

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, 2016

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**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**20-5956993**  
(I.R.S. Employer  
Identification No.)

**Fulbright Tower**  
**1301 McKinney Street, Suite 2300**  
**Houston, Texas**  
(Address of Principal Executive Offices)

**77010**  
(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 or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ X ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [ ]

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

The Company's common stock is traded on the New York Stock Exchange under the symbol "MRC". There were 95,298,276 shares of the registrant's common stock (excluding 554,594 unvested restricted shares), par value \$0.01 per share, issued and outstanding as of October 28, 2016.

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## CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

MRC GLOBAL INC.

*(in millions)*

	September 30, 2016	December 31, 2015
<b>Assets</b>		
Current assets:		
Cash	\$ 213	\$ 69
Accounts receivable, net	448	533
Inventories, net	581	781
Other current assets	26	22
Total current assets	<u>1,268</u>	<u>1,405</u>
Other assets	22	22
Property, plant and equipment, net	135	127
Intangible assets:		
Goodwill, net	485	484
Other intangible assets, net	425	459
	<u>\$ 2,335</u>	<u>\$ 2,497</u>
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Trade accounts payable	\$ 344	\$ 327
Accrued expenses and other current liabilities	99	110
Current portion of long-term debt	8	8
Total current liabilities	<u>451</u>	<u>445</u>
Long-term obligations:		
Long-term debt, net	507	511
Deferred income taxes	197	208
Other liabilities	20	22
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, 102,513,201 and 102,202,599 issued, respectively	1	1
Additional paid-in capital	1,674	1,666
Retained deficit	(550)	(467)
Less: Treasury stock at cost: 7,215,774 and 816,389 shares, respectively	(100)	(12)
Accumulated other comprehensive loss	(220)	(232)
	<u>805</u>	<u>956</u>
	<u>\$ 2,335</u>	<u>\$ 2,497</u>

*See notes to condensed consolidated financial statements.*

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

MRC GLOBAL INC.

*(in millions, except per share amounts)*

	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Sales	\$ 793	\$ 1,071	\$ 2,322	\$ 3,562
Cost of sales	705	886	1,976	2,951
Gross profit	88	185	346	611
Selling, general and administrative expenses	124	142	396	460
Operating (loss) income	(36)	43	(50)	151
Other expense:				
Interest expense	(9)	(10)	(26)	(38)
Other, net	3	3	2	(6)
(Loss) income before income taxes	(42)	36	(74)	107
Income tax (benefit) expense	(2)	20	(9)	46
Net (loss) income	(40)	16	(65)	61
Series A preferred stock dividends	6	6	18	7
Net (loss) income attributable to common stockholders	\$ (46)	\$ 10	\$ (83)	\$ 54
Basic (loss) earnings per common share	\$ (0.48)	\$ 0.10	\$ (0.85)	\$ 0.53
Diluted (loss) earnings per common share	\$ (0.48)	\$ 0.10	\$ (0.85)	\$ 0.53
Weighted-average common shares, basic	95.9	102.2	98.1	102.1
Weighted-average common shares, diluted	95.9	102.5	98.1	102.4

*See notes to condensed consolidated financial statements.*

## CONDENSED CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE INCOME (UNAUDITED)

MRC GLOBAL INC.

*(in millions)*

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30, 2016</b>	<b>September 30, 2015</b>	<b>September 30, 2016</b>	<b>September 30, 2015</b>
Net (loss) income	\$ (40)	\$ 16	\$ (65)	\$ 61
Other comprehensive (loss) income				
Foreign currency translation adjustments	-	(44)	12	(85)
Comprehensive loss	\$ (40)	\$ (28)	\$ (53)	\$ (24)

*See notes to condensed consolidated financial statements.*

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

MRC GLOBAL INC.

*(in millions)*

	Nine Months Ended	
	September 30, 2016	September 30, 2015
<b>Operating activities</b>		
Net (loss) income	\$ (65)	\$ 61
Adjustments to reconcile net (loss) income to net cash provided by operations:		
Depreciation and amortization	16	15
Amortization of intangibles	35	46
Equity-based compensation expense	9	8
Deferred income tax benefit	(12)	(17)
Amortization of debt issuance costs	3	3
Write off of debt issuance costs	-	3
Decrease in LIFO reserve	(7)	(30)
Inventory-related charges	45	-
Provision for uncollectible accounts	2	2
Foreign currency losses	1	4
Other non-cash items	2	-
Changes in operating assets and liabilities:		
Accounts receivable	88	283
Inventories	119	289
Other current assets	1	(3)
Income taxes payable	(2)	(5)
Accounts payable	11	(136)
Accrued expenses and other current liabilities	(16)	(42)
Net cash provided by operations	<u>230</u>	<u>481</u>
<b>Investing activities</b>		
Purchases of property, plant and equipment	(24)	(24)
Proceeds from the disposition of property, plant and equipment	1	1
Proceeds from the disposition of non-core product line	48	-
Other investing activities	-	(4)
Net cash provided by (used in) investing activities	<u>25</u>	<u>(27)</u>
<b>Financing activities</b>		
Payments on revolving credit facilities	(32)	(1,102)
Proceeds from revolving credit facilities	32	567
Payments on long-term obligations	(6)	(256)
Proceeds from issuance of preferred stock, net of issuance costs	-	355
Purchase of common stock	(88)	-
Dividends paid on preferred stock	(18)	(4)
Debt issuance costs paid	-	(1)
Net cash used in financing activities	<u>(112)</u>	<u>(441)</u>
Increase in cash	143	13
Effect of foreign exchange rate on cash	1	(5)
Cash -- beginning of period	69	25
Cash -- end of period	<u>\$ 213</u>	<u>\$ 33</u>
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 23	\$ 35
Cash paid for income taxes	\$ 8	\$ 70

*See notes to condensed consolidated financial statements.*

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
MRC GLOBAL INC.

**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 processing) 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, 2016 are not necessarily indicative of the results that will be realized for the fiscal year ending December 31, 2016. We have derived our condensed consolidated balance sheet as of December 31, 2015 from the audited consolidated financial statements for the year ended December 31, 2015. You should read these condensed consolidated financial statements in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2015.

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.

**Reclassifications:** Certain prior-period amounts have been reclassified to conform to the current year presentation, which includes the adoption of Accounting Standards Update (“ASU”) 2015-03 *Interest-Imputation of Interest (Subtopic 855-30): Simplifying the Presentation of Debt Issuance Costs*.

