NATIONAL OILWELL VARCO INC
Form 10-Q
October 27, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 1-12317

NATIONAL OILWELL VARCO, INC.

(Exact name of registrant as specified in its charter)

Delaware	**76-0475815**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

7909 Parkwood Circle Drive

Houston, Texas

77036-6565

(Address of principal executive offices)

(713) 346-7500

(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 No

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

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

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging growth company

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

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

As of October 20, 2017, the registrant had 380,032,211 shares of common stock, par value $0.01 per share, outstanding.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

NATIONAL OILWELL VARCO, INC.

CONSOLIDATED BALANCE SHEETS

(In millions, except share data)

	September 30, 2017 (Unaudited)	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,722	$ 1,408
Receivables, net	2,060	2,083
Inventories, net	3,219	3,325
Costs in excess of billings	518	665
Prepaid and other current assets	306	395
Total current assets	7,825	7,876
Property, plant and equipment, net	3,031	3,150
Deferred income taxes	71	86
Goodwill	6,165	6,067
Intangibles, net	3,377	3,530
Investment in unconsolidated affiliates	309	307
Other assets	156	124
Total assets	$ 20,934	$ 21,140
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 447	$ 414
Accrued liabilities	1,544	1,568
Billings in excess of costs	288	440
Current portion of long-term debt and short-term borrowings	506	506
Accrued income taxes	57	119
Total current liabilities	2,842	3,047
Long-term debt	2,707	2,708
Deferred income taxes	925	1,064
Other liabilities	309	318
Total liabilities	6,783	7,137
Commitments and contingencies		
Stockholders equity:		

Common stock par value $.01; 1 billion shares authorized; 380,053,721 and 378,637,403 shares issued and outstanding at September 30, 2017 and December 31, 2016		4		4
Additional paid-in capital		8,190		8,103
Accumulated other comprehensive loss		(1,109)		(1,452)
Retained earnings		6,999		7,285
Total Company stockholders equity		14,084		13,940
Noncontrolling interests		67		63
Total stockholders equity		14,151		14,003
Total liabilities and stockholders equity	$	20,934	$	21,140

See notes to unaudited consolidated financial statements.

NATIONAL OILWELL VARCO, INC.

CONSOLIDATED STATEMENTS OF LOSS (UNAUDITED)

(In millions, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	**2016**	**2017**	**2016**
Revenue	$ 1,835	$ 1,646	$ 5,335	$ 5,559
Cost of revenue	1,550	1,567	4,610	5,201
Gross profit	285	79	725	358
Selling, general and administrative	292	293	891	1,031
Goodwill impairment		972		972
Operating loss	(7)	(1,186)	(166)	(1,645)
Interest and financial costs	(26)	(25)	(77)	(80)
Interest income	11	3	19	11
Equity loss in unconsolidated affiliates	(2)	(6)	(4)	(19)
Other income (expense), net	(6)	(30)	(19)	(85)
Loss before income taxes	(30)	(1,244)	(247)	(1,818)
Provision for income taxes	(3)	120	(26)	(119)
Net loss	(27)	(1,364)	(221)	(1,699)
Net income (loss) attributable to noncontrolling interests	(1)	(2)	2	(1)
Net loss attributable to Company	$ (26)	$ (1,362)	$ (223)	$ (1,698)
Net loss attributable to Company per share:				
Basic	$ (0.07)	$ (3.62)	$ (0.59)	$ (4.53)
Diluted	$ (0.07)	$ (3.62)	$ (0.59)	$ (4.53)
Cash dividends per share	$ 0.05	$ 0.05	$ 0.15	$ 0.56
Weighted average shares outstanding:				
Basic	377	376	377	375
Diluted	377	376	377	375

See notes to unaudited consolidated financial statements.

NATIONAL OILWELL VARCO, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

(In millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net loss	$ (27)	$ (1,364)	$ (221)	$ (1,699)
Currency translation adjustments	124	(18)	290	79
Changes in derivative financial instruments, net of tax	25	60	53	191
Comprehensive income (loss)	122	(1,322)	122	(1,429)
Comprehensive income (loss) attributable to noncontrolling interest	(1)	(2)	2	(1)
Comprehensive income (loss) attributable to Company	$ 123	$ (1,320)	$ 120	$ (1,428)

See notes to unaudited consolidated financial statements.

