

KEY ENERGY SERVICES INC

Form 10-Q

May 13, 2016

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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Form 10-Q

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(Mark One)

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

For the Quarterly Period Ended March 31, 2016

or

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

Commission file number: 001-08038

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KEY ENERGY SERVICES, INC.

(Exact name of registrant as specified in its charter)

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Maryland

(State or other jurisdiction of  
incorporation or organization)

04-2648081

(I.R.S. Employer  
Identification No.)

1301 McKinney Street, Suite 1800, Houston, Texas 77010

(Address of principal executive offices) (Zip Code)

(713) 651-4300

(Registrant's telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer ☐

Accelerated filer ☐

☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

As of May 3, 2016, the number of outstanding shares of common stock of the registrant was 160,995,578.

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For the Quarter Ended March 31, 2016

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Statements that are not historical in nature or that relate to future events and conditions are, or may be deemed to be, forward-looking statements. These forward-looking statements are based on our current expectations, estimates and projections and management’s beliefs and assumptions concerning future events and financial trends affecting our financial condition and results of operations. In some cases, you can identify these statements by terminology such as “may,” “will,” “should,” “predicts,” “expects,” “believes,” “anticipates,” “projects,” “potential” or “continue” or the negative of these terms and other comparable terminology. These statements are only predictions and are subject to substantial risks and uncertainties and are not guarantees of performance. Future actions, events and conditions and future results of operations may differ materially from those expressed in these statements. In evaluating those statements, you should carefully consider the information above as well as the risks outlined in “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015.

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

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

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

- volatility in oil and natural gas prices;
- our ability to implement price increases or maintain pricing on our core services;
- industry capacity;
- increased labor costs or unavailability of skilled workers;
- asset impairments or other charges;
- the periodic low demand for our services and resulting operating losses and negative cash flows;
- our highly competitive industry as well as operating risks, which are primarily self-insured, and the possibility that our insurance may not be adequate to cover all of our losses or liabilities;
- the economic, political and social instability risks of doing business in certain foreign countries;
- significant costs and potential liabilities resulting from compliance with investigations relating to the possible violations the U.S. Foreign Corruption Practices Act and other applicable laws;
- our historically high employee turnover rate and our ability to replace or add workers;

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• our ability to incur debt or long-term lease obligations;

• our ability to implement technological developments and enhancements;

• significant costs and liabilities resulting from environmental, health and safety laws and regulations, including those relating to hydraulic fracturing;

• severe weather impacts on our business;

• our ability to successfully identify, make and integrate acquisitions and our ability to finance future growth of our operations or future acquisitions;

• the loss of one or more of our larger customers;

• the impact of compliance with climate change legislation or initiatives;

• our ability to generate sufficient cash flow to meet debt service obligations;

• the amount of our debt and the limitations imposed by the covenants in the agreements governing our debt, including our ability to comply with covenants under our current debt agreements;

• an increase in our debt service obligations due to variable rate indebtedness;

• our ability to receive shareholder approval at the 2016 annual meeting with respect to the reverse stock split proposal;

• the delisting of our common stock from trading on the NYSE;

• our inability to achieve our financial, capital expenditure and operational projections, including quarterly and annual projections of revenue and/or operating income and our inaccurate assessment of future activity levels, customer demand, and pricing stability which may not materialize (whether for Key as a whole or for geographic regions and/or business segments individually);

• our ability to execute our plans to withdraw from international markets outside North America;

• our ability to achieve the benefits expected from acquisition and disposition transactions;

• our ability to respond to changing or declining market conditions, including our ability to reduce the costs of labor, fuel, equipment and supplies employed and used in our businesses;

• our ability to maintain sufficient liquidity;

• the terms and conditions of any strategic transaction or alternative undertaken to restructure or refinance our indebtedness; and

• other factors affecting our business described in “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015.

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## PART I — FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

Key Energy Services, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except share amounts)

	March 31, 2016 (unaudited)	December 31, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$155,704	\$204,354
Restricted cash	18,605	—
Accounts receivable, net of allowance for doubtful accounts of \$21,526 and \$20,951, respectively	84,929	115,992
Inventories	27,056	29,395
Other current assets	67,960	70,685
Total current assets	354,254	420,426
Property and equipment	2,345,961	2,376,388
Accumulated depreciation	(1,491,385 )	(1,496,356 )
Property and equipment, net	854,576	880,032
Intangible assets, net	4,443	5,883
Other non-current assets	12,773	21,457
<b>TOTAL ASSETS</b>	<b>\$1,226,046</b>	<b>\$1,327,798</b>
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Accounts payable	\$23,022	\$30,740
Current portion of long-term debt	10,650	3,150
Other current liabilities	106,830	120,593
Total current liabilities	140,502	154,483
Long-term debt	954,719	961,700
Workers' compensation, vehicular and health insurance liabilities	24,229	26,327
Deferred tax liabilities	14,031	14,252
Other non-current liabilities	33,695	30,746
Commitments and contingencies		
Equity:		
Common stock, \$0.10 par value; 200,000,000 shares authorized, 161,020,295 and 157,543,259 shares issued and outstanding	16,102	15,754
Additional paid-in capital	965,951	966,637
Accumulated other comprehensive loss	(43,208 )	(43,740 )
Retained deficit	(879,975 )	(798,361 )
Total equity	58,870	140,290
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$1,226,046</b>	<b>\$1,327,798</b>

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

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

	Three Months Ended March 31,	
	2016	2015
REVENUES	\$111,088	\$267,799
COSTS AND EXPENSES:		
Direct operating expenses	90,598	204,530
Depreciation and amortization expense	35,752	47,211
General and administrative expenses	46,245	67,644
Impairment expense	—	21,700
Operating loss	(61,507 )	(73,286 )
Interest expense, net of amounts capitalized	21,584	13,342
Other (income) loss, net	(1,231 )	4,432
Loss before income taxes	(81,860 )	(91,060 )
Income tax benefit	246	31,384
NET LOSS	\$(81,614 )	\$(59,676 )
Loss per share:		
Basic and diluted	\$(0.51 )	\$(0.39 )
Weighted average shares outstanding:		
Basic and diluted	160,047	154,816

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

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Key Energy Services, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income

(in thousands)

(unaudited)

	Three Months Ended	
	March 31,	
	2016	2015
NET LOSS	\$(81,614)	\$(59,676)
Other comprehensive income (loss):		
Foreign currency translation income (loss)	532	(697)
COMPREHENSIVE LOSS	\$(81,082)	\$(60,373)

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



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

	Three Months Ended March 31,	
	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$(81,614 )	\$(59,676 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense	35,752	47,211
Impairment expense	—	21,700
Bad debt expense	665	1,001
Accretion of asset retirement obligations	142	152
Loss (income) from equity method investments	83	(10 )
Amortization and write-off of deferred financing costs and premium	1,306	490
Deferred income tax benefit	(252 )	(11,692 )
Loss on disposal of assets, net	1,934	2,246
Share-based compensation	2,313	3,523
Excess tax expense from share-based compensation	2,508	2,840
Changes in working capital:		
Accounts receivable	30,653	60,214
Other current assets	5,038	4,711
Accounts payable, accrued interest and accrued expenses	(20,895 )	(57,899 )
Share-based compensation liability awards	(189 )	599
Other assets and liabilities	(7,508 )	(18,074 )
Net cash used in operating activities	(30,064 )	(2,664 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(2,701 )	(18,995 )
Proceeds from sale of fixed assets	7,435	2,890
Proceeds from notes receivable	—	400
Net cash provided by (used in) investing activities	4,734	(15,705 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayments of long-term debt	(787 )	—
Restricted cash	(18,605 )	—
Proceeds from borrowings on revolving credit facility	—	91,000
Repayments on revolving credit facility	—	(61,000 )
Payment of deferred financing costs	—	(125 )
Repurchases of common stock	(143 )	(210 )
Excess tax expense from share-based compensation	(2,508 )	(2,840 )
Net cash provided by (used in) financing activities	(22,043 )	26,825
Effect of changes in exchange rates on cash	(1,277 )	159
Net increase (decrease) in cash and cash equivalents	(48,650 )	8,615
Cash and cash equivalents, beginning of period	204,354	27,304
Cash and cash equivalents, end of period	\$ 155,704	\$ 35,919

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



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Key Energy Services, Inc. and Subsidiaries

### NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

#### NOTE 1. GENERAL

Key Energy Services, Inc., and its wholly owned subsidiaries (collectively, “Key,” the “Company,” “we,” “us,” “its,” and “our”) provide a full range of well services to major oil companies, foreign national oil companies and independent oil and natural gas production companies. Our services include rig-based and coiled tubing-based well maintenance and workover services, well completion and recompletion services, fluid management services, fishing and rental services, and other ancillary oilfield services. Additionally, certain of our rigs are capable of specialty drilling applications. We operate in most major oil and natural gas producing regions of the continental United States and have operations in Mexico 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, 2015 balance sheet was prepared from audited financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2015 (the “2015 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 2015 Form 10-K.