**Recent Accounting Pronouncements:** In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU 2014-09 provides comprehensive guidance on the recognition of revenue from customers arising from the transfer of goods and services. The ASU also provides guidance on accounting for certain contract costs and requires new disclosures. The FASB voted to defer the effective date of ASU 2014-09 by one year to annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. We are currently evaluating the effect of the adoption of ASU 2014-09 on our consolidated financial statements and the implementation approach to be used.

In July 2015, the FASB issued ASU 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory*. ASU 2015-11 provides guidance on simplifying the measurement of inventory. The current standard is to measure inventory at lower of cost or market; where market could be replacement cost, net realizable value or net realizable value less an approximately normal profit margin. ASU 2015-11 updates this guidance to measure inventory at the lower of cost or net realizable value; where net realizable value is considered to be the estimated selling price in the ordinary course of business, less reasonably predictable cost of completion, disposal and transportation. We expect to adopt this guidance in 2017. This amendment is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

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 results.

In March 2016, the FASB issued ASU 2016-09, *Compensation - Stock Compensation*, which simplifies the accounting for the taxes related to stock based compensation. Under the standard, excess tax benefits and certain tax deficiencies will no longer be recorded in additional paid-in capital (“APIC”), and APIC pools will be eliminated. Instead, all excess tax benefits and tax deficiencies will be recorded as income tax expense or benefit in the income statement. In addition, excess tax benefits are

required to be presented as operating activities rather than financing activities in the statement of cash flows. This guidance is effective for annual and interim reporting periods of public entities beginning after December 15, 2016. This amendment is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. This ASU addresses the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (including bank-owned life insurance policies); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. This standard is effective for fiscal years beginning after December 15, 2017. This amendment is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

## **NOTE 2 – INVENTORIES**

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

	<b>September 30, 2016</b>	<b>December 31, 2015</b>
Finished goods inventory at average cost:		
Energy carbon steel tubular products	\$ 142	\$ 253
Valves, valve actuation and instrumentation	236	273
All other products	342	374
	<b>720</b>	<b>900</b>
Less: Excess of average cost over LIFO cost (LIFO reserve)	(74)	(89)
Less: Other inventory reserves	(65)	(30)
	<b>\$ 581</b>	<b>\$ 781</b>

Our inventory quantities are expected to be reduced for the year, 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 in the current year (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. For the three and nine months ended September 30, 2015, the effect of this LIFO decrement increased cost of sales by approximately \$4 million and \$8 million, respectively.

In the third quarter of 2016, we incurred inventory-related charges totaling \$45 million. These charges reflect 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 current market outlook for certain products. This amount includes \$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, 2016	December 31, 2015
Senior Secured Term Loan B, net of discount and issuance costs of \$6 and \$7, respectively	\$ 515	\$ 519
Global ABL Facility	-	-
	515	519
Less: Current portion	8	8
	\$ 507	\$ 511

**Senior Secured Term Loan B:** We have a seven year Senior Secured Term Loan B (the “Term Loan”) with an original principal amount of \$794 million which amortizes in equal quarterly installments of 1% per year with the balance payable in November 2019 when the facility matures. Subject to securing additional lender commitments, the Term Loan allows for incremental increases in facility size up to an aggregate of \$200 million, plus an additional amount such that the Company’s senior secured leverage ratio (as defined under the Term Loan) would not exceed 3.50 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 (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. In certain circumstances, we are required to repay the Term Loan with certain asset sales and insurance proceeds, certain debt proceeds and 50% of excess cash flow (reducing to 25% if our senior secured leverage ratio is no more than 2.75 to 1.00 and 0% if our senior secured 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 5.41% as of September 30, 2016 and 4.98% at December 31, 2015.

On November 2, 2016, the company provided notice of intent to voluntarily repay \$100 million of the Term Loan with available cash on hand and expects to make the voluntary repayment on November 7, 2016.

**Global ABL Facility:** We have a \$1.05 billion multi-currency global asset-based revolving credit facility (the “Global ABL Facility”) that matures in July 2019. This facility is comprised of \$977 million in revolver commitments in the United States, \$30 million in Norway, \$20 million in Canada, \$5 million in the United Kingdom, \$10 million in Australia, \$4 million in the Netherlands and \$4 million in Belgium. It contains an accordion feature that allows us to increase the principal amount of the facility by up to \$300 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 \$475 million as of September 30, 2016.

**Debt Issuance Costs:** In the first quarter of 2016, we adopted ASU No. 2015-03 *Interest-Imputation of Interest (Subtopic 855-30): Simplifying the Presentation of Debt Issuance Costs*. This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability consistent with debt discounts. As a result of the adoption, we have reclassified debt issuance costs associated with our Term Loan of \$5 million as of December 31, 2015, from other assets to long term debt in our balance sheet. Accordingly, long term debt reported as \$524 million at December 31, 2015 has been revised to \$519 million. Debt issuance costs associated with our Global ABL Facility will continue to be presented in other assets. These amounts were \$7 million and \$8 million as of September 30, 2016 and December 31, 2015, respectively.

**NOTE 4 – INCOME TAXES**

For interim periods, our income tax benefit or expense is computed based upon our estimated annual effective tax rate. Our effective tax rates for the three and nine months ended September 30, 2016 were 5% and 12%, respectively. The effective tax rates for the three and nine months ended September 30, 2015 were 56% and 43%, respectively. The decrease in our 2016 effective tax rates below their customary levels is the result of a lower expected tax rate for the full year of 12% primarily due

to an increase in forecasted pre-tax losses across all segments, combined with an increase of the relative significance of pre-tax losses in certain foreign jurisdictions where the losses have no corresponding tax benefit.

**NOTE 5 – DISPOSITION OF NON-CORE PRODUCT LINE**

In February 2016, we completed the disposition of our U.S. oil country tubular goods (“OCTG”) product line for \$48 million. As a result of this transaction, we incurred a loss of \$5 million that was reflected in our fourth quarter 2015 results. Net of reserves, including LIFO and an adjustment to write the inventory down to its net realizable value, the carrying value of the U.S. OCTG inventories as of December 31, 2015 was \$50 million.

**NOTE 6 – 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 approximately \$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 7 – 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. The program is scheduled to expire on December 31, 2017. 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.

Summary of share repurchase activity under the repurchase program:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30, 2016</b>	<b>September 30, 2015</b>	<b>September 30, 2016</b>	<b>September 30, 2015</b>
Number of shares acquired on the open market	<b>1,121,111</b>	-	<b>6,399,385</b>	-
Average price per share	<b>\$ 14.92</b>	\$ -	<b>\$ 13.82</b>	\$ -
Total cost of acquired shares (in millions)	<b>\$ 17</b>	\$ -	<b>\$ 88</b>	\$ -

In total, we have acquired 7,215,774 shares under this program at a total cost of \$100 million. There were 95,297,427 shares of common stock outstanding as of September 30, 2016.