NATIONAL OILWELL VARCO, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In millions)

	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Cash flows from operating activities:		
Net loss	$ (221)	$ (1,699)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	523	529
Deferred income taxes	16	(216)
Equity loss in unconsolidated affiliates	4	19
Goodwill impairment		972
Other, net	141	287
Change in operating assets and liabilities, net of acquisitions:		
Receivables	13	1,089
Inventories	103	430
Costs in excess of billings	147	485
Prepaid and other current assets	95	31
Accounts payable	36	(230)
Accrued liabilities	(50)	(664)
Billings in excess of costs	(152)	(235)
Income taxes payable	(72)	(229)
Other assets/liabilities, net	(72)	238
Net cash provided by operating activities	511	807
Cash flows from investing activities:		
Purchases of property, plant and equipment	(127)	(221)
Business acquisitions, net of cash acquired	(85)	(60)
Other	28	4
Net cash used in investing activities	(184)	(277)
Cash flows from financing activities:		
Borrowings against lines of credit and other debt		3,972
Payments against lines of credit and other debt	(4)	(4,869)
Cash dividends paid	(57)	(211)
Activity under stock incentive plans	11	2
Other	(2)	(10)
Net cash used in financing activities	(52)	(1,116)
Effect of exchange rates on cash	39	16
Increase (decrease) in cash and cash equivalents	314	(570)

Cash and cash equivalents, beginning of period	1,408	2,080
Cash and cash equivalents, end of period	$ 1,722	$ 1,510
Supplemental disclosures of cash flow information:		
Cash payments during the period for:		
Interest	$ 51	$ 56
Income taxes	$ 130	$ 173

See notes to unaudited consolidated financial statements.

NATIONAL OILWELL VARCO, INC.

Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

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

The accompanying unaudited consolidated financial statements of National Oilwell Varco, Inc. (NOV or the Company) present information in accordance with GAAP in the United States for interim financial information and the instructions to Form 10-Q and applicable rules of Regulation S-X. They do not include all information or footnotes required by GAAP in the United States for complete consolidated financial statements and should be read in conjunction with our 2016 Annual Report on Form 10-K.

In our opinion, the consolidated financial statements include all adjustments, which are of a normal recurring nature, unless otherwise disclosed, necessary for a fair presentation of the results for the interim periods. The results of operations for the three and nine months ended September 30, 2017 are not necessarily indicative of the results to be expected for the full year.

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, receivables, and payables approximated fair value because of the relatively short maturity of these instruments. Cash equivalents include only those investments having a maturity date of three months or less at the time of purchase. See Note 7 for the fair value of long-term debt and Note 10 for the fair value of derivative financial instruments.

2. Inventories, net

Inventories consist of (in millions):

		September 30, 2017		December 31, 2016
Raw materials and supplies	$	719	$	961
Work in process		499		561
Finished goods and purchased products		2,001		1,803
Total	$	3,219	$	3,325

3. Accrued Liabilities

Accrued liabilities consist of (in millions):

	September 30, 2017	December 31, 2016
Compensation	$ 314	$ 181
Customer prepayments and billings	262	222
Vendor costs	202	235
Warranty	147	172
Taxes (non-income)	133	176
Insurance	77	103
Commissions	55	57
Fair value of derivative financial instruments	7	66
Interest	29	8
Other	318	348
Total	$ 1,544	$ 1,568

Service and Product Warranties

The Company provides service and warranty policies on certain of its products. The Company accrues liabilities under service and warranty policies based upon specific claims and a review of historical warranty and service claim experience in accordance with Accounting Standards Codification (ASC) Topic 450 Contingencies . Adjustments are made to accruals as claim data and historical experience change. In addition, the Company incurs discretionary costs to service its products in connection with product performance issues and accrues for them when they are encountered.

