

MRC GLOBAL INC.
Form 10-Q
August 03, 2016

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 JUNE 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

20-5956993
(I.R.S. Employer)

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(State or Other Jurisdiction of Identification No.)
Incorporation or Organization)

Fulbright Tower

1301 McKinney Street, Suite 2300

Houston, Texas 77010
(Address of Principal Executive Offices) (Zip Code)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer 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 96,395,357 shares of the registrant's common stock (excluding 570,845 unvested restricted shares), par value \$0.01 per share, issued and outstanding as of July 22, 2016.

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CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

MRC GLOBAL INC.

(in millions)

	June 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash	\$ 167	\$ 69
Accounts receivable, net	430	533
Inventories, net	689	781
Other current assets	29	22
Total current assets	1,315	1,405
Other assets	21	22
Property, plant and equipment, net	131	127
Intangible assets:		
Goodwill, net	484	484
Other intangible assets, net	436	459
	\$ 2,387	\$ 2,497
Liabilities and stockholders' equity		
Current liabilities:		
Trade accounts payable	\$ 320	\$ 327
Accrued expenses and other current liabilities	104	110
Current portion of long-term debt	8	8
Total current liabilities	432	445
Long-term obligations:		
Long-term debt, net	508	511
Deferred income taxes	204	208
Other liabilities	23	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, 102,488,749 and 102,202,599 issued, respectively	1		1	
Additional paid-in capital	1,671		1,666	
Retained deficit	(504)		(467)	
Less: Treasury stock at cost: 6,094,663 and 816,389 shares, respectively	(83)		(12)	
Accumulated other comprehensive loss	(220)		(232)	
	865		956	
	\$	2,387	\$	2,497

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

MRC GLOBAL INC.

(in millions, except per share amounts)

	Three Months Ended		Six Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Sales	\$ 746	\$ 1,198	\$ 1,529	\$ 2,490
Cost of sales	621	992	1,271	2,064
Gross profit	125	206	258	426
Selling, general and administrative expenses	135	159	272	318
Operating (loss) income	(10)	47	(14)	108
Other expense:				
Interest expense	(9)	(13)	(17)	(28)
Other, net	-	(5)	(1)	(9)
(Loss) income before income taxes	(19)	29	(32)	71
Income tax (benefit) expense	(2)	13	(7)	26
Net (loss) income	(17)	16	(25)	45
Series A preferred stock dividends	6	1	12	1
Net (loss) income attributable to common stockholders	\$ (23)	\$ 15	\$ (37)	\$ 44
Basic (loss) earnings per common share	\$ (0.24)	\$ 0.15	\$ (0.37)	\$ 0.43
Diluted (loss) earnings per common share	\$ (0.24)	\$ 0.15	\$ (0.37)	\$ 0.43
Weighted-average common shares, basic	97.7	102.2	99.2	102.1
Weighted-average common shares, diluted	97.7	102.8	99.2	102.6

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

MRC GLOBAL INC.

(in millions)

	Three Months Ended		Six Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Net (loss) income	\$ (17)	\$ 16	\$ (25)	\$ 45
Other comprehensive (loss) income				
Foreign currency translation adjustments	(4)	11	12	(42)
Comprehensive (loss) income	\$ (21)	\$ 27	\$ (13)	\$ 3

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

MRC GLOBAL INC.

(in millions)

