KEY ENERGY SERVICES INC
Form 10-Q
August 07, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2014

or

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 001-08038

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	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 ý

As of July 31, 2014, the number of outstanding shares of common stock of the registrant was 153,535,485.

Table of Contents

KEY ENERGY SERVICES, INC.
QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended June 30, 2014

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

In addition to statements of historical fact, this report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Statements that are not historical in nature or that relate to future events and conditions are, or may be deemed to be, forward-looking statements. These "forward-looking statements" are based on our current expectations, estimates and projections about Key Energy Services, Inc. and its wholly owned and controlled subsidiaries, our industry and management's beliefs and assumptions concerning future events and financial trends affecting our financial condition and results of operations. In some cases, you can identify these statements by terminology such as "may," "will," "should," "predicts," "expects," "believes," "anticipates," "projects," "potent "continue" or the negative of such terms and other comparable terminology. These statements are only predictions and are subject to substantial risks and uncertainties and not guarantees of performance. Future actions, events and conditions and future results of operations may differ materially from those expressed in these statements. In evaluating those statements, you should carefully consider the information above as well as the risks outlined in this report, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2013 and "Part II - Item 1A. Risk Factors" in our Quarterly Report Form 10-Q for the quarter ended March 31, 2014.

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

Table of Contents

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

	June 30, 2014 (unaudited)	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$23,448	$28,306
Accounts receivable, net of allowance for doubtful accounts of $1,671 and $766, respectively	300,733	348,966
Inventories	40,563	32,335
Other current assets	87,747	96,546
Total current assets	452,491	506,153
Property and equipment	2,593,631	2,606,738
Accumulated depreciation	(1,268,123)	(1,241,092)
Property and equipment, net	1,325,508	1,365,646
Goodwill	601,839	624,875
Other intangible assets, net	29,639	41,146
Deferred financing costs, net	12,498	13,897
Other assets	35,631	35,753
TOTAL ASSETS	$2,457,606	$2,587,470
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$65,679	$58,826
Other current liabilities	151,164	169,945
Current portion of long-term debt	—	3,573
Total current liabilities	216,843	232,344
Long-term debt	718,704	763,981
Workers' compensation, vehicular and health insurance liabilities	31,384	29,944
Deferred tax liabilities	275,557	284,453
Other non-current liabilities	26,452	25,655
Commitments and contingencies		
Equity:		
Common stock, $0.10 par value; 200,000,000 shares authorized, 153,584,564 and 152,331,006 shares issued and outstanding	15,359	15,233
Additional paid-in capital	956,849	953,306
Accumulated other comprehensive loss	(17,415)	(15,414)
Retained earnings	233,873	297,968
Total equity	1,188,666	1,251,093
TOTAL LIABILITIES AND EQUITY	$2,457,606	$2,587,470

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

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
REVENUES	$350,595	$411,390	$706,736	$839,839
COSTS AND EXPENSES:				
Direct operating expenses	262,883	287,102	521,185	586,284
Depreciation and amortization expense	52,184	58,208	103,279	112,401
General and administrative expenses	57,881	57,736	110,747	120,981
Goodwill and tradenames impairment	28,687	—	28,687	—
Operating income (loss)	(51,040)	8,344	(57,162)	20,173
Interest expense, net of amounts capitalized	13,426	13,984	26,980	27,788
Other (income) loss, net	(2,733)	430	(2,802)	(793)
Loss before income taxes	(61,733)	(6,070)	(81,340)	(6,822)
Income tax benefit	9,537	2,298	17,245	2,864
Net loss	(52,196)	(3,772)	(64,095)	(3,958)
Income attributable to noncontrolling interest	—	356	—	444
LOSS ATTRIBUTABLE TO KEY	$(52,196)	$(4,128)	$(64,095)	$(4,402)
Loss per share attributable to Key:				
Basic and diluted	$(0.34)	$(0.03)	$(0.42)	$(0.03)
Weighted average shares outstanding:				
Basic and diluted	153,496	152,384	153,157	152,175