The unaudited condensed consolidated financial statements contained in this report include all normal and recurring material adjustments that, in the opinion of management, are necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods presented herein. The results of operations for the three months ended March 31, 2016 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 2015 Form 10-K.

#### Recent Accounting Developments

ASU 2016-09. In March 2016, the FASB Issued ASU 2016-09 Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The updated guidance changes how companies account for certain aspects of share-based payment awards to employees, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU

2016-09 is effective for the Company for annual reporting periods beginning after December 15, 2016, including interim periods within those fiscal years, with early adoption permitted. We are currently evaluating the standard to determine the impact of its adoption on the consolidated financial statements.

ASU 2016-02. In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which will replace the existing lease guidance. The new standard is intended to provide enhanced transparency and comparability by requiring lessees to

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record right-of-use assets and corresponding lease liabilities on the balance sheet. Additional disclosure requirements include qualitative disclosures along with specific quantitative disclosures with the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for the Company for annual reporting periods beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The new standard is required to be applied with a modified retrospective approach to each prior reporting period presented. We are currently evaluating the standard to determine the impact of its adoption on the consolidated financial statements.

ASU 2015-17. In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes (Topic 740). The objective of this ASU is to simplify the current guidance which requires entities to separately present deferred tax assets and liabilities as current and non-current in a classified balance sheet. The new guidance will require entities to present deferred tax assets and liabilities as non-current in a classified balance sheet. ASU 2015-17 is effective for fiscal years beginning after December 15, 2016, and interim periods within those years, and may be applied either prospectively to all deferred tax assets and liabilities or retrospectively to all periods presented. We are currently evaluating the standard to determine the impact of its adoption on the consolidated financial statements.

ASU 2014-09. In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The objective of this ASU is to establish the principles to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue from contracts with customers. The core principle is to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 must be adopted using either a full retrospective method or a modified retrospective method. During a July 2015 meeting, the FASB affirmed a proposal to defer the effective date of the new revenue standard for all entities by one year. As a result, ASU 2014-09 is effective for the Company for interim and annual reporting periods beginning after December 15, 2017 with early adoption permitted for interim and annual reporting periods beginning after December 15, 2016. We are currently evaluating the standard to determine the impact of its adoption on the consolidated financial statements.

**NOTE 3. ASSETS HELD FOR SALE**

In April 2015, we announced our decision to exit markets in which we participate outside of North America. Our strategy is to sell or relocate the assets of the businesses operating in these markets. During the fourth quarter of 2015, the assets and related liabilities of our Russian business unit which is included in our International reporting segment met the criteria for assets held for sale. We expect this sale to occur by the end of 2016.

During the third quarter of 2015, certain assets of our Enhanced Oilfield Technology business unit, which is included in our Fishing and Rental reporting segment, met the criteria for assets held for sale. This sale was completed in the first quarter of 2016.

The following assets and related liabilities of our Russian business unit are classified as held for sale on our March 31, 2016 condensed consolidated balance sheet (in thousands):

## Current assets:

Cash and cash equivalents \$250

Accounts receivable 3,105

Total current assets 3,355

## Current liabilities:

Accounts payable 354

Other current liabilities 630

Total current liabilities 984

Net Assets \$2,371

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## NOTE 4. EQUITY

A reconciliation of the total carrying amount of our equity accounts for the three months ended March 31, 2016 is as follows:

	COMMON STOCKHOLDERS					
	Common Stock Number of Shares	Amount at Par	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Deficit	Total
	(in thousands)					
Balance at December 31, 2015	157,543	\$ 15,754	\$ 966,637	\$ (43,740 )	\$ (798,361)	\$ 140,290
Foreign currency translation	—	—	—	532	—	532
Common stock purchases	(449 )	(45 )	(98 )	—	—	(143 )
Share-based compensation	3,926	393	1,920	—	—	2,313
Tax expense from share-based compensation	—	—	(2,508 )	—	—	(2,508 )
Net loss	—	—	—	—	(81,614 )	(81,614 )
Balance at March 31, 2016	161,020	\$ 16,102	\$ 965,951	\$ (43,208 )	\$ (879,975)	\$ 58,870

A reconciliation of the total carrying amount of our equity accounts for three months ended March 31, 2015 is as follows:

	COMMON STOCKHOLDERS					
	Common Stock Number of Shares	Amount at Par	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total
	(in thousands)					
Balance at December 31, 2014	153,557	\$ 15,356	\$ 960,647	\$ (37,280 )	\$ 119,340	\$ 1,058,063
Foreign currency translation	—	—	—	(697 )	—	(697 )
Common stock purchases	(106 )	(11 )	(199 )	—	—	(210 )
Share-based compensation	2,517	252	2,753	—	—	3,005
Tax expense from share-based compensation	—	—	(2,840 )	—	—	(2,840 )
Net loss	—	—	—	—	(59,676 )	(59,676 )
Balance at March 31, 2015	155,968	\$ 15,597	\$ 960,361	\$ (37,977 )	\$ 59,664	\$ 997,645

## NOTE 5. OTHER BALANCE SHEET INFORMATION

The table below presents comparative detailed information about other current assets at March 31, 2016 and December 31, 2015:

	March 31, 2016	December 31, 2015
	(in thousands)	
Other current assets:		
Deferred tax assets	\$ 10,131	\$ 10,131
Prepaid current assets	21,352	23,287
Reinsurance receivable	8,165	8,409
VAT asset	12,437	12,784
Current assets held for sale	3,355	4,691
Other	12,520	11,383
Total	\$ 67,960	\$ 70,685



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The table below presents comparative detailed information about other non-current assets at March 31, 2016 and December 31, 2015:

	March 31, 2016	December 31, 2015
	(in thousands)	
Other non-current assets:		
Deferred tax assets	\$—	\$ 6,260
Reinsurance receivable	8,728	8,877
Deposits	2,578	3,463
Equity method investments	943	1,026
Non-current assets held for sale	—	1,209
Other	524	622
Total	\$12,773	\$ 21,457

The table below presents comparative detailed information about other current liabilities at March 31, 2016 and December 31, 2015:

	March 31, 2016	December 31, 2015
	(in thousands)	
Other current liabilities:		
Accrued payroll, taxes and employee benefits	\$16,657	\$ 19,578
Accrued operating expenditures	9,372	12,514
Income, sales, use and other taxes	20,083	24,833
Self-insurance reserve	27,909	30,029
Accrued interest	12,162	23,685
Accrued insurance premiums	2,344	3,588
Current liabilities held for sale	984	529
Other	17,319	5,837
Total	\$106,830	\$ 120,593

The table below presents comparative detailed information about other non-current liabilities at March 31, 2016 and December 31, 2015:

	March 31, 2016	December 31, 2015
	(in thousands)	
Other non-current liabilities:		
Asset retirement obligations	\$11,902	\$ 12,218
Environmental liabilities	4,925	5,520
Accrued rent	738	192
Accrued sales, use and other taxes	10,967	11,137
Other	5,163	1,679
Total	\$33,695	\$ 30,746



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## NOTE 6. INTANGIBLE ASSETS

The components of our other intangible assets as of March 31, 2016 and December 31, 2015 are as follows:

