OCEANEERING INTERNATIONAL INC
Form 10-Q
November 07, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2007

OR

o **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 1-10945

OCEANEERING INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	95-2628227
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
11911 FM 529 Houston, Texas	77041
(Address of principal executive offices)	(Zip Code)

(713) 329-4500
(Registrant s telephone number, including area code)
Not Applicable
(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 þ, No o.

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

The number of shares of the registrant s common stock outstanding as of October 29, 2007 was 55,072,938.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

OCEANEERING INTERNATIONAL, INC. & SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(unaudited)
(in thousands)

	Sept. 30, 2007	Dec. 31, 2006
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 43,502	$ 26,228
Accounts receivable, net of allowances for doubtful accounts of $160 and $114	415,582	315,255
Inventory and other current assets	278,135	182,162
Total current assets	737,219	523,645
Property and Equipment, at cost	1,202,672	1,040,042
Less accumulated depreciation	586,742	516,335
Net Property and Equipment	615,930	523,707
Other Assets:		
Goodwill	112,123	86,931
Investments in unconsolidated affiliates	64,632	64,496
Other	45,861	43,243
Total other assets	222,616	194,670
TOTAL ASSETS	$ 1,575,765	$ 1,242,022
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 92,096	$ 70,777
Accrued liabilities	234,379	180,073
Income taxes payable	41,376	28,856
Total current liabilities	367,851	279,706
Long-term Debt	263,000	194,000
Other Long-term Liabilities	75,816	71,552
Commitments and Contingencies		
Shareholders Equity	869,098	696,764

TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 1,575,765	$ 1,242,022

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OCEANEERING INTERNATIONAL, INC. & SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(unaudited)
(in thousands, except per share amounts)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
Revenue	$ 485,424	$ 337,263	$ 1,261,469	$ 937,835
Cost of Services and Products	367,911	249,038	958,344	717,336
Gross margin	117,513	88,225	303,125	220,499
Selling, General and Administrative Expense	31,908	27,634	87,686	74,045
Income from operations	85,605	60,591	215,439	146,454
Interest Income	316	130	568	260
Interest Expense, net of amounts capitalized	(4,400)	(3,528)	(11,502)	(9,450)
Equity Earnings of Unconsolidated Affiliates	1,022	2,482	3,263	10,715
Other Expense, Net	(69)	(1,213)	(242)	(2,400)
Income before income taxes	82,474	58,462	207,526	145,579
Provision for Income Taxes	28,621	19,915	72,634	50,929
Net Income	$ 53,853	$ 38,547	$ 134,892	$ 94,650
Basic Earnings per Share	$ 0.98	$ 0.71	$ 2.47	$ 1.76
Diluted Earnings per Share	$ 0.96	$ 0.70	$ 2.42	$ 1.72
Weighted average number of common shares	54,979	54,185	54,689	53,829
Incremental shares from stock equivalents	842	1,098	995	1,220
Weighted average number of common shares and equivalents	55,821	55,283	55,684	55,049

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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OCEANEERING INTERNATIONAL, INC. & SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(in thousands)

	For the Nine Months Ended September 30, 2007	2006
Cash Flows from Operating Activities:		
Net income	$ 134,892	$ 94,650
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	68,666	58,939
Gain on sales of property and equipment	(4,198)	
Noncash compensation and other	13,036	6,110
Undistributed earnings of unconsolidated affiliates	(18)	(2,749)
Increase (decrease) in cash from:		
Accounts receivable	(100,327)	(56,768)
Inventory and other current assets	(95,973)	(60,568)
Other assets	2,511	(2,968)
Current liabilities	88,146	54,050
Other long-term liabilities	2,670	8,084
Total adjustments to net income	(25,487)	4,130
Net Cash Provided by Operating Activities	109,405	98,780
Cash Flows from Investing Activities:		
Business acquisitions	(25,116)	(1,109)
Purchases of property and equipment and other, net	(151,585)	(126,949)
Proceeds on sales of property and equipment	5,222	
Net Cash Used in Investing Activities	(171,479)	(128,058)
Cash Flows from Financing Activities:		
Net proceeds from revolving credit, net of expenses	88,561	46,000
Payments of 6.72% Senior Notes	(20,000)	(20,000)
Proceeds from issuance of common stock	5,118	5,352
Excess tax benefits from stock-based compensation	5,669	5,282

