KEY ENERGY SERVICES INC
Form 10-Q
May 11, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended March 31, 2017
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number: 001-08038

KEY ENERGY SERVICES, INC.
(Exact name of registrant as specified in its charter)

Delaware	04-2648081
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1301 McKinney Street, Suite 1800, Houston, Texas	77010
(Address of principal executive offices)	(Zip Code)

(713) 651-4300
(Registrant's telephone number, including area code)
None
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý 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 ý 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.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ý
	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. No ¨

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ý No ¨

As of May 5, 2017, the number of outstanding shares of common stock of the registrant was 20,096,462.

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KEY ENERGY SERVICES, INC.
QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended March 31, 2017

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Statements that are not historical in nature or that relate to future events and conditions are, or may be deemed to be, forward-looking statements. These forward-looking statements are based on our current expectations, estimates and projections and management's beliefs and assumptions concerning future events and financial trends affecting our financial condition and results of operations. In some cases, you can identify these statements by terminology such as "may," "will," "should," "predicts," "expects," "believes," "anticipates," "projects," "potential" or "continue" or the negative o and other comparable terminology. These statements are only predictions and are subject to substantial risks and uncertainties and are not guarantees of performance. Future actions, events and conditions and future results of operations may differ materially from those expressed in these statements. In evaluating those statements, you should carefully consider the information above as well as the risks outlined in "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016 and in the other reports we file with the Securities and Exchange Commission.

We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date of this report except as required by law. All of our written and oral forward-looking statements are expressly qualified by these cautionary statements and any other cautionary statements that may accompany such forward-looking statements.

Important factors that may affect our expectations, estimates or projections include, but are not limited to, the following:

- conditions in the oil and natural gas industry, especially oil and natural gas prices and capital expenditures by oil and natural gas companies;

- volatility in oil and natural gas prices;
- our ability to implement price increases or maintain pricing on our core services;
- risks that we may not be able to reduce, and could even experience increases in, the costs of labor, fuel, equipment and supplies employed in our businesses;
- industry capacity;
- asset impairments or other charges;
- the periodic low demand for our services and resulting operating losses and negative cash flows;
- our highly competitive industry as well as operating risks, which are primarily self-insured, and the possibility that our insurance may not be adequate to cover all of our losses or liabilities;
- significant costs and potential liabilities resulting from compliance with applicable laws, including those resulting from environmental, health and safety laws and regulations, specifically those relating to hydraulic fracturing, as well as climate change legislation or initiatives;

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- our historically high employee turnover rate and our ability to replace or add workers, including executive officers and skilled workers;
- our ability to incur debt or long-term lease obligations;
- our ability to implement technological developments and enhancements;
- severe weather impacts on our business;
- our ability to successfully identify, make and integrate acquisitions and our ability to finance future growth of our operations or future acquisitions;
- our ability to achieve the benefits expected from disposition transactions;
- the loss of one or more of our larger customers;
- our ability to generate sufficient cash flow to meet debt service obligations;
- the amount of our debt and the limitations imposed by the covenants in the agreements governing our debt, including our ability to comply with covenants under our debt agreements;
- an increase in our debt service obligations due to variable rate indebtedness;
- our inability to achieve our financial, capital expenditure and operational projections, including quarterly and annual projections of revenue and/or operating income and our inaccurate assessment of future activity levels, customer demand, and pricing stability which may not materialize (whether for Key as a whole or for geographic regions and/or business segments individually);
- risks affecting our international operations, including risks affecting our ability to execute our plans to withdraw from international markets outside North America;
- our ability to respond to changing or declining market conditions, including our ability to reduce the costs of labor, fuel, equipment and supplies employed and used in our businesses;
- our ability to maintain sufficient liquidity;
- adverse impact of litigation; and
- other factors affecting our business described in “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2016 and in the other reports we file with the Securities and Exchange Commission.