	March 31, 2016	December 31, 2015
	(in thousands)	
Noncompete agreements:		
Gross carrying value	\$ 1,535	\$ 1,535
Accumulated amortization	(1,338 )	(1,289 )
Net carrying value	197	246
Patents, trademarks and tradenames:		
Gross carrying value	400	1,329
Accumulated amortization	(313 )	(302 )
Net carrying value	87	1,027
Customer relationships and contracts:		
Gross carrying value	40,650	41,996
Accumulated amortization	(37,730)	(38,705 )
Net carrying value	2,920	3,291
Developed technology:		
Gross carrying value	4,778	4,778
Accumulated amortization	(3,539 )	(3,459 )
Net carrying value	1,239	1,319
Total:		
Gross carrying value	48,139	50,417
Accumulated amortization	(43,696)	(44,534 )
Net carrying value	\$4,443	\$ 5,883

The weighted average remaining amortization periods and expected amortization expense for the next five years for our definite lived intangible assets are as follows:

	Weighted average remaining amortization period (years)	Expected Amortization Expense					
		Remainder of 2016	2017	2018	2019	2020	2021
		(in thousands)					
Noncompete agreements	1.5	\$117	\$80	\$—	\$—	\$—	\$—
Trademarks	2.2	30	40	17	—	—	—
Customer relationships and contracts	3.4	929	989	431	341	230	—
Developed technology	4.0	237	316	316	243	127	—
Total expected intangible asset amortization expense		\$1,313	\$1,425	\$764	\$584	\$357	\$—

Amortization expense for our intangible assets was \$0.5 million and \$0.8 million for the three months ended March 31, 2016 and 2015, respectively.

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## NOTE 7. LONG-TERM DEBT

As of March 31, 2016 and December 31, 2015, the components of our long-term debt were as follows:

	March 31, 2016	December 31, 2015
	(in thousands)	
6.75% Senior Notes due 2021	\$675,000	\$ 675,000
Term Loan Facility due 2020	312,638	313,425
Senior Secured Credit Facility revolving loans due 2016	—	—
Debt issuance costs and unamortized premium (discount) on debt, net	(22,269 )	(23,575 )
Total	965,369	964,850
Less current portion	(10,650 )	(3,150 )
Long-term debt	\$954,719	\$ 961,700

## 6.75% Senior Notes due 2021

We have outstanding \$675.0 million of 6.75% Senior Notes due 2021 (the “2021 Notes”). The 2021 Notes are general unsecured senior obligations and are effectively subordinated to all of our existing and future secured indebtedness. The 2021 Notes are or will be jointly and severally guaranteed on a senior unsecured basis by certain of our existing and future domestic subsidiaries. Interest on the 2021 Notes is payable on March 1 and September 1 of each year. The 2021 Notes mature on March 1, 2021.

The 2021 Notes are subject to redemption at any time and from time to time at our option, in whole or in part, at the redemption prices below (expressed as percentages of the principal amount redeemed), plus accrued and unpaid interest to the applicable redemption date, if redeemed during the twelve-month period beginning on March 1 of the years indicated below:

Year	Percentage
2016	103.375 %
2017	102.250 %
2018	101.125 %
2019 and thereafter	100.000 %

If we experience a change of control, subject to certain exceptions, we must give holders of the 2021 Notes the opportunity to sell to us their 2021 Notes, in whole or in part, at a purchase price equal to 101% of the aggregate principal amount, plus accrued and unpaid interest to the date of purchase.

We are subject to certain negative covenants under the Indenture. The Indenture limits our ability to, among other things:

- incur additional indebtedness and issue preferred equity interests;
- pay dividends or make other distributions or repurchase or redeem equity interests;
- make loans and investments;
- enter into sale and leaseback transactions;
- sell, transfer or otherwise convey assets;
- create liens;
- enter into transactions with affiliates;
- enter into agreements restricting subsidiaries’ ability to pay dividends;
- designate future subsidiaries as unrestricted subsidiaries; and
- consolidate, merge or sell all or substantially all of the applicable entities’ assets.

These covenants are subject to certain exceptions and qualifications, and contain cross-default provisions relating to the covenants of our Facilities discussed below. Substantially all of the covenants will terminate before the 2021 Notes mature if one of two specified ratings agencies assigns the 2021 Notes an investment grade rating in the future and no events of default exist under the Indenture. As of March 31, 2016, the 2021 Notes were rated below investment grade. Any covenants that cease to apply to us as a result of achieving an investment grade rating will not be restored, even if the investment rating assigned to the 2021 Notes later falls below investment grade. We were in compliance

with these covenants as of March 31, 2016.

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### ABL Facility

On June 1, 2015, the Company entered into a Loan and Security Agreement (the “ABL Facility”), among the Company and Key Energy Services, LLC, as the Borrowers (collectively, the “ABL Borrowers”), certain subsidiaries of the ABL Borrowers named as guarantors therein, the financial institutions party thereto from time to time as Lenders (collectively, the “ABL Lenders”), Bank of America, N.A., as Administrative Agent for the Lenders (the “ABL Administrative Agent”), and Bank of America, N.A. and Wells Fargo Bank, National Association, as Co-Collateral Agents for the Lenders. The ABL Facility provides for aggregate initial commitments from the ABL Lenders of \$100 million (the “Commitments”) and matures on February 28, 2020.

The ABL Facility provides the ABL Borrowers with the ability to borrow up to an aggregate principal amount equal to the lesser of (i) the Commitments and (ii) the sum of (a) 85% of the value of eligible accounts receivable plus (b) 80% of the value of eligible unbilled accounts receivable, subject to a limit equal to the greater of (x) \$35 million and (y) 25% of the Commitments plus (c) certain cash and cash equivalents deposited for the benefit of the ABL Lenders, subject to a limit of \$15 million. The amount that may be borrowed under the ABL Facility is subject to reduction for certain reserves provided for by the ABL Facility. In addition, the percentages of accounts receivable and unbilled accounts receivable included in the calculation described above is subject to reduction to the extent of certain bad debt write-downs and similar amounts provided in the ABL Facility.

Borrowings under the ABL Facility bear interest, at the ABL Borrowers’ option, at a per annum rate equal to (i) LIBOR for 30, 60, 90, 180, or, with the consent of the ABL Lenders, 360 days, plus 4.5% or (ii) a base rate equal to the sum of (a) the greatest of (x) the prime rate, (y) the Federal Funds rate, plus 0.50% or (z) 30-day LIBOR, plus 1.0% plus (b) 3.5%. In addition, the ABL Facility provides for unused line fees of 1.00% to 1.25% per year, depending on utilization, letter of credit fees and certain other fees.

The ABL Facility is guaranteed by certain of the Company’s existing and future subsidiaries (the “ABL Guarantors,” and together with the ABL Borrowers, the “ABL Loan Parties”). To secure their obligations under the ABL Facility, each of the ABL Loan Parties has granted to the Administrative Agent a first-priority security interest for the benefit of the ABL Lenders in its present and future accounts receivable, inventory and related assets and proceeds of the foregoing (the “ABL Priority Collateral”). In addition, the obligations of the ABL Loan Parties under the ABL Facility are secured by second-priority liens on the Term Priority Collateral (as described below under “Term Loan Facility”).

The revolving loans under the ABL Facility may be voluntarily prepaid, in whole or in part, without premium or penalty, subject to breakage or similar costs.

The ABL Facility contains certain affirmative and negative covenants, including covenants that restrict the ability of the ABL Loan Parties to take certain actions without the permission of the ABL Lenders or as permitted under the ABL Facility including the incurrence of debt, the granting of liens, the making of investments, the payment of dividends and the sale of assets. The ABL Facility also contains a requirement that the ABL Borrowers comply with a minimum liquidity covenant, an asset coverage ratio and, during certain periods, a fixed charge coverage ratio.

Under the asset coverage ratio covenant, the ABL Borrowers must maintain an asset coverage ratio of at least 1.5 to 1.0. The asset coverage ratio is generally defined as the ratio of (i) the sum of (a) the value of the Term Priority Collateral plus (b) certain cash and cash equivalents in excess of \$100 million held for the benefit of the Term Loan Lenders to (ii) the sum of (a) the amount outstanding under the Term Loan Facility and, following repayment of the Term Loan Facility, the amount outstanding under the ABL Facility, plus (b) the amount of any fine or settlement in respect of the FCPA Matter (as defined in the ABL Facility) that is secured by a lien on the ABL Priority Collateral or the Term Priority Collateral (the “Asset Coverage Ratio”).

