrant’s Telephone Number, including Area Code)

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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, 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. (Check one):

Large accelerated filer [ X ] Accelerated filer [ ] Non-accelerated filer (do not check if a smaller reporting company) [ ]

Smaller 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 [X]

The Company’s common stock is traded on the New York Stock Exchange under the symbol “MRC”. There were 94,533,513 shares of the registrant’s common stock (excluding 284,786 unvested restricted shares), par value $0.01 per share, issued and outstanding as of October 27, 2017.

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|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
|  | **September 30,**  |  | **December 31,**  |
|  | **2017** |  | **2016** |
|  |  |  |  |
| **Assets** |  |  |  |
| Current assets:  |  |  |  |
| Cash  | **$                    40** |  | $               109 |
| Accounts receivable, net |  **578** |  |  399 |
| Inventories, net |  **649** |  |  561 |
| Other current assets |  **40** |  |  48 |
| Total current assets |  **1,307** |  |  1,117 |
|  |  |  |  |
| Other assets |  **20** |  |  19 |
|  |  |  |  |
| Property, plant and equipment, net |  **144** |  |  135 |
|  |  |  |  |
| Intangible assets:  |  |  |  |
| Goodwill, net |  **486** |  |  482 |
| Other intangible assets, net |  **379** |  |  411 |
|  |  |  |  |
|  | **$               2,336** |  | $            2,164 |
|  |  |  |  |
| **Liabilities and stockholders' equity** |  |  |  |
| Current liabilities:  |  |  |  |
| Trade accounts payable | **$                  449** |  | $               314 |
| Accrued expenses and other current liabilities |  **115** |  |  111 |
| Current portion of long-term debt |  **3** |  |  8 |
| Total current liabilities |  **567** |  |  433 |
|  |  |  |  |
| Long-term obligations:  |  |  |  |
| Long-term debt, net |  **444** |  |  406 |
| Deferred income taxes |  **172** |  |  184 |
| Other liabilities |  **22** |  |  23 |
|  |  |  |  |
| Commitments and contingencies |  |  |  |
|  |  |  |  |
|  6.5% Series A Convertible Perpetual Preferred Stock, $0.01 par value; authorized  |  |  |  |
|  363,000 shares; 363,000 shares issued and outstanding |  **355** |  |  355 |
|  |  |  |  |
| Stockholders' equity:  |  |  |  |
| Common stock, $0.01 par value per share: 500 million shares authorized,  |  |  |  |
| 103,051,858 and 102,529,637 issued, respectively |  **1** |  |  1 |
| Additional paid-in capital |  **1,686** |  |  1,677 |
| Retained deficit |  **(577)** |  |  (574) |
| Less: Treasury stock at cost: 8,537,410 and 7,677,580 shares, respectively |  **(125)** |  |  (107) |
| Accumulated other comprehensive loss |  **(209)** |  |  (234) |
|  |  **776** |  |  763 |
|  | **$               2,336** |  | $            2,164 |
| *See notes to condensed consolidated financial statements.* |  |  |  |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended** |  | **Nine Months Ended** |
|  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |
|  | **2017** |  |  **2016** |  | **2017** |  |  **2016** |
|  |  |  |  |  |  |  |  |
| Sales | **$                   959** |  | $                   793 |  | **$                2,743** |  | $                2,322 |
| Cost of sales |  **807** |  |  705 |  |  **2,302** |  |  1,976 |
| Gross profit |  **152** |  |  88 |  |  **441** |  |  346 |
| Selling, general and administrative expenses |  **130** |  |  124 |  |  **388** |  |  396 |
| Operating income (loss) |  **22** |  |  (36) |  |  **53** |  |  (50) |
| Other expense: |  |  |  |  |  |  |  |
| Interest expense |  **(9)** |  |  (9) |  |  **(24)** |  |  (26) |
| Write off of debt issuance costs |  **(8)** |  |  - |  |  **(8)** |  |  - |
| Other, net |  **-** |  |  3 |  |  **-** |  |  2 |
|  |  |  |  |  |  |  |  |
| Income (loss) before income taxes |  **5** |  |  (42) |  |  **21** |  |  (74) |
| Income tax expense (benefit) |  **2** |  |  (2) |  |  **6** |  |  (9) |
| Net income (loss) |  **3** |  |  (40) |  |  **15** |  |  (65) |
| Series A preferred stock dividends |  **6** |  |  6 |  |  **18** |  |  18 |
| Net loss attributable to common stockholders | **$                     (3)** |  | $                   (46) |  | **$                     (3)** |  | $                   (83) |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Basic loss per common share | **$                (0.03)** |  | $                (0.48) |  | **$                (0.03)** |  | $                (0.85) |
| Diluted loss per common share | **$                (0.03)** |  | $                (0.48) |  | **$                (0.03)** |  | $                (0.85) |
| Weighted-average common shares, basic |  **94.5** |  |  95.9 |  |  **94.6** |  |  98.1 |
| Weighted-average common shares, diluted |  **94.5** |  |  95.9 |  |  **94.6** |  |  98.1 |

*See notes to condensed consolidated financial statements.*

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended** |  | **Nine Months Ended** |
|  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |
|  | **2017** |  |  **2016** |  | **2017** |  |  **2016** |
|  |  |  |  |  |  |  |  |
| Net income (loss) | **$                    3** |  | $                  (40) |  | **$                  15** |  | $                  (65) |
|  |  |  |  |  |  |  |  |
| Other comprehensive income  |  |  |  |  |  |  |  |
|  Foreign currency translation adjustments |  **11** |  |  - |  |  **25** |  |  12 |
| Comprehensive income (loss) | **$                  14** |  | $                  (40) |  | **$                  40** |  | $                  (53) |
|  |  |  |  |  |  |  |  |

*See notes to condensed consolidated financial statements.*

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
|  | **Nine Months Ended** |
|  | **September 30,**  |  | **September 30,**  |
|  | **2017** |  |  **2016** |
|  |  |  |  |
| **Operating activities** |  |
| Net income (loss) | **$                 15** |  | $                   (65) |
| Adjustments to reconcile net income (loss) to net cash (used in) provided by operations: |  |  |  |
| Depreciation and amortization |  **16** |  |  16 |
| Amortization of intangibles |  **34** |  |  35 |
| Equity-based compensation expense |  **12** |  |  9 |
| Deferred income tax benefit |  **(13)** |  |  (12) |
| Amortization of debt issuance costs |  **3** |  |  3 |
| Write off of debt issuance costs |  **8** |  |  - |
| Increase (decrease) in LIFO reserve |  **19** |  |  (7) |
| Inventory-related charges |  **-** |  |  45 |
| Foreign currency (gains) losses  |  **(2)** |  |  1 |
| Other  |  **3** |  |  4 |
| Changes in operating assets and liabilities: |  |  |  |
| Accounts receivable |  **(165)** |  |  88 |
| Inventories |  **(100)** |  |  119 |
| Other current assets |  **15** |  |  1 |
| Accounts payable |  **127** |  |  11 |
| Accrued expenses and other current liabilities |  **(9)** |  |  (18) |
| Net cash (used in) provided by operations |  **(37)** |  |  230 |
|  |  |  |  |
| **Investing activities** |  |  |  |
| Purchases of property, plant and equipment |  **(23)** |  |  (24) |
| Proceeds from the disposition of property, plant and equipment |  **-** |  |  1 |
| Proceeds from the disposition of non-core product line |  **-** |  |  48 |
| Net cash (used in) provided by investing activities |  **(23)** |  |  25 |
|  |  |  |  |
| **Financing activities** |  |  |  |
| Payments on revolving credit facilities |  **(468)** |  |  (32) |
| Proceeds from revolving credit facilities |  **518** |  |  32 |
| Payments on long-term obligations |  **(18)** |  |  (6) |
| Debt issuance costs paid |  **(7)** |  |  - |
| Purchase of common stock |  **(18)** |  |  (88) |
| Dividends paid on preferred stock |  **(18)** |  |  (18) |
| Repurchases of shares to satisfy tax withholdings |  **(3)** |  |  - |
| Net cash used in financing activities |  **(14)** |  |  (112) |
|  |  |  |  |
| (Decrease) increase in cash |  **(74)** |  |  143 |
| Effect of foreign exchange rate on cash |  **5** |  |  1 |
| Cash -- beginning of period |  **109** |  |  69 |
| Cash -- end of period | **$                 40** |  | $                  213 |
|  |  |  |  |
| Supplemental disclosures of cash flow information: |  |  |  |
| Cash paid for interest | **$                 21** |  | $                    23 |
| Cash paid for income taxes | **$                 33** |  | $                      8 |
| *See notes to condensed consolidated financial statements.* |  |  |  |

NOTE 1 – BACKGROUND AND BASIS OF PRESENTATION

**Business Operations:** MRC Global Inc. is a holding company headquartered in Houston, Texas. Our wholly owned subsidiaries are global distributors of pipe, valves, fittings (“PVF”) and related products and services across each of the upstream (exploration, production and extraction of underground oil and gas), midstream (gathering and transmission of oil and gas, gas utilities, and the storage and distribution of oil and gas) and downstream (crude oil refining and petrochemical and chemical processing and general industrials) sectors. We have branches in principal industrial, hydrocarbon producing and refining areas throughout the United States, Canada, Europe, Asia, Australasia, the Middle East and Caspian. Our products are obtained from a broad range of suppliers.

**Basis of Presentation:** We have prepared our unaudited condensed consolidated financial statements in accordance with Rule 10-01 of Regulation S-X for interim financial statements. These statements do not include all information and footnotes that generally accepted accounting principles require for complete annual financial statements. However, the information in these statements reflects all normal recurring adjustments which are, in our opinion, 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 that will be realized for the fiscal year ending December 31, 2017. We have derived our condensed consolidated balance sheet as of December 31, 2016 from the audited consolidated financial statements for the year ended December 31, 2016. You should read these condensed consolidated financial statements in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2016.

The consolidated financial statements include the accounts of MRC Global Inc. and its wholly owned and majority owned subsidiaries (collectively referred to as the “Company” or by such terms as “we,” “our” or “us”). All material intercompany balances and transactions have been eliminated in consolidation.

**Recent Accounting Pronouncements:** In May 2014, the Financial Accounting Standards Board (“FASB”) issued a comprehensive new revenue recognition standard, which will supersede previous existing revenue recognition guidance. The Accounting Standards Update (“ASU”) also provides guidance on accounting for certain contract costs and requires new disclosures. During 2016, the FASB issued additional clarification guidance on the new revenue recognition standard, which also included certain scope improvements and practical expedients. The standard (including clarification guidance issued) is effective for fiscal periods beginning after December 15, 2017 and allows for either full retrospective or modified retrospective adoption. We have completed a formal review of contracts with 36 of our largest customers, based on revenue, which represented 58% of 2016 revenue.  This review encompassed customers from a wide variety of end markets and geographies and involved inquiry of sales and operations personnel responsible for servicing these accounts in addition to review of the contracts.  The balance of our revenue is derived from thousands of customers with which we generally interact in a transactional relationship where goods are purchased from our branch locations.  Based on our analysis to date, we do not expect the guidance to have a material impact on the timing of our revenue recognition; however, our disclosures will be expanded to address the qualitative and quantitative requirements of the new standard.  We expect to finalize our analysis and related documentation and to adopt the standard in the first quarter of 2018 and have determined that we will utilize the modified retrospective transition method.  We are still assessing the impact of the standard on our internal control processes and information systems.  However, we do not currently believe that significant modifications of our systems will be required.