	Six Months Ended	
	June 30, 2016	June 30, 2015
Operating activities		
Net (loss) income	\$ (25)	\$ 45
Adjustments to reconcile net (loss) income to net cash provided by operations:		
Depreciation and amortization	10	10
Amortization of intangibles	23	31
Equity-based compensation expense	7	5
Deferred income tax benefit	(5)	(16)
Write off of debt issuance costs	-	3
Decrease in LIFO reserve	(4)	(15)
Provision for uncollectible accounts	2	2
Foreign currency losses	2	6
Other non-cash items	4	3
Changes in operating assets and liabilities:		
Accounts receivable	104	207
Inventories	51	152
Other current assets	2	1
Income taxes payable	(6)	(7)
Accounts payable	(10)	(111)
Accrued expenses and other current liabilities	(7)	(39)
Net cash provided by operations	148	277
Investing activities		
Purchases of property, plant and equipment	(14)	(13)
Proceeds from the disposition of non-core product line	48	-
Other investing activities	2	(2)
Net cash provided by (used in) investing activities	36	(15)
Financing activities		
Payments on revolving credit facilities	(27)	(765)
Proceeds from revolving credit facilities	27	412
Payments on long-term obligations	(4)	(254)
Proceeds from issuance of preferred stock, net of issuance costs	-	355

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Purchase of common stock	(71)	-	
Dividends paid on preferred stock	(12)	-	
Net cash used in financing activities	(87)	(252)	
Increase in cash	97	10	
Effect of foreign exchange rate on cash	1	(2)	
Cash -- beginning of period	69	25	
Cash -- end of period	\$	167	\$ 33
Supplemental disclosures of cash flow information:			
Cash paid for interest	\$	16	\$ 26
Cash paid for income taxes	\$	6	\$ 50
See notes to condensed consolidated financial statements.			

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NOTES TO 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 six months ended June 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 operation 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

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December 15, 2018. We are beginning to evaluate 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.

NOTE 2 – INVENTORIES

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

	June 30, 2016	December 31, 2015
Finished goods inventory at average cost:		
Energy carbon steel tubular products	\$ 165	\$ 253
Valves, valve actuation and instrumentation	246	273
All other products	388	374
	799	900
Less: Excess of average cost over LIFO cost (LIFO reserve)	(77)	(89)
Less: Other inventory reserves	(33)	(30)
	\$ 689	\$ 781

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 six months ended June 30, 2016, the effect of this LIFO decrement decreased cost of sales by approximately \$2 million and \$3 million, respectively. For the three and six months ended June 30, 2015, the effect of this LIFO decrement increased cost of sales by approximately \$4 million.

NOTE 3 – LONG-TERM DEBT

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

	June 30, 2016	December 31, 2015
Senior Secured Term Loan B, net of discount and issuance costs of \$6 and \$7, respectively	\$ 516	\$ 519
Global ABL Facility	-	-
	516	519
Less: Current portion	8	8
	\$ 508	\$ 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

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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 June 30, 2016 and 4.98% at December 31, 2015.

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 \$478 million as of June 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 June 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 six months ended June 30, 2016 were 11% and 22%, respectively. The effective tax rates for the three and six months ended June 30, 2015 were 45% and 37%, 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 22% 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.

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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. The program is scheduled to expire 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:

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	Three Months Ended		Six Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Number of shares acquired on the open market	2,399,400	-	5,278,274	-
Average price per share	\$ 13.82	\$ -	\$ 13.59	\$ -
Total cost of acquired shares (in millions)	\$ 33	\$ -	\$ 71	\$ -

In total, we have acquired 6,094,663 shares under this program at a total cost of \$83 million. There were 96,394,086 shares of common stock outstanding as of June 30, 2016.

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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 February 2016, 16,789 shares of restricted stock, 334,900 performance share unit awards and 1,149,039 restricted stock units were granted to employees. In the second quarter of 2016, 86,912 shares of restricted stock and 10,022 performance share unit awards were granted to employees. To date, before consideration of forfeitures, 5,084,734 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):

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

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Earnings per Share

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

	Three Months Ended		Six Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Net (loss) income	\$ (17)	\$ 16	\$ (25)	\$ 45
Less: Dividends on Series A Preferred Stock	6	1	12	1
Net (loss) income attributable to common stockholders	\$ (23)	\$ 15	\$ (37)	\$ 44
Weighted average basic shares outstanding	97.7	102.2	99.2	102.1
Effect of dilutive securities	-	0.6	-	0.5
Weighted average diluted shares outstanding	97.7	102.8	99.2	102.6
Net (loss) income per share:				
Basic	\$ (0.24)	\$ 0.15	\$ (0.37)	\$ 0.43
Diluted	\$ (0.24)	\$ 0.15	\$ (0.37)	\$ 0.43