Under the fixed charge coverage ratio covenant, the ABL Borrowers must maintain a fixed charge coverage ratio of at least 1.0 to 1.0 during the period commencing on the day that availability under the ABL Facility is less than the greater of \$20 million and 20% of the Commitments and continuing until the 90th day following the day that availability under the ABL Facility is greater than the greater of \$20 million and 20% of the Commitments. The fixed charge coverage ratio is generally defined as the ratio of (i) EBITDA minus certain capital expenditures and cash taxes paid to (ii) the sum of cash interest expenses, scheduled principal payments on borrowed money and certain distributions. The ABL Facility permits the ABL Borrowers, in calculating EBITDA, to add back certain amounts in respect of the investigatory expenses associated with the FCPA Matter and amounts paid in settlement of the FCPA

Matter to the extent such amounts do not exceed net liquidity, defined as certain cash and cash equivalents minus the principal amount of loans outstanding under the ABL Facility.

Under the minimum liquidity covenant (the “Minimum Liquidity Covenant”), the ABL Borrowers must not permit Liquidity, defined as the sum of (i) availability under the ABL Facility plus (ii) certain unrestricted cash and cash equivalents, to be less than \$100.0 million as of the last day of any fiscal quarter or immediately after any cash payment of a settlement of, or fine in connection with, the FCPA Matter.

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The ABL Facility contains customary representations and warranties and conditions to borrowing, including the absence of any default or event of default, the accuracy in all material respects of the representations and warranties of the ABL Loan Parties contained in the ABL Facility and the absence of any event or circumstance that has or could reasonably be expected to have a material adverse effect.

The ABL Facility contains customary events of default, the occurrence of which entitle the ABL Lenders to accelerate the maturity of amounts outstanding under the ABL Facility and exercise other customary remedies including an event of default that is triggered if, immediately after any cash payment of a settlement of the FCPA Matter (and after any cash or borrowings under the ABL Facility are used to fund such payment), (i) the Company shall fail to be in compliance with the Minimum Liquidity Covenant or (ii) if any loans under the ABL Facility are outstanding on the date of such cash payment, availability under the ABL Facility is less than 33% of the borrowing base in effect on such date.

As of March 31, 2016, we have no borrowings outstanding under the ABL Facility and \$45.8 million of letters of credit outstanding with borrowing capacity of \$25.9 million available subject to covenant constraints under our ABL Facility.

### Term Loan Facility

On June 1, 2015, the Company entered into a Term Loan and Security Agreement (the “Term Loan Facility”), among the Company, as Borrower, certain subsidiaries of the Company named as guarantors therein, the financial institutions party thereto from time to time as Lenders (collectively, the “Term Loan Lenders”), Cortland Capital Market Services LLC, as Agent for the Lenders (the “Term Loan Administrative Agent”), and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Sole Lead Arranger and Sole Bookrunner.

On June 1, 2015, the Company and other parties thereto closed on the Term Loan Facility, the Company borrowed \$315 million (prior to giving effect to an upfront discount of 3% which resulted in net proceeds to the Company, prior to expenses, of approximately \$305.5 million), and the Company used a portion of such proceeds to repay its prior credit facility. The Term Loan Facility provides for an incremental facility which, subject to the agreement of one or more Term Loan Lenders or other institutional lenders agreeing to provide the additional loans and the satisfaction of certain terms and conditions, would enable the Company to borrow additional amounts under the Term Loan Facility as long as the aggregate outstanding amount of all borrowings thereunder does not exceed \$400 million. The Term Loan Facility will mature on June 1, 2020, although such maturity date may, at the Company’s request, be extended by one or more of the Term Loan Lenders pursuant to the terms of the Term Loan Facility.

Borrowings under the Term Loan Facility bear interest, at the Company’s option, at a per annum rate equal to (i) LIBOR for one, two, three, six, or, with the consent of the Term Loan Lenders, 12 months, plus 9.25% or (ii) a base rate equal to the sum of (a) the greatest of (x) the prime rate, (y) the Federal Funds rate, plus 0.50% and (z) 30-day LIBOR, plus 1.0% plus (b) 8.25%.

The Term Loan Facility is guaranteed by certain of the Company’s existing and future subsidiaries (the “Term Loan Guarantors,” and together with the Company, the “Term Loan Parties”). To secure their obligations under the Term Loan Facility, each of the Term Loan Parties has granted to the Agent a first-priority security interest for the benefit of the Term Loan Lenders in substantially all of each Term Loan Party’s assets other than certain excluded assets and the ABL Priority Collateral (the “Term Priority Collateral”). In addition, the obligations of the Term Loan Parties under the Term Loan Facility are secured by second-priority liens on the ABL Priority Collateral (as described above under “ABL Facility”).

The loans under the Term Loan Facility may be prepaid at the Company’s option, subject to the payment of a prepayment premium in certain circumstances as provided in the Term Loan Facility. The Company is required to make principal payments in the amount of \$787,500 per quarter commencing with the quarter ended September 30, 2015. In addition, pursuant to the Term Loan Facility, the Company must offer to prepay term loans out of the Net Cash Proceeds (as defined in the Term Loan Facility) of certain asset sales and, for each fiscal year beginning with the Company’s fiscal year ending December 31, 2015, the Company must offer to prepay term loans in an aggregate principal amount equal to 50% of the Company’s Excess Cash Flow (as defined in the Term Loan Facility) for such fiscal year. Within 30 days following any Change of Control (as defined in the Term Loan Facility), the Company must offer to prepay all term loans (i) at a price of 101% of the amount thereof if, after giving effect to such Change of

Control, the Asset Coverage Ratio is at least 1.5 to 1.0 or (ii) at a price equal to the greater of 101% of the amount thereof and the applicable prepayment premium provided for in the Term Loan Facility if, after giving effect to such Change of Control, the Asset Coverage Ratio is less than 1.5 to 1.0.

The Term Loan Facility contains customary representations and warranties and certain affirmative and negative covenants, including covenants that restrict the ability of the Term Loan Parties to take certain actions without the permission of the Term Loan Lenders or as permitted under the Term Loan Facility including the incurrence of debt, the granting of liens, the making of investments, the payment of dividends and the sale of assets. The Term Loan Facility also contains financial covenants requiring that the Company maintain an Asset Coverage Ratio of at least 1.5 to 1.0 and that Liquidity (as defined in

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the Term Loan Facility) must not be less than \$100 million as of the last day of any fiscal quarter or immediately after any cash payment of a settlement of, or fine in connection with, the FCPA Matter.

The Term Loan Facility contains events of default, the occurrence of which entitle the Term Loan Lenders to accelerate the maturity of amounts outstanding under the Term Loan Facility and exercise other customary remedies. Covenant Compliance

As of March 31, 2016, we were in compliance with the covenants under the indenture governing the 2021 Notes and under the ABL Facility and the Term Loan Facility (collectively, the “Facilities”), subject to the matter described below. In calculating the Asset Coverage Ratio under the Term Loan Facility and the ABL Facility, the value of certain of the Term Priority Collateral used in calculating the Asset Coverage Ratio is determined pursuant to an appraisal required to be obtained by the Company and provided to the Term Loan Administrative Agent and the ABL Administrative Agent (collectively, the “Administrative Agents”) in connection with the delivery to the Administrative Agents of the Company’s year-end and June 30 financial statements. In addition, the Term Loan Lenders are permitted to request an additional appraisal once each fiscal year.