In February 2016, the FASB issued ASU 2016-02, *Leases,* which will replace the existing guidance in ASC 870, *Leases.* This ASU requires a dual approach for lessee accounting under which a lessee would account for leases as finance leases or operating leases. Both finance leases and operating leases will result in the lessee recognizing a right-of-use asset and a corresponding lease liability. For finance leases, the lessee would recognize interest expense and amortization of the right-of-use asset, and for operating leases, the lessee would recognize a straight-line total lease expense. This guidance is effective for annual and interim reporting periods of public entities beginning after December 15, 2018. We are in the process of evaluating the effect of the adoption of ASU 2016-02 on our consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, *Income Taxes (Topic 740).* The guidance requires companies to recognize the income tax effects of intercompany sales and transfers of assets, other than inventory, in the income statement as income tax expense (or benefit) in the period in which the transfer occurs. The effective date will be the first quarter of fiscal year 2018, with early adoption permitted. The changes are required to be applied by means of a cumulative-effect adjustment recorded in retained earnings as of the beginning of the fiscal year of adoption. We do not expect the adoption of ASU 2016-16 to have a material impact on our consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, *Simplifying the Test for Goodwill Impairment*. The amendments in ASU 2017-04 eliminate the current two-step approach used to test goodwill for impairment and require an entity to apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. ASU 2017-04 is effective for fiscal years, including interim periods within, beginning after December 15, 2019 (upon the first goodwill impairment test performed during that fiscal year). Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. A reporting entity must apply the amendments in ASU 2017-04 using a prospective approach. We do not expect the adoption of ASU 2017-04 to have a material impact on our consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, *Compensation – Stock Compensation (Topic 718) Scope of Modification Accounting* which clarifies modification accounting for share-based payment awards should not be applied if the fair value, vesting conditions, and the classification of the modified award as an equity instrument or as a liability instrument are the same before and immediately after the modification. This standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Adoption will be applied prospectively to awards modified on or after the adoption date. We do not expect the adoption of ASU 2017-09 to have a material impact on our consolidated financial statements.

NOTE 2 – INVENTORIES

The composition of our inventory is as follows (in millions):

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
|  | **September 30,**  |  | **December 31,** |
|  | **2017** |  | **2016** |
| Finished goods inventory at average cost:  |  |  |  |
| Line pipe | **$                158** |  | $              124 |
| Valves, automation, measurement and instrumentation |  **250** |  |  225 |
| All other products |  **362** |  |  313 |
|  |  **770** |  |  662 |
| Less: Excess of average cost over LIFO cost (LIFO reserve) |  **(86)** |  |  (67) |
| Less: Other inventory reserves |  **(35)** |  |  (34) |
|  | **$                649** |  | $              561 |

In 2016, we experienced reductions in inventory quantities, resulting in a liquidation of a last-in, first out (“LIFO”) inventory layer that was carried at a lower cost prevailing from a prior year, as compared with current costs (a “LIFO decrement”). A LIFO decrement results in the erosion of layers created in earlier years, and, therefore, a LIFO layer is not created for years that have decrements. For the three and nine months ended September 30, 2016, the effect of this LIFO decrement decreased cost of sales by approximately $8 million and $11 million, respectively.

In the third quarter of 2016, we incurred inventory-related charges totaling $45 million. These charges reflected adjustments necessary to reduce the carrying value of certain products determined to be excess or obsolete to their estimated net realizable value based on our market outlook for certain products at that time. This amount included $24 million in the International segment primarily related to a restructuring of our Australian business and market conditions in Iraq. Reserves for excess and obsolete inventory were increased in the U.S. and Canada by $16 million and $5 million, respectively.

NOTE 3 – LONG-TERM DEBT

The components of our long-term debt are as follows (in millions):

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
|  | **September 30,**  |  | **December 31,**  |
|  | **2017** |  |  **2016** |
| Senior Secured Term Loan B, net of discount and issuance costs of $3 and $4, respectively | **$              397** |  | $              414 |
| Global ABL Facility |  **50** |  |  - |
|  |  **447** |  |  414 |
| Less: current portion |  **3** |  |  8 |
|  | **$              444** |  | $              406 |

**Senior Secured Term Loan B:** In September 2017, the Company entered into a Refinancing Amendment and Successor Administrative Agent Agreement relating to the Term Loan Credit Agreement, dated as of November 9, 2012, by and among the Company, MRC Global (US) Inc., as the borrower, the other subsidiaries of the Company from time to time party thereto as guarantors, the several lenders from time to time party thereto, Bank of America, N.A., as administrative agent, and U.S. Bank National Association, as collateral trustee. Pursuant to the amendment, the parties thereto agreed to appoint JPMorgan Chase Bank, N.A. as the new administrative agent for the lenders. As amended, the Term Loan Agreement provides for a $400 million seven-year Term Loan B (the “Term Loan”) which matures in September 2024. The Term Loan allows for incremental increases in facility size by up to an aggregate of $200 million, plus an additional amount such that the Company’s first lien leverage ratio (as defined under the Term Loan) would not exceed 4.00 to 1.00. MRC Global (US) Inc. is the borrower under this facility, which is guaranteed by MRC Global Inc. as well as all of its wholly owned U.S. subsidiaries. In addition, it is secured by a second lien on the assets securing our Global ABL Facility, defined below, (which includes accounts receivable, inventory and related assets) and a first lien on substantially all of the other assets of MRC Global Inc. and those of its U.S. subsidiaries, as well as a pledge of all of the capital stock of our domestic subsidiaries and 65% of the capital stock of first tier, non-U.S. subsidiaries. We are required to repay the Term Loan with certain asset sales and insurance proceeds, certain debt proceeds and 50% of excess cash flow, as defined in the Term Loan, (reducing to 25% if our first lien leverage ratio is no more than 2.75 to 1.00 and 0% if our first lien leverage ratio is no more than 2.50 to 1.00). In addition, the Term Loan contains a number of customary restrictive covenants.

The interest rate for the Term Loan, including the amortization of original issue discount and debt issuance costs, was 4.85% as of September 30, 2017 and 5.51% at December 31, 2016.

**Global ABL Facility:** In September 2017, the Company entered into a Third Amended and Restated Loan, Security and Guarantee Agreement (the “Global ABL Facility”) by and among the Company, the subsidiaries of the Company from time to time party thereto as borrowers and guarantors, the several lenders from time to time party thereto and Bank of America, N.A. as administrative agent, security trustee and collateral agent.As part of the amendment, the multi-currency global asset-based revolving credit facility was re-sized to $800 million from $1.05 billion and the maturity was extended to September 2022 from July 2019. This facility is comprised of $675 million in revolver commitments in the United States, $65 million in Canada, $18 million in Norway, $15 million in Australia, $13 million in the Netherlands, $7 million in the United Kingdom and $7 million in Belgium. It contains an accordion feature that allows us to increase the principal amount of the facility by up to $200 million, subject to securing additional lender commitments. MRC Global Inc. and each of its current and future wholly owned material U.S. subsidiaries guarantee the obligations of our borrower subsidiaries under the Global ABL Facility. Additionally, each of our non-U.S. borrower subsidiaries guarantees the obligations of our other non-U.S. borrower subsidiaries under the Global ABL Facility. Outstanding obligations are generally secured by a first priority security interest in accounts receivable, inventory and related assets. Excess Availability, as defined under our Global ABL Facility, was $489 million as of September 30, 2017.

The interest rate for the Global ABL Facility was 4.92% as of September 30, 2017. We had no borrowings on our Global ABL Facility at December 31, 2016.

NOTE 4 – INCOME TAXES

In the first quarter of 2017, we adopted ASU 2016-09, *Compensation - Stock Compensation*, which simplified the accounting for taxes related to stock based compensation. Under the standard, excess tax benefits and certain tax deficiencies are no longer recorded in additional paid-in capital (“APIC”), and APIC pools are eliminated. Instead, all excess tax benefits and tax deficiencies are recorded as income tax expense or benefit in the income statement. In addition, excess tax benefits are presented as operating activities rather than financing activities in the statement of cash flows. For the three and nine months ended September 30, 2017, we recorded a tax benefit of $0 million and $2 million, respectively, related to the vesting of stock awards. The impacts of this standard are reflected in the consolidated financial statements on a prospective basis.

For interim periods, our income tax expense is computed based upon our estimated annual effective tax rate. Our effective tax rates for the three and nine months ended September 30, 2017 were 40% and 29%, respectively. The effective tax rates for the three and nine months ended September 30, 2016 were 5% and 12%, respectively. Our rates generally differ from the U.S. federal statutory rate of 35% as a result of state income taxes and differing, generally lower, foreign income tax rates. The effective tax rate for the nine months ended September 30, 2017 was lower than our U.S. federal statutory rate primarily due to the discrete impact of the implementation of ASU 2016-09 and a benefit related to foreign currency exchange losses. Our 2016 effective tax rates were significantly lower than our U.S. federal statutory rate due to forecasted pre-tax losses across all segments including significant pre-tax losses in jurisdictions where there was no corresponding tax benefit.

NOTE 5 – REDEEMABLE PREFERRED STOCK

Preferred Stock Issuance

In June 2015, we issued 363,000 shares of Series A Convertible Perpetual Preferred Stock (the “Preferred Stock”) and received gross proceeds of $363 million. The Preferred Stock ranks senior to our common stock with respect to dividend rights and rights on liquidation, winding-up and dissolution. The Preferred Stock has a stated value of $1,000 per share, and holders of Preferred Stock are entitled to cumulative dividends payable quarterly in cash at a rate of 6.50% per annum. Holders of Preferred Stock are entitled to vote together with the holders of the common stock as a single class, in each case, on an as-converted basis, except where a separate class vote of the common stockholders is required by law. Holders of Preferred Stock have certain limited special approval rights, including with respect to the issuance of pari passu or senior equity securities of the Company.

The Preferred Stock is convertible at the option of the holders into shares of common stock at an initial conversion rate of 55.9284 shares of common stock for each share of Preferred Stock, which represents an initial conversion price of $17.88 per share of common stock, subject to adjustment. On or after the fifth anniversary of the initial issuance of the Preferred Stock, the Company will have the option to redeem, in whole but not in part, all the outstanding shares of Preferred Stock, subject to certain redemption price adjustments on the basis of the date of the conversion. We may elect to convert the Preferred Stock, in whole but not in part, into the relevant number of shares of common stock on or after the 54th month after the initial issuance of the Preferred Stock if the last reported sale price of the common stock has been at least 150% of the conversion price then in effect for a specified period. The conversion rate is subject to customary anti-dilution and other adjustments.