**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 2016, 103,701 shares of restricted stock, 344,922 performance share unit awards and 1,151,340 restricted stock units have been granted to employees. To date, before consideration of forfeitures, 5,087,035 shares have been granted to management, members of our Board of Directors and key employees under this plan. A Monte Carlo simulation is completed to estimate the fair value of performance share unit awards with a stock price performance component. A Black-Scholes option-pricing model is used to estimate the fair value of the stock options. 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):

	<u>September 30, 2016</u>	<u>December 31, 2015</u>
Currency translation adjustments	\$ (219)	\$ (231)
Pension related adjustments	(1)	(1)
Accumulated other comprehensive loss	<u>\$ (220)</u>	<u>\$ (232)</u>

**Earnings per Share**

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

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30, 2016</u>	<u>September 30, 2015</u>	<u>September 30, 2016</u>	<u>September 30, 2015</u>
Net (loss) income	\$ (40)	\$ 16	\$ (65)	\$ 61
Less: Dividends on Series A Preferred Stock	6	6	18	7
Net (loss) income attributable to common stockholders	<u>\$ (46)</u>	<u>\$ 10</u>	<u>\$ (83)</u>	<u>\$ 54</u>
Weighted average basic shares outstanding	95.9	102.2	98.1	102.1
Effect of dilutive securities	-	0.3	-	0.3
Weighted average diluted shares outstanding	<u>95.9</u>	<u>102.5</u>	<u>98.1</u>	<u>102.4</u>
Net (loss) income per share:				
Basic	\$ (0.48)	\$ 0.10	\$ (0.85)	\$ 0.53
Diluted	<u>\$ (0.48)</u>	<u>\$ 0.10</u>	<u>\$ (0.85)</u>	<u>\$ 0.53</u>

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, 2016, all of the shares of the Preferred Stock were anti-dilutive. 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. For the three and nine months ended September 30, 2015, we had approximately 3.8 million anti-dilutive stock options. There were 1.0 million and no anti-dilutive restricted stock, restricted units or performance stock unit awards for the three months ended September 30, 2016 and 2015, respectively. There were 0.8 million and no anti-dilutive restricted stock, restricted units or performance stock unit awards for the nine months ended September 30, 2016 and 2015, respectively.

**NOTE 8 – SEGMENT INFORMATION**

We operate as four business segments: U.S. East and Gulf Coast, U.S. West, 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 processing) 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.

Prior to organizational changes that occurred in April 2016, our U.S. business consisted of a single operating segment. As a result of the separation of U.S. segment into two distinct operating segments based on our new management structure, we completed an interim goodwill impairment test, as of April 1, 2016, and concluded that no indication of impairment existed as the fair values of each U.S. reporting unit significantly exceeded its carrying value.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
<b>Sales</b>				
U.S.	\$ 590	\$ 866	\$ 1,747	\$ 2,794
Canada	70	69	188	266
International	133	136	387	502
Sales	<u>\$ 793</u>	<u>\$ 1,071</u>	<u>\$ 2,322</u>	<u>\$ 3,562</u>
<b>Operating (loss) income</b>				
U.S.	\$ (4)	\$ 46	\$ (2)	\$ 147
Canada	(4)	1	(7)	9
International	(28)	(4)	(41)	(5)
Operating (loss) income	<u>(36)</u>	<u>43</u>	<u>(50)</u>	<u>\$ 151</u>
<b>Interest expense</b>	(9)	(10)	(26)	(38)
<b>Other, net</b>	3	3	2	(6)
<b>(Loss) income before income taxes</b>	<u>\$ (42)</u>	<u>\$ 36</u>	<u>\$ (74)</u>	<u>\$ 107</u>

Included in the operating results for the three and nine months ended September 30, 2016 are inventory-related charges of \$45 million including \$16 million, \$5 million and \$24 million in the U.S., Canada, and International segments, respectively.

	September 30, 2016	December 31, 2015
<b>Total assets</b>		
U.S.	\$ 2,011	\$ 2,135
Canada	142	142
International	182	220
Total assets	<u>\$ 2,335</u>	<u>\$ 2,497</u>

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

Type	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
<b>Energy carbon steel tubular products:</b>				
Line pipe (1)	\$ 117	\$ 195	\$ 345	\$ 702
Oil country tubular goods (OCTG)	-	64	-	249
	<u>\$ 117</u>	<u>\$ 259</u>	<u>\$ 345</u>	<u>\$ 951</u>
<b>Valves, fittings, flanges and other products:</b>				
Valves, valve actuation and instrumentation	\$ 296	\$ 360	\$ 894	\$ 1,167
Fittings, flanges and stainless steel and alloy pipe	177	222	508	741
Gas products	124	126	332	363
Other	79	104	243	340
	<u>\$ 676</u>	<u>\$ 812</u>	<u>\$ 1,977</u>	<u>\$ 2,611</u>

(1) As a result of the disposition of our U.S. OCTG product line, as described in Note 5, pre-disposition OCTG sales of \$18 million have been included within line pipe sales for the nine months ended September 30, 2016.

## **NOTE 9 – 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, 2016, we do 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 \$40 million and \$41 million at September 30, 2016 and December 31, 2015, respectively. We had approximately \$0 million recorded as liabilities on our consolidated balance sheets as of September 30, 2016 and December 31, 2015.

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 \$515 million and \$519 million at September 30, 2016 and December 31, 2015, 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 \$513 million and \$510 million at September 30, 2016 and December 31, 2015, respectively.

## **NOTE 10 – 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, 2016, we are named a defendant in approximately 512 lawsuits involving approximately 1,132 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. A subsidiary of Halliburton Company purchased Europump in 2014. 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.

From 2006 through 2012, the case focused largely on Weatherford's questioning of defense witnesses. In 2013, the defendants began substantive questioning of Weatherford and its witnesses. Discovery is ongoing and expected to last through 2016. In April 2016, the court dismissed two suppliers from the case. Weatherford has appealed this dismissal. The case is scheduled for trial in March 2018.

While the Company believes Weatherford's claims are without merit and we intend to defend against them vigorously, in November 2015, the Company filed with the Court a formal offer of settlement for \$2 million plus one half of the Weatherford party's costs and interest under the *Judgment Interest Act* and reserved \$3 million for the offer. Weatherford declined to accept the offer.