Based on the appraisal obtained by the Company and delivered to the Administrative Agents with our financial statements for the year ended December 31, 2015, we were in compliance with the Asset Coverage Ratio as of March 31, 2016. However, during the first quarter of 2016, certain of the Term Loan Lenders requested a new appraisal from a different appraiser, and, based on that appraisal, certain of the Term Loan Lenders have alleged that we were not in compliance with the Asset Coverage Ratio as of March 31, 2016. Although the Company disagrees with the validity of the appraisal commissioned by the Term Loan Lenders, and has reserved certain of its rights to contest such appraisal, we entered into a Forbearance Agreement dated as of May 11, 2016 (the “Forbearance Agreement”) with certain of the Term Loan Lenders pursuant to which such lenders agreed that, subject to the terms and conditions of the Forbearance Agreement, they would forbear through June 6, 2016 from exercising remedies available to them under the Term Loan Facility as a result of our alleged non-compliance with the Asset Coverage Ratio under the Term Loan Facility. As consideration for the Term Loan Lenders’ forbearance, we prepaid \$7.5 million in principal and accrued interest under the Term Loan Facility. We also entered into a Limited Consent and Forbearance Agreement dated May 11, 2016 (the “Limited Consent”) with certain of the ABL Lenders pursuant to which such lenders consented to the prepayment we made under the Term Loan Facility and agreed to a substantially similar forbearance. The forbearance provided by the Term Loan Lenders and the ABL Lenders is subject to termination under certain circumstances, including if a default or event of default occurs under the Term Loan Facility or, in the case of the Term Loan Agreement, if we terminate discussions with the Term Loan Lenders related to the negotiation and implementation of an amendment and/or restatement of the Term Loan Facility.

In addition to entering into the Forbearance Agreement and the Limited Consent, we included additional collateral that was omitted from the Term Loan Lenders’ appraisal, and we believe that the inclusion of this additional collateral, together with the \$7.5 million prepayment made to the Term Loan Lenders, results in the cure of the alleged default, as contemplated in each facility, and our being in compliance with the Asset Coverage Ratio under both Facilities as of March 31, 2016.

### Liquidity and Capital Resources

Our ability to fund our operations, pay the principal and interest on our long-term debt and satisfy our other obligations will depend upon our available liquidity and the amount of cash flows we are able to generate from our operations. Cash used in operations was \$22.4 million during 2015 and \$30.1 million during the quarter ended March 31, 2016, and, if industry conditions do not improve, we are likely to continue to have significant negative cash flows from operations during the remainder of 2016.

We believe that our current reserves of cash and availability under our ABL facility are sufficient to finance our cash requirements for current and future operations, budgeted capital expenditures, debt service and other obligations for the next twelve months. However, in light of the current conditions in our industry, our significant negative cash flow, our high level of indebtedness and diminishing liquidity and the risk that we may be unable to remain in compliance with the financial ratios in our Facilities, we continue to analyze a variety of transactions and alternatives designed to reduce our debt and improve our liquidity, and we are in active discussions with our lenders and noteholders regarding such transactions and alternatives. No assurance can be given, however, that we will be able to implement any such



transaction or alternative, if necessary, on commercially reasonable terms or at all, and, even if we are successful in implementing a strategic transaction or alternative, such transaction or alternative may not be successful in allowing us to meet our debt obligations and improving our liquidity.

If we breach the covenants under our debt agreements or otherwise default under those agreements or if we lack sufficient liquidity to satisfy our debt or other obligations, then, in the absence of a strategic transaction or alternative, our creditors could potentially force us into bankruptcy or we could be forced to seek bankruptcy protection to restructure our business and capital structure, in which case we could be forced to liquidate our assets and may receive less than the value at which those assets are carried on our financial statements. Even if we are able to implement a strategic transaction or alternative,

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such transaction or alternative may impose onerous terms on us. Additionally, we have a significant amount of secured indebtedness that is senior to our unsecured indebtedness and a significant amount of total indebtedness that is senior to our existing common stock in our capital structure. As a result, implementation of a strategic transaction or alternative or a bankruptcy proceeding could result in a limited recovery for unsecured noteholders, if any, and place equity holders at significant risk of losing all of their interests in the Company.

Additionally, if we default under one or more of our debt agreements, the ABL Lenders will no longer be obligated to extend credit to us. Finally, access to the liquidity provided by our ABL Facility is predicated upon the absence of a default under the ABL Facility and our other debt agreements and on our ability to satisfy the conditions to borrowing, which among other things require that the representations and warranties under the ABL Facility, including representations and warranties related to our solvency and the absence of a material adverse effect, remain true and correct and that we not be in violation of any of the covenants in the ABL Facility.

The weighted average interest rates on the outstanding borrowings under the ABL Facility and Term Loan Facility for the three months ended March 31, 2016 were as follows:

	Three	
	Months	
	Ended	
	March 31,	
	2016	
	(in	
	thousands)	
ABL Facility	—	%
Term Loan Facility	10.25	%
Letter of Credit Facility		

On November 7, 2013, we entered into an uncommitted, unsecured \$15.0 million letter of credit facility to be used solely for the issuances of performance letters of credit. As of March 31, 2016, \$2.0 million of letters of credit were outstanding under the facility.

**NOTE 8. OTHER (INCOME) LOSS**

The table below presents comparative detailed information about our other income and expense, shown on the condensed consolidated statements of operations as “other (income) loss, net” for the periods indicated:

	Three Months	
	Ended March 31,	
	2016	2015
	(in thousands)	
Interest income	\$(132 )	\$(15 )
Foreign exchange (gain) loss	(252 )	1,260
Allowance for collectibility of notes receivable	—	3,950
Other, net	(847 )	(763 )
Total	\$(1,231 )	\$4,432

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### NOTE 9. INCOME TAXES

We are subject to U.S. federal income tax as well as income taxes in multiple state and foreign jurisdictions. Our effective tax rates for the three months ended March 31, 2016 and 2015 were 0.3% and 34.5%, respectively. Our effective tax rate varies due to the mix of pre-tax profit between the U.S. and international taxing jurisdictions with varying statutory rates, the impact of permanent differences, including goodwill impairment expense, and discrete tax adjustments, such as valuation allowances against deferred tax assets and tax expense or benefit recognized for uncertain tax positions. The variance between our effective rate and the U.S. statutory rate reflects international profits and losses subject to varying statutory rates, the impact of permanent items, including goodwill impairment expense and expenses subject to statutorily imposed limitations such as meals and entertainment expenses, plus the impact of state income taxes and discrete tax adjustments, such as valuation allowances against deferred tax assets and tax expense or benefit recognized for uncertain tax positions.

The Company assesses the realizability of its deferred tax assets each period by considering whether it is more likely than not that all or a portion of the deferred tax assets will not be realized. In 2015, due to the history of losses in recent years and the current downturn in the oil and gas industry, management has determined it is more likely than not that we will not be able to realize a substantial portion of our net deferred tax assets.

As of March 31, 2016 and December 31, 2015, we had \$0.4 million of unrecognized tax benefits, net of federal tax benefit, which, if recognized, would impact our effective tax rate. We recognized a tax expense of less than \$0.1 million for the three months ended March 31, 2016 and 2015, related to these items. We have substantially concluded all U.S. federal and state tax matters through the year ended December 31, 2012.

We record interest and penalties related to unrecognized tax benefits as income tax expense. We have accrued a liability of less than \$0.1 million for the payment of interest and penalties as of March 31, 2016 and December 31, 2015. We believe that it is reasonably possible that \$0.1 million of our currently remaining unrecognized tax positions, each of which is individually insignificant, may be recognized in the next twelve months as a result of a lapse of statute of limitations and settlement of ongoing audits. No release of our deferred tax asset valuation allowance was made during the three months ended March 31, 2016 and 2015.

### NOTE 10. COMMITMENTS AND CONTINGENCIES

#### Litigation

Various suits and claims arising in the ordinary course of business are pending against us. We conduct business throughout the continental United States and may be subject to jury verdicts or arbitrations that result in outcomes in favor of the plaintiffs. We are also exposed to various claims abroad. We continually assess our contingent liabilities, including potential litigation liabilities, as well as the adequacy of our accruals and our need for the disclosure of these items, if any. We establish a provision for a contingent liability when it is probable that a liability has been incurred and the amount is reasonably estimable. We have \$1.7 million of other liabilities related to litigation that is deemed probable and reasonably estimable as of March 31, 2016. We do not believe that the disposition of any of these matters will result in an additional loss materially in excess of amounts that have been recorded.