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PART I — FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
Key Energy Services, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(in thousands, except share amounts)

	March 31, 2017 (unaudited)	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 82,710	$ 90,505
Restricted cash	15,628	24,707
Accounts receivable, net of allowance for doubtful accounts of $902 and $168, respectively	62,939	71,327
Inventories	22,282	22,269
Other current assets	25,040	25,762
Total current assets	208,599	234,570
Property and equipment	408,405	408,716
Accumulated depreciation	(24,339)	(3,565)
Property and equipment, net	384,066	405,151
Intangible assets, net	506	520
Other non-current assets	11,075	17,740
TOTAL ASSETS	$ 604,246	$ 657,981
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 13,037	$ 10,357
Current portion of long-term debt	2,500	2,500
Other current liabilities	89,740	103,938
Total current liabilities	105,277	116,795
Long-term debt	244,623	245,477
Workers' compensation, vehicular and health insurance liabilities	23,686	23,313
Deferred tax liabilities	—	35
Other non-current liabilities	29,645	29,744
Commitments and contingencies		
Equity:		
Preferred stock, $0.01 par value; 10,000,000 shares authorized, none issued	—	—
Common stock, $0.01 par value; 100,000,000 shares authorized, 20,096,462 shares issued and outstanding	201	201
Additional paid-in capital	256,445	252,421
Accumulated other comprehensive loss	1,472	239
Retained deficit	(57,103)	(10,244)
Total equity	201,015	242,617
TOTAL LIABILITIES AND EQUITY	$ 604,246	$ 657,981

See the accompanying notes which are an integral part of these condensed consolidated financial statements.

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Key Energy Services, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
(in thousands, except per share data)
(unaudited)

	Successor Three Months Ended March 31, 2017	Predecessor Three Months Ended March 31, 2016
REVENUES	$ 101,452	$ 111,088
COSTS AND EXPENSES:		
Direct operating expenses	87,306	90,598
Depreciation and amortization expense	21,301	35,752
General and administrative expenses	30,996	46,245
Impairment expense	187	—
Operating loss	(38,338)	(61,507)
Interest expense, net of amounts capitalized	7,710	21,584
Other income, net	(240)	(1,231)
Reorganization items, net	1,340	—
Loss before income taxes	(47,148)	(81,860)
Income tax benefit	289	246
NET LOSS	$ (46,859)	$ (81,614)
Loss per share:		
Basic and diluted	$ (2.33)	$ (0.51)
Weighted average shares outstanding:		
Basic and diluted	20,096	160,047

See the accompanying notes which are an integral part of these condensed consolidated financial statements.

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Key Energy Services, Inc. and Subsidiaries
Condensed Consolidated Statements of Comprehensive Income
(in thousands)
(unaudited)

	Successor Three Months Ended March 31, 2017	Predecessor Three Months Ended March 31, 2016
NET LOSS	$ (46,859)	$ (81,614)
Other comprehensive income:		
Foreign currency translation income	1,233	532
COMPREHENSIVE LOSS	$ (45,626)	$ (81,082)

See the accompanying notes which are an integral part of these condensed consolidated financial statements.

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Key Energy Services, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Successor Three Months Ended March 31, 2017	Predecessor Three Months Ended March 31, 2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(46,859)	$(81,614)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense	21,301	35,752
Impairment expense	187	—
Bad debt expense	622	665
Accretion of asset retirement obligations	59	142
Loss (income) from equity method investments	(19)	83
Amortization and write-off of deferred financing costs and premium	121	1,306
Deferred income tax benefit	(32)	(252)
Loss (gain) on disposal of assets, net	(194)	1,934
Share-based compensation	4,024	2,313
Excess tax expense from share-based compensation	—	2,508
Changes in working capital:		
Accounts receivable	7,964	30,653
Other current assets	164	5,038
Accounts payable, accrued interest and accrued expenses	(11,004)	(20,895)
Share-based compensation liability awards	—	(189)
Other assets and liabilities	11,019	(7,508)
Net cash used in operating activities	(12,647)	(30,064)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(2,440)	(2,701)
Proceeds from sale of fixed assets	—	7,435
Net cash provided by (used in) investing activities	(2,440)	4,734
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(625)	(787)
Restricted cash	9,079	(18,605)
Payment of deferred financing costs	(350)	—
Repurchases of common stock	—	(143)
Excess tax expense from share-based compensation	—	(2,508)
Net cash provided by (used in) financing activities	8,104	(22,043)
Effect of changes in exchange rates on cash	(812)	(1,277)
Net decrease in cash and cash equivalents	(7,795)	(48,650)
Cash and cash equivalents, beginning of period	90,505	204,354
Cash and cash equivalents, end of period	$82,710	$155,704

See the accompanying notes which are an integral part of these condensed consolidated financial statements.