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 six months ended June 30, 2016 and 2015, all of the shares of the Preferred Stock were anti-dilutive. For the three and six months ended June 30, 2016 and 2015, we had approximately 3.7 million and 3.9 million anti-dilutive stock options, respectively. There were 0.8 million and no anti-dilutive restricted stock, restricted units or performance stock unit awards for the three months ended June 30, 2016 and 2015. There were 0.7 million and no anti-dilutive restricted stock, restricted units or performance stock unit awards for the six months ended June 30, 2016 and 2015.

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 and concluded that no indication of impairment existed as the fair values of each U.S. reporting unit significantly exceeded its carrying value.

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

	Three Months Ended		Six Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Sales				
U.S.	\$ 551	\$ 956	\$ 1,157	\$ 1,928
Canada	54	78	118	197
International	141	164	254	365
Sales	\$ 746	\$ 1,198	\$ 1,529	\$ 2,490
Operating (loss) income				
U.S.	\$ (2)	\$ 49	\$ 2	\$ 101
Canada	(2)	2	(3)	8
International	(6)	(4)	(13)	(1)
Operating (loss) income	(10)	47	(14)	\$ 108
Interest expense	(9)	(13)	(17)	(28)
Other, net	-	(5)	(1)	(9)
(Loss) income before income taxes	\$ (19)	\$ 29	\$ (32)	\$ 71
			June 30, 2016	December 31, 2015
Total assets				
U.S.			\$ 2,011	\$ 2,135
Canada			145	142
International			231	220
Total assets			\$ 2,387	\$ 2,497

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

Type	Three Months Ended		Six Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Energy carbon steel tubular products:				
Line pipe (1)	\$ 96	\$ 242	\$ 228	\$ 508
Oil country tubular goods (OCTG)	-	78	-	184

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\$ 96 \$ 320 \$ 228 \$ 692

Valves, fittings, flanges and other products:

Valves, valve actuation and instrumentation	\$ 299	\$ 396	\$ 598	\$ 807
Fittings, flanges and stainless steel and alloy pipe	163	250	331	519
Gas products	108	121	208	237
Other	80	111	164	235
	\$ 650	\$ 878	\$ 1,301	\$ 1,798

(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 six months ended June 30, 2016.

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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 June 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 \$36 million and \$41 million at June 30, 2016 and December 31, 2015, respectively. We had approximately \$0 million recorded as liabilities on our consolidated balance sheets as of June 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 \$516 million and \$519 million at June 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 \$507 million and \$510 million at June 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 June 30, 2016, we are named a defendant in approximately 497 lawsuits involving approximately 1,121 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

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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 January 2017.

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.

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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 other 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;

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- 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

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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. Although 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 six months of 2016, the average oil price of West Texas Intermediate (“WTI”) decreased to \$39.55 per barrel from \$53.25 per barrel in the first six months of 2015. Natural gas prices decreased to an average price of \$2.07/Mcf (Henry Hub) for the first six months of 2016 compared to \$2.82/Mcf (Henry Hub) for the first six months of 2015. North American drilling rig activity decreased 56% in the first six months of 2016 as compared to the first six months of 2015.

Recent exploration and production spending forecasts indicated 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. With the sustained decline in both oil and natural gas prices, and forecasts indicating that prices will be at low levels throughout the remainder of 2016

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and into 2017, we expect our customers' spending, particularly those in the upstream sector within North America, will continue to remain low in 2016 as compared to 2015. With the exception of the gas utilities component of our midstream business, these lower spending levels will also have a significant impact on our midstream and downstream business across all segments.