Since January 2014, the Company has been cooperating with investigations by the Department of Justice and the Securities and Exchange Commission into possible violations by the Company of the Foreign Corrupt Practices Act ("FCPA"). On April 28, 2016, the Company announced that the Department of Justice had closed its investigation and that the Department had decided to decline prosecution of the Company. In addition, the Company has been engaged in negotiations with the staff of the Division of Enforcement of the SEC in an effort to reach a resolution of the staff's investigation related to these same matters. the Company has reached an agreement in principle with the staff on the terms of a proposed offer of settlement, which must be presented to the Commission for approval. While there is no assurance that the offer of settlement will be accepted by the Commission, the Company is optimistic that the proposed resolution will become final in the second quarter of 2016. In connection with the offer of settlement, the Company has accrued a liability in the amount of \$5 million.

Between May of 2013 and June of 2014, five lawsuits (four class actions and one enforcement action) were filed in California involving alleged violations of California's wage and hour laws. In general, the lawsuits allege failure to pay wages, including overtime and minimum wages, failure to pay final wages upon employment terminations in a timely manner, failure to reimburse reasonable and necessary business expenses, failure to provide wage statements

consistent with California law, and violations of the California meal and break period laws, among other claims. Two of the five cases have been consolidated in United States District Court for the Central District of California. On December 22, 2015, that court issued an order granting in part and denying in part a class certification motion. The court certified a class of hourly paid, non-exempt oilfield employees who allege they did not receive reimbursement for all business expenses and allege they did not receive all rest breaks required by California law. The court did not determine whether Key is liable to any of the class members. Plaintiffs have moved to reconsider the class certification ruling, and the Court has taken that motion under submission. In addition, the

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parties are working on scheduling a mediation. The court in one of the remaining cases that had been stayed pending the outcome of the class certification motion recently issued an order lifting the stay, and the parties have agreed to an amended complaint. No date has been set for class certification. The fourth case is waiting for a decision regarding whether it will move forward in California state court or in federal court. The fifth case is an enforcement action for civil penalties based on California's Private Attorneys General Act, which is pending in California state court. We have investigated the claims in all five lawsuits, and intend to vigorously defend them. Because these cases are at an early stage, we cannot estimate any possible loss or range of loss.

In August 2014, two class action lawsuits were filed in the U.S. District Court, Southern District of Texas, Houston Division, individually and on behalf of all other persons similarly situated against the Company and certain officers of the Company, alleging violations of federal securities laws, specifically, violations of Section 10(b) thereunder, and Rule 10(b)-5 thereunder, and Section 20(a) of the Securities Exchange Act of 1934. Those lawsuits were styled as follows: Sean Cady, Individually and on Behalf of All Other Persons Similarly Situated v. Key Energy Services, Inc., Richard J. Alario, and J. Marshall Dodson, No. 4:14-cv-2368, filed on August 15, 2014; and Ian W. Davidson, Individually and on Behalf of All Other Persons Similarly Situated v. Key Energy Services, Inc., Richard J. Alario, and J. Marshall Dodson, No. 4:14-cv-2403, filed on August 21, 2014. On December 11, 2014, the Court entered an order that consolidated the two lawsuits into one action, along with any future filed tag-along actions brought on behalf of purchasers of Key Energy Services, Inc. common stock. The order also appointed Inter-Local Pension Fund as the lead plaintiff in the class action and approved the law firm of Spector Roseman Kodroff & Willis, P.C. as lead counsel for the consolidated class and Kendall Law Group, LLP, as local counsel for the consolidated class. The lead plaintiff filed the consolidated amended complaint on February 13, 2015. Among other changes, the consolidated amended complaint added Taylor M. Whichard III and Newton W. Wilson III as defendants, and sought to represent a class of purchasers of the Company's stock between September 4, 2012 and July 17, 2014. Defendants Key Energy Services, Inc., Richard J. Alario, J. Marshall Dodson and Newton W. Wilson III filed a Motion to Dismiss on April 14, 2015. Defendant Taylor M. Whichard III filed a Joinder in Motion and Motion to Dismiss on the same date. Lead plaintiff filed an opposition to that motion, and all defendants filed reply briefs in support of the motion. On April 1, 2016, the Court issued its Opinion and Order granting the defendants' Motion to Dismiss. The Court allowed the lead plaintiff 20 days to file another amended complaint or to inform the Court that it no longer wishes to proceed with the suit. On April 20, 2016, the lead plaintiff notified the Court that it did not intend to amend its complaint. On April 26, 2016, the Court entered a final judgment dismissing the case. The deadline for the lead plaintiff to appeal the dismissal of its suit has not yet expired. Accordingly, we cannot estimate any possible loss or range of loss.

In addition, in a letter dated September 4, 2014, a purported shareholder of the Company demanded that the Board commence an independent internal investigation into and legal proceedings against each member of the Board, a former member of the Board and certain officers of the Company for alleged violations of Maryland and/or federal law. The letter alleges that the Board and senior officers breached their fiduciary duties to the Company, including the duty of loyalty and due care, by (i) improperly accounting for goodwill, (ii) causing the Company to potentially violate the FCPA, resulting in an investigation by the SEC, (iii) causing the Company to engage in improper conduct related to the Company's Russia operations; and (iv) making false statements regarding, and failing to properly account for, certain contracts with Pemex. As described in the letter, the purported shareholder believes that the legal proceedings should seek recovery of damages in an unspecified amount allegedly sustained by the Company. The Board of Directors referred the demand letter to a special committee of the Board. We cannot predict the outcome of this matter.

In March 2015, two collective action lawsuits were filed in the Southern District of Texas, Corpus Christi Division, individually and on behalf of all others similarly situated, alleging violations of the Fair Labor Standards Act of 1938 ("FLSA"). We agreed to conditional certification in the first lawsuit and notice of the case issued to 56 putative class members. Roughly 20% of the eligible putative class members timely filed a notice of consent to join the lawsuit. We will soon begin merit-based discovery in the first lawsuit, which we expect to last at least six months. We also agreed to conditional certification in the second lawsuit and notice of the case recently issued to 14 putative class members. Nine putative class members, including the named plaintiff, have filed a notice of consent to join the lawsuit and the deadline to join expired on April 4, 2016. The parties will begin merit-based discovery in the second case soon.

Because merit based discovery has not commenced, we cannot predict the outcome of these cases at this time. Accordingly, we cannot estimate any possible loss or range of loss for either case.

In May 2015, a class and collective action lawsuit was filed in the Southern District of Texas, Houston Division, individually and on behalf of all others similarly situated, alleging violations of the FLSA and the New Mexico Minimum Wage Act. We agreed to conditional certification of a putative class and notice issued to 174 putative class members. The notice period closed in early February and roughly 15% of eligible putative class members timely filed consents to join the lawsuit. The parties will soon begin merit-based discovery in this case, which will likely last six to nine months. Because merit based discovery has not begun, we cannot predict the outcome at this time. Accordingly, we cannot estimate any possible loss or range of loss for this case.

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In November 2015, the Santa Barbara County District Attorney filed a criminal complaint against two former employees and Key, specifically alleging three counts of violations of California Labor Code section 6425(a) against Key. The complaint seeks unspecified penalties against Key related to an October 12, 2013 accident which resulted in the death of one Key employee at a drilling site near Santa Maria, California. An arraignment was held on February 10, 2016, where Key and its former employees pleaded not guilty to all charges. Because the matter is in early stages, we cannot predict the outcome at this time. Accordingly, we cannot estimate any possible loss or range of loss. On or about November 23, 2015, the North Dakota Industrial Commission (“NDIC”) filed a notice in the county of Burleigh County, ND alleging statutory violations by Key Energy Services, LLC, as operator of two salt water disposal wells in the state of North Dakota. The NDIC has pled for approximately \$888,000 in fines and costs. The Company is currently in discussions with the NDIC and is not able to estimate any possible loss or range of loss at this time.