Net Cash Provided by Financing Activities	79,348	36,634
Net Increase in Cash and Cash Equivalents	17,274	7,356
Cash and Cash Equivalents Beginning of Period	26,228	26,308
Cash and Cash Equivalents End of Period	$ 43,502	$ 33,664

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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OCEANEERING INTERNATIONAL, INC. & SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation and Significant Accounting Policies

We have prepared these unaudited consolidated financial statements pursuant to instructions for the quarterly report on Form 10-Q, which we are required to file with the Securities and Exchange Commission. These financial statements do not include all information and footnotes normally included in financial statements prepared in accordance with generally accepted accounting principles. These financial statements reflect all adjustments that we believe are necessary to present fairly our financial position at September 30, 2007 and our results of operations and cash flows for the periods presented. All such adjustments are of a normal and recurring nature. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in our annual report on Form 10-K for the year ended December 31, 2006. The results for interim periods are not necessarily indicative of annual results.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires that our management make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates.

2. Investments in Unconsolidated Affiliates

Our investments in unconsolidated affiliates consisted of the following:

	Sept. 30, 2007	Dec. 31, 2006
	(in thousands)	
Medusa Spar LLC	$ 63,167	$ 63,149
Other	1,465	1,347
Total	$ 64,632	$ 64,496

We own a 50% equity interest in Medusa Spar LLC. Medusa Spar LLC owns a 75% interest in a production spar platform in the Gulf of Mexico. Medusa Spar LLC s revenue is derived from processing oil and gas production for a fee based on the volumes processed through the platform (throughput). The majority working interest owner of the Medusa field, the spar s initial location, has committed to deliver a minimum throughput, which we expect will generate sufficient revenue to repay Medusa Spar LLC s bank debt. Medusa Spar LLC financed its acquisition of its 75% interest in the production spar platform using approximately 50% debt and 50% equity from its equity holders. We believe our maximum exposure to loss from our investment in Medusa Spar LLC is our $63 million investment. Medusa Spar LLC is a variable interest entity. As we are not the primary beneficiary under Financial Accounting Standards Board (FASB) Interpretation Number 46(R), *Consolidation of Variable Interest Entities,* we are accounting for our investment in Medusa Spar LLC under the equity method of accounting. Equity earnings from Medusa Spar LLC reflected in our financial statements are after amortization of our initial acquisition costs. The following are summarized 100% statements of income of Medusa Spar LLC.

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	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
	(in thousands)			
Medusa Spar LLC Condensed Statements of Income				
Revenue	$ 4,381	$ 8,157	$ 14,538	$ 28,883
Depreciation	(2,369)	(2,369)	(7,108)	(7,108)
General and Administrative	(63)	(17)	(96)	(93)
Interest	(347)	(484)	(1,131)	(1,481)
Net Income	$ 1,602	$ 5,287	$ 6,203	$ 20,201
Equity Earnings reflected in our financial statements	$ 771	$ 2,614	$ 3,012	$ 9,996

3. Inventory and Other Current Assets

Our inventory and other current assets consisted of the following:

	Sept. 30, 2007	Dec. 31, 2006
	(in thousands)	
Inventory of parts for remotely operated vehicles	$ 83,532	$ 61,763
Other inventory, primarily raw materials	141,277	78,130
Deferred income taxes	26,160	18,618
Other	27,166	23,651
Total	$ 278,135	$ 182,162

We state our inventory at the lower of cost or market. We determine cost using the weighted-average method.

4. Debt

Our long-term debt consisted of the following:

	Sept. 30, 2007	Dec. 31, 2006
	(in thousands)	
6.72% Senior Notes	$ 60,000	$ 80,000
Revolving credit facility	203,000	114,000
Total	$ 263,000	$ 194,000

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Scheduled maturities of our long-term debt as of September 30, 2007 were as follows:

	6.72% Notes	Revolving Credit	Total
		(in thousands)	
Remainder of 2007	$	$	$
2008	20,000		20,000
2009	20,000		20,000
2010	20,000		20,000
2011			
Thereafter		203,000	203,000
Total	$ 60,000	$ 203,000	$ 263,000

Maturities through September 30, 2008 are not classified as current as of September 30, 2007 because we are able and intend to extend the maturity by reborrowing under our revolving credit facility, which has a maturity date beyond one year. We capitalized interest charges of $765,000 and $47,000 in the nine-month periods ended September 30, 2007 and 2006, respectively, and $247,000 in the three-month period ended September 30, 2007, as part of construction-in-progress.