Because the business environment remains challenging, we have taken further steps during the first half of 2016 to reduce our operating costs. We have maintained our hiring and salary freezes, which were implemented in 2015, and eliminated an additional 400 full-time positions and closed 19 branches during the first half of 2016. As a result of these actions, we recorded pre-tax severance and restructuring charges of \$9 million in the first six months of 2016. We have reduced our headcount by approximately 1,300, or 26%, and our number of branch locations by 63, or 26%, over the past two years. 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 2016 and beyond decline 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 the 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 June 30, 2016, total backlog was \$657 million, including \$376 million in our U.S. segment, \$34 million in our Canada segment and \$247 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 June 30, 2015, total backlog was \$768 million (\$698 million excluding OCTG), including \$540 million in our U.S. segment (\$470 million excluding OCTG), \$37 million in our Canada segment and \$191 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.

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	Three Months Ended		Six Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Average Rig Count (1):				
United States	422	907	483	1,144
Canada	48	98	108	206
International	943	1,169	979	1,215
Total	1,413	2,174	1,570	2,565
Average Commodity Prices (2):				
WTI crude oil (per barrel)	\$ 45.46	\$ 57.85	\$ 39.55	\$ 53.25
Brent crude oil (per barrel)	\$ 45.57	\$ 61.65	\$ 39.80	\$ 57.84
Natural gas (\$/Mcf)	\$ 2.15	\$ 2.75	\$ 2.07	\$ 2.82
Average Monthly U.S. Well Permits (3)				
	2,048	3,716	2,051	3,828
3:2:1 Crack Spread (4)	\$ 17.12	\$ 24.41	\$ 16.29	\$ 23.05

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

(2) Source-Department of Energy, EIA (www.eia.gov)

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

(4) Source-Bloomberg

Results of Operations

Three Months Ended June 30, 2016 Compared to the Three Months Ended June 30, 2015

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

	Three Months Ended			
	June 30, 2016		June 30, 2015	
Upstream	\$ 211	28%	\$ 434	36%
Midstream	292	39%	419	35%
Downstream	243	33%	345	29%
	\$ 746	100%	\$ 1,198	100%

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

	Three Months Ended			
	June 30,	June 30,	\$ Change	% Change
	2016	2015		
Sales:				
U.S.	\$ 551	\$ 956	\$ (405)	(42%)
Canada	54	78	(24)	(31%)
International	141	164	(23)	(14%)
Consolidated	\$ 746	\$ 1,198	\$ (452)	(38%)
Operating (loss) income:				
U.S.	\$ (2)	\$ 49	\$ (51)	(104%)
Canada	(2)	2	(4)	(200%)
International	(6)	(4)	(2)	50%
Consolidated	(10)	47	(57)	(121%)
Interest expense	(9)	(13)	4	(31%)
Other expense	-	(5)	5	(100%)
Income tax (benefit) expense	(2)	13	(15)	(115%)
Net (loss) income	(17)	16	(33)	(206%)
Series A preferred stock dividends	6	1	5	N/M
Net (loss) income attributable to common stockholders	\$ (23)	\$ 15	\$ (38)	(253%)
Gross profit	\$ 125	\$ 206	\$ (81)	(39%)
Adjusted Gross Profit (1)	\$ 140	\$ 211	\$ (71)	(34%)
Adjusted EBITDA (1)	\$ 15	\$ 63	\$ (48)	(76%)

(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 20-22 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 \$746 million for the three months ended June 30, 2016 as compared to \$1,198 million for the three months ended June 30, 2015. The \$452 million decrease in sales reflected a \$7 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 \$551 million for the three months ended June 30, 2016 from \$956 million for the three months ended June 30, 2015. This \$405 million, or 42%, decrease reflected a \$196 million decrease in the upstream sector, a \$129 million decrease in the midstream sector and an \$80 million decrease in the downstream sector. The decline in the upstream sector included a \$78 million impact from the disposition of our OCTG product

line. The remaining decrease in sales in the second 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 decline in oil and natural gas prices and the resulting decline in rig count.