**Self-Insurance Reserves**

We maintain reserves for workers’ compensation and vehicle liability on our balance sheet based on our judgment and estimates using an actuarial method based on claims incurred. We estimate general liability claims on a case-by-case basis. We maintain insurance policies for workers’ compensation, vehicle liability and general liability claims. These insurance policies carry self-insured retention limits or deductibles on a per occurrence basis. The retention limits or deductibles are accounted for in our accrual process for all workers’ compensation, vehicular liability and general liability claims. As of March 31, 2016 and December 31, 2015, we have recorded \$54.0 million and \$56.4 million, respectively, of self-insurance reserves related to workers’ compensation, vehicular liabilities and general liability claims. Partially offsetting these liabilities, we had \$16.9 million and \$17.3 million of insurance receivables as of March 31, 2016 and December 31, 2015, respectively. We believe that the liabilities we have recorded are appropriate based on the known facts and circumstances and do not expect further losses materially in excess of the amounts already accrued for existing claims.

**Environmental Remediation Liabilities**

For environmental reserve matters, including remediation efforts for current locations and those relating to previously disposed properties, we record liabilities when our remediation efforts are probable and the costs to conduct such remediation efforts can be reasonably estimated. As of March 31, 2016 and December 31, 2015, we have recorded \$4.9 million and \$5.5 million, respectively, for our environmental remediation liabilities. We believe that the liabilities we have recorded are appropriate based on the known facts and circumstances and do not expect further losses materially in excess of the amounts already accrued.

**NOTE 11. LOSS PER SHARE**

Basic loss per share is determined by dividing net loss attributable to Key by the weighted average number of common shares actually outstanding during the period. Diluted loss per common share is based on the increased number of shares that would be outstanding assuming conversion of potentially dilutive outstanding securities using the treasury stock and “as if converted” methods.

The components of our loss per share are as follows:

	Three Months Ended	
	March 31,	
	2016	2015
	(in thousands, except per share amounts)	

**Basic and Diluted EPS Calculation:****Numerator**

Net loss	\$ (81,614 )	\$ (59,676 )
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**Denominator**

Weighted average shares outstanding	160,047	154,816
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Basic and diluted loss per share	\$ (0.51 )	\$ (0.39 )
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Stock options and stock appreciation rights (“SARs”) are included in the computation of diluted loss per share using the treasury stock method. Restricted stock awards are legally considered issued and outstanding when granted and are

included in basic weighted average shares outstanding.

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The company has issued potentially dilutive instruments such as stock options and SARs. However, the company did not include these instruments in its calculation of diluted loss per share during the periods presented, because to include them would be anti-dilutive. The following shows potentially dilutive instruments:

	Three	
	Months	
	Ended	
	March 31,	
	2016	2015
	(in	
	thousands)	
Stock options	812	1,319
SARs	240	315

No events occurred after March 31, 2016 that would materially affect the number of weighted average shares outstanding.

**NOTE 12. SHARE-BASED COMPENSATION**

We recognized employee share-based compensation expense of \$2.4 million and \$4.1 million during the three months ended March 31, 2016 and 2015, respectively. We did not capitalize any share-based compensation during the three months ended March 31, 2016 and 2015.

The unrecognized compensation cost related to our unvested restricted stock as of March 31, 2016 is estimated to be \$4.4 million and is expected to be recognized over a weighted-average period of 1.6 years. All outstanding stock options are vested and there are no unrecognized cost related to our stock options as of March 31, 2016.

In January 2015, we issued 2.1 million performance units to our executive officers under the 2014 Plan with such material terms as set forth in the 2014 PU Award Agreement. In February 2015, we issued 0.4 million performance units to certain other employees under the 2015 PU Plan. The performance units are measured based on one three-year performance period from January 1, 2015 to December 31, 2017. The number of performance units that may be earned by a participant is determined at the end of the performance period based on the relative placement of Key's total stockholder return for that period within the peer group, as follows:

Company Placement for the Performance Period	Performance Units Earned as a Percentage of Target	
First	200	%
Second	180	%
Third	160	%
Fourth	140	%
Fifth	120	%
Sixth	100	%
Seventh	0	%
Eighth	0	%
Ninth	0	%
Tenth	0	%
Eleventh	0	%
Twelfth	0	%

If any performance units vest for a given performance period, the award holder will be paid a cash amount equal to the vested percentage of the performance units multiplied by the closing stock price of our common stock on the last trading day of the performance period. We account for the performance units as a liability-type award as they are settled in cash. As of March 31, 2016, the fair value of outstanding performance units was \$0.2 million, and is being accreted to compensation expense over the vesting terms of the awards. As of March 31, 2016, the unrecognized compensation cost related to our unvested performance units is estimated to be \$0.1 million and is expected to be recognized over a weighted-average period of 2.8 years.



Table of Contents**NOTE 13. TRANSACTIONS WITH RELATED PARTIES****Board of Director Relationships**

A member of our board of directors is the Executive Vice President, General Counsel and Chief Administrative Officer of Anadarko Petroleum Corporation (“Anadarko”), which is one of our customers. Sales to Anadarko were approximately \$1.8 million and \$5.1 million for the three months ended March 31, 2016 and 2015, respectively. Receivables outstanding from Anadarko were approximately \$0.6 million and \$0.9 million as of March 31, 2016 and December 31, 2015, respectively. Transactions with Anadarko for our services are made on terms consistent with other customers.

**NOTE 14. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS**

The following is a summary of the carrying amounts and estimated fair values of our financial instruments as of March 31, 2016 and December 31, 2015.

Cash, cash equivalents, accounts receivable, accounts payable and accrued liabilities. These carrying amounts approximate fair value because of the short maturity of the instruments or because the carrying value is equal to the fair value of those instruments on the balance sheet date.

	March 31, 2016	December 31, 2015
	Carrying Value	Carrying Value
	Fair Value	Fair Value
	(in thousands)	

**Financial liabilities:**

6.75% Senior Notes due 2021	\$675,000	\$136,755	\$675,000	\$175,568
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Term Loan Facility due 2020	312,638	312,638	313,425	313,425
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6.75% Senior Notes due 2021. The fair value of these notes are based upon the quoted market prices for those securities as of the dates indicated. The carrying value of these notes as of March 31, 2016 was \$675.0 million, and the fair value was \$136.8 million (20.3% of carrying value).

Term Loan Facility due 2020. Because the variable interest rates of these loans approximate current market rates, the fair values of the loans borrowed under this facility approximate their carrying values.

**NOTE 15. SEGMENT INFORMATION**

Our reportable business segments are U.S. Rig Services, Fluid Management Services, Coiled Tubing Services, Fishing and Rental Services and International. We also have a “Functional Support” segment associated with overhead and other costs in support of our reportable segments. Our U.S. Rig Services, Fluid Management Services, Coiled Tubing Services, Fishing and Rental Services operate geographically within the United States. The International reportable segment includes our operations in Mexico and Russia and our Canadian subsidiary. During the second half of 2015, we ceased operations in Colombia, Ecuador and the Middle East. We evaluate the performance of our segments based on gross margin measures. All inter-segment sales pricing is based on current market conditions.

**U.S. Rig Services**

Our U.S. Rig Services include the completion of newly drilled wells, workover and recompletion of existing oil and natural gas wells, well maintenance, and the plugging and abandonment of wells at the end of their useful lives. We also provide specialty drilling services to oil and natural gas producers with certain of our larger rigs that are capable of providing conventional and horizontal drilling services. Our rigs encompass various sizes and capabilities, allowing us to service all types of wells with depths up to 20,000 feet. Many of our rigs are outfitted with our proprietary KeyView® technology, which captures and reports well site operating data and provides safety control systems. We believe that this technology allows our customers and our crews to better monitor well site operations, improves efficiency and safety, and adds value to the services that we offer.

The completion and recompletion services provided by our rigs prepare wells for production, whether newly drilled, or recently extended through a workover operation. The completion process may involve selectively perforating the well casing to access production zones, stimulating and testing these zones, and installing tubular and downhole equipment. We typically provide a well service rig and may also provide other equipment to assist in the completion process. Completion services vary by well and our work may take a few days to several weeks to perform, depending on the nature of the completion.

The workover services that we provide are designed to enhance the production of existing wells and generally are more complex and time consuming than normal maintenance services. Workover services can include deepening or extending wellbores into new formations by drilling horizontal or lateral wellbores, sealing off depleted production zones and accessing previously bypassed production zones, converting former production wells into injection wells for enhanced recovery operations

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and conducting major subsurface repairs due to equipment failures. Workover services may last from a few days to several weeks, depending on the complexity of the workover.