### **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.

### **NOTE 11 – RESTRUCTURING**

In August 2016, we announced a plan to restructure and downsize our Australian operations in response to the continued downturn in the oil and gas and mining industries in the region. As a result of this plan, we originally expected to incur pre-tax charges of \$18 million to \$24 million, including cash expenditures of \$11 million to \$14 million. Components of these costs included \$7 million to \$10 million in inventory-related charges, \$6 million to \$7 million in lease termination costs, \$3 million to \$4 million for facilities relocations, and \$2 million to \$3 million for employee severance. In the third quarter of 2016, we recorded \$10 million of charges associated with this plan, including \$9 million of inventory-related charges and \$1 million of employee severance. In the statement of operations, inventory-related charges are reflected in cost of sales while all other costs are reflected in selling, general and administrative expenses. We expect to incur an additional \$8 million to \$10 million of charges in the fourth quarter. The plan is expected to be completed by the first quarter of 2017.

## **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. All references throughout this section (and elsewhere in this report) to amounts available for borrowing under various credit facilities refer to amounts actually available for borrowing after giving effect to any borrowing base limitations that the facility imposes.

### **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 statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). 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 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 or adverse positions taken by taxing authorities in the countries in which the company operates;
- our intention not to pay dividends on our common stock; and
- compliance with and changes in laws and regulations in the countries in which we operate.

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 13,000 suppliers to our more than 19,000 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 revenues are 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 have seen customer spending fall off significantly beginning in late 2014 and continuing through the present time as a result of lower oil and natural gas prices. 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 a significant portion 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.
- *Customer, Manufacturer and Distributor Inventory Levels of PVF and Related Products.* Customer, manufacturer and distributor inventory levels of PVF and related products can change significantly from period to period. Increases in our customers’ inventory levels can have an adverse effect on the demand for the products we distribute when customers draw from their inventory rather than purchase new products. Reduced demand, in turn, would likely result in reduced sales volume and profitability. 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 customer and 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 2016, the average oil price of West Texas Intermediate (“WTI”) decreased to \$41.35 per barrel from \$50.94 per barrel in the first nine months of 2015. Natural gas prices decreased to an average price of \$2.34/Mcf (Henry Hub) for the first nine months of 2016 compared to \$2.80/Mcf (Henry Hub) for the first nine months of 2015. North American drilling rig activity decreased 53% in the first nine months of 2016 as compared to the first nine months of 2015.

Recent exploration and production spending forecasts continue to indicate that customer spending in 2016 will be down 25-30% globally, including 40-45% in the U.S. This follows a 21% decline in 2015. At current oil and natural gas prices, we expect our customers’ spending, particularly those in the upstream sector within North America, will continue to remain low for the remainder of 2016 and early 2017 as compared to 2015. However, we are encouraged by recent improvements in oil prices and drilling activity and expect 2017 revenue to be higher than 2016.

In the third quarter of 2016, we incurred non-cash inventory-related charges totaling \$45 million necessary to reduce the carrying value of certain products determined to be excess or obsolete to their estimated net realizable value based on our current market outlook for certain products. This amount includes \$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.

In August 2016, we announced a plan to restructure and downsize our Australian operations in response to the continued downturn in the oil and gas and mining industries in the region. As a result of this plan, we originally expected to incur pre-tax charges of \$18 million to \$24 million, including cash expenditures of \$11 million to \$14 million. Components of these costs included \$7 million to \$10 million in inventory-related charges, \$6 million to \$7 million in lease termination costs, \$3 million to \$4 million for facilities relocations, and \$2 million to \$3 million for employee severance. In the third quarter of 2016, we recorded \$10 million of charges associated with this plan, including \$9 million of inventory-related charges and \$1 million of employee severance. We expect to incur an additional \$8 million to \$10 million of charges in the fourth quarter of 2016. The

plan is expected to be completed by the first quarter of 2017. Elsewhere in our International segment, the United Kingdom’s decision to exit the European Union (“Brexit”) has created uncertainty around European currencies, along with uncertain effects of future trade and other cross border activities of the U.K. with the European Union and other countries. We expect a minimal impact on our business, and our regional distribution centers in both Bradford, U.K. and Rotterdam, Netherlands position us well to serve our customers in the U.K. and the European Union.

We have taken steps during the first nine months of 2016 to reduce our operating costs. We have maintained our hiring and salary freezes, which were implemented in 2015, and eliminated an additional 560 full-time positions and closed 24 branches during the first nine months of 2016. As a result of these actions, we recorded pre-tax severance and restructuring charges of \$12 million in the first nine months of 2016. We have reduced our headcount by approximately 1,450 or 29%, and our number of branch locations by 68, or 28%, since June 2014. We will continue to monitor the business outlook and take actions as appropriate in response to negative changes in that outlook, which may require additional severance and restructuring charges. In addition to these efforts to address costs, we continuously manage our investment in working capital to an appropriate level. To the extent customer spending in 2017 declines to levels below current expectations, additional actions may be required to reduce operating costs and working capital levels further. In such a situation, we may also incur charges related to impairment of the carrying value of certain assets, including goodwill and other intangible assets.

In February 2016, we completed the disposition of our U.S. oil country tubular goods (“OCTG”) product line for \$48 million. As a result of this transaction, we recorded a loss of \$5 million that was reflected in our fourth quarter 2015 results. This divestiture represents the culmination of a multi-year strategy to decrease our exposure to the direct volatility of drilling activity and lower margins as compared to our other product lines. For the year ended 2015, sales of U.S. OCTG totaled \$305 million, or 7% of our total sales. Net of reserves, including LIFO and an adjustment to write the inventory down to its net realizable value, the carrying value of U.S. OCTG inventories as of December 31, 2015 was \$50 million.

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 circumstances. At September 30, 2016, total backlog was \$659 million, including \$411 million in our U.S. segment, \$29 million in our Canada segment and \$219 million in our International segment. Our backlog at December 31, 2015 was \$542 million (\$500 million excluding OCTG) including \$347 million (\$305 million excluding OCTG), \$34 million and \$161 million in our U.S., Canada and International segments, respectively. At September 30, 2015, total backlog was \$659 million (\$603 million excluding OCTG), including \$461 million in our U.S. segment (\$405 million excluding OCTG), \$32 million in our Canada segment and \$166 million in our International segment. 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 a substantial majority of sales in our backlog will be realized in the next twelve months.

	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
<i>Average Rig Count (1):</i>				
United States	479	866	482	1,059
Canada	121	190	112	200
International	936	1,132	965	1,187
Total	1,536	2,188	1,559	2,446
<i>Average Commodity Prices (2):</i>				
WTI crude oil (per barrel)	\$ 44.85	\$ 46.49	\$ 41.35	\$ 50.94
Brent crude oil (per barrel)	\$ 45.80	\$ 50.44	\$ 41.86	\$ 55.31
Natural gas (\$/Mcf)	\$ 2.88	\$ 2.76	\$ 2.34	\$ 2.80
Average Monthly U.S. Well Permits (3)	2,678	3,604	2,260	3,753
3:2:1 Crack Spread (4)	\$ 13.61	\$ 20.93	\$ 15.38	\$ 22.33

(1) Source-Baker Hughes ([www.bakerhughes.com](http://www.bakerhughes.com)) (Total rig count includes oil, natural gas and other rigs.)