Canada Segment—Our Canada sales decreased to \$54 million for the three months ended June 30, 2016 from \$78 million for the three months ended June 30, 2015. This \$24 million, or 31%, decrease reflected a \$16 million

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decrease in the upstream business also due to a decrease in customer spending. Approximately \$3 million, or 13%, 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 \$141 million for the three months ended June 30, 2016 from \$164 million for the same period in 2015. The \$23 million, or 14%, decrease reflected the combined impact of lower project activity and deferral of MRO expenditures particularly in Norway and Australia. The impact of the decline in the foreign currencies in areas where we operate outside of the U.S. dollar accounted for \$4 million, or 17%, of the total decline.

Gross Profit. Our gross profit was \$125 million (16.8% of sales) for the three months ended June 30, 2016 as compared to \$206 million (17.2% of sales) for the three months ended June 30, 2015. Gross profit for the three months ended June 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 \$1 million and \$15 million in the second quarters of 2016 and 2015, respectively. Excluding the impact of LIFO, gross profit percentage improved 70 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 \$7 million and \$9 million for the three months ended June 30, 2016 and 2015, respectively.

Adjusted Gross Profit. Adjusted Gross Profit decreased to \$140 million (18.8% of sales) for the three months ended June 30, 2016 from \$211 million (17.6% of sales) for the three months ended June 30, 2015, a decrease of \$71 million. 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):

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	Three Months Ended			
	June 30, 2016	Percentage of Revenue*	June 30, 2015	Percentage of Revenue
Gross profit, as reported	\$ 125	16.8%	\$ 206	17.2%
Depreciation and amortization	5	0.7%	5	0.4%
Amortization of intangibles	11	1.5%	15	1.2%
Decrease in LIFO reserve	(1)	(0.1%)	(15)	(1.2%)
Adjusted Gross Profit	\$ 140	18.8%	\$ 211	17.6%

*Does not foot due to rounding.

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 \$135 million for the three months ended June 30, 2016 as compared to \$159 million for the three months ended June 30, 2015. SG&A for the second quarter of 2016 included \$8 million of expense related to the implementation of a new information technology system compared to \$3 million of similar expenses for the same period in 2015. These expenses, which are reflected in our U.S. operating segment, were elevated in the current

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quarter as a result of roll-out, training and support activities occurring in our Asia Pacific businesses where the system went live in May 2016. Severance and restructuring charges resulting from our cost reduction efforts for the three months ending June 30, 2016 totaled \$4 million as compared to \$7 million of expenses for the three months ending June 30, 2015. The second quarter of 2016 also reflected a \$2 million favorable impact from foreign exchange rates compared to the second quarter of 2015. Excluding these amounts, SG&A decreased \$24 million which was attributable to volume-related declines and the cost reduction efforts we have made.

Operating (Loss) Income. Operating loss was \$10 million for the three months ended June 30, 2016, as compared to \$47 million of operating income for the three months ended June 30, 2015, a decrease of \$57 million.

U.S. Segment—Operating loss for our U.S. segment was \$2 million for the three months ended June 30, 2016 compared to operating income of \$49 million for the three months ended June 30, 2015. The decrease in operating income of \$51 million was driven by lower sales due to decreased customer spending partially offset by a reduction in SG&A expenses. Severance costs included in operating expenses were \$2 million for the three months ended June 30, 2016 and 2015.

Canada Segment—Operating loss for our Canada segment was \$2 million for the three months ended June 30, 2016 as compared to operating income of \$2 million for the three months ended June 30, 2015. The decrease of \$4 million reflected the decline in sales partially offset by corresponding reductions in SG&A.