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

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
NET LOSS	$(52,196)	$(3,772)	$(64,095)	$(3,958)
Other comprehensive income (loss):				
Foreign currency translation income (loss)	3,264	(3,848)	(2,001)	(5,366)
COMPREHENSIVE LOSS	(48,932)	(7,620)	(66,096)	(9,324)
Comprehensive (income) loss attributable to noncontrolling interest	—	(367)	—	223
COMPREHENSIVE LOSS ATTRIBUTABLE TO KEY	$(48,932)	$(7,987)	$(66,096)	$(9,101)

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

Table of Contents

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

	Six Months Ended June 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(64,095)	$(3,958)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization expense	103,279	112,401
Goodwill and tradenames impairment	28,687	—
Bad debt expense	1,151	901
Accretion of asset retirement obligations	294	305
Loss from equity method investments	79	242
Amortization of deferred financing costs and premium	1,121	1,358
Deferred income tax benefit	(7,707)	(3,085)
Capitalized interest	—	(292)
Loss on disposal of assets, net	3,452	848
Share-based compensation	7,101	9,393
Excess tax expense from share-based compensation	1,221	1,501
Changes in working capital:		
Accounts receivable	46,970	(30,449)
Other current assets	(2,419)	4,611
Accounts payable, accrued interest and accrued expenses	(13,781)	(40,457)
Share-based compensation liability awards	1,587	493
Other assets and liabilities	328	(7,131)
Net cash provided by operating activities	107,268	46,681
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(69,429)	(72,577)
Proceeds from sale of fixed assets	7,239	3,881
Proceeds from notes receivable	2,150	—
Acquisition of the 50% noncontrolling interest in Geostream	—	(14,600)
Net cash used in investing activities	(60,040)	(83,296)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(3,573)	—
Repayments of capital lease obligations	—	(379)
Proceeds from borrowings on revolving credit facility	115,000	155,000
Repayments on revolving credit facility	(160,000)	(135,000)
Payment of deferred financing costs	—	(69)
Repurchases of common stock	(2,211)	(3,134)
Excess tax expense from share-based compensation	(1,221)	(1,501)
Net cash provided by (used in) financing activities	(52,005)	14,917
Effect of changes in exchange rates on cash	(81)	484
Net decrease in cash and cash equivalents	(4,858)	(21,214)
Cash and cash equivalents, beginning of period	28,306	45,949
Cash and cash equivalents, end of period	$23,448	$24,735

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

6

Table of Contents

Key Energy Services, Inc. and Subsidiaries
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS
NOTE 1. GENERAL

Key Energy Services, Inc., and its wholly owned subsidiaries (collectively, "Key," the "Company," "we," "us," "its," and "our") provide a full range of well services to major oil companies, foreign national oil companies and independent oil and natural gas production companies. Our services include rig-based and coiled tubing-based well maintenance and workover services, well completion and recompletion services, fluid management services, fishing and rental services, and other ancillary oilfield services. Additionally, certain rigs are capable of specialty drilling applications. We operate in most major oil and natural gas producing regions of the continental United States and have operations in Mexico, Colombia, Ecuador, the Middle East and Russia. In addition, we have a technology development and control systems business based in Canada.

The accompanying unaudited condensed consolidated financial statements were prepared using generally accepted accounting principles in the United States of America ("GAAP") for interim financial information and in accordance with the rules and regulations of the Securities and Exchange Commission (the "SEC"). The condensed December 31, 2013 balance sheet was prepared from audited financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2013 (the "2013 Form 10-K"). Certain information relating to our organization and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted in this Quarterly Report on Form 10-Q. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our 2013 Form 10-K.

The unaudited condensed consolidated financial statements contained in this report include all normal and recurring material adjustments that, in the opinion of management, are necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods presented herein. The results of operations for the six months ended June 30, 2014 are not necessarily indicative of the results expected for the full year or any other interim period, due to fluctuations in demand for our services, timing of maintenance and other expenditures, and other factors.

We have evaluated events occurring after the balance sheet date included in this Quarterly Report on Form 10-Q and through the date on which the unaudited condensed consolidated financial statements were issued, for possible disclosure of a subsequent event.