5. Shareholders Equity and Comprehensive Income

Our shareholders equity consisted of the following:

	Sept. 30, 2007	Dec. 31, 2006
	(in thousands)	
Retained earnings, December 31, 2006	$ 472,525	$ 472,525
Adjustment to beginning retained earnings to implement FIN No. 48	(1,595)	
Net income for the period ended September 30, 2007	134,892	
Retained earnings, end of period	605,822	472,525
Common Stock, par value $0.25; 90,000,000 shares authorized; 55,062,898 and 54,440,488 shares issued	13,766	13,610
Additional paid-in capital	206,628	191,910
Other comprehensive income	42,882	18,719
Total	$ 869,098	$ 696,764

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN No. 48), *Accounting for Uncertainty in Income Taxes*. The interpretation became effective for us beginning January 1, 2007, and we made an adjustment of $1.6 million to our retained earnings account as of January 1, 2007 to record the effect of our adoption of this interpretation.

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Comprehensive income is the total of net income and all nonowner changes in equity. The amounts of comprehensive income for the periods indicated are as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
	(in thousands)			
Net Income per Consolidated Statements of Income	$ 53,853	$ 38,547	$ 134,892	$ 94,650
Foreign Currency Translation Gains, net	14,986	(1,031)	24,334	8,410
Change in Pension Liability Adjustment, net of tax		(124)	15	442
Change in Fair Value of Hedge, net of tax	(112)	(174)	(186)	(120)
Total	$ 68,727	$ 37,218	$ 159,055	$ 103,382

Amounts comprising other elements of comprehensive income in Shareholders Equity are as follows:

	Sept. 30, 2007	Dec. 31, 2006
	(in thousands)	
Accumulated Net Foreign Currency Translation Adjustments	$ 45,907	$ 21,573
Pension Liability Adjustment	(3,192)	(3,207)
Fair Value of Hedge	167	353
Total	$ 42,882	$ 18,719

6. Income Taxes

During interim periods, we provide for income taxes at our estimated effective tax rate, currently 35.0%, using assumptions as to (1) earnings and other factors that would affect the tax calculation for the remainder of the year and (2) the operations of foreign branches and subsidiaries that are subject to local income and withholding taxes.

Effective January 1, 2007, we adopted FIN No. 48. This interpretation clarifies the criteria for recognizing income tax benefits under Statement of Financial Accounting Standards (SFAS) No. 109, and requires additional disclosures about uncertain tax positions. Under FIN No. 48, the financial statement recognition of the benefit for a tax position depends on the benefit being more likely than not to be sustainable upon audit by the applicable taxing authority. If this threshold is met, the tax benefit is then measured and recognized at the largest amount that is greater than 50 percent likely of being realized upon ultimate settlement.

We account for any applicable interest and penalties on uncertain tax positions as a component of our provision for income taxes on our financial statements. We charged $0.4 million to income tax expense in the nine months ended September 30, 2007 for penalties and interest taken on our financial statements on uncertain tax positions, which brought our total liabilities for penalties and interest on uncertain tax positions to $2.8 million on our balance sheet at September 30, 2007. Including penalties and interest, we have accrued a total of $6.2 million in the caption other long-term liabilities on our balance sheet for unrecognized tax benefits. All additions or reductions to those liabilities affect our effective income tax rate in the periods of change.

We do not believe that the total of unrecognized tax benefits will significantly increase or decrease in the next 12 months.

The following lists the earliest tax years open to examination by tax authorities where we have significant operations:

Jurisdiction	Periods
United States	2004
United Kingdom	2004
Norway	2000
Angola	2002
Nigeria	2001
Brazil	2001

We conduct our operations in a number of locations that have varying laws and regulations with regard to income and other taxes, some of which are subject to interpretation. Our tax returns are subject to audit by taxing authorities in multiple jurisdictions. These audits often take years to complete and settle. Our management believes that adequate provisions have been made for all taxes that will ultimately be payable, although final determination of tax liabilities may differ from our estimates.

7. Business Segment Information

We supply a comprehensive range of technical services and specialty products to customers in a variety of industries. Our Oil and Gas business consists of five business segments: Remotely Operated Vehicles (ROVs); Subsea Products; Subsea Projects; Inspection; and Mobile Offshore Production Systems. Our Advanced Technologies business is a separate segment that provides project management, engineering services, products and equipment for applications outside the oil and gas industry. Unallocated Expenses are those not associated with a specific business segment. These consist of expenses related to our incentive and deferred compensation plans, including restricted stock and bonuses, as well as other general expenses.