The changes in the carrying amount of service and product warranties are as follows (in millions):

Balance at December 31, 2016	$ 172
Net provisions for warranties issued during the year	27
Amounts incurred	(60)
Currency translation adjustments and other	8
Balance at September 30, 2017	$ 147

4. Costs and Estimated Earnings on Uncompleted Contracts

Costs and estimated earnings on uncompleted contracts consist of (in millions):

	September 30, 2017	December 31, 2016
Costs incurred on uncompleted contracts	$ 6,807	$ 8,132

Estimated earnings		3,242		3,869
		10,049		12,001
Less: Billings to date		9,819		11,776
	$	230	$	225
Costs and estimated earnings in excess of billings on uncompleted contracts	$	518	$	665
Billings in excess of costs and estimated earnings on uncompleted contracts		(288)		(440)
	$	230	$	225

5. Accumulated Other Comprehensive Income (Loss)

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

	Currency Translation Adjustments	Derivative Financial Instruments, Net of Tax	Defined Benefit Plans, Net of Tax	Total
Balance at December 31, 2016	$ (1,376)	$ (39)	$ (37)	$ (1,452)
Accumulated other comprehensive income (loss) before reclassifications	290	50		340
Amounts reclassified from accumulated other comprehensive income (loss)		3		3
Balance at September 30, 2017	$ (1,086)	$ 14	$ (37)	$ (1,109)

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

	Three Months Ended September 30,							
	2017				2016			
	Currency Translation Adjustment	Derivative Financial Instruments	Defined Benefit Plans	Total	Currency Translation Adjustment	Derivative Financial Instruments	Defined Benefit Plans	Total
Revenue	$	$ (2)	$	$ (2)	$	$	$	$
Cost of revenue		4		4		48		48
Tax effect		(1)		(1)		(12)		(12)
	$	$ 1	$	$ 1	$	$ 36	$	$ 36

	Nine Months Ended September 30,							
	2017				2016			
	Currency Translation Adjustment	Derivative Financial Instruments	Defined Benefit Plans	Total	Currency Translation Adjustment	Derivative Financial Instruments	Defined Benefit Plans	Total
Revenue	$	$ (6)	$	$ (6)	$	$ (3)	$	$ (3)
Cost of revenue		8		8		170		170
Tax effect		1		1		(47)		(47)
	$	$ 3	$	$ 3	$	$ 120	$	$ 120

The Company s reporting currency is the U.S. dollar. For a majority of the Company s international entities in which there is a substantial investment, the local currency is their functional currency. As a result, currency translation adjustments resulting from the process of translating the entities financial statements into the reporting currency are reported in other comprehensive income or loss in accordance with ASC Topic 830 Foreign Currency Matters (ASC Topic 830). For the three months ended September 30, 2017, a majority of these local currencies strengthened against the U.S. dollar resulting in net other comprehensive income of $124 million, upon the translation from local currencies to the U.S. dollar. For the nine months ended September 30, 2017, a majority of these local currencies strengthened against the U.S. dollar resulting in net other comprehensive income of $290 million, upon the translation from local currencies to the U.S. dollar. For the three months ended September 30, 2016, a majority of these local currencies weakened against the U.S. dollar resulting in net other comprehensive loss of $18 million upon the translation from local currencies to the U.S. dollar. For the nine months ended September 30, 2016, a majority of these local currencies strengthened against the U.S. dollar resulting in net other comprehensive income of $79 million, upon the translation from local currencies to the U.S. dollar.

The effect of changes in the fair values of derivatives designated as cash flow hedges are accumulated in other comprehensive income or loss, net of tax, until the underlying transactions to which they are designed to hedge are realized. The movement in other comprehensive income or loss from period to period will be the result of the combination of changes in fair value for open derivatives and the outflow of other comprehensive income or loss related to cumulative changes in the fair value of derivatives that have settled in the current or prior periods. The accumulated effect was other comprehensive income of $25 million (net of tax of $8 million) and $53 million (net of tax of $15 million) for the three and nine months ended September 30, 2017, respectively. The accumulated effect was other comprehensive income of $60 million (net of tax of $20 million) and $191 million (net of tax of $72 million) for the three and nine months ended September 30, 2016, respectively.

6. Business Segments

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	**2016**	**2017**	**2016**
Revenue:				
Rig Systems	$ 330	$ 470	$ 1,069	$ 1,960
Rig Aftermarket	311	322	973	1,077
Wellbore Technologies	693	526	1,862	1,668
Completion & Production Solutions	682	543	1,982	1,639
Eliminations	(181)	(215)	(551)	(785)
Total revenue	$ 1,835	$ 1,646	$ 5,335	$ 5,559
Operating profit (loss):				
Rig Systems	$ 11	$ (962)	$ 13	$ (888)
Rig Aftermarket	64	72	201	203
Wellbore Technologies		(94)	(81)	(331)
Completion & Production Solutions	44	(61)	79	(132)
Eliminations and corporate costs	(126)	(141)	(378)	(497)
Total operating profit (loss)	$ (7)	$ (1,186)	$ (166)	$ (1,645)
Operating profit (loss)%:				
Rig Systems	3.3%	(204.7%)	1.2%	(45.3%)
Rig Aftermarket	20.6%	22.4%	20.7%	18.8%
Wellbore Technologies	0.0%	(17.9%)	(4.4%)	(19.8%)
Completion & Production Solutions	6.5%	(11.2%)	4.0%	(8.1%)
Total operating profit (loss) %	(0.4%)	(72.1%)	(3.1%)	(29.6%)