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Key Energy Services, Inc. and Subsidiaries
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS
NOTE 1. GENERAL
Key Energy Services, Inc., and its wholly owned subsidiaries (collectively, “Key,” the “Company,” “we,” “us,” “its,” and “our”) provide a full range of well services to major oil companies, foreign national oil companies and independent oil and natural gas production companies. Our services include rig-based and coiled tubing-based well maintenance and workover services, well completion and recompletion services, fluid management services, fishing and rental services, and other ancillary oilfield services. Additionally, certain of our rigs are capable of specialty drilling applications. We operate in most major oil and natural gas producing regions of the continental United States and we have operations in Russia, which we are attempting to sell. In addition, we have a technology development and control systems business based in Canada.
The accompanying unaudited condensed consolidated financial statements were prepared using generally accepted accounting principles in the United States of America (“GAAP”) for interim financial information and in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”). The condensed December 31, 2016 balance sheet was prepared from audited financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2016 (the “2016 Form 10-K”). Certain information relating to our organization and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted in this Quarterly Report on Form 10-Q. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our 2016 Form 10-K.
The unaudited condensed consolidated financial statements contained in this report include all normal and recurring material adjustments that, in the opinion of management, are necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods presented herein. The results of operations for the three months ended March 31, 2017 are not necessarily indicative of the results expected for the full year or any other interim period, due to fluctuations in demand for our services, timing of maintenance and other expenditures, and other factors.
On October 24, 2016, Key and certain of our domestic subsidiaries filed voluntary petitions for reorganization under chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware pursuant to a prepackaged plan of reorganization (“the Plan”). The Plan was confirmed by the Bankruptcy Court on December 6, 2016, and the Company emerged from the bankruptcy proceedings on December 15, 2016 (“the Effective Date”).
Upon emergence on the Effective Date, the Company adopted fresh start accounting which resulted in the creation of a new entity for financial reporting purposes. As a result of the application of fresh start accounting, as well as the effects of the implementation of the Plan, the Consolidated Financial Statements on or after December 16, 2016 are not comparable with the Consolidated Financial Statements prior to that date.
References to “Successor” or “Successor Company” relate to the financial position and results of operations of the reorganized Company subsequent to December 15, 2016. References to “Predecessor” or “Predecessor Company” refer to the financial position and results of operations of the Company on and prior to December 15, 2016.
We have evaluated events occurring after the balance sheet date included in this Quarterly Report on Form 10-Q and through the date on which the unaudited condensed consolidated financial statements were issued, for possible disclosure of a subsequent event.
NOTE 2. SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES
The preparation of these unaudited condensed consolidated financial statements requires us to develop estimates and to make assumptions that affect our financial position, results of operations and cash flows. These estimates may also impact the nature and extent of our disclosure, if any, of our contingent liabilities. Among other things, we use estimates to (i) analyze assets for possible impairment, (ii) determine depreciable lives for our assets, (iii) assess future tax exposure and realization of deferred tax assets, (iv) determine amounts to accrue for contingencies, (v) value tangible and intangible assets, (vi) assess workers’ compensation, vehicular liability, self-insured risk accruals and other insurance reserves, (vii) provide allowances for our uncollectible accounts receivable, (viii) value our asset

retirement obligations, and (ix) value our equity-based compensation. We review all significant estimates on a recurring basis and record the effect of any necessary adjustments prior to publication of our financial statements. Adjustments made with respect to the use of estimates relate to improved information not previously available. Because of the limitations inherent in this process, our actual results may differ materially from these estimates. We believe that the estimates used in the preparation of these interim financial statements are reasonable.

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There have been no material changes or developments in our evaluation of accounting estimates and underlying assumptions or methodologies that we believe to be a "Critical Accounting Policy or Estimate" as disclosed in our 2016 Form 10-K.