International Segment—Our International segment incurred an operating loss of \$6 million for the three months ended June 30, 2016 as compared to \$4 million for the three months ended June 30, 2015. The decrease of \$2 million was the result of lower sales partially offset by corresponding reductions in SG&A. Severance costs included in operating expenses were \$2 million and \$4 million for the three months ended June 30, 2016 and 2015, respectively.

Interest Expense. Our interest expense was \$9 million for the three months ended June 30, 2016 as compared to \$13 million for the three months ended June 30, 2015. This represented a decrease of \$4 million resulting from lower average debt levels.

Other Expense. Our other expense was \$0 million for the three months ended June 30, 2016 compared to \$5 million for the three months ended June 30, 2015, which included a \$3 million write off of debt issuance costs.

Income Tax (Benefit) Expense. Our income tax benefit was \$2 million for the three months ended June 30, 2016 as compared to expense of \$13 million for the three months ended June 30, 2015. Our effective tax rates were 11% and 45% for the three months ended June 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 11% in the second quarter of 2016 from 43% in the first quarter of 2016 was a result of a lower expected tax rate for the full year of 22%. The full year 2016 expected effective tax rate of 22% 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 \$17 million for the three months ended June 30, 2016 as compared to net income of \$16 million for the three months ended June 30, 2015, a decrease of \$33 million.

Adjusted EBITDA. Adjusted EBITDA, a non-GAAP financial measure, was \$15 million (2.0% of sales) for the three months ended June 30, 2016 as compared to \$63 million (5.3% of sales) for the three months ended June 30, 2015.

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

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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):

	Three Months Ended		
	June 30, 2016	June 30, 2015	
Net (loss) income	\$ (17)	\$ 16	
Income tax (benefit) expense	(2)	13	
Interest expense	9	13	
Depreciation and amortization	5	5	
Amortization of intangibles	11	15	
Decrease in LIFO reserve	(1)	(15)	
Change in fair value of derivative instruments	1	1	
Equity-based compensation expense	4	3	
Write off of debt issuance costs	-	3	
Severance and restructuring charges	4	7	
Foreign currency losses	1	2	
Adjusted EBITDA	\$ 15	\$ 63	

Six Months Ended June 30, 2016 Compared to the Six Months Ended June 30, 2015

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

	Six Months Ended			
	June 30, 2016		June 30, 2015	
Upstream	\$ 442	29%	\$ 981	39%
Midstream	570	37%	798	32%
Downstream	517	34%	711	29%
	\$ 1,529	100%	\$ 2,490	100%

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

	Six Months Ended			
	June 30,	June 30,	\$ Change	% Change
	2016	2015		
Sales:				
U.S.	\$ 1,157	\$ 1,928	\$ (771)	(40%)
Canada	118	197	(79)	(40%)
International	254	365	(111)	(30%)
Consolidated	\$ 1,529	\$ 2,490	\$ (961)	(39%)
Operating (loss) income:				
U.S.	\$ 2	\$ 101	\$ (99)	(98%)
Canada	(3)	8	(11)	(138%)
International	(13)	(1)	(12)	N/M
Consolidated	(14)	108	(122)	(113%)
Interest expense	(17)	(28)	11	(39%)
Other expense	(1)	(9)	8	(89%)
Income tax (benefit) expense	(7)	26	(33)	(127%)
Net (loss) income	(25)	45	(70)	(156%)
Series A preferred stock dividends	12	1	11	N/M
Net (loss) income attributable to common stockholders	\$ (37)	\$ 44	\$ (81)	(184%)
Gross profit	\$ 258	\$ 426	\$ (168)	(39%)
Adjusted Gross Profit (1)	\$ 287	\$ 452	\$ (165)	(37%)
Adjusted EBITDA (1)	\$ 34	\$ 150	\$ (116)	(77%)

(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 24-26 herein.