There are no differences in the basis of segmentation or in the basis of measurement of segment profit or loss from those used in our consolidated financial statements for the year ended December 31, 2006. The following summarizes certain financial data by business segment:

MLPF&S has advised us that the hedging arrangements will include hedging related charges, reflecting the costs associated with, and our affiliates' profit earned from, these hedging arrangements. Since hedging entails risk and may be influenced by unpredictable market forces, actual profits or losses from these hedging transactions may be more or less than any expected amounts.

For further information, see "Risk Factors" beginning on page PS-6 above and "Supplemental Use of Proceeds" on page PS-16 of the accompanying product supplement.

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U.S. FEDERAL INCOME TAX SUMMARY

The following summary of the material U.S. federal income tax considerations of the acquisition, ownership, and disposition of the notes supplements, and to the extent inconsistent supersedes, the discussions under "U.S. Federal Income Tax Considerations" in the accompanying prospectus and under "U.S. Federal Income Tax Considerations" in the accompanying prospectus supplement and is not exhaustive of all possible tax considerations. In addition, any reference to "Morrison & Foerster LLP" in the aforementioned tax discussions in the accompanying prospectus and prospectus supplement should be read as a reference to "Sidley Austin LLP." This summary is based upon the Internal Revenue Code of 1986, as amended (the "Code"), regulations promulgated under the Code by the U.S. Treasury Department ("Treasury") (including proposed and temporary regulations), rulings, current administrative interpretations and official pronouncements of the IRS, and judicial decisions, all as currently in effect and all of which are subject to differing interpretations or to change, possibly with retroactive effect. No assurance can be given that the IRS would not assert, or that a court would not sustain, a position contrary to any of the tax consequences described below. This summary does not include any description of the tax laws of any state or local governments, or of any foreign government, that may be applicable to a particular holder.

Although the notes are issued by us, they will be treated as if they were issued by Bank of America Corporation for U.S. federal income tax purposes. Accordingly throughout this tax discussion, references to "we," "our" or "us" are generally to Bank of America Corporation unless the context requires otherwise.

This summary is directed solely to U.S. Holders and Non-U.S. Holders that, except as otherwise specifically noted, will purchase the notes upon original issuance and will hold the notes as capital assets within the meaning of Section 1221 of the Code, which generally means property held for investment, and that are not excluded from the discussion under "U.S. Federal Income Tax Considerations" in the accompanying prospectus.

You should consult your own tax advisor concerning the U.S. federal income tax consequences to you of acquiring, owning, and disposing of the notes, as well as any tax consequences arising under the laws of any state, local, foreign, or other tax jurisdiction and the possible effects of changes in U.S. federal or other tax laws.

General

Although there is no statutory, judicial, or administrative authority directly addressing the characterization of the notes, in the opinion of our counsel, Sidley Austin LLP, and based on certain factual representations received from us, the notes should be treated as single financial contracts with respect to the Underlying and under the terms of the notes, we and every investor in the notes agree, in the absence of an administrative determination or judicial ruling to the contrary, to treat the notes in accordance with such characterization. This discussion assumes that the notes constitute single financial contracts with respect to the Underlying for U.S. federal income tax purposes. If the notes did not constitute single financial contracts, the tax consequences described below would be materially different.

This characterization of the notes is not binding on the IRS or the courts. No statutory, judicial, or administrative authority directly addresses the characterization of the notes or any similar instruments for U.S. federal income tax purposes, and no ruling is being requested from the IRS with respect to their proper characterization and treatment. Due to the absence of authorities on point, significant aspects of the U.S. federal income tax consequences of an investment in the notes are not certain, and no assurance can be given that the IRS or any court will agree with the characterization and tax treatment described in this pricing supplement. Accordingly, you are urged to consult your tax advisor regarding all aspects of the U.S. federal income tax consequences of an investment in the notes, including possible alternative characterizations.

Unless otherwise stated, the following discussion is based on the characterization described above. The discussion in this section assumes that there is a significant possibility of a significant loss of principal on an investment in the notes.