Recent Accounting Developments

ASU 2016-18. In November 2016, the FASB issued ASU No. 2016-18 Statement of Cash Flows (Topic 230), Restricted Cash. This standard provides guidance on the presentation of restricted cash and restricted cash equivalents in the statement of cash flows. Restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period amounts shown on the statements of cash flows. The amendments of this ASU should be applied using a retrospective transition method and are effective for reporting periods beginning after December 15, 2017, with early adoption permitted. Other than the revised statement of cash flows presentation of restricted cash, the adoption of this standard is not expected to have an impact on our consolidated financial statements.

ASU 2016-15. In August 2016 the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments (a consensus of the FASB Emerging Issues Task Force) (ASU 2016-15), that clarifies how entities should classify certain cash receipts and cash payments on the statement of cash flows. The guidance also clarifies how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. The guidance will be effective for annual periods beginning after December 15, 2017 and interim periods within those annual periods. Early adoption is permitted. The Company is evaluating the effect of this standard on its consolidated financial statements.

ASU 2016-13. In June 2016, the FASB issued ASU 2016-13, Measurement of Credit Losses on Financial Instruments, that will change how companies measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. The standard will replace today's "incurred loss" approach with an "expected loss" model for instruments measured at amortized cost. For available-for-sale debt securities, entities will be required to record allowances rather than reduce the carrying amount. The amendments in this update will be effective for annual periods beginning after December 15, 2019 and interim periods within those annual periods. Early adoption is permitted for annual periods beginning after December 15, 2018. The Company is evaluating the effect of this standard on our consolidated financial statements.

ASU 2016-09. In March 2016, the FASB Issued ASU 2016-09 Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. This standard changes how companies account for certain aspects of share-based payment awards to employees, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The Company adopted the accounting guidance as of January 1, 2017 on a prospective basis. In accordance with the standard, the Company has made an election to account for forfeitures of equity awards as they occur. With the exception of excess tax benefits and deficiencies related to the vesting of share-based compensation now being recognized as an income tax expense or benefit on the income statement rather than additional paid in capital on the balance sheet, the adoption of this guidance did not have a material impact our consolidated financial statements.

ASU 2016-02. In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which will replace the existing lease guidance. The new standard is intended to provide enhanced transparency and comparability by requiring lessees to record right-of-use assets and corresponding lease liabilities on the balance sheet. Additional disclosure requirements include qualitative disclosures along with specific quantitative disclosures with the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for the Company for annual reporting periods beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The new standard is required to be applied with a modified retrospective approach to each prior reporting period presented. We are currently evaluating the standard to determine the impact of its adoption on the consolidated financial statements.

ASU 2014-09. In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The objective of this ASU is to establish the principles to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue from contracts with customers. The core principle is to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 must be adopted using either a full retrospective method or a modified retrospective method. During a July 2015 meeting, the FASB affirmed a proposal to defer the effective date of the new revenue standard for all entities by one year. As a result, ASU 2014-09 is effective for the Company for interim and annual reporting periods beginning after December 15, 2017 with early adoption permitted for interim and annual reporting periods beginning after December 15, 2016. We are currently evaluating the standard to determine the impact of its adoption on the consolidated financial statements, however, management believes that the impact to the financial statements will not be material.

NOTE 3. ASSETS HELD FOR SALE

In April 2015, we announced our decision to exit markets in which we participate outside of North America. Our strategy is to sell or relocate the assets of the businesses operating in these markets. During the fourth quarter of 2015, the

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assets and related liabilities of our Russian business unit which is included in our International reporting segment met the criteria for assets held for sale. We recorded a $0.2 million impairment during the three months ended March 31, 2017 to reduce the carrying value of these assets to fair market value. We expect this sale to occur in the first half of 2017.

The following assets and related liabilities are classified as held for sale on our March 31, 2017 condensed consolidated balance sheet (in thousands):

Current assets:	
Cash and cash equivalents	$1,844
Accounts receivable	1,068
Inventories	216
Other current assets	198
Total current assets	3,326
Property and equipment, net	493
Total assets	$3,819
Current liabilities:	
Accounts payable	$232
Total current liabilities	232
Net Assets	$3,587

NOTE 4. EQUITY

A reconciliation of the total carrying amount of our equity accounts for the