Sales. Our sales were \$1,529 million for the six months ended June 30, 2016 as compared to \$2,490 million for the six months ended June 30, 2015. The \$961 million decrease in sales reflected a \$22 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 \$1,157 million for the six months ended June 30, 2016 from \$1,928 million for the six months ended June 30, 2015. This \$771 million, or 40%, decrease reflected a \$422 million decrease in the

upstream sector, a \$223 million decrease in the midstream sector and a \$126 million decrease in the downstream sector. The decline in the upstream sector included a \$163 million impact from the disposition of our OCTG product line. The remaining decrease in sales in the first half 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 decline in oil and natural gas prices and the resulting decline in rig count.

Canada Segment—Our Canada sales decreased to \$118 million for the six months ended June 30, 2016 from \$197 million for the six months ended June 30, 2015. This \$79 million, or 40%, decrease reflected a \$59 million decrease

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in the upstream business also due to a decrease in customer spending. Approximately \$10 million, or 13%, 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 \$254 million for the six months ended June 30, 2016 from \$365 million for the same period in 2015. The \$111 million, or 30%, 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 \$12 million, or 11%, of the total decline.

Gross Profit. Our gross profit was \$258 million (16.9% of sales) for the six months ended June 30, 2016 as compared to \$426 million (17.1% of sales) for the six months ended June 30, 2015. Gross profit for the six months ended June 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 \$4 million and \$15 million in the first half of 2016 and 2015, respectively. Excluding the impact of LIFO, gross profit percentage improved by 10 basis points.

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 \$15 million and \$20 million for the six months ended June 30, 2016 and 2015, respectively.

Adjusted Gross Profit. Adjusted Gross Profit decreased to \$287 million (18.8% of sales) for the six months ended June 30, 2016 from \$452 million (18.1% of sales) for the six months ended June 30, 2015, a decrease of \$165 million. 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):

	Six Months Ended			
	June 30, 2016	Percentage of Revenue	June 30, 2015	Percentage of Revenue
Gross profit, as reported	\$ 258	16.9%	\$ 426	17.1%
Depreciation and amortization	10	0.7%	10	0.4%
Amortization of intangibles	23	1.5%	31	1.2%
Decrease in LIFO reserve	(4)	(0.3%)	(15)	(0.6%)
Adjusted Gross Profit	\$ 287	18.8%	\$ 452	18.1%

Selling, General and Administrative (“SG&A”) Expenses. Our SG&A expenses were \$272 million for the six months ended June 30, 2016 as compared to \$318 million for the six months ended June 30, 2015. SG&A for the first half of both 2016 and 2015 included \$9 million of severance and restructuring charges resulting from cost reduction efforts. SG&A for the six months ended June 30, 2016 also included \$11 million of expense related to the implementation of a new information technology system in the international segment as compared to \$4 million of expense for the same period in 2015. These expenses, which are reflected in our U.S. operating segment, were elevated in the current year as a result of roll-out, training and support activities occurring in our Asia Pacific businesses where the system went live in May 2016. The first half of 2016 also reflected a \$5 million favorable

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impact from foreign exchange rates compared to the first half of 2015. Excluding these amounts, SG&A decreased \$48 million which was attributable to volume-related declines and the cost reduction efforts we have made.

Operating (Loss) Income. Operating loss was \$14 million for the six months ended June 30, 2016, as compared to \$108 million of operating income for the six months ended June 30, 2015, a decrease of \$122 million.

U.S. Segment—Operating income for our U.S. segment decreased to \$2 million for the six months ended June 30, 2016 from \$101 million for the six months ended June 30, 2015. The decrease in operating income of \$99 million was driven by lower revenue due to decreased customer spending offset by a reduction in SG&A expenses. Severance costs included in operating expenses were \$4 million and \$3 million for the six months ended June 30, 2016 and 2015, respectively.

Canada Segment—Operating loss for our Canada segment was \$3 million for the six months ended June 30, 2016 as compared to operating income of \$8 million for the six months ended June 30, 2015. The decrease of \$11 million reflected the decline in sales offset by corresponding reductions in SG&A. Severance costs included in operating expenses were \$1 million for the six months ended June 30, 2016 and 2015.