(2) Source-Department of Energy, EIA ([www.eia.gov](http://www.eia.gov))

(3) Source-Rig Data (U.S.)

(4) Source- Bloomberg

## Results of Operations

### Three Months Ended September 30, 2016 Compared to the Three Months Ended September 30, 2015

The breakdown of our sales by sector for the three months ended September 30, 2016 and 2015 was as follows (in millions):

	Three Months Ended			
	September 30, 2016		September 30, 2015	
Upstream	\$ 224	28%	\$ 379	35%
Midstream	327	41%	370	35%
Downstream	242	31%	322	30%
	<u>\$ 793</u>	<u>100%</u>	<u>\$ 1,071</u>	<u>100%</u>

For the three months ended September 30, 2016 and 2015, the following table summarizes our results of operations (in millions):

	Three Months Ended			
	September 30, 2016	September 30, 2015	\$ Change	% Change
<i>Sales:</i>				
U.S.	\$ 590	\$ 866	\$ (276)	(32%)
Canada	70	69	1	1%
International	133	136	(3)	(2%)
Consolidated	<u>\$ 793</u>	<u>\$ 1,071</u>	<u>\$ (278)</u>	<u>(26%)</u>
<i>Operating (loss) income:</i>				
U.S.	\$ (4)	\$ 46	\$ (50)	N/M
Canada	(4)	1	(5)	N/M
International	(28)	(4)	(24)	N/M
Consolidated	<u>(36)</u>	<u>43</u>	<u>(79)</u>	<u>N/M</u>
Interest expense	(9)	(10)	1	(10%)
Other income	3	3	-	0%
Income tax (benefit) expense	(2)	20	(22)	N/M
Net (loss) income	(40)	16	(56)	N/M
Series A preferred stock dividends	6	6	-	0%
Net (loss) income attributable to common stockholders	<u>\$ (46)</u>	<u>\$ 10</u>	<u>\$ (56)</u>	<u>N/M</u>
Gross profit	\$ 88	\$ 185	\$ (97)	(52%)
Adjusted Gross Profit (1)	<u>\$ 103</u>	<u>\$ 190</u>	<u>\$ (87)</u>	<u>(46%)</u>
Adjusted EBITDA (1)	<u>\$ 24</u>	<u>\$ 51</u>	<u>\$ (27)</u>	<u>(53%)</u>

(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 \$793 million for the three months ended September 30, 2016 as compared to \$1,071 million for the three months ended September 30, 2015. The \$278 million decrease in sales reflected a \$1 million impact of the decline in foreign currencies in areas where we operate compared to the U.S. dollar.

*U.S. Segment*—Our U.S. sales decreased to \$590 million for the three months ended September 30, 2016 from \$866 million for the three months ended September 30, 2015. This \$276 million, or 32%, decrease reflected a \$146 million decrease in the upstream sector, a \$61 million decrease in the midstream sector and a \$69 million decrease in the downstream sector. The decline in the upstream sector included a \$63 million impact from the disposition of our U.S. OCTG product line. The remaining decrease in sales in the third quarter of 2016 as compared to the same period in 2015 was caused by decreased customer spending for both maintenance, repair and operations (“MRO”) and projects, driven by the sustained low oil and natural gas prices and the resulting decline in rig count.

*Canada Segment*—Our Canada sales increased to \$70 million for the three months ended September 30, 2016 from \$69 million for the three months ended September 30, 2015. This \$1 million, or 1%, increase reflected an \$18 million increase in the midstream business offset by declines in the upstream business due to a decrease in customer spending.

*International Segment*—Our International sales decreased slightly to \$133 million for the three months ended September 30, 2016 from \$136 million for the same period in 2015. The \$3 million, or 2%, decrease included an impact of the decline in the foreign currencies in areas where we operate outside of the U.S. dollar accounted for \$1 million, or 33%, of the total decline.

**Gross Profit.** Our gross profit was \$88 million (11.1% of sales) for the three months ended September 30, 2016 as compared to \$185 million (17.3% of sales) for the three months ended September 30, 2015. The \$97 million decrease was primarily attributable to the reduction in sales volumes. In addition, 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. Gross profit for the three months ended September 30, 2016 benefited modestly from lower product costs reflected in our last-in, first-out (“LIFO”) inventory costing methodology. LIFO resulted in a reduction of cost of sales of \$3 million and \$15 million in the third quarters of 2016 and 2015, respectively. Excluding the impact of LIFO and the inventory-related charges, gross profit percentage improved 50 basis points as a result of sales mix changes including the elimination of our lower margin OCTG product line.

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 \$8 million and \$9 million for the three months ended September 30, 2016 and 2015, respectively.

**Adjusted Gross Profit.** Adjusted Gross Profit decreased to \$103 million (13.0% of sales) for the three months ended September 30, 2016 from \$190 million (17.7% of sales) for the three months ended September 30, 2015, a decrease of \$87 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 with gross profit, as derived from our financial statements (in millions):

	Three Months Ended			
	September 30, 2016	Percentage of Revenue	September 30, 2015	Percentage of Revenue
Gross profit, as reported	\$ 88	11.1%	\$ 185	17.3%
Depreciation and amortization	6	0.8%	5	0.4%
Amortization of intangibles	12	1.5%	15	1.4%
Decrease in LIFO reserve	(3)	(0.4%)	(15)	(1.4%)
Adjusted Gross Profit	<u>\$ 103</u>	<u>13.0%</u>	<u>\$ 190</u>	<u>17.7%</u>

**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 \$124 million for the

three months ended September 30, 2016 as compared to \$142 million for the three months ended September 30, 2015. Severance and restructuring charges resulting from our cost reduction efforts for the three months ending September 30, 2016 totaled \$3 million. No such expenses were incurred for the three months ending September 30, 2015. Excluding these amounts, SG&A decreased \$21 million which was attributable to volume-related declines and the cost reduction efforts we have made.

**Operating (Loss) Income.** Operating loss was \$36 million for the three months ended September 30, 2016, as compared to \$43 million of operating income for the three months ended September 30, 2015, a decrease of \$79 million.