Holders of the Preferred Stock may, at their option, require the Company to repurchase their shares in the event of a fundamental change, as defined in the agreement. The repurchase price is based on the original $1,000 per share purchase price except in the case of a liquidation in which case they would receive the greater of $1,000 per share and the amount that would be received if they held common stock converted at the conversion rate in effect at the time of the fundamental change. Because this feature could require redemption as a result of the occurrence of an event not solely within the control of the Company, the Preferred Stock is classified as temporary equity on our balance sheet.

NOTE 6 – STOCKHOLDERS’ EQUITY

**Share Repurchase Program**

In November 2015, the Company’s board of directors authorized a share repurchase program for common stock up to $100 million, which was increased in November 2016 to $125 million. In the first quarter of 2017, the Company completed the repurchase of all shares authorized under the program.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
| Summary of share repurchase activity under the repurchase program: |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended** |  | **Nine Months Ended** |
|  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |
|  | **2017** |  | **2016** |  | **2017** |  |  **2016** |
| Number of shares acquired on the open market |  **-** |  |  1,121,111 |  |  **859,830** |  |  6,399,385 |
| Average price per share  | **$                    -** |  | $             14.92 |  | **$             20.54** |  | $             13.82 |
| Total cost of acquired shares (in millions)  | **$                    -** |  | $                  17 |  | **$                  18** |  | $                  88 |

In total, we have acquired 8,537,410 shares under this program at an average price per share of $14.64 for a total cost of $125 million. There were 94,514,448 shares of common stock outstanding as of September 30, 2017.

**Equity Compensation Plans**

Our 2011 Omnibus Incentive Plan originally had 3,250,000 shares reserved for issuance under the plan. In April 2015, our shareholders approved an additional 4,250,000 shares for reservation for issuance under the plan. The plan permits the issuance of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, performance units and other stock-based and cash-based awards. Since the adoption of the 2011 Omnibus Incentive Plan, the Company’s Board of Directors has periodically granted stock options, restricted stock awards, restricted stock units and performance share units to directors and employees. Options and stock appreciation rights may not be granted at prices less than the fair market value of our common stock on the date of the grant, nor for a term exceeding ten years. For employees, vesting generally occurs ratably over a three to five year period on the anniversaries of the date specified in the employees’ respective stock option, restricted stock award, restricted stock unit and performance share unit award agreements, subject to accelerated vesting under certain circumstances set forth in the agreements. Vesting for directors generally occurs on the one-year anniversary of the grant date. In 2017, 164,098 performance share unit awards, 544,918 restricted stock units, and 63,272 shares of restricted stock have been granted to employees and members of our board of directors. To date, since the plan’s inception in 2011, before consideration of forfeitures, 5,860,597 shares have been granted to management, members of our board of directors and key employees under this plan. A Black-Scholes option-pricing model is used to estimate the fair value of the stock options. A Monte Carlo simulation is completed to estimate the fair value of performance share unit awards with a stock price performance component. We expense the fair value of all equity grants, including performance share unit awards, on a straight-line basis over the vesting period.

**Accumulated Other Comprehensive Loss**

Accumulated other comprehensive loss in the accompanying consolidated balance sheets consists of the following (in millions):

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
|  |  |  |  |
|  | **September 30,**  |  | **December 31,** |
|  | **2017** |  | **2016** |
|  |  |  |  |
| Currency translation adjustments | **$             (208)** |  | $             (233) |
| Pension related adjustments |  **(1)** |  |  (1) |
| Accumulated other comprehensive loss | **$             (209)** |  | $             (234) |

Earnings per Share

Earnings per share are calculated in the table below (in millions, except per share amounts).

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended** |  | **Nine Months Ended** |
|  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |
|  | **2017** |  |  **2016** |  | **2017** |  |  **2016** |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Net income (loss) | **$                    3** |  | $                 (40) |  | **$                  15** |  | $                 (65) |
| Less: Dividends on Series A Preferred Stock |  **6** |  |  6 |  |  **18** |  |  18 |
| Net loss attributable to common stockholders | **$                   (3)** |  | $                 (46) |  | **$                   (3)** |  | $                 (83) |
|  |  |  |  |  |  |  |  |
| Weighted average basic shares outstanding |  **94.5** |  |  95.9 |  |  **94.6** |  |  98.1 |
| Effect of dilutive securities |  **-** |  |  - |  |  **-** |  |  - |
| Weighted average diluted shares outstanding |  **94.5** |  |  95.9 |  |  **94.6** |  |  98.1 |
|  |  |  |  |  |  |  |  |
| Net loss per share: |  |  |  |  |  |  |  |
|  Basic | **$              (0.03)** |  | $              (0.48) |  | **$              (0.03)** |  | $              (0.85) |
|  Diluted | **$              (0.03)** |  | $              (0.48) |  | **$              (0.03)** |  | $              (0.85) |

Equity awards and shares of Preferred Stock are disregarded in the calculation of diluted earnings per share if they are determined to be anti-dilutive. For the three and nine months ended September 30, 2017 and 2016, all of the shares of the Preferred Stock were anti-dilutive. For the three and nine months ended September 30, 2017, we had approximately 3.6 million and 2.1 million anti-dilutive stock options, respectively. For the three and nine months ended September 30, 2016, we had approximately 3.7 million and 3.6 million anti-dilutive stock options, respectively. There were 1.2 million anti-dilutive restricted stock, restricted units or performance stock unit awards for the three and nine months ended September 30, 2017. There were 1.0 million and 0.8 million anti-dilutive restricted stock, restricted units or performance stock unit awards for the three and nine months ended September 30, 2016 respectively.

NOTE 7 – SEGMENT INFORMATION

Our business is comprised of four operating segments: U.S. Eastern Region and Gulf Coast, U.S. Western Region, Canada and International. Our International segment consists of our operations outside of the U.S. and Canada. These segments represent our business of selling PVF to the energy sector across each of the upstream (exploration, production and extraction of underground oil and gas), midstream (gathering and transmission of oil and gas, gas utilities, and the storage and distribution of oil and gas) and downstream (crude oil refining and petrochemical and chemical processing and general industrials) markets. Our two U.S. operating segments have been aggregated into a single reportable segment based on their economic similarities. As a result, we report segment information for the U.S., Canada and International.

The following table presents financial information for each reportable segment (in millions):

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended** |  | **Nine Months Ended** |
|  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |
|  | **2017** |  |  **2016** |  | **2017** |  |  **2016** |
| **Sales** |  |  |  |  |  |  |  |
| U.S. | **$              759** |  | $              590 |  | **$             2,145** |  | $             1,747 |
| Canada |  **77** |  |  70 |  |  **223** |  |  188 |
| International |  **123** |  |  133 |  |  **375** |  |  387 |
| Consolidated sales | **$              959** |  | $              793 |  | **$             2,743** |  | $             2,322 |
|  |  |  |  |  |  |  |  |
| **Operating income (loss)** |  |  |  |  |  |  |  |
| U.S. | **$                21** |  | $                 (4) |  | **$                  53** |  | $                    (2) |
| Canada |  **4** |  |  (4) |  |  **8** |  |  (7) |
| International |  **(3)** |  |  (28) |  |  **(8)** |  |  (41) |
| Total operating income (loss) |  **22** |  |  (36) |  | **$                  53** |  | $                  (50) |
|  |  |  |  |  |  |  |  |
| **Interest expense** |  **(9)** |  |  (9) |  |  **(24)** |  |  (26) |
| **Other, net** |  **(8)** |  |  3 |  |  **(8)** |  |  2 |
| **Income (loss) before income taxes** | **$                  5** |  | $               (42) |  | **$                  21** |  | $                  (74) |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  | **September 30,**  |  | **December 31,**  |
|  |  |  |  |  | **2017** |  |  **2016** |
| **Total assets** |  |  |  |  |  |  |  |
| U.S. |  |  |  |  | **$             2,001** |  | $             1,862 |
| Canada |  |  |  |  |  **152** |  |  139 |
| International |  |  |  |  |  **183** |  |  163 |
| Total assets |  |  |  |  | **$             2,336** |  | $             2,164 |

 Our sales by product line are as follows (in millions):

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |
|  |  | **Three Months Ended** |  | **Nine Months Ended** |
|  |  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |
| **Type** |  | **2017** |  |  **2016** |  | **2017** |  |  **2016** |
|  |  |  |  |  |  |  |  |  |
| Valves, automation, measurement and instrumentation  |  | **$                338** |  | $                296 |  | **$                987** |  | $                894 |
| Line pipe |  |  **201** |  |  117 |  |  **517** |  |  345 |
| Gas products |  |  **150** |  |  124 |  |  **427** |  |  332 |
| Carbon steel fittings and flanges |  |  **143** |  |  117 |  |  **405** |  |  353 |
| Stainless steel and alloy pipe and fittings |  |  **45** |  |  60 |  |  **136** |  |  155 |
| Other |  |  **82** |  |  79 |  |  **271** |  |  243 |
|  |  | **$                959** |  | **$                793** |  | **$             2,743** |  | $             2,322 |

NOTE 8 – FAIR VALUE MEASUREMENTS

From time to time, we use derivative financial instruments to help manage our exposure to interest rate risk and fluctuations in foreign currencies. All of our derivative instruments are freestanding and, accordingly, changes in their fair market value are recorded in earnings. As of September 30, 2017, we did not have any interest rate swap agreements. Foreign exchange forward contracts and options are reported at fair value utilizing Level 2 inputs, as the fair value is based on broker quotes for the same or similar derivative instruments. The total notional amount of our forward foreign exchange contracts and options was approximately $45 million and $36 million at September 30, 2017 and December 31, 2016, respectively. We had approximately $0 million recorded as liabilities on our consolidated balance sheets as of September 30, 2017 and December 31, 2016.

With the exception of long-term debt, the fair values of our financial instruments, including cash and cash equivalents, accounts receivable, trade accounts payable and accrued liabilities approximate carrying value. The carrying value of our debt was $447 million and $414 million at September 30, 2017 and December 31, 2016, respectively. We estimate the fair value of the Term Loan using Level 2 inputs, or quoted market prices. The fair value of our debt was $448 million and $417 million at September 30, 2017 and December 31, 2016, respectively.

**NOTE 9 – COMMITMENTS AND CONTINGENCIES**

*Litigation*

*Asbestos Claims.*    We are one of many defendants in lawsuits that plaintiffs have brought seeking damages for personal injuries that exposure to asbestos allegedly caused. Plaintiffs and their family members have brought these lawsuits against a large volume of defendant entities as a result of the defendants’ manufacture, distribution, supply or other involvement with asbestos, asbestos containing-products or equipment or activities that allegedly caused plaintiffs to be exposed to asbestos. These plaintiffs typically assert exposure to asbestos as a consequence of third-party manufactured products that our MRC Global (US) Inc. subsidiary purportedly distributed. As of September 30, 2017, we are named a defendant in approximately 543 lawsuits involving approximately 1,163 claims. No asbestos lawsuit has resulted in a judgment against us to date, with a majority being settled, dismissed or otherwise resolved. Applicable third-party insurance has substantially covered these claims, and insurance should continue to cover a substantial majority of existing and anticipated future claims. Accordingly, we have recorded a liability for our estimate of the most likely settlement of asserted claims and a related receivable from insurers for our estimated recovery, to the extent we believe that the amounts of recovery are probable. It is not possible to predict the outcome of these claims and proceedings. However, in our opinion, the likelihood that the ultimate disposition of any of these claims and legal proceedings will have a material adverse effect on our consolidated financial statements is remote.