International Segment—Our International segment incurred an operating loss of \$13 million for the six months ended June 30, 2016 as compared to \$1 million for the six months ended June 30, 2015. The decrease of \$12 million was the result of lower sales offset by corresponding reductions in SG&A. Severance costs included in operating expenses were \$4 million and \$5 million for the six months ended June 30, 2016 and 2015, respectively.

Interest Expense. Our interest expense was \$17 million for the six months ended June 30, 2016 as compared to \$28 million for the six months ended June 30, 2015. This represented a decrease of \$11 million resulting from lower average debt levels.

Other Expense. Our other expense was \$1 million for the six months ended June 30, 2016 compared to \$9 million for the six months ended June 30, 2015, which included a \$3 million write off of debt issuance costs as well as \$6 million of foreign currency losses.

Income Tax (Benefit) Expense. Our income tax benefit was \$7 million for the six months ended June 30, 2016 as compared to income tax expense of \$26 million for the six months ended June 30, 2015. Our effective tax rates were 22% and 37% for the six months ended June 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. Our effective tax rate of 22% was lower than the 43% effective tax rate in the first quarter of 2016 as a result of a lower expected tax rate for the full year. The full year 2016 expected effective tax rate of 22% 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 \$25 million for the six months ended June 30, 2016 as compared to net income of \$45 million for the six months ended June 30, 2015, a decrease of \$70 million.

Adjusted EBITDA. Adjusted EBITDA, a non-GAAP financial measure, was \$34 million (2.2% of sales) for the six months ended June 30, 2016 as compared to \$150 million (6.0% of sales) for the six months ended June 30, 2015.

We define Adjusted EBITDA as net income plus interest, income taxes, depreciation and amortization, amortization of intangibles and certain other expenses (such as equity-based compensation, severance and restructuring, changes in the fair value of derivative instruments and goodwill impairment) 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.

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

	Six Months Ended		
	June 30, 2016	June 30, 2015	
Net (loss) income	\$ (25)	\$ 45	
Income tax (benefit) expense	(7)	26	
Interest expense	17	28	
Depreciation and amortization	10	10	
Amortization of intangibles	23	31	
Decrease in LIFO reserve	(4)	(15)	
Change in fair value of derivative instruments	2	2	
Equity-based compensation expense	7	5	
Write off of debt issuance costs	-	3	
Severance and restructuring charges	9	9	
Foreign currency losses	2	6	
Adjusted EBITDA	\$ 34	\$ 150	

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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 June 30, 2016, our total liquidity, including cash on hand, was \$645 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 June 30, 2016 and December 31, 2015, we had cash and cash equivalents of \$167 million and \$69 million, respectively. As of June 30, 2016 and December 31, 2015, \$86 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 June 30, 2016, the outstanding balance on our Term Loan, net of original issue discount and issuance costs, was \$508 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 June 30, 2016, we had no borrowings outstanding and \$478 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 six months ended June 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

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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 of up to \$100 million. The program is scheduled to expire 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 half of 2016, we purchased 5,278,274 shares of common stock at a total cost of \$71 million. In total under this plan, we have purchased 6,094,663 shares at a total cost of \$83 million.

Cash Flows

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

	Six Months Ended	
	June 30, 2016	June 30, 2015
Net cash provided by (used in):		
Operating activities	\$ 148	\$ 277
Investing activities	36	(15)
Financing activities	(87)	(252)
Net increase in cash and cash equivalents	\$ 97	\$ 10

Operating Activities

Net cash provided by operating activities was \$148 million during the six months ended June 30, 2016 compared to \$277 million during the six months ended June 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 \$134 million in the first six months of 2016 compared to \$203 million in the first six months of 2015. The current year decline in working capital was impacted most significantly by \$104 million and \$51 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 \$36 million for the six months ended June 30, 2016, compared to \$15