Maintenance services provided with our rig fleet are generally required throughout the life cycle of an oil or natural gas well. Examples of these maintenance services include routine mechanical repairs to the pumps, tubing and other equipment, removing debris and formation material from wellbores, and pulling rods and other downhole equipment from wellbores to identify and resolve production problems. Maintenance services are generally less complicated than completion and workover related services and require less time to perform.

Our rig fleet is also used in the process of permanently shutting-in oil or natural gas wells that are at the end of their productive lives. These plugging and abandonment services generally require auxiliary equipment in addition to a well servicing rig. The demand for plugging and abandonment services is not significantly impacted by the demand for oil and natural gas because well operators are required by state regulations to plug wells that are no longer productive.

### Fluid Management Services

We provide transportation and well-site storage services for various fluids utilized in connection with drilling, completions, workover and maintenance activities. We also provide disposal services for fluids produced subsequent to well completion. These fluids are removed from the well site and transported for disposal in saltwater disposal wells owned by us or a third party. In addition, we operate a fleet of hot oilers capable of pumping heated fluids used to clear soluble restrictions in a wellbore. Demand and pricing for these services generally correspond to demand for our well service rigs.

### Coiled Tubing Services

Coiled Tubing Services involve the use of a continuous metal pipe spooled onto a large reel which is then deployed into oil and natural gas wells to perform various applications, such as wellbore clean-outs, nitrogen jet lifts, through-tubing fishing, and formation stimulations utilizing acid and chemical treatments. Coiled tubing is also used for a number of horizontal well applications such as milling temporary isolation plugs that separate frac zones, and various other pre- and post-hydraulic fracturing well preparation services.

### Fishing and Rental Services

We offer a full line of fishing services and rental equipment designed for use in providing both onshore and offshore drilling and workover services. Fishing services involve recovering lost or stuck equipment in the wellbore utilizing a broad array of “fishing tools.” Our rental tool inventory consists of drill pipe, tubulars, handling tools (including our patented Hydra-Walk® pipe-handling units and services), pressure-control equipment, pumps, power swivels, reversing units, foam air units, frac stack equipment used to support hydraulic fracturing operations and the associated flowback of frac fluids, proppants, oil and natural gas. We also provide well testing services.

Demand for our fishing and rental services is closely related to capital spending by oil and natural gas producers, which is generally a function of oil and natural gas prices.

### International

Our International segment includes operations in Mexico and Russia. During the second half of 2015, we ceased operations in Colombia, Ecuador and the Middle East. We provide rig-based services such as the maintenance, workover, recompletion of existing oil wells, completion of newly-drilled wells and plugging and abandonment of wells at the end of their useful lives in each of our international markets. In addition, in Mexico we provide drilling, coiled tubing, wireline and project management and consulting services. Our work in Mexico also requires us to provide third-party services, which vary in scope by project. We also have a technology development and control systems business based in Canada which is focused on the development of hardware and software related to oilfield service equipment controls, data acquisition and digital information flow.

In April 2015, we announced our decision to exit markets in which we participate outside of North America. Our strategy is to sell or relocate the assets of the businesses operating in these markets. As of December 31, 2015, we sold our subsidiary in Bahrain and certain assets in Oman, Ecuador and Colombia and are no longer operating in these markets. We are currently in discussions to sell our subsidiary in Russia.

### Functional Support

Our Functional Support segment includes unallocated overhead costs associated with administrative support for our U.S. and International reporting segments.



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## Financial Summary

The following tables set forth our unaudited segment information as of and for the three months ended March 31, 2016 and 2015 (in thousands):

As of and for the three months ended March 31, 2016

	U.S. Rig Services	Fluid Management Services	Coiled Tubing Services	Fishing and Rental Services	International	Functional Support	Reconciling (E)	Total
Revenues from external customers	\$58,988	\$ 22,670	\$9,531	\$16,283	\$ 3,616	\$ —	\$ —	\$111,088
Intersegment revenues	245	309	40	987	140	—	(1,721)	—
Depreciation and amortization	14,905	5,880	2,986	7,182	2,237	2,562	—	35,752
Other operating expenses	50,449	23,062	12,694	13,113	6,439	31,086	—	136,843
Operating loss	(6,366 )	(6,272 )	(6,149 )	(4,012 )	(5,060 )	(33,648 )	—	(61,507 )
Interest expense, net of amounts capitalized	—	—	—	—	—	21,584	—	21,584
Loss before income taxes	(6,362 )	(6,268 )	(6,076 )	(4,014 )	(4,497 )	(54,643 )	—	(81,860 )
Long-lived assets(1)	482,588	123,400	52,113	120,984	53,894	174,785	(135,972 )	871,792
Total assets	1,323,797	262,688	131,421	482,133	175,044	(737,293 )	(411,744 )	1,226,046
Capital expenditures	140	820	101	1,084	364	192	—	2,701

As of and for the three months ended March 31, 2015

	U.S. Rig Services	Fluid Management Services	Coiled Tubing Services	Fishing and Rental Services	International	Functional Support	Reconciling (E)	Total
Revenues from external customers	\$120,822	\$ 50,755	\$31,017	\$42,690	\$ 22,515	\$ —	\$ —	\$267,799
Intersegment revenues	263	308	—	1,802	1,367	542	(4,282 )	—
Depreciation and amortization	14,710	7,722	5,767	8,964	6,829	3,219	—	47,211
Impairment expense	—	—	21,700	—	—	—	—	21,700
Other operating expenses	98,112	41,557	27,372	33,782	25,297	46,054	—	272,174
Operating income (loss)	8,000	1,476	(23,822 )	(56 )	(9,611 )	(49,273 )	—	(73,286 )
Interest expense, net of amounts capitalized	—	—	—	—	—	13,342	—	13,342
Income (loss) before income taxes	8,032	1,524	(23,820 )	(226 )	(10,631 )	(65,939 )	—	(91,060 )
Long-lived assets(1)	796,710	177,308	170,972	324,197	256,741	269,613	(153,366 )	1,842,175
Total assets	1,609,337	297,450	257,599	664,370	390,886	(606,273 )	(390,969 )	2,222,400
Capital expenditures	9,661	1,294	2,114	3,495	1,366	1,065	—	18,995

(1) Long-lived assets include fixed assets, goodwill, intangibles and other non-current assets.

(2) Functional Support is geographically located in the United States.

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## NOTE 16. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

Our 2021 Notes, ABL Facility and Term Loan Facility are guaranteed by virtually all our domestic subsidiaries, all of which are wholly owned. The guarantees are joint and several, full, complete and unconditional. There are no restrictions on the ability of subsidiary guarantors to transfer funds to the parent company.

As a result of these guarantee arrangements, we are required to present the following condensed consolidating financial information pursuant to SEC Regulation S-X Rule 3-10, "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered."

## CONDENSED CONSOLIDATING UNAUDITED BALANCE SHEETS

	March 31, 2016				
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(in thousands)				
Assets:					
Current assets	\$159,025	\$132,720	\$ 62,509	\$—	\$ 354,254
Property and equipment, net	—	829,364	25,212	—	854,576
Intercompany notes and accounts receivable and investment in subsidiaries	2,061,038	1,426,173	23,085	(3,510,296 )	—
Other assets	—	14,261	2,955	—	17,216
<b>TOTAL ASSETS</b>	<b>\$2,220,063</b>	<b>\$2,402,518</b>	<b>\$ 113,761</b>	<b>\$(3,510,296)</b>	<b>\$ 1,226,046</b>
Liabilities and equity:					
Current liabilities	\$31,403	\$70,193	\$ 38,906	\$—	\$ 140,502
Long-term debt	954,719	—	—	—	954,719
Intercompany notes and accounts payable	1,162,648	2,671,057	272,137	(4,105,842 )	—
Deferred tax liabilities	6,166	—	7,865	—	14,031
Other long-term liabilities	6,273	51,087	564	—	57,924
Equity	58,854	(389,819 )			