*Other Legal Claims and Proceedings.*    From time to time, we have been subject to various claims and involved in legal proceedings incidental to the nature of our businesses. We maintain insurance coverage to reduce financial risk associated with certain of these claims and proceedings. It is not possible to predict the outcome of these claims and proceedings. However, in our opinion, the likelihood that the ultimate disposition of any of these claims and legal proceedings will have a material adverse effect on our consolidated financial statements is remote.

*Product Claims.*    From time to time, in the ordinary course of our business, our customers may claim that the products that we distribute are either defective or require repair or replacement under warranties that either we or the manufacturer may provide to the customer. These proceedings are, in the opinion of management, ordinary and routine matters incidental to our normal business. Our purchase orders with our suppliers generally require the manufacturer to indemnify us against any product liability claims, leaving the manufacturer ultimately responsible for these claims. In many cases, state, provincial or foreign law provides protection to distributors for these sorts of claims, shifting the responsibility to the manufacturer. In some cases, we could be required to repair or replace the products for the benefit of our customer and seek our recovery from the manufacturer for our expense. In our opinion, the likelihood that the ultimate disposition of any of these claims and legal proceedings will have a material adverse effect on our consolidated financial statements is remote.

*Weatherford Claim.* In addition to PVF, our Canadian subsidiary, Midfield Supply (“Midfield”), now known as MRC Global (Canada) ULC, also distributed progressive cavity pumps and related equipment (“PCPs”) under a distribution agreement with Weatherford Canada Partnership (“Weatherford”) within a certain geographical area located in southern Alberta, Canada. In late 2005 and early 2006, Midfield hired new employees, including former Weatherford employees, as part of Midfield’s desire to expand its PVF business into northern Alberta. Shortly thereafter, many of these employees left Midfield and formed a PCP manufacturing, distribution and service company named Europump Systems Inc. (“Europump”) in 2006. The distribution agreement with Weatherford expired in 2006. Midfield supplied Europump with PVF products that Europump distributed along with PCP pumps. In April 2007, Midfield purchased Europump’s distribution branches and began distributing and servicing Europump PCPs.

Pursuant to a complaint that Weatherford filed on April 11, 2006 in the Court of Queen’s Bench of Alberta, Judicial Bench of Edmonton (Action No. 060304628), Weatherford sued Europump, three of Europump’s part suppliers, Midfield, certain current and former employees of Midfield, and other related entities, asserting a host of claims including breach of contract, breach of fiduciary duty, misappropriation of confidential information related to the PCPs, unlawful interference with economic relations and conspiracy. The Company denies these allegations and contends that Midfield’s expansion and subsequent growth was the result of fair competition.

In June 2017, Midfield and Europump and certain individual defendants and related entities settled the case. As part of the settlement, MRC Global (Canada) ULC agreed to pay $6 million in exchange for a release from Weatherford and agreement to dismiss the case. The Company had previously recorded a reserve of $3 million. As a result of the settlement, an additional charge of $3 million was recorded in the second quarter of 2017.

Customer Contracts

We have contracts and agreements with many of our customers that dictate certain terms of our sales arrangements (pricing, deliverables, etc.). While we make every effort to abide by the terms of these contracts, certain provisions are complex and often subject to varying interpretations. Under the terms of these contracts, our customers have the right to audit our adherence to the contract terms. Historically, any settlements that have resulted from these customer audits have not been material to our consolidated financial statements.

Purchase Commitments

We have purchase obligations consisting primarily of inventory purchases made in the normal course of business to meet operating needs. While our vendors often allow us to cancel these purchase orders without penalty, in certain cases, cancellations may subject us to cancellation fees or penalties depending on the terms of the contract.

***ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS***

# You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our financial statements and related notes included elsewhere in this report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. As used in this Form 10-Q, unless otherwise indicated or the context otherwise requires, all references to the “Company”, “MRC Global”, “we”, “our” or “us” refer to MRC Global Inc. and its consolidated subsidiaries.

**Cautionary Note Regarding Forward-Looking Statements**

Management’s Discussion and Analysis of Financial Condition and Results of Operations (as well as other sections of this Quarterly Report on Form 10-Q) contain forward-looking statementswithin the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements include those preceded by, followed by or including the words “will,” “expect,” “intended,” “anticipated,” “believe,” “project,” “forecast,” “propose,” “plan,” “estimate,” “enable,” and similar expressions, including, for example, statements about our business strategy, our industry, our future profitability, growth in the industry sectors we serve, our expectations, beliefs, plans, strategies, objectives, prospects and assumptions, and estimates and projections of future activity and trends in the oil and natural gas industry. These forward-looking statements are not guarantees of future performance. These statements are based on management’s expectations that involve a number of business risks and uncertainties, any of which could cause actual results to differ materially from those expressed in or implied by the forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors, most of which are difficult to predict and many of which are beyond our control, including the factors described under “Risk Factors”, that may cause our actual results and performance to be materially different from any future results or performance expressed or implied by these forward-looking statements. Such risks and uncertainties include, among other things:

• decreases in oil and natural gas prices;

• decreases in oil and natural gas industry expenditure levels, which may result from decreased oil and natural gas prices or other factors;

• increased usage of alternative fuels, which may negatively affect oil and natural gas industry expenditure levels;

• U.S. and international general economic conditions;

• our ability to compete successfully with other companies in our industry;

• the risk that manufacturers of the products we distribute will sell a substantial amount of goods directly to end users in the industry sectors we serve;

• unexpected supply shortages;

• cost increases by our suppliers;

• our lack of long-term contracts with most of our suppliers;

• suppliers’ price reductions of products that we sell, which could cause the value of our inventory to decline;

• decreases in steel prices, which could significantly lower our profit;

• increases in steel prices, which we may be unable to pass along to our customers which could significantly lower our profit;

• our lack of long-term contracts with many of our customers and our lack of contracts with customers that require minimum purchase volumes;

• changes in our customer and product mix;

• risks related to our customers’ creditworthiness;

• the success of our acquisition strategies;

• the potential adverse effects associated with integrating acquisitions into our business and whether these acquisitions will yield their intended benefits;

• our significant indebtedness;

• the dependence on our subsidiaries for cash to meet our obligations;

• changes in our credit profile;

• a decline in demand for certain of the products we distribute if import restrictions on these products are lifted;

• environmental, health and safety laws and regulations and the interpretation or implementation thereof;

• the sufficiency of our insurance policies to cover losses, including liabilities arising from litigation;

• product liability claims against us;

• pending or future asbestos-related claims against us;

• the potential loss of key personnel;

• interruption in the proper functioning of our information systems;

• the occurrence of cybersecurity incidents;

• loss of third-party transportation providers;

• potential inability to obtain necessary capital;

• risks related to adverse weather events or natural disasters;

• impairment of our goodwill or other intangible assets;

• adverse changes in political or economic conditions in the countries in which we operate;

• exposure to U.S. and international laws and regulations, including the Foreign Corrupt Practices Act and the U.K. Bribery Act and other economic sanctions programs;

• risks associated with international instability and geopolitical developments;

• risks relating to ongoing evaluations of internal controls required by Section 404 of the Sarbanes-Oxley Act;

• the impact on us of changes in U.S. generally accepted accounting principles or tax laws;

• our intention not to pay dividends; and

• the impact of U.S government policies.

Undue reliance should not be placed on our forward-looking statements. Although forward-looking statements reflect our good faith beliefs, reliance should not be placed on forward-looking statements because they involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events, changed circumstances or otherwise, except to the extent law requires.

**Overview**

We are the largest global industrial distributor, based on sales, of pipe, valves, and fittings (“PVF”) and related products and services to the energy industry and hold a leading position in our industry across each of the upstream (exploration, production and extraction of underground oil and natural gas), midstream (gathering and transmission of oil and natural gas, natural gas utilities and the storage and distribution of oil and natural gas) and downstream (crude oil refining, petrochemical and chemical processing and general industrials) sectors. Our business is segregated into three geographic reportable segments, consisting of our U.S., Canada and International operations. We serve our customers from approximately 300 service locations. We offer a wide array of PVF and oilfield supplies encompassing a complete line of products from our global network of over 12,000 suppliers to our more than 17,000 customers. We are diversified by geography, the industry sectors we serve and the products we sell. We seek to provide best-in-class service to our customers by satisfying the most complex, multi-site needs of many of the largest companies in the energy sector as their primary PVF supplier. We believe the critical role we play in our customers’ supply chain, together with our extensive product offering, broad global presence, customer-linked scalable information systems and efficient distribution capabilities, serve to solidify our long-standing customer relationships and drive our growth. As a result, we have an average relationship of over 25 years with our 25 largest customers.

**Key Drivers of Our Business**

Our revenue is predominantly derived from the sale of PVF and other oilfield and industrial supplies to the energy sector globally. Our business is therefore dependent upon both the current conditions and future prospects in the energy industry and, in particular, maintenance and expansionary operating and capital expenditures by our customers in the upstream, midstream and downstream sectors of the industry. We saw customer spending fall off significantly beginning in late 2014 and continuing through 2016 as a result of lower oil and natural gas prices. However, customer spending has increased in 2017 as oil and natural gas prices have improved from the lows of the past two years. Long-term growth in spending has been driven by several factors, including underinvestment in global energy infrastructure, growth in shale and unconventional exploration and production (“E&P”) activity, and anticipated strength in the oil, natural gas, refined products and petrochemical sectors. The outlook for future oil, natural gas, refined products and petrochemical PVF spending is influenced by numerous factors, including the following:

• *Oil and Natural Gas Prices.* Sales of PVF and related products to the oil and natural gas industry constitute over 90% of our sales. As a result, we depend upon the oil and natural gas industry and its ability and willingness to make maintenance and capital expenditures to explore for, produce and process oil, natural gas and refined products. Oil and natural gas prices, both current and projected, along with the costs necessary to produce oil and gas, impact other drivers of our business, including capital spending by customers, additions and maintenance to pipeline mileage, refinery utilization and petrochemical processing activity.

• *Economic Conditions.* The demand for the products we distribute is dependent on the general economy, the energy sector and other factors. Changes in the general economy or in the energy sector (domestically or internationally) can cause demand for the products we distribute to materially change.

• *Manufacturer and Distributor Inventory Levels of PVF and Related Products.* Manufacturer and distributor inventory levels of PVF and related products can change significantly from period to period. Increased inventory levels by manufacturers or other distributors can cause an oversupply of PVF and related products in the industry sectors we serve and reduce the prices that we are able to charge for the products we distribute. Reduced prices, in turn, would likely reduce our profitability. Conversely, decreased manufacturer inventory levels may ultimately lead to increased demand for our products and would likely result in increased sales volumes and overall profitability.

• *Steel Prices, Availability and Supply and Demand.* Fluctuations in steel prices can lead to volatility in the pricing of the products we distribute, especially carbon steel tubular products, which can influence the buying patterns of our customers. A majority of the products we distribute contain various types of steel. The worldwide supply and demand for these products, or other steel products that we do not supply, impacts the pricing and availability of our products and, ultimately, our sales and operating profitability.