We will not attempt to ascertain whether the issuer of any component stocks included in the Underlying would be treated as a "passive foreign investment company" ("PFIC"), within the meaning of Section 1297 of the Code, or a United States real property holding corporation, within the meaning of Section 897(c) of the Code. If the issuer of one or more stocks included in the Underlying were so treated, certain adverse U.S. federal income tax consequences could possibly apply to a holder of the notes. You

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should refer to information filed with the SEC by the issuers of the component stocks included in the Underlying and consult your tax advisor regarding the possible consequences to you, if any, if any issuer of a component stock included in the Underlying is or becomes a PFIC or is or becomes a United States real property holding corporation.

U.S. Holders

Upon receipt of a cash payment at maturity or upon a sale or exchange of the notes prior to maturity, a U.S. Holder generally will recognize capital gain or loss equal to the difference between the amount realized and the U.S. Holder's tax basis in the notes. A U.S. Holder's tax basis in the notes will equal the amount paid by that holder to acquire them. This capital gain or loss generally will be long-term capital gain or loss if the U.S. Holder held the notes for more than one year. The deductibility of capital losses is subject to limitations.

Alternative Tax Treatments. Due to the absence of authorities that directly address the proper tax treatment of the notes, prospective investors are urged to consult their tax advisors regarding all possible alternative tax treatments of an investment in the notes. In particular, the IRS could seek to subject the notes to the Treasury regulations governing contingent payment debt instruments. If the IRS were successful in that regard, the timing and character of income on the notes would be affected significantly. Among other things, a U.S. Holder would be required to accrue original issue discount every year at a "comparable yield" determined at the time of issuance. In addition, any gain realized by a U.S. Holder at maturity or upon a sale or exchange of the notes generally would be treated as ordinary income, and any loss realized at maturity or upon a sale or exchange of the notes generally would be treated as ordinary loss to the extent of the U.S. Holder's prior accruals of original issue discount, and as capital loss thereafter.

The IRS released Notice 2008-2 (the "Notice"), which sought comments from the public on the taxation of financial instruments currently taxed as "prepaid forward contracts." This Notice addresses instruments such as the notes. According to the Notice, the IRS and Treasury are considering whether a holder of an instrument such as the notes should be required to accrue ordinary income on a current basis, regardless of whether any payments are made prior to maturity. It is not possible to determine what guidance the IRS and Treasury will ultimately issue, if any. Any such future guidance may affect the amount, timing and character of income, gain, or loss in respect of the notes, possibly with retroactive effect.

The IRS and Treasury are also considering additional issues, including whether additional gain or loss from such instruments should be treated as ordinary or capital, whether foreign holders of such instruments should be subject to withholding tax on any deemed income accruals, whether Section 1260 of the Code, concerning certain "constructive ownership transactions," generally applies or should generally apply to such instruments, and whether any of these determinations depend on the nature of the underlying asset.

In addition, proposed Treasury regulations require the accrual of income on a current basis for contingent payments made under certain notional principal contracts. The preamble to the regulations states that the "wait and see" method of accounting does not properly reflect the economic accrual of income on those contracts, and requires current accrual of income for some contracts already in existence. While the proposed regulations do not apply to prepaid forward contracts, the preamble to the proposed regulations expresses the view that similar timing issues exist in the case of prepaid forward contracts. If the IRS or Treasury publishes future guidance requiring current economic accrual for contingent payments on prepaid forward contracts, it is possible that you could be required to accrue income over the term of the notes.

Because of the absence of authority regarding the appropriate tax characterization of the notes, it is also possible that the IRS could seek to characterize the notes in a manner that results in tax consequences that are different from those described above. For example, the IRS could possibly assert that any gain or loss that a holder may recognize at maturity or upon the sale or exchange of the notes should be treated as ordinary gain or loss.

Because the Underlying is an index that periodically rebalances, it is possible that the notes could be treated as a series of single financial contracts, each of which matures on the next rebalancing date. If the notes were properly characterized in such a manner, a U.S. Holder would be treated as disposing of the notes on each rebalancing date in return for new notes that mature on the next rebalancing date, and a U.S. Holder would accordingly likely recognize capital gain or loss on each rebalancing date equal to the difference between the holder's tax basis in the notes (which would be adjusted to take into account any prior recognition of gain or loss) and the fair market value of the notes on such date.

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Non-U.S. Holders

Except as discussed below, a Non-U.S. Holder generally will not be subject to U.S. federal income or withholding tax for amounts paid in respect of the notes provided that the Non-U.S. Holder complies with applicable certification requirements and that the payment is not effectively connected with the conduct by the Non-U.S. Holder of a U.S. trade or business. Notwithstanding the foregoing, gain from the sale or exchange of the notes or their settlement at maturity may be subject to U.S. federal income tax if that Non-U.S. Holder is a non-resident alien individual and is present in the U.S. for 183 days or more during the taxable year of the sale, exchange or settlement and certain other conditions are satisfied.