*U.S. Segment*—Operating loss for our U.S. segment was \$4 million for the three months ended September 30, 2016 compared to operating income of \$46 million for the three months ended September 30, 2015. The decrease in operating income of \$50 million was primarily driven by lower sales due to decreased customer spending partially offset by a reduction in SG&A expenses. In addition, 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. Severance costs included in operating expenses were \$1 million for the three months ended September 30, 2016. No such expenses were incurred for the three months ending September 30, 2015.

*Canada Segment*—Operating loss for our Canada segment was \$4 million for the three months ended September 30, 2016 as compared to operating income of \$1 million for the three months ended September 30, 2015. The decrease of \$5 million reflected \$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 \$28 million for the three months ended September 30, 2016 as compared to an operating loss of \$4 million for the three months ended September 30, 2015. The decrease of \$24 million was the result of \$24 million of inventory-related charges to reduce the carrying value of certain obsolete and excess inventory items to their net realizable value primarily related to the restructuring of our Australian business and market conditions in Iraq. Severance costs included in operating expenses were \$1 million and \$0 million for the three months ended September 30, 2016 and 2015, respectively.

**Interest Expense.** Our interest expense was \$9 million for the three month periods ended September 30, 2016 as compared to \$10 million for the three months ended September 30, 2015. This represented a decrease of \$1 million resulting from lower average debt levels.

**Other Income.** Our other income was \$3 million for each of the three month periods ended September 30, 2016 and 2015.

**Income Tax (Benefit) Expense.** Our income tax benefit was \$2 million for the three months ended September 30, 2016 as compared to income tax expense of \$20 million for the three months ended September 30, 2015. Our effective tax rates were 5% and 56% for the three months ended September 30, 2016 and 2015, 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 decrease in the effective tax rate to 5% in the third quarter of 2016 from 11% in the second quarter of 2016 was a result of a lower expected tax rate for the full year. The full year 2016 expected effective tax rate of 12% is lower than our customary effective tax rate as a result of forecasted pre-tax losses in all segments combined with an increase of the relative significance of pre-tax losses in certain foreign jurisdictions where the losses have no corresponding tax benefit.

**Net (Loss) Income.** Our net loss was \$40 million for the three months ended September 30, 2016 as compared to net income of \$16 million for the three months ended September 30, 2015, a decrease of \$56 million.

**Adjusted EBITDA.** Adjusted EBITDA, a non-GAAP financial measure, was \$24 million (3.0% of sales) for the three months ended September 30, 2016 as compared to \$51 million (4.8% of sales) for the three months ended September 30, 2015.

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 have different financing and capital structures or tax rates. 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 with net (loss) income, as derived from our financial statements (in millions):

	<b>Three Months Ended</b>	
	<b>September 30, 2016</b>	<b>September 30, 2015</b>
Net (loss) income	\$ (40)	\$ 16
Income tax (benefit) expense	(2)	20
Interest expense	9	10
Depreciation and amortization	6	5
Amortization of intangibles	12	15
Decrease in LIFO reserve	(3)	(15)
Inventory-related charges	40	-
Change in fair value of derivative instruments	(2)	(1)
Equity-based compensation expense	2	3
Severance and restructuring charges	3	-
Foreign currency losses	(1)	(2)
Adjusted EBITDA	<u>\$ 24</u>	<u>\$ 51</u>

*Nine Months Ended September 30, 2016 Compared to the nine Months Ended September 30, 2015*

The breakdown of our sales by sector for the nine months ended September 30, 2016 and 2015 was as follows (in millions):

	<b>Nine Months Ended</b>			
	<b>September 30, 2016</b>		<b>September 30, 2015</b>	
Upstream	\$ 666	29%	\$ 1,360	38%
Midstream	897	38%	1,169	33%
Downstream	759	33%	1,033	29%
	<u>\$ 2,322</u>	<u>100%</u>	<u>\$ 3,562</u>	<u>100%</u>

For the nine months ended September 30, 2016 and 2015, the following table summarizes our results of operations (in millions):

	<b>Nine Months Ended</b>		<b>\$ Change</b>	<b>% Change</b>
	<b>September 30, 2016</b>	<b>September 30, 2015</b>		
<i>Sales:</i>				
U.S.	\$ 1,747	\$ 2,794	\$ (1,047)	(37%)
Canada	188	266	(78)	(29%)
International	387	502	(115)	(23%)
Consolidated	<u>\$ 2,322</u>	<u>\$ 3,562</u>	<u>\$ (1,240)</u>	<u>(35%)</u>
<i>Operating (loss) income:</i>				
U.S.	\$ (2)	\$ 147	\$ (149)	N/M
Canada	(7)	9	(16)	N/M
International	(41)	(5)	(36)	N/M
Consolidated	<u>(50)</u>	<u>151</u>	<u>(201)</u>	<u>N/M</u>
Interest expense	(26)	(38)	12	(32%)
Other income (expense)	2	(6)	8	N/M
Income tax (benefit) expense	(9)	46	(55)	N/M
Net (loss) income	(65)	61	(126)	N/M
Series A preferred stock dividends	18	7	11	N/M
Net (loss) income attributable to common stockholders	<u>\$ (83)</u>	<u>\$ 54</u>	<u>\$ (137)</u>	<u>N/M</u>
Gross profit	\$ 346	\$ 611	\$ (265)	(43%)
Adjusted Gross Profit (1)	<u>\$ 390</u>	<u>\$ 642</u>	<u>\$ (252)</u>	<u>(39%)</u>
Adjusted EBITDA (1)	<u>\$ 58</u>	<u>\$ 201</u>	<u>\$ (143)</u>	<u>(71%)</u>

(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 \$2,322 million for the nine months ended September 30, 2016 as compared to \$3,562 million for the nine months ended September 30, 2015. The \$1,240 million decrease in sales reflected a \$23 million impact of the decline in foreign currencies in areas where we operate compared to the U.S. dollar.

**U.S. Segment**—Our U.S. sales decreased to \$1,747 million for the nine months ended September 30, 2016 from \$2,794 million for the nine months ended September 30, 2015. This \$1,047 million, or 37% decrease reflected a \$568 million decrease in the upstream sector, a \$284 million decrease in the midstream sector and a \$195 million decrease in the downstream sector. The decline in the upstream sector included a \$226 million impact from the disposition of our U.S. OCTG product line. The remaining decrease in sales in the first nine months of 2016 as compared to the same period in 2015 was caused by decreased customer spending for both MRO and projects, driven by the sustained low oil and natural gas prices and the resulting decline in rig count.