**Recent Trends and Outlook**

During the first nine months of 2017, the average oil price of West Texas Intermediate (“WTI”) increased to $49.30 per barrel from $41.35 per barrel in the first nine months of 2016. Natural gas prices increased to an average price of $3.01/Mcf (Henry Hub) for the first nine months of 2017 compared to $2.34/Mcf (Henry Hub) for the first nine months of 2016.North American drilling rig activity increased 80% in the first nine months of 2017 as compared to the first nine months of 2016. U.S. well completions were up 36% in the first nine months of 2017 compared to the same period in 2016.

In recent years, there has been an increase in the global supply of crude oil, including the contribution of U.S. shale oil, at a pace exceeding demand growth.  This increase combined with a hesitance on the part of the Organization of Petroleum Exporting Countries (“OPEC”) to curb production triggered a dramatic decline in oil prices that began in late 2014 and continued throughout 2016.  This low price environment, in turn, resulted in a dramatic decline in E&P capital spending by our customers, which directly impacted our business.  In 2016, customer spending fell by 27%, following a 21% decline in 2015, which brought spending to its lowest levels since 2009. This marked the first time in nearly 30 years that global spending has been down in consecutive years. However, since its November 2016 announcement, OPEC has attempted to enforce production cuts, and we have been encouraged by stability in oil prices and increased drilling activity. As a result, our 2017 revenue will be higher than 2016 and prominent E&P spending surveys, which include many of our customers, indicate that spending will continue to increase in North America in 2018 and 2019, while forecasts outside of North America are more subdued. We expect our business to follow the same trend. However, in the short-term, oil prices remain volatile and changes in oil prices could impact customer spending levels.

Beginning in 2015, the international segment has seen customer spending continue to decline, even as the U.S. and Canadian segment sales have increased from improved spending by our customer base in 2017. We took actions in 2016 to reduce our international footprint and cost structure and yet we have been unable to return to profitability. For the first nine months of 2017 our international segment is reporting an operating loss of $8 million. As such, we are in the process of further reducing our headcount and cost structure in the international segment and expect to record a severance and restructuring charge in the fourth quarter of 2017.

In January 2017, a new U.S. President took office and a new U.S. Congress was seated. They have publicly made statements regarding the desire to support United States energy producers, refocus the EPA on its core mission, focus on United States interests first and lessen the regulatory burden on businesses to create job growth. These statements have been further supported by the approval of a number of pipeline projects. They have also announced an aggressive policy agenda to change the tax system, modify the relationships between the United States and other countries, cancel or modify trade treaties and remake relationships with other countries. Until specific laws are passed, executive actions are taken or federal regulatory action is enacted, it is unclear what impact these policies will have on our business. While at first impression these policies could decrease the regulatory and tax burden on our business and the businesses of our U.S. customers, increase oil and gas production in the U.S. and, as a result, our U.S. business activity and increase the sales of product from our U.S. suppliers, it is not clear that all impacts would be positive. However, in the absence of specifics and given the government’s generally supportive stance for the oil and gas industry, and based on E&P spending surveys and our customers’ current outlook for oil and gas supply and demand, we expect our business to increase in 2017 and 2018.

We determine backlog by the amount of unshipped customer orders, either specific or general in nature, which the customer may revise or cancel in certain instances.  The table below details our backlog by segment (in millions):

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |
|  | **September 30,**  |  | **December 31,** |  | **September 30,**  |
|  | **2017** |  | **2016** |  | **2016** |
| U.S. | **$              520** |  | $              472 |  | $              411 |
| Canada |  **35** |  |  36 |  |  29 |
| International |  **247** |  |  241 |  |  219 |
|  | **$              802** |  | $              749 |  | $              659 |

Approximately 20% and 28% of our September 30, 2017 and December 31, 2016 ending backlog, respectively, was associated with one customer in our U.S. segment as the result of a significant ongoing customer project. There can be no assurance that the backlog amounts will ultimately be realized as revenue or that we will earn a profit on the backlog of orders, but we expect that substantially all of the sales in our backlog will be realized in the next twelve months.

The following table shows key industry indicators for the three and nine months ended September 30, 2017 and 2016:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended** |  | **Nine Months Ended** |
|  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |  | **September 30,**  |
|  | **2017** |  |  **2016** |  | **2017** |  |  **2016** |
| *Average Rig Count (1):* |  |  |  |  |  |  |  |
| United States |  **946** |  |  479 |  |  **861** |  |  482 |
| Canada |  **208** |  |  121 |  |  **207** |  |  112 |
| Total North America |  **1,154** |  |  600 |  |  **1,068** |  |  594 |
| International |  **947** |  |  936 |  |  **948** |  |  965 |
| Total  |  **2,101** |  |  1,536 |  |  **2,016** |  |  1,559 |
|  |  |  |  |  |  |  |  |
| *Average Commodity Prices (2):* |  |  |  |  |  |  |  |
| WTI crude oil (per barrel) | **$           48.18** |  | $           44.85 |  | **$             49.30** |  | $             41.35 |
| Brent crude oil (per barrel) | **$           52.10** |  | $           45.80 |  | **$             51.75** |  | $             41.86 |
| Natural gas ($/Mcf) | **$             2.95** |  | $             2.88 |  | **$               3.01** |  | $               2.34 |
|  |  |  |  |  |  |  |  |
| Average Monthly U.S. Well Permits *(3)* |  **3,877** |  |  2,678 |  |  **3,553** |  |  2,260 |
| U.S. Wells Completed *(2)* |  **3,370** |  |  2,287 |  |  **8,913** |  |  6,531 |
| 3:2:1 Crack Spread *(4)* | **$           19.77** |  | $           13.61 |  | **$             17.52** |  | $             15.38 |
| *(1) Source-Baker Hughes (www.bhge.com) (Total rig count includes oil, natural gas and other rigs.)* |
| *(2) Source-Department of Energy, EIA (www.eia.gov)*  |
| *(3) Source-Rig Data (U.S.)* |
| *(4) Source- Bloomberg* |

**Results of Operations**

***Three Months Ended September 30, 2017 Compared to the Three Months Ended September 30, 2016***

The breakdown of our sales by sector for the three months ended September 30, 2017 and 2016 was as follows (in millions):

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended** |
|  |  **September 30, 2017** |  |  **September 30, 2016** |
| Upstream | **$          269** |  | **28%** |  | $         224 |  | 28% |
| Midstream |  **437** |  | **46%** |  |  327 |  | 41% |
| Downstream |  **253** |  | **26%** |  |  242 |  | 31% |
|  | **$          959** |  | **100%** |  | $         793 |  | 100% |
|  |  |  |  |  |  |  |  |

For the three months ended September 30, 2017 and 2016, the following table summarizes our results of operations (in millions):

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended** |  |  |  |  |
|  | **September 30,**  |  | **September 30,**  |  |  |  |  |
|  | **2017** |  |  **2016** |  | **$ Change** |  | **% Change** |
| *Sales:* |  |  |  |  |  |  |  |
| U.S. | **$                   759** |  | $                   590 |  | $            169 |  | 29% |
| Canada |  **77** |  |  70 |  |  7 |  | 10% |
| International |  **123** |  |  133 |  |  (10) |  | (8%) |
| Consolidated | **$                   959** |  | $                   793 |  | $            166 |  | 21% |
|  |  |  |  |  |  |  |  |
| *Operating income (loss):* |  |  |  |  |  |  |  |
| U.S. | **$                     21** |  | $                     (4) |  | $              25 |  | N/M |
| Canada |  **4** |  |  (4) |  |  8 |  | N/M |
| International |  **(3)** |  |  (28) |  |  25 |  | N/M |
| Consolidated |  **22** |  |  (36) |  |  58 |  | N/M |
|  |  |  |  |  |  |  |  |
| Interest expense |  **(9)** |  |  (9) |  |  - |  | 0% |
| Other (expense) income |  **(8)** |  |  3 |  |  (11) |  | N/M |
| Income tax (expense) benefit |  **(2)** |  |  2 |  |  (4) |  | N/M |
| Net income (loss) |  **3** |  |  (40) |  |  43 |  | N/M |
| Series A preferred stock dividends |  **6** |  |  6 |  |  - |  | 0% |
| Net loss attributable to common stockholders | **$                     (3)** |  | $                   (46) |  | $              43 |  | N/M |
|  |  |  |  |  |  |  |  |
| Gross profit | **$                   152** |  | $                     88 |  | $              64 |  | 73% |
| Adjusted Gross Profit (1) | **$                   182** |  | $                   103 |  | $              79 |  | 77% |
| Adjusted EBITDA (1) | **$                     56** |  | $                     24 |  | $              32 |  | N/M |

1. Adjusted Gross Profit and Adjusted EBITDA are non-GAAP financial measures. For a reconciliation of these measures to an equivalent GAAP measure, see pages 19-21 herein.

***Sales****.*    Sales include the revenue recognized from the sale of products we distribute, services we provide and freight billings to customers, less cash discounts taken by customers in return for their early payment. Our sales were $959 million for the three months ended September 30, 2017 as compared to $793 million for the three months ended September 30, 2016, an increase of $166 million, or 21%.

*U.S. Segment—*Our U.S. sales increased to $759 million for the three months ended September 30, 2017 from $590 million for the three months ended September 30, 2016. This $169 million, or 29%, increase reflected a $49 million increase in the upstream sector, a $110 million increase in the midstream sector and a $10 million increase in the downstream sector. The increase in the midstream sector is related to increased activity in the gas utility and transmission and gathering subsectors with several of our customers, and the increase in the upstream sector is related to the increase in rig count and well completions. We estimate that business disruption from hurricanes negatively impacted sales by $8 million in the third quarter of 2017.

*Canada Segment—*Our Canada sales increased to $77 million for the three months ended September 30, 2017 from $70 million for the three months ended September 30, 2016. This $7 million, or 10%, increase was primarily due to the upstream business as a result of an increase in rig count and well completions offset by a decrease in the midstream sector. Canadian sales were favorably impacted by $3 million, or 4%, as a result of the stronger Canadian dollar relative to the U.S. dollar.

*International Segment*—Our International sales decreased to $123 million for the three months ended September 30, 2017 from $133 million for the same period in 2016. The $10 million, or 8%, decrease was primarily due to a $24 million decrease in the upstream business, related to one of our project customers in Norway, offset by a $12 million Australian line pipe sale in the midstream sector. The strengthening of foreign currencies in areas where we operate outside of the U.S. dollar favorably impacted sales by $3 million, or 2%.

***Gross Profit****.*    Our gross profit was $152 million (15.8% of sales) for the three months ended September 30, 2017 as compared to $88 million (11.1% of sales) for the three months ended September 30, 2016. Third quarter 2016 gross profit was negatively impacted by $45 million of inventory-related charges to reduce the carrying value of certain excess and obsolete inventory items to their net realizable value. Aside from the impact of this charge, the $64 million increase was primarily attributable to the increase in sales volumes. Excluding this charge, the reduction in gross profit percentage for the three months ended September 30, 2017, compared to the same period in 2016, was the result of our last-in, first-out (“LIFO”) inventory costing methodology which resulted in an increase in cost of sales of $13 million and a reduction of cost of sales of $3 million in the third quarter of 2017 and 2016, respectively

Certain purchasing costs and warehousing activities (including receiving, inspection and stocking costs), as well as general warehousing expenses, are included in selling, general and administrative expenses and not in cost of sales. As such, our gross profit may not be comparable to others that may include these expenses as a component of cost of sales. Purchasing and warehousing costs were $7 million and $8 million for the three months ended September 30, 2017 and 2016, respectively.