Sales from one segment to another generally are priced at estimated equivalent commercial selling prices; however, segments originating an external sale are credited with the full profit to the Company. Eliminations include intercompany transactions conducted between the four reporting segments that are eliminated in consolidation. Intercompany transactions within each reporting segment are eliminated within each reporting segment.

On July 1, 2017, the Company s Wellbore Technologies segment reorganized three of its reporting units, moving various operations between them. The goodwill impairment analyses performed prior to and subsequent to the restructuring of the three reporting units, concluded that the calculated fair values of these reporting units were substantially in excess of their carrying value. The restructuring had no effect on Wellbore Technologies consolidated financial position and results of operations.

Included in operating profit (loss) are other items primarily related to costs associated with severance, facility closures, goodwill impairment, and a Voluntary Early Retirement Plan (VERP) established by the Company during the first quarter of 2016. As of September 30, 2017, the Company had approximately $44 million accrued for the VERP postretirement medical benefits.

7. Debt

Debt consists of (in millions):

	September 30, 2017		December 31, 2016	
$500 million in Senior Notes, interest at 1.35% payable semiannually, principal due on December 1, 2017	$	500	$	499
$1.4 billion in Senior Notes, interest at 2.60% payable semiannually, principal due on December 1, 2022		1,392		1,391
$1.1 billion in Senior Notes, interest at 3.95% payable semiannually, principal due on December 1, 2042		1,087		1,087
Other		234		237
Total debt		3,213		3,214
Less current portion		506		506
Long-term debt	$	2,707	$	2,708

On June 27, 2017, the Company entered into a new $3.0 billion credit agreement evidencing a five-year unsecured revolving credit facility, which expires on June 27, 2022, with a syndicate of financial institutions. This new credit facility replaced the Company s previous $4.5 billion revolving credit facility. The Company has the right to increase the aggregate commitments under this new agreement to an aggregate amount of up to $4.0 billion upon the consent of only those lenders holding any such increase. Interest under the new multicurrency facility is based upon LIBOR, NIBOR or CDOR plus 1.125% subject to a ratings-based grid or the U.S. prime rate. The new credit facility contains a financial covenant regarding maximum debt-to-capitalization ratio of 60%. As of September 30, 2017, the Company was in compliance with a debt-to-capitalization ratio of 18.5%.

The Company has a commercial paper program under which borrowings are classified as long-term since the program is supported by the $3.0 billion, five-year credit facility. At September 30, 2017, there were no commercial paper borrowings, and there were no outstanding letters of credit issued under the credit facility, resulting in $3.0 billion of funds available under this credit facility.

The Company had $731 million of outstanding letters of credit at September 30, 2017 that are under various bilateral letter of credit facilities. Letters of credit are issued as bid bonds, advanced payment bonds and performance bonds.

The fair value of the Company s debt is estimated using Level 2 inputs in the fair value hierarchy and is based on quoted prices for those or similar instruments. At September 30, 2017 and December 31, 2016, the fair value of the Company s unsecured Senior Notes approximated $2,817 million and $2,669 million, respectively. At September 30, 2017 and December 31, 2016, the carrying value of the Company s unsecured Senior Notes approximated $2,979 million and $2,977 million, respectively.

8. Tax

The effective tax rates for the three and nine months ended September 30, 2017 were 10.0% and 10.5%, respectively, compared to (9.6)% and 6.5% for the same periods in 2016. Market conditions continued to negatively impact our business in the third quarter of 2017. As a result of these conditions, we continue to establish valuation allowances on deferred tax assets for losses and tax credits generated in the current year, which, when applied to losses resulted in a lower effective tax rate than the U.S. statutory rate. For the three and nine months ended September 30, 2016, impairment of goodwill not deductible for tax purposes, lower tax rates on losses incurred in foreign jurisdictions, and the establishment of valuation allowances, when applied to losses resulted in a lower effective tax rate than the U.S. statutory rate.