**Canada Segment**—Our Canada sales decreased to \$188 million for the nine months ended September 30, 2016 from \$266 million for the nine months ended September 30, 2015. This \$78 million, or 29%, decrease reflected a \$71 million decrease in the upstream business also due to a decrease in customer spending. Approximately \$9 million, or 12%, of the total decline was a result of the weaker Canadian dollar relative to the U.S. dollar.

**International Segment**—Our International sales decreased to \$387 million for the nine months ended September 30, 2016 from \$502 million for the same period in 2015. The \$115 million, or 23%, decrease reflected the combined impact of lower project activity and deferral of MRO expenditures particularly in Norway, Australia, the Netherlands, the U.K., and Singapore. The



impact of the decline in the foreign currencies in areas where we operate outside of the U.S. dollar accounted for \$14 million, or 12%, of the total decline.

**Gross Profit.** Our gross profit was \$346 million (14.9% of sales) for the nine months ended as compared to \$611 million (17.2% of sales) for the nine months ended September 30, 2015. The \$265 million decrease was primarily attributable to the reduction 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. Gross profit for the nine months ended September 30, 2016 benefited modestly from lower product costs reflected in our LIFO inventory costing methodology. LIFO resulted in a reduction of cost of sales of \$7 million and \$30 million in the first nine months of 2016 and 2015, respectively. Excluding the impact of LIFO and the inventory write-down, gross profit percentage improved 20 basis points as a result of sales mix changes including the elimination of our lower margin OCTG product line.

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 \$23 million and \$28 million for the nine months ended September 30, 2016 and 2015, respectively.

**Adjusted Gross Profit.** Adjusted Gross Profit decreased to \$390 million (16.8% of sales) for the nine months ended September 30, 2016 from \$642 million (18.0% of sales) for the nine months ended September 30, 2015, a decrease of \$252 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 with gross profit, as derived from our financial statements (in millions):

	Nine Months Ended			
	September 30, 2016	Percentage of Revenue	September 30, 2015	Percentage of Revenue
Gross profit, as reported	\$ 346	14.9%	\$ 611	17.2%
Depreciation and amortization	16	0.7%	15	0.3%
Amortization of intangibles	35	1.5%	46	1.3%
Decrease in LIFO reserve	(7)	(0.3%)	(30)	(0.8%)
Adjusted Gross Profit	\$ 390	16.8%	\$ 642	18.0%

**Selling, General and Administrative (“SG&A”) Expenses.** Our SG&A expenses were \$396 million for the nine months ended September 30, 2016 as compared to \$460 million for the nine months ended September 30, 2015. SG&A for the first nine months of 2016 and 2015 included \$12 million and \$9 million, respectively, of severance and restructuring charges resulting from cost reduction efforts. SG&A for the nine months ended September 30, 2016 also included \$13 million of expense related to the implementation of a new information technology system in the international segment as compared to \$6 million of expense for the same period in 2015. The first nine months of 2016 reflected a \$5 million favorable impact from foreign exchange rates compared to the first nine months of 2015. Excluding these amounts, SG&A decreased \$69 million which was attributable to volume-related declines and the cost reduction efforts we have made.

**Operating (Loss) Income.** Operating loss was \$50 million for the nine months ended September 30, 2016, as compared to \$151 million of operating income for the nine months ended September 30, 2015, a decrease of \$201 million.

**U.S. Segment**—Operating loss for our U.S. segment decreased to \$2 million for the nine months ended September 30, 2016 from operating income of \$147 million for the nine months ended September 30, 2015. The decrease in operating income of \$149 million was primarily driven by lower revenue due to decreased customer spending offset by a reduction in SG&A expenses. In addition, 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. Severance costs included in operating expenses were \$5 million and \$3 million for the nine months ended September 30, 2016 and 2015, respectively.

*Canada Segment*—Operating loss for our Canada segment was \$7 million for the nine months ended September 30, 2016 as compared to operating income of \$9 million for the nine months ended September 30, 2015. The decrease of \$16 million reflected the decline in sales offset by corresponding reductions in SG&A, as well as, \$5 million of inventory-related charges to reduce the carrying value of certain obsolete and excess inventory items to their net realizable value. Severance costs included in operating expenses were \$1 million for the nine months ended September 30, 2016 and 2015.

*International Segment*—Our International segment incurred an operating loss of \$41 million for the nine months ended September 30, 2016 as compared to an operating loss of \$5 million for the nine months ended September 30, 2015. The decrease of \$36 million was the result of lower sales offset by corresponding reductions in SG&A, as well as, \$24 million of inventory-related charges to reduce the carrying value of certain obsolete and excess inventory items to their net realizable value primarily related to the restructuring of our Australian business and market conditions in Iraq. Severance costs included in operating expenses were \$6 million and \$5 million for the nine months ended September 30, 2016 and 2015, respectively.

**Interest Expense.** Our interest expense was \$26 million for the nine months ended September 30, 2016 as compared to \$38 million for the nine months ended September 30, 2015. This represented a decrease of \$12 million resulting from lower average debt levels.

**Other Income (Expense).** Our other income was \$2 million for the nine months ended September 30, 2016 compared to expense of \$6 million for the nine months ended September 30, 2015. The first nine months of 2015 included a \$3 million write-off of debt issuance costs. No such costs were incurred in 2016.

**Income Tax (Benefit) Expense.** Our income tax benefit was \$9 million for the nine months ended September 30, 2016 as compared to income tax expense of \$46 million for the nine months ended September 30, 2015. Our effective tax rates were 12% and 43% for the nine months ended September 30, 2016 and 2015, 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 full year 2016 expected effective tax rate of 12% is lower than our customary effective tax rate as a result of forecasted pre-tax losses in all segments combined with an increase of the relative significance of pre-tax losses in certain foreign jurisdictions where the losses have no corresponding tax benefit.

**Net (Loss) Income.** Our net loss was \$65 million for the nine months ended September 30, 2016 as compared to net income of \$61 million for the nine months ended September 30, 2015, a decrease of \$126 million.

**Adjusted EBITDA.** Adjusted EBITDA, a non-GAAP financial measure, was \$58 million (2.5% of sales) for the nine months ended September 30, 2016 as compared to \$201 million (5.6% of sales) for the nine months ended September 30, 2015.