***Adjusted Gross Profit****.*    Adjusted Gross Profit increased to $182 million (19.0% of sales) for the three months ended September 30, 2017 from $103 million (13.0% of sales) for the three months ended September 30, 2016, an increase of $79 million. Third quarter 2016 Adjusted Gross Profit included the impact of the $45 million of inventory-related charges discussed above. Adjusted Gross Profit is a non-GAAP financial measure. We define Adjusted Gross Profit as sales, less cost of sales, plus depreciation and amortization, plus amortization of intangibles, and plus or minus the impact of our LIFO inventory costing methodology. We present Adjusted Gross Profit because we believe it is a useful indicator of our operating performance without regard to items, such as amortization of intangibles, that can vary substantially from company to company depending upon the nature and extent of acquisitions. Similarly, the impact of the LIFO inventory costing method can cause results to vary substantially from company to company depending upon whether they elect to utilize LIFO and depending upon which method they may elect. We use Adjusted Gross Profit as a key performance indicator in managing our business. We believe that gross profit is the financial measure calculated and presented in accordance with U.S. generally accepted accounting principles that is most directly comparable to Adjusted Gross Profit.

The following table reconciles Adjusted Gross Profit, a non-GAAP financial measure, with gross profit, as derived from our financial statements (in millions):

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
|  | **Three Months Ended** |
|  | **September 30,**  |  | **Percentage**  |  | **September 30,**  |  | **Percentage**  |
|  | **2017** |  | **of Revenue** |  |  **2016** |  | **of Revenue** |
| Gross profit, as reported | **$           152** |  | **15.8%** |  | $             88 |  | 11.1% |
| Depreciation and amortization |  **5** |  | **0.5%** |  |  6 |  | 0.8% |
| Amortization of intangibles |  **12** |  | **1.3%** |  |  12 |  | 1.5% |
| Increase (decrease) in LIFO reserve |  **13** |  | **1.4%** |  |  (3) |  | (0.4%) |
| Adjusted Gross Profit | **$           182** |  | **19.0%** |  | $           103 |  | 13.0% |
|  |  |  |  |  |  |  |  |

***Selling, General and Administrative (“SG&A”) Expenses****.*    Costs such as salaries, wages, employee benefits, rent, utilities, communications, insurance, fuel and taxes (other than state and federal income taxes) that are necessary to operate our branch and corporate operations are included in SG&A. Also contained in this category are certain items that are nonoperational in nature, including certain costs of acquiring and integrating other businesses. Our SG&A expenses were $130 million for the three months ended September 30, 2017 as compared to $124 million for the three months ended September 30, 2016. Severance and restructuring charges for the three months ended September 30, 2016 totaled $3 million. No such expenses were incurred for the three months ending September 30, 2017.  The increase in SG&A is primarily related to an increase in volume-related activity.

***Operating Income (Loss)****.* Operating income was $22 million for the three months ended September 30, 2017, as compared to a $36 million operating loss for the three months ended September 30, 2016, an improvement of $58 million.

*U.S. Segment*—Operating income for our U.S. segment was $21 million for the three months ended September 30, 2017 compared to a $4 million operating loss for the three months ended September 30, 2016. The $25 million improvement in operating income was driven, in part, by higher sales. In addition, in 2016, we recorded $16 million of inventory-related charges to reduce the carrying value of certain obsolete and excess inventory items to their net realizable value.

*Canada Segment*—Operating income for our Canada segment was $4 million for the three months ended September 30, 2017 as compared to a $4 million operating loss for the three months ended September 30, 2016. The $8 million improvement was driven, in part, by higher sales. In addition, in 2016, we recorded $5 million of inventory-related charges to reduce the carrying value of certain obsolete and excess inventory items to their net realizable value.

*International Segment*—Our International segment incurred an operating loss of $3 million for the three months ended September 30, 2017 as compared to an operating loss of $28 million for the three months ended September 30, 2016. In the third quarter of 2016, we recorded $24 million of inventory-related charges to reduce the carrying value of certain obsolete and excess inventory items to their net realizable value. No such charges were recorded in the third quarter of 2017.

***Interest Expense****.* Our interest expense was $9 million for the three month periods ended September 30, 2017 and 2016.

***Other (Expense) Income****.* Our other expense was $8 million for the three month period ended September 30, 2017 as compared to other income of $3 million for the three month period ending September 30, 2016. Other expense for the three months ended September 30, 2017 included an $8 million charge for the write off of debt issuance costs associated with the refinancing of our Term Loan and Global ABL Facility. Other income for the three months ended September 30, 2016 included $1 million of foreign currency gains.

***Income Tax (Expense) Benefit.*** Our income tax expense was $2 million for the three months ended September 30, 2017, as compared to a $2 million benefit for the three months ended September 30, 2016. For interim periods, our income tax expense is computed based upon our estimated annual effective tax rate. Our effective tax rates were 40% and 5% for the three months ended September 30, 2017 and 2016, respectively. Our rates generally differ from the U.S. federal statutory rate of 35% as a result of state income taxes and differing, generally lower, foreign income tax rates. The 2016 effective tax rate was significantly lower than our federal statutory rate due to forecasted pre-tax losses across all segments including significant pre-tax losses in jurisdictions where there was no corresponding tax benefit.

***Net Income (Loss)****.* Our net income was $3 million for the three months ended September 30, 2017 as compared to a net loss of $40 million for the three months ended September 30, 2016, an improvement of $43 million.

***Adjusted EBITDA****.* Adjusted EBITDA, a non-GAAP financial measure, was $56 million (5.8% of sales) for the three months ended September 30, 2017 as compared to $24 million (3.0% of sales) for the three months ended September 30, 2016.

We define Adjusted EBITDA as net income plus interest, income taxes, depreciation and amortization, amortization of intangibles and certain other expenses, including non-cash expenses, (such as equity-based compensation, severance and restructuring, changes in the fair value of derivative instruments and asset impairments, including inventory) and plus or minus the impact of our LIFO inventory costing methodology.

We believe Adjusted EBITDA provides investors a helpful measure for comparing our operating performance with the performance of other companies that may have different financing and capital structures or tax rates. We believe it is a useful indicator of our operating performance without regard to items, such as amortization of intangibles, that can vary substantially from company to company depending upon the nature and extent of acquisitions. Similarly, the impact of the LIFO inventory costing method can cause results to vary substantially from company to company depending upon whether they elect to utilize LIFO and depending upon which method they may elect. We use Adjusted EBITDA as a key performance indicator in managing our business. We believe that net income is the financial measure calculated and presented in accordance with U.S. generally accepted accounting principles that is most directly comparable to Adjusted EBITDA.

The following table reconciles Adjusted EBITDA, a non-GAAP financial measure, with net income (loss), as derived from our financial statements (in millions):

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
|  | **Three Months Ended** |
|  | **September 30,**  |  | **September 30,**  |
|  | **2017** |  |  **2016** |
| Net income (loss) | **$                   3** |  | $                 (40) |
| Income tax expense (benefit) |  **2** |  | (2) |
| Interest expense |  **9** |  | 9 |
| Depreciation and amortization |  **5** |  | 6 |
| Amortization of intangibles  |  **12** |  | 12 |
| Increase (decrease) in LIFO reserve |  **13** |  |  (3) |
| Inventory-related charges |  **-** |  |  40 |
| Change in fair value of derivative instruments |  **1** |  |  (2) |
| Equity-based compensation expense |  **3** |  | 2 |
| Write off of debt issuance costs |  **8** |  |  - |
| Severance and restructuring charges |  **-** |  |  3 |
| Foreign currency gains  |  **-** |  |  (1) |
| Adjusted EBITDA | **$                 56** |  | $                 24 |
|  |  |  |  |

***Nine Months Ended September 30, 2017 Compared to the Nine Months Ended September 30, 2016***

The breakdown of our sales by sector for the nine months ended September 30, 2017 and 2016 was as follows (in millions):

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
|  | **Nine Months Ended** |
|  |  **September 30, 2017** |  |  **September 30, 2016** |
| Upstream | **$          772** |  | **28%** |  | $         666 |  | 29% |
| Midstream |  **1,228** |  | **45%** |  |  897 |  | 38% |
| Downstream  |  **743** |  | **27%** |  |  759 |  | 33% |
|  | **$       2,743** |  | **100%** |  | $      2,322 |  | 100% |

For the nine months ended September 30, 2017 and 2016, the following table summarizes our results of operations (in millions):

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
|  | **Nine Months Ended** |  |  |  |  |
|  | **September 30,**  |  | **September 30,**  |  |  |  |  |
|  | **2017** |  |  **2016** |  | **$ Change** |  | **% Change** |
| *Sales:* |  |  |  |  |  |  |  |
| U.S. | **$                2,145** |  | $                1,747 |  | $            398 |  | 23% |
| Canada |  **223** |  |  188 |  |  35 |  | 19% |
| International |  **375** |  |  387 |  |  (12) |  | (3%) |
| Consolidated | **$                2,743** |  | $                2,322 |  | $            421 |  | 18% |
|  |  |  |  |  |  |  |  |
| *Operating income (loss):* |  |  |  |  |  |  |  |
| U.S. | **$                     53** |  | $                     (2) |  | $              55 |  | N/M |
| Canada |  **8** |  |  (7) |  |  15 |  | N/M |
| International |  **(8)** |  |  (41) |  |  33 |  | N/M |
| Consolidated |  **53** |  |  (50) |  |  103 |  | N/M |
|  |  |  |  |  |  |  |  |
| Interest expense |  **(24)** |  |  (26) |  |  2 |  | (8%) |
| Other (expense) income |  **(8)** |  |  2 |  |  (10) |  | N/M |
| Income tax (expense) benefit |  **(6)** |  |  9 |  |  (15) |  | N/M |
| Net income (loss) |  **15** |  |  (65) |  |  80 |  | N/M |
| Series A preferred stock dividends |  **18** |  |  18 |  |  - |  | 0% |
| Net loss attributable to common stockholders | **$                     (3)** |  | $                   (83) |  | $              80 |  | N/M |
|  |  |  |  |  |  |  |  |
| Gross profit | **$                   441** |  | $                   346 |  | $              95 |  | 27% |
| Adjusted Gross Profit (1) | **$                   510** |  | $                   390 |  | $            120 |  | 31% |
| Adjusted EBITDA (1) | **$                   136** |  | $                     58 |  | $              78 |  | N/M |

 (1) Adjusted Gross Profit and Adjusted EBITDA are non-GAAP financial measures. For a reconciliation of these measures to an equivalent GAAP measure, see pages 23-25 herein.

***Sales****.*   Our sales were $2,743 million for the nine months ended September 30, 2017 as compared to $2,322 million for the nine months ended September 30, 2016, an increase of $421 million, or 18%.