For the three and nine months ended September 30, 2016, the Company utilized the discrete-period method to compute its interim tax provision due to significant variations in the relationship between income tax expense and pre-tax accounting income or loss; consequently, the actual effective rate for the interim period was reported. For the three and nine months ended September 30, 2017, the Company returned to estimating and recording a full year effective tax rate.

9. Stock-Based Compensation

The Company has a stock-based compensation plan known as the National Oilwell Varco, Inc. Long-Term Incentive Plan (the Plan). The Plan provides for the granting of stock options, performance-based share awards, restricted stock, phantom shares, stock payments and stock appreciation rights (SARs). The number of shares authorized under the Plan is 69.4 million. The Plan is subject to a fungible ratio concept, such that the issuance of stock options and SARs reduces the number of available shares under the Plan on a 1-for-1 basis, and the issuance of other awards reduces the number of available shares under the Plan on a 3-for-1 basis. At September 30, 2017, 21,026,617 shares remain available for future grants under the Plan, all of which are available for grants of stock options, performance-based share awards, restricted stock awards, phantom shares, stock payments and SARs.

On February 22, 2017, the Company granted 3,362,460 stock options with a fair value of $10.98 per share and an exercise price of $38.86 per share; 1,504,450 shares of restricted stock and restricted stock units with a fair value of $38.86 per share; and performance share awards to senior management employees with potential payouts varying from zero to 388,380 shares. The stock options vest over a three-year period from the grant date. The restricted stock and restricted stock units vest on the third anniversary of the grant date or in three equal annual installments commencing on the first anniversary of the grant date. The performance share awards can be earned based on performance against established goals over a three-year performance period. The performance share awards are based entirely on a TSR (total shareholder return) goal. Performance against the TSR goal is determined by comparing the performance of the Company s TSR with the TSR performance of the members of the OSX index for the three-year performance period.

On May 17, 2017, the Company granted 36,701 restricted stock awards with a fair value of $33.38 per share. The awards were granted to non-employee members of the board of directors and vest on the first anniversary of the grant date.

Total stock-based compensation for all stock-based compensation arrangements under the Plan was $33 million and $85 million for the three and nine months ended September 30, 2017, respectively, and $28 million and $78 million for the three and nine months ended September 30, 2016, respectively. Included in stock-based compensation for the nine months ended September 30, 2016 is $5 million related to the Voluntary Early Retirement Plan established by the Company in the first quarter of 2016. The total income tax benefit recognized in the Consolidated Statements of Loss for all stock-based compensation arrangements under the Plan was $9 million and $18 million for the three and nine months ended September 30, 2017, respectively, and $5 million and $17 million for the three and nine months ended

September 30, 2016, respectively.

10. Derivative Financial Instruments

ASC Topic 815, Derivatives and Hedging requires a company to recognize all of its derivative instruments as either assets or liabilities in the Consolidated Balance Sheet at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation.

The Company is exposed to certain risks relating to its ongoing business operations. The primary risk managed by using derivative instruments is foreign currency exchange rate risk. Forward contracts against various foreign currencies are entered into to manage the foreign currency exchange rate risk on forecasted revenues and expenses denominated in currencies other than the functional currency of the operating unit (cash flow hedge). In addition, the Company will enter into non-designated forward contracts against various foreign currencies to manage the foreign currency exchange rate risk on recognized nonfunctional currency monetary accounts (non-designated hedge).

The Company records all derivative financial instruments at their fair value in its Consolidated Balance Sheet. Except for certain non-designated hedges discussed below, all derivative financial instruments that the Company holds are designated as cash flow hedges and are highly effective in offsetting movements in the underlying risks. Such arrangements typically have terms between 2 and 24 months, but may have longer terms depending on the underlying cash flows being hedged, typically related to the projects in our backlog. The Company may also use interest rate contracts to mitigate its exposure to changes in interest rates on anticipated long-term debt issuances.

At September 30, 2017, the Company has determined that the fair value of its derivative financial instruments representing assets of $42 million and liabilities of $10 million (primarily currency related derivatives) are determined using level 2 inputs (inputs other than quoted prices in active markets for identical assets and liabilities that are observable either directly or indirectly for substantially the full term of the asset or liability) in the fair value hierarchy as the fair value is based on publicly available foreign exchange and interest rates at each financial reporting date. At September 30, 2017, the net fair value of the Company s foreign currency forward contracts totaled a net asset of $32 million.