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 have different financing and capital structures or tax rates. 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 with net (loss) income, as derived from our financial statements (in millions):

	<b>Nine Months Ended</b>	
	<b>September 30, 2016</b>	<b>September 30, 2015</b>
Net (loss) income	\$ (65)	\$ 61
Income tax (benefit) expense	(9)	46
Interest expense	26	38
Depreciation and amortization	16	15
Amortization of intangibles	35	46
Decrease in LIFO reserve	(7)	(30)
Inventory-related charges	40	-
Change in fair value of derivative instruments	-	1
Equity-based compensation expense	9	8
Write off of debt issuance costs	-	3
Severance and restructuring charges	12	9
Foreign currency losses	1	4
<b>Adjusted EBITDA</b>	<b>\$ 58</b>	<b>\$ 201</b>

### 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 ABL Facility. At September 30, 2016, our total liquidity, including cash on hand, was \$688 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 expenses. As of September 30, 2016 and December 31, 2015, we had cash and cash equivalents of \$213 million and \$69 million, respectively. As of September 30, 2016 and December 31, 2015, \$106 million and \$51 million of our cash and cash equivalents, respectively, were maintained in the accounts of our various foreign subsidiaries. If such 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 November 2019 with an original principal amount of \$794 million and a five-year \$1.05 billion Global ABL Facility that provides a \$977 million facility in the United States, a \$30 million facility in Norway, a \$20 million facility in Canada, a \$10 million facility in Australia, a \$5 million facility in the United Kingdom, a \$4 million facility in the Netherlands and a \$4 million facility in Belgium. As of September 30, 2016, the outstanding balance on our Term Loan, net of original issue discount and issuance costs, was \$515 million. The Global ABL Facility matures in July 2019. The Global ABL Facility contains an accordion feature that allows us to increase the principal amount of the facility by up to \$300 million, subject to additional lender commitments. As of September 30, 2016, we had no borrowings outstanding and \$475 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, 2016.

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. The program is scheduled to expire on December 31, 2017. 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. During the first nine months of 2016, we purchased 6,399,385 shares of common stock at a total cost of \$88 million. In total under this plan, we have purchased 7,215,774 shares at a total cost of \$100 million.

On November 2, 2016, the company provided notice of intent to voluntarily repay \$100 million of the Term Loan with available cash on hand and expects to make the voluntary repayment on November 7, 2016.

### ***Cash Flows***

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

	<b>Nine Months Ended</b>	
	<b>September 30, 2016</b>	<b>September 30, 2015</b>
Net cash provided by (used in):		
Operating activities	\$ 230	\$ 481
Investing activities	25	(27)
Financing activities	(112)	(441)
Net increase in cash and cash equivalents	<b>\$ 143</b>	<b>\$ 13</b>

### ***Operating Activities***

Net cash provided by operating activities was \$230 million during the nine months ended September 30, 2016 compared to \$481 million during the nine months ended September 30, 2015. The decrease in cash provided by operations was primarily the result of reduced profitability combined with a reduction in the pace of working capital contraction in response to slowing sales. Excluding cash, working capital decreased \$201 million in the first nine months of 2016 compared to \$386 million in the first nine months of 2015. The current year decline in working capital was impacted most significantly by \$88 million and \$119 million reductions in accounts receivable and inventory, respectively, caused by declining sales levels. We continue to actively manage our investment in working capital to an appropriate level given current market conditions.

### ***Investing Activities***

Net cash provided by investing activities was \$25 million for the nine months ended September 30, 2016, compared to \$27 million used in investing activities for the nine months ended September 30, 2015. The \$52 million increase in cash provided by investing activities is the result of \$48 million in proceeds from the disposition of our U.S. OCTG product line. Our capital expenditures were \$24 million for the nine months ended September 30, 2016 and 2015.

### ***Financing Activities***

Net cash used in financing activities was \$112 million for the nine months ended September 30, 2016 compared to \$441 million for the nine months ended September 30, 2015. Net repayments on our Global ABL Facility totaled \$0 million in the first nine months of 2016, compared to \$535 million in the first nine months of 2015. In the first nine months of 2016, we used \$88 million and \$18 million to fund purchases of our common stock and dividends on our preferred stock, respectively. In June 2015, we received \$355 million of net proceeds related to the issuance of Series A Preferred Stock. We used these proceeds to repay a portion of the outstanding borrowings under our Term Loan and our Global ABL Facility.

### ***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, 2015.

### **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, 2015.

### **ITEM 4. CONTROLS AND PROCEDURES**

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

As of September 30, 2016, 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. As a part of this implementation, various controls over financial reporting for the region changed. During the third quarter of 2016, we began a similar implementation effort in our European, Nordic and Middle Eastern businesses which will be completed in 2017.

Other than described above, there were no changes in our internal control over financial reporting that occurred during the first nine months of 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**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 10 - 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, 2015 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 2016 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 (2)	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
July 1 - July 31	15	\$ 13.25	-	\$ 16,763,722
Aug 1 - Aug 31	1,016,977	\$ 14.88	1,016,977	\$ 1,635,162
Sep 1 - Sep 30	104,204	\$ 15.35	104,134	\$ 36,934
	<u>1,121,196</u>			

(1) We purchased 85 shares in connection with funding employee income tax withholding obligations arising upon the lapse of restrictions on restricted shares.

(2) We purchased 1,121,111 shares during the period as part of a share repurchase program authorized by the Company's board in November 2015. The plan originally allowed for purchases of common stock up to \$100 million and is scheduled to expire in December 2017. In November 2016, the Company's board approved an increase in the plan to \$125 million.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINING SAFETY DISCLOSURES**

None.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

<b>Number</b>	<b>Description</b>
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.
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.
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.
100*	The following financial information from MRC Global Inc.'s Quarterly Report on Form 10-Q for the period ended September 30, 2016, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheets at September 30, 2016 and December 31, 2015, (ii) the Condensed Consolidated Statements of Operations for the three and nine month periods ended September 30, 2016 and 2015, (iii) the Condensed Consolidated Statements of Comprehensive Income for the three and nine month periods ended September 30, 2016 and 2015, (iv) the Condensed Consolidated Statements of Cash Flows for the nine month periods ended September 30, 2016 and 2015 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

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James E. Braun  
Executive Vice President and Chief Financial  
Officer

Date: November 4, 2016

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## CERTIFICATION

I, Andrew R. Lane, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the period ended September 30, 2016 of MRC Global Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 4, 2016

/s/ Andrew R. Lane

Name: Andrew R. Lane

Title: President and Chief Executive Officer

## CERTIFICATION

I, James E. Braun, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the period ended September 30, 2016 of MRC Global Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 4, 2016

/s/ James E. Braun

Name: James E. Braun

Title: Executive Vice President and  
Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the filing of the Quarterly Report on Form 10-Q of MRC Global Inc., a Delaware corporation (the "Company"), for the period ended September 30, 2016 (the "Report"), each of the undersigned officers of the Company certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 4, 2016

/s/ Andrew R. Lane

Name: Andrew R. Lane

Title: President and Chief Executive Officer

/s/ James E. Braun

Name: James E. Braun

Title: Executive Vice President and  
Chief Financial Officer

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