*U.S. Segment—*Our U.S. sales increased to $2,145 million for the nine months ended September 30, 2017 from $1,747 million for the nine months ended September 30, 2016. This $398 million, or 23%, increase reflected a $118 million increase in the upstream sector, a $295 million increase in the midstream sector and a $15 million decrease in the downstream sector. The increase in the midstream sector is primarily related to a large, ongoing transmission project with one of our customers while the decrease in the downstream sector was a result of the conclusion of a large petrochemical project in 2016. The increase in the upstream sector is related to the increase in rig count and well completions.

*Canada Segment—*Our Canada sales increased to $223 million for the nine months ended September 30, 2017 from $188 million for the nine months ended September 30, 2016. This $35 million, or 19%, increase was primarily due to the increase in the upstream business as a result of the increase in rig count and well completions.

*International Segment*—Our International sales decreased to $375 million for the nine months ended September 30, 2017 from $387 million for the same period in 2016. The $12 million, or 3%, decrease was due to a $58 million decline related to one of our project customers in Norway offset by a $50 million increase in the midstream sector related to the Australian line pipe sale.

***Gross Profit****.*    Our gross profit was $441 million (16.1% of sales) for the nine months ended September 30, 2017 as compared to $346 million (14.9% of sales) for the nine months ended September 30, 2016. The $95 million increase was primarily attributable to the increase in sales volumes. In addition, gross profit for the nine months ended September 30, 2016 was negatively impacted by $45 million of inventory-related charges to reduce the carrying value of certain obsolete and excess inventory items to their realizable value. Excluding the 2016 charge, the reduction in gross profit percentage for the nine months ended September 30, 2017 compared to the same period in 2016 was the result of our LIFO inventory costing methodology, which resulted in an increase in cost of sales of $19 million and a reduction in cost of sales of $7 million in the first nine months of 2017 and 2016, respectively.

Certain purchasing costs and warehousing activities (including receiving, inspection and stocking costs), as well as general warehousing expenses, are included in selling, general and administrative expenses and not in cost of sales. As such, our gross profit may not be comparable to others that may include these expenses as a component of cost of sales. Purchasing and warehousing costs were $22 million and $23 million for the nine months ended September 30, 2017 and 2016, respectively.

***Adjusted Gross Profit****.*    Adjusted Gross Profit increased to $510 million (18.6% of sales) for the nine months ended September 30, 2017 from $390 million (16.8% of sales) for the nine months ended September 30, 2016, an increase of $120 million. Adjusted Gross Profit for the nine months ended September 30, 2016 included the impact of the $45 million of inventory-related charges discussed above. Adjusted Gross Profit is a non-GAAP financial measure. We define Adjusted Gross Profit as sales, less cost of sales, plus depreciation and amortization, plus amortization of intangibles, and plus or minus the impact of our LIFO inventory costing methodology. We present Adjusted Gross Profit because we believe it is a useful indicator of our operating performance without regard to items, such as amortization of intangibles, that can vary substantially from company to company depending upon the nature and extent of acquisitions. Similarly, the impact of the LIFO inventory costing method can cause results to vary substantially from company to company depending upon whether they elect to utilize LIFO and depending upon which method they may elect. We use Adjusted Gross Profit as a key performance indicator in managing our business. We believe that gross profit is the financial measure calculated and presented in accordance with U.S. generally accepted accounting principles that is most directly comparable to Adjusted Gross Profit.

The following table reconciles Adjusted Gross Profit, a non-GAAP financial measure, with gross profit, as derived from our financial statements (in millions):

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
|  | **Nine Months Ended** |
|  | **September 30,**  |  | **Percentage**  |  | **September 30,**  |  | **Percentage**  |
|  | **2017** |  | **of Revenue** |  |  **2016** |  | **of Revenue** |
| Gross profit, as reported | **$           441** |  | **16.1%** |  | $           346 |  | 14.9% |
| Depreciation and amortization |  **16** |  | **0.6%** |  |  16 |  | 0.7% |
| Amortization of intangibles |  **34** |  | **1.2%** |  |  35 |  | 1.5% |
| Increase (decrease) in LIFO reserve |  **19** |  | **0.7%** |  |  (7) |  | (0.3%) |
| Adjusted Gross Profit | **$           510** |  | **18.6%** |  | $           390 |  | 16.8% |
|  |  |  |  |  |  |  |  |

***Selling, General and Administrative (“SG&A”) Expenses****.* Our SG&A expenses were $388 million for the nine months ended September 30, 2017 as compared to $396 million for the nine months ended September 30, 2016. The $8 million decline in SG&A is attributable to 2016 cost reduction measures including headcount reductions and associated severance costs offset by volume-related increases. Severance and restructuring charges for the nine months ended September 30, 2016 totaled $12 million. No such expenses were incurred for the nine months ending September 30, 2017.

***Operating Income (Loss)****.* Operating income was $53 million for the nine months ended September 30, 2017, as compared to a $50 million operating loss for the nine months ended September 30, 2016, an improvement of $103 million.

*U.S. Segment*—Operating income for our U.S. segment was $53 million for the nine months ended September 30, 2017 compared to a $2 million operating loss for the nine months ended September 30, 2016. The $55 million improvement was primarily driven by higher sales. Severance costs included in operating expenses were $5 million for the nine months ended September 30, 2016. No such expenses were incurred for the nine months ended September 30, 2017. In addition, in 2016, we recorded $16 million of inventory-related charges to reduce the carrying value of certain obsolete and excess inventory items to their net realizable value.

*Canada Segment*—Operating income for our Canada segment was $8 million for the nine months ended September 30, 2017 as compared to a $7 million operating loss for the nine months ended September 30, 2016. The $15 million improvement was primarily a result of higher sales volume. In addition, in 2016 we recorded $5 million of inventory-related charges to reduce the carrying value of certain obsolete and excess inventory items to their net realizable value.

*International Segment*—Our International segment incurred an operating loss of $8 million for the nine months ended September 30, 2017 as compared to an operating loss of $41 million for the nine months ended September 30, 2016. In 2016, we recorded $24 million of inventory-related charges to reduce the carrying value of certain obsolete and excess inventory items to their net realizable value. The improvement of $33 million was primarily due to these prior year charges combined with lower SG&A attributable to 2016 cost reduction measures including headcount reductions and associated severance costs. Severance costs included in operating expenses were $0 million and $6 million for the nine months ended September 30, 2017 and 2016, respectively.

***Interest Expense****.* Our interest expense was $24 million for the nine month period ended September 30, 2017 as compared to $26 million for the nine months ended September 30, 2016. This represented a decrease of $2 million resulting from lower average debt levels.

***Other (Expense) Income****.* Our other expense was $8 million for the nine month period ended September 30, 2017 as compared to other income of $2 million for the nine month period ended September 30, 2016. For the nine months ended September 30, 2017, other expense included an $8 million charge for the write off of debt issuance costs associated with the refinancing of our Term Loan and Global ABL Facility.

***Income Tax (Expense) Benefit.*** Our income tax expense was $6 million for the nine months ended September 30, 2017 as compared to a benefit of $9 million for the nine months ended September 30, 2016. For interim periods, our income tax expense is computed based upon our estimated annual effective tax rate. Our effective tax rates were 29% and 12% for the nine months ended September 30, 2017 and 2016, respectively. Our rates generally differ from the U.S. federal statutory rate of 35% as a result of state income taxes and differing, generally lower, foreign income tax rates. In the first nine months of 2017, we adopted ASU 2016-09, *Compensation - Stock Compensation*, which requires all excess tax benefits and tax deficiencies are recorded as income tax expense or benefit in the income statement on a prospective basis. In the first nine months of 2017, we recorded a tax benefit of $2 million related to the vesting of stock awards.The 2017 effective tax rate is lower than our federal statutory rate primarily due to this discrete tax benefit and a benefit related to foreign currency exchange losses. The 2016 effective tax rate was significantly lower than our federal statutory rate due to forecasted pre-tax losses across all segments including significant pre-tax losses in jurisdictions where there was no corresponding tax benefit.

***Net Income (Loss)****.* Our net income was $15 million for the nine months ended September 30, 2017 as compared to a net loss of $65 million for the nine months ended September 30, 2016, an improvement of $80 million.

***Adjusted EBITDA****.* Adjusted EBITDA, a non-GAAP financial measure, was $136 million (5.0% of sales) for the nine months ended September 30, 2017 as compared to $58 million (2.5% of sales) for the nine months ended September 30, 2016.

We define Adjusted EBITDA as net income plus interest, income taxes, depreciation and amortization, amortization of intangibles and certain other expenses, including non-cash expenses, (such as equity-based compensation, severance and restructuring, changes in the fair value of derivative instruments and asset impairments, including inventory) and plus or minus the impact of our LIFO inventory costing methodology.

We believe Adjusted EBITDA provides investors a helpful measure for comparing our operating performance with the performance of other companies that may have different financing and capital structures or tax rates. We believe it is a useful indicator of our operating performance without regard to items, such as amortization of intangibles, that can vary substantially from company to company depending upon the nature and extent of acquisitions. Similarly, the impact of the LIFO inventory costing method can cause results to vary substantially from company to company depending upon whether they elect to utilize LIFO and depending upon which method they may elect. We use Adjusted EBITDA as a key performance indicator in managing our business. We believe that net income is the financial measure calculated and presented in accordance with U.S. generally accepted accounting principles that is most directly comparable to Adjusted EBITDA.

The following table reconciles Adjusted EBITDA, a non-GAAP financial measure, with net income (loss), as derived from our financial statements (in millions):

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
|  | **Nine Months Ended** |
|  | **September 30,**  |  | **September 30,**  |
|  | **2017** |  |  **2016** |
| Net income (loss) | **$                 15** |  | $                 (65) |
| Income tax expense (benefit) |  **6** |  |  (9) |
| Interest expense |  **24** |  |  26 |
| Depreciation and amortization |  **16** |  |  16 |
| Amortization of intangibles  |  **34** |  |  35 |
| Increase (decrease) in LIFO reserve |  **19** |  |  (7) |
| Inventory-related charges |  **-** |  |  40 |
| Change in fair value of derivative instruments |  **1** |  |  - |
| Equity-based compensation expense |  **12** |  |  9 |
| Write off of debt issuance costs |  **8** |  |  - |
| Severance and restructuring charges |  **-** |  |  12 |
| Litigation settlement |  **3** |  |  - |
| Foreign currency (gains) losses  |  **(2)** |  |  1 |
| Adjusted EBITDA | **$               136** |  | $                 58 |
|  |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |

**Liquidity and Capital Resources**

Our primary sources of liquidity consist of cash generated from our operating activities, existing cash balances and borrowings under our global asset-based lending facility (“Global ABL Facility”). At September 30, 2017, our total liquidity, including cash on hand, was $529 million. Our ability to generate sufficient cash flows from our operating activities will continue to be primarily dependent on our sales of products and services to our customers at margins sufficient to cover our fixed and variable costs. As of September 30, 2017 and December 31, 2016, we had cash and cash equivalents of $40 million and $109 million, respectively. As of September 30, 2017 and December 31, 2016, $40 million and $61 million of our cash and cash equivalents, respectively, were maintained in the accounts of our various foreign subsidiaries. If these amounts were transferred among countries or repatriated to the U.S., such amounts may be subject to additional tax liabilities, which would be recognized in our financial statements in the period during which such decision would be made. We have the intent and ability to indefinitely reinvest the cash held by our foreign subsidiaries, and there are currently no plans that require the repatriation of this cash.