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES

The preparation of these unaudited condensed consolidated financial statements requires us to develop estimates and to make assumptions that affect our financial position, results of operations and cash flows. These estimates may also impact the nature and extent of our disclosure, if any, of our contingent liabilities. Among other things, we use estimates to (i) analyze assets for possible impairment, (ii) determine depreciable lives for our assets, (iii) assess future tax exposure and realization of deferred tax assets, (iv) determine amounts to accrue for contingencies, (v) value tangible and intangible assets, (vi) assess workers' compensation, vehicular liability, self-insured risk accruals and other insurance reserves, (vii) provide allowances for our uncollectible accounts receivable, (viii) value our asset retirement obligations, and (ix) value our equity-based compensation. We review all significant estimates on a recurring basis and record the effect of any necessary adjustments prior to publication of our financial statements. Adjustments made with respect to the use of estimates relate to improved information not previously available. Because of the limitations inherent in this process, our actual results may differ materially from these estimates. We believe that the estimates used in the preparation of these interim financial statements are reasonable.

There have been no material changes or developments in our evaluation of accounting estimates and underlying assumptions or methodologies that we believe to be a "Critical Accounting Policy or Estimate" as disclosed in our 2013 Form 10-K.

Accounting Standards Adopted or Not Yet Adopted in this Report

There are no new accounting standards that have been adopted in this report.

ASU 2014-09. In May 2014, the FASB issued ASU 2014-09, Revenue from Contract with Customers (Topic 606). The objective of this ASU is to establish the principles to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue from contracts with customers. The core principle is to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for interim and annual reporting periods beginning after December 15, 2016 and must be adopted using either a full retrospective method or a modified retrospective method. We are currently evaluating the standard to determine the impact of its adoption on the consolidated financial statements.

Table of Contents

NOTE 3. ACQUISITION OF NONCONTROLLING INTERESTS

Geostream. On October 31, 2008, we acquired a 26% interest in OOO Geostream Services Group ("Geostream"), a limited liability company incorporated in the Russian Federation that provides a wide range of drilling, workover and reservoir engineering services for $17.4 million. On September 1, 2009, we acquired an additional 24% interest for $16.4 million, which brought our total investment in Geostream to 50% and provided us a controlling interest with representation on Geostream's board of directors. We accounted for the second investment as a business combination achieved in stages. The results of Geostream have been included in our consolidated financial statements since the initial acquisition date, with the portion outside of our control forming a noncontrolling interest. On April 9, 2013, we completed the acquisition of the 50% noncontrolling interest in Geostream for $14.6 million. Geostream is now our wholly owned subsidiary. This acquisition of the 50% noncontrolling interest in Geostream was accounted for as an equity transaction. Therefore, our acquisition of the non-controlling interest in Geostream in the second quarter of 2013 did not result in a gain or loss.

AlMansoori Key Energy Services, LLC. On March 7, 2010, we entered into an agreement with AlMansoori Petroleum Services, LLC ("AlMansoori") to form the joint venture AlMansoori Key Energy Services, LLC, a joint venture under the laws of Abu Dhabi, UAE. The purpose of the joint venture was to engage in conventional workover and drilling services, coiled tubing services, fishing and rental services, rig monitoring services, pipe handling services and fluids, waste treatment and handling services. Although AlMansoori held a 51% interest in the joint venture and we held a 49% interest, we held three of the five board of directors seats and a controlling financial interest. In addition, profits and losses of the joint venture were shared on equal terms and in equal amounts with AlMansoori. Because the joint venture did not have sufficient resources to carry on its activities without our financial support, we determined it to be a variable interest entity of which we were the primary beneficiary. We consolidated the entity in our financial statements. On August 5, 2013, we agreed to the dissolution of AlMansoori Key Energy Services, LLC and the acquisition of the underlying business for $5.1 million. The $5.1 million is expected to be paid in 2014 and is recorded in "Other current liabilities" in our consolidated balance sheet. The acquisition of the 51% noncontrolling interest in AlMansoori Key Energy Services, LLC was accounted for as an equity transaction therefore did not result in a gain or loss.

NOTE 4. EQUITY

A reconciliation of the total carrying amount of our equity accounts for the six months ended June 30, 2014 is as follows:

	COMMON STOCKHOLDERS						
	Common Stock						
	Number of Shares	Amount at Par	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Noncontrolling Interest	Total
	(in thousands)						
BALANCE AT DECEMBER 31, 2013	152,331	$15,233	$953,306	$ (15,414)	$297,968		