At September 30, 2017, the Company did not have any interest rate swaps and its financial instruments do not contain any credit-risk-related or other contingent features that could cause accelerated payments when the Company s financial instruments are in net liability positions. We do not use derivative financial instruments for trading or speculative purposes.

Cash Flow Hedging Strategy

To protect against the volatility of forecasted foreign currency cash flows resulting from forecasted revenues and expenses, the Company has instituted a cash flow hedging program. The Company hedges portions of its forecasted revenues and expenses denominated in nonfunctional currencies with forward contracts. When the U.S. dollar strengthens or weakens against the foreign currencies, the change in present value of future foreign currency revenues and expenses is offset by changes in the fair value of the forward contracts designated as hedges.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is subject to a particular currency risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income (loss) and reclassified into earnings in the same line item associated with the forecasted transaction and in the same period or periods during which the hedged transaction affects earnings (e.g., in revenues when the hedged transactions are cash flows associated with forecasted revenues). The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any (i.e., the ineffective portion), or hedge components excluded from the assessment of effectiveness, is recognized in the Consolidated Statements of Loss during the current period.

For the three and nine months ended September 30, 2017, the Company recognized a loss of $3 million and a gain of $10 million, respectively, as a result of the discontinuance of certain cash flow hedges when it became probable that the original forecasted transactions would not occur by the end of the originally specified time period. At September 30, 2017, there were $19 million in pre-tax gains recorded in accumulated other comprehensive income (loss). Significant changes in forecasted operating levels or delays in large capital construction projects, whereby certain hedged transactions associated with these projects are no longer probable of occurring by the end of the originally specified time period, could result in additional gains or losses due to the de-designation of existing hedge contracts.

The Company had the following outstanding foreign currency forward contracts that were entered into to hedge nonfunctional currency cash flows from forecasted revenues and expenses (in millions):

	Currency Denomination			
Foreign Currency	**September 30, 2017**		**December 31, 2016**	
Norwegian Krone	NOK	3,692	NOK	5,621
Japanese Yen	JPY	1,071	JPY	1,462
U.S. Dollar	USD	229	USD	321
Euro	EUR	74	EUR	279
Danish Krone	DKK	29	DKK	29
British Pound Sterling	GBP	7	GBP	1
Singapore Dollar	SGD	1	SGD	2

Non-designated Hedging Strategy

The Company enters into forward exchange contracts to hedge certain nonfunctional currency monetary accounts. The purpose of the Company s foreign currency hedging activities is to protect the Company from risk that the eventual U.S. dollar equivalent cash flows from the nonfunctional currency monetary accounts will be adversely affected by changes in the exchange rates.

For derivative instruments that are non-designated, the gain or loss on the derivative instrument subject to the hedged risk (i.e., nonfunctional currency monetary accounts) is recognized in other income (expense), net in current earnings.

The Company had the following outstanding foreign currency forward contracts that hedge the fair value of nonfunctional currency monetary accounts (in millions):

	Currency Denomination			
Foreign Currency	**September 30, 2017**		**December 31, 2016**	
Russian Ruble	RUB	2,645	RUB	1,893
Norwegian Krone	NOK	1,766	NOK	538
U.S. Dollar	USD	461	USD	457
South African Rand	ZAR	150	ZAR	150
Euro	EUR	101	EUR	272
Danish Krone	DKK	38	DKK	49
Singapore Dollar	SGD	2	SGD	7
British Pound Sterling	GBP	2	GBP	3
Canadian Dollar	CAD	1	CAD	1

The Company has the following gross fair values of its derivative instruments and their balance sheet classifications:

	Asset Derivatives			Liability Derivatives		
		Fair Value			Fair Value	
	Balance Sheet Location	September 30, 2017	December 31, 2016	Balance Sheet Location	September 30, 2017	December 31, 2016
Derivatives designated as hedging instruments under ASC Topic 815						
Foreign exchange contracts	Prepaid and other current assets	$ 20	$ 24	Accrued liabilities	$ 2	$ 37
Foreign exchange contracts	Other Assets	14	6	Other liabilities	3	11
Total derivatives designated as hedging instruments under ASC Topic 815						