Our primary credit facilities consist of a seven-year Term Loan maturing in September 2024 with an original principal amount of $400 million and a five-year $800 million Global ABL Facility that provides a $675 million in revolver commitments in the United States, $65 million in Canada, $18 million in Norway, $15 million in Australia, $13 million in the Netherlands, $7 million in the United Kingdom and $7 million in Belgium. As of September 30, 2017, the outstanding balance on our Term Loan, net of original issue discount and issuance costs, was $397 million. The Global ABL Facility, which was re-sized to $800 million from $1.05 billion in our September 2017 amendment, matures in September 2022. The Global ABL Facility contains an accordion feature that allows us to increase the principal amount of the facility by up to $200 million, subject to securing additional lender commitments. As of September 30, 2017, we had $50 million of borrowings outstanding and $489 million of Excess Availability, as defined under our Global ABL Facility. Availability is dependent on a borrowing base comprised of a percentage of eligible accounts receivable and inventory which is subject to redetermination from time to time.

Our credit ratings are below “investment grade” and as such could impact both our ability to raise new funds as well as the interest rates on our future borrowings. Our ability to incur additional debt is restricted by our existing obligations. We were in compliance with the covenants contained in our various credit facilities as of and during the nine months ended September 30, 2017.

We believe our sources of liquidity will be sufficient to satisfy the anticipated cash requirements associated with our existing operations for at least the next twelve months. However, our future cash requirements could be higher than we currently expect as a result of various factors. Additionally, our ability to generate sufficient cash from our operating activities depends on our future performance, which is subject to general economic, political, financial, competitive and other factors beyond our control. We may, from time to time, seek to raise additional debt or equity financing or re-price or refinance existing debt in the public or private markets, based on market conditions.  Any such capital markets activities would be subject to market conditions, reaching final agreement with lenders or investors, and other factors, and there can be no assurance that we would successfully consummate any such transactions.

In November 2015, the Company’s board of directors authorized a share repurchase program for common stock up to $100 million, which was increased in November 2016 to $125 million. During the first quarter of 2017, we purchased 859,830 shares of common stock at a total cost of $18 million, which completed the repurchase of all shares authorized under the program. In total under this plan, we have purchased 8,537,410 shares at a total cost of $125 million.

In October 2017, the Company’s board of directors authorized a new share repurchase program for common stock of up to $100 million. The program is scheduled to expire December 31, 2018. The shares may be repurchased at management’s discretion in the open market. Depending on market conditions and other factors, these repurchases may be commenced or suspended from time to time without prior notice.

***Cash Flows***

The following table sets forth our cash flows for the periods indicated below (in millions):

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
|  | **Nine Months Ended** |
|  | **September 30,**  |  | **September 30,**  |
|  | **2017** |  |  **2016** |
| Net cash (used in) provided by: |  |  |  |
|  Operating activities | **$           (37)** |  | $          230 |
|  Investing activities |  **(23)** |  |  25 |
|  Financing activities |  **(14)** |  |  (112) |
| Net (decrease) increase in cash and cash equivalents | **$           (74)** |  | $          143 |
|  |  |  |  |

***Operating Activities***

Net cash used in operating activities was $37 million during the nine months ended September 30, 2017 compared to $230 million provided by operating activities during the nine months ended September 30, 2016. The decrease in cash provided by operations was primarily the result of working capital expansion in response to the increase in sales activity in the first nine months of 2017 as compared to a working capital contraction in the first nine months of 2016. Working capital growth used cash of $132 million in the first nine months of 2017 compared to the working capital contraction providing cash of $201 million in the first nine months of 2016. In particular, growth in accounts receivable utilized $165 million of cash in the first nine months of 2017 as a result of the 18% increase in sales relative to the first nine months of 2016 when accounts receivable contraction provided cash of $88 million. Growth in inventory required to support higher sales levels utilized $100 million of cash in the first nine months of 2017 as compared to cash provided of $119 million in the same period of 2016. These uses of cash were offset by $127 million generated from an increase in accounts payable, which was attributable to higher purchasing activities and the timing of payments to our suppliers.

***Investing Activities***

Net cash used in investing activities was $23 million for the nine months ended September 30, 2017, compared to $25 million provided by investing activities for the nine months ended September 30, 2016. The $48 million increase in cash used in investing activities is the result of $48 million in proceeds from the disposition of our U.S. OCTG product line in February 2016. Our capital expenditures were $23 million and $24 million for of the nine months ended September 30, 2017 and 2016, respectively.

***Financing Activities***

Net cash used in financing activities was $14 million for the nine months ended September 30, 2017 compared to $112 million for the nine months ended September 30, 2016. In the first nine months of 2017 and 2016, we used $18 million and $88 million to fund purchases of our common stock, respectively.

***Critical Accounting Policies***

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses in the financial statements. Management bases its estimates on historical experience and other assumptions, which it believes are reasonable. If actual amounts are ultimately different from these estimates, the revisions are included in our results of operations for the period in which the actual amounts become known.

Accounting policies are considered critical when they require management to make assumptions about matters that are highly uncertain at the time the estimates are made and when there are different estimates that management reasonably could have made, which would have a material impact on the presentation of our financial condition, changes in our financial condition or results of operations. For a description of our critical accounting policies, see “Item 7: “Management’s Discussion and Analysis of Financial Condition and Results from Operations” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are primarily exposed to the market risk associated with unfavorable movements in interest rates, foreign currencies and steel price volatility. There have been no material changes to our market risk policies or our market risk sensitive instruments and positions as described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

ITEM 4. CONTROLS AND PROCEDURES

***Evaluation of disclosure controls and procedures****.*

As of September 30, 2017, we have reviewed, under the direction of our Chief Executive Officer and Chief Financial Officer, the Company’s disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e). Based upon and as of the date of that review, the Company’s Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to the Company’s management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

As part of a continuing effort to improve the Company’s business processes, management is evaluating its internal controls and may update certain controls to accommodate any modifications to its business processes or accounting procedures.

***Changes in internal control over financial reporting****.*

The Company has undertaken a multi-year enterprise resource planning (“ERP”) project to migrate certain systems to SAP software. During the second quarter of 2016, we completed the SAP implementation in our Asia Pacific-based businesses. During the second quarter of 2017, we completed the implementation effort in our European and Middle Eastern businesses. During the third quarter of 2017, we completed the implementation effort in our Nordic businesses. As a part of these implementations, various controls over financial reporting for the international segment changed during the third quarter.

Other than described above, there were no changes in our internal control over financial reporting that occurred during the first nine months of 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Part II**—**other information**

# **ITEM 1. LEGAL PROCEEDINGS**

From time to time, we have been subject to various claims and involved in legal proceedings incidental to the nature of our businesses. We maintain insurance coverage to reduce financial risk associated with certain of these claims and proceedings. It is not possible to predict the outcome of these claims and proceedings. However, in our opinion, there are no pending legal proceedings that are likely to have a material effect on our business, financial condition, results of operations or cash flows, although it is possible that the resolution of certain actual, threatened or anticipated claims or proceedings could have a material adverse effect on our results of operations in the period of resolution.

Also, from time to time, in the ordinary course of our business, our customers may claim that the products that we distribute are either defective or require repair or replacement under warranties that either we or the manufacturer may provide to the customer. These proceedings are, in the opinion of management, ordinary and routine matters incidental to our normal business. Our purchase orders with our suppliers generally require the manufacturer to indemnify us against any product liability claims, leaving the manufacturer ultimately responsible for these claims. In many cases, state, provincial or foreign law provides protection to distributors for these sorts of claims, shifting the responsibility to the manufacturer. In some cases, we could be required to repair or replace the products for the benefit of our customer and seek recovery from the manufacturer for our expense. In the opinion of management, the ultimate disposition of these claims and proceedings is not expected to have a material adverse effect on our financial condition, results of operations or cash flows.

For information regarding asbestos cases in which we are a defendant and other claims and proceedings, see Note 9 - Commitments and Contingencies to our unaudited condensed consolidated financial statements.

**Item 1A.  Risk Factors**

We are affected by risks specific to us as well as factors that affect all businesses operating in a global market. The significant factors known to us that could materially adversely affect our business, financial condition or operating results are described in Part I, Item 2 of this Quarterly Report on Form 10-Q and in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016 under “Risk Factors”.

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

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
| A summary of our purchases of MRC Global Inc. common stock during the third quarter of fiscal year 2017 is as follows: |
|  |  |  |  |  |  |  |  |
|  | Total Number of Shares Purchased (1) |  | Average Price Paid per Share |  | Total number of Shares Purchased as Part of Publicly Announced Plans or Programs  |  | Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs |
| Jul 1 - Jul 31 |  15 |  | $              16.18 |  |  - |  | $                                           - |
| Aug 1 - Aug 31 |  569 |  | $              16.10 |  |  - |  | $                                           - |
| Sep 1 - Sep 30 |  88 |  | $              16.49 |  |  - |  | $                                           - |
|  |  672 |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| *(1) We purchased 672 shares in connection with funding employee income tax withholding obligations arising upon the lapse of restrictions on restricted shares.*  |
|   |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |

**Item 3.  Defaults Upon Senior Securities**

None.

**Item 4.  MINING SAFETY DISCLOSURES**

None.

**Item 5.  Other Information**

None.

**Item 6.  Exhibits**

|  |  |  |
| --- | --- | --- |
|  |  |  |
|  |  |  |
| **Number** |    | **Description** |
|  |  |  |
| 31.1\* |    | [Certification of the Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended, and Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](file:///C%3A%5CcurrentExhibit%5Cmrc-20170930xex31_1.htm) |
|  |  |
| 31.2\* |    | [Certification of the Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended, and Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](file:///C%3A%5CcurrentExhibit%5Cmrc-20170930xex31_2.htm) |
|  |  |
| 32\*\* |    | [Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002](file:///C%3A%5CcurrentExhibit%5Cmrc-20170930xex32.htm). |
|  |  |
| 100\* |    | The following financial information from MRC Global Inc.’s Quarterly Report on Form 10-Q for the period ended September 30, 2017, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheets at September 30, 2017 and December 31, 2016, (ii) the Condensed Consolidated Statements of Operations for the three and nine month periods ended September 30, 2017 and 2016, (iii) the Condensed Consolidated Statements of Comprehensive Income for the three and nine month periods ended September 30, 2017 and 2016, (iv) the Condensed Consolidated Statements of Cash Flows for the nine month periods ended September 30, 2017 and 2016 and (v) Notes to Condensed Consolidated Financial Statements. |
|  |  |
| 101\* |    | Interactive data file. |

\* Filed herewith.

\*\* Furnished herewith.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

|  |
| --- |
|  |
| MRC GLOBAL INC. |
| By: /s/ James E. Braun  |
| James E. Braun Executive Vice President and Chief Financial Officer |

Date: November 3, 2017