If a Non-U.S. Holder of the notes is engaged in the conduct of a trade or business within the U.S. and if gain realized on the settlement at maturity, or upon sale or exchange of the notes, is effectively connected with the conduct of such trade or business (and, if certain tax treaties apply, is attributable to a permanent establishment maintained by the Non-U.S. Holder in the U.S.), the Non-U.S. Holder, although exempt from U.S. federal withholding tax, generally will be subject to U.S. federal income tax on such gain on a net income basis in the same manner as if it were a U.S. Holder. Such Non-U.S. Holders should read the material under the heading "—U.S. Holders," for a description of the U.S. federal income tax consequences of acquiring, owning, and disposing of the notes. In addition, if such Non-U.S. Holder is a foreign corporation, it may also be subject to a branch profits tax equal to 30% (or such lower rate provided by any applicable tax treaty) of a portion of its earnings and profits for the taxable year that are effectively connected with its conduct of a trade or business in the U.S., subject to certain adjustments.

A "dividend equivalent" payment is treated as a dividend from sources within the United States and such payments generally would be subject to a 30% U.S. withholding tax if paid to a Non-U.S. Holder. Under U.S. Treasury Department regulations, payments (including deemed payments) with respect to equity-linked instruments ("ELIs") that are "specified ELIs" may be treated as dividend equivalents if such specified ELIs reference an interest in an "underlying security," which is generally any interest in an entity taxable as a corporation for U.S. federal income tax purposes, if a payment with respect to such interest could give rise to a U.S. source dividend. However, IRS guidance provides that withholding on dividend equivalent payments will not apply to specified ELIs that are not delta-one instruments and that are issued before January 1, 2021. Based on our determination that the notes are not delta-one instruments, Non-U.S. Holders should not be subject to withholding on dividend equivalent payments, if any, under the notes. However, it is possible that the notes could be treated as deemed reissued for U.S. federal income tax purposes upon the occurrence of certain events affecting the Underlying or the notes, and following such occurrence the notes could be treated as subject to withholding on dividend equivalent payments. Non-U.S. Holders that enter, or have entered, into other transactions in respect of the Underlying or the notes should consult their tax advisors as to the application of the dividend equivalent withholding tax in the context of the notes and their other transactions. If any payments are treated as dividend equivalents subject to withholding, we (or the applicable paying agent) would be entitled to withhold taxes without being required to pay any additional amounts with respect to amounts so withheld.

As discussed above, alternative characterizations of the notes for U.S. federal income tax purposes are possible. Should an alternative characterization, by reason of change or clarification of the law, by regulation or otherwise, cause payments as to the notes to become subject to withholding tax, tax will be withheld at the applicable statutory rate. As discussed above, the IRS has indicated in the Notice that it is considering whether income in respect of instruments such as the notes should be subject to withholding tax. Prospective Non-U.S. Holders should consult their own tax advisors regarding the tax consequences of such alternative characterizations.

U.S. Federal Estate Tax. Under current law, while the matter is not entirely clear, individual Non-U.S. Holders, and entities whose property is potentially includible in those individuals' gross estates for U.S. federal estate tax purposes (for example, a trust funded by such an individual and with respect to which the individual has retained certain interests or powers), should note that, absent an applicable treaty benefit, a note is likely to be treated as U.S. situs property, subject to U.S. federal estate tax. These individuals and entities should consult their own tax advisors regarding the U.S. federal estate tax consequences of investing in a note.

Backup Withholding and Information Reporting

Please see the discussion under "U.S. Federal Income Tax Considerations — Taxation of Debt Securities — Backup Withholding and Information Reporting" in the accompanying prospectus for a description of the applicability of the backup withholding and information reporting rules to payments made on the notes.

Foreign Account Tax Compliance Act ("FATCA")

The discussion in the accompanying prospectus under "U.S. Federal Income Tax Considerations – Foreign Account Tax Compliance Act" is hereby modified to reflect regulations proposed by the Treasury Department indicating its intent to eliminate the requirements under FATCA of withholding on gross proceeds from the sale, exchange, maturity or other disposition of relevant financial instruments. The Treasury Department has indicated that taxpayers may rely on these proposed regulations pending their finalization.