

KEY ENERGY SERVICES INC
Form 10-Q
May 13, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the Quarterly Period Ended 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

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

Maryland 04-2648081
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

1301 McKinney Street, Suite 1800, Houston, Texas 77010
(Address of principal executive offices) (Zip Code)

(713) 651-4300
(Registrant's telephone number, including area code)

None
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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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KEY ENERGY SERVICES, INC.
 QUARTERLY REPORT ON FORM 10-Q
 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 or 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 |
|--|----------------------------------|----------------------|
| ASSETS | | |
| 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 |
| TOTAL ASSETS | \$1,226,046 | \$1,327,798 |
| LIABILITIES AND EQUITY | | |
| 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 |
| TOTAL LIABILITIES AND EQUITY | \$1,226,046 | \$1,327,798 |

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 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| 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) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| 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) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| 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

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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, | December 31, |
|----------------------------------|----------------|--------------|
| | 2016 | 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, December 31, | |
|--|------------------------|------------|
| | 2016 | 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, | December 31, |
|------------------------------------|----------------|--------------|
| | 2016 | 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, | December 31, |
|---------------------------------------|----------------|--------------|
| | 2016 | 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) |
| Denominator | | |
| Weighted average shares outstanding | 160,047 | 154,816 |
| Basic and diluted loss per share | \$ (0.51) | \$ (0.39) |

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.

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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 | Fair Value | Carrying Value | Fair Value |
| | (in thousands) | | | |

Financial liabilities:

| | | | | |
|-----------------------------|-----------|-----------|-----------|-----------|
| 6.75% Senior Notes due 2021 | \$675,000 | \$136,755 | \$675,000 | \$175,568 |
| Term Loan Facility due 2020 | 312,638 | 312,638 | 313,425 | 313,425 |

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 |
| TOTAL ASSETS | \$2,220,063 | \$2,402,518 | \$ 113,761 | \$(3,510,296) | \$ 1,226,046 |
| 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) | (205,711) | 595,546 | 58,870 |
| TOTAL LIABILITIES AND EQUITY | \$2,220,063 | \$2,402,518 | \$ 113,761 | \$(3,510,296) | \$ 1,226,046 |

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CONDENSED CONSOLIDATING BALANCE SHEETS

| | December 31, 2015 | | | | |
|--|--------------------|---------------------------|-------------------------------|----------------------|---------------------|
| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| | (in thousands) | | | | |
| Assets: | | | | | |
| Current assets | \$202,688 | \$192,083 | \$ 25,655 | \$— | \$ 420,426 |
| Property and equipment, net | — | 869,150 | 10,882 | — | 880,032 |
| Intercompany notes and accounts receivable and investment in subsidiaries | 2,107,092 | 1,226,433 | 87,435 | (3,420,960) | — |
| Other assets | — | 16,885 | 10,455 | — | 27,340 |
| TOTAL ASSETS | \$2,309,780 | \$2,304,551 | \$ 134,427 | \$(3,420,960) | \$ 1,327,798 |
| Liabilities and equity: | | | | | |
| Current liabilities | \$35,233 | \$101,594 | \$ 17,656 | \$— | \$ 154,483 |
| Long-term debt | 961,700 | — | — | — | 961,700 |
| Intercompany notes and accounts payable | 1,162,648 | 2,731,926 | 125,565 | (4,020,139) | — |
| Deferred tax liabilities | 3,658 | 15,159 | (4,565) | — | 14,252 |
| Other long-term liabilities | 6,267 | 50,229 | 577 | — | 57,073 |
| Equity | 140,274 | (594,357) | (4,806) | 599,179 | 140,290 |
| TOTAL LIABILITIES AND EQUITY | \$2,309,780 | \$2,304,551 | \$ 134,427 | \$(3,420,960) | \$ 1,327,798 |

CONDENSED CONSOLIDATING UNAUDITED STATEMENTS OF OPERATIONS

| | Three Months Ended March 31, 2016 | | | | |
|--|-----------------------------------|---------------------------|-------------------------------|--------------|--------------|
| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| | (in thousands) | | | | |
| Revenues | \$— | \$ 107,472 | \$ 3,756 | \$ (140) | \$ 111,088 |
| Direct operating expense | — | 86,807 | 3,923 | (132) | 90,598 |
| Depreciation and amortization expense | — | 34,534 | 1,218 | — | 35,752 |
| General and administrative expense | 193 | 43,598 | 2,454 | — | 46,245 |
| Operating loss | (193) | (57,467) | (3,839) | (8) | (61,507) |
| Interest expense, net of amounts capitalized | 21,584 | — | — | — | 21,584 |
| Other income, net | (645) | (143) | (558) | 115 | (1,231) |
| Loss before income taxes | (21,132) | (57,324) | (3,281) | (123) | (81,860) |
| Income tax (expense) benefit | (6) | — | 252 | — | 246 |
| Net loss | \$(21,138) | \$(57,324) | \$(3,029) | \$(123) | \$(81,614) |

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CONDENSED CONSOLIDATING UNAUDITED STATEMENTS OF OPERATIONS

| | Three Months Ended March 31, 2015 | | | | |
|--|-----------------------------------|---------------------------|-------------------------------|--------------|--------------|
| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| | (in thousands) | | | | |
| Revenues | \$— | \$ 249,407 | \$ 22,951 | \$ (4,559) | \$ 267,799 |
| Direct operating expense | — | 189,626 | 17,295 | (2,391) | 204,530 |
| Depreciation and amortization expense | — | 44,439 | 2,772 | — | 47,211 |
| General and administrative expense | 221 | 65,635 | 3,951 | (2,163) | 67,644 |
| Impairment expense | — | 21,700 | — | — | 21,700 |
| Operating loss | (221) | (71,993) | (1,067) | (5) | (73,286) |
| Interest expense, net of amounts capitalized | 13,342 | — | — | — | 13,342 |
| Other (income) loss, net | (318) | 4,041 | 709 | — | 4,432 |
| Loss before income taxes | (13,245) | (76,034) | (1,776) | (5) | (91,060) |
| Income tax benefit | 30,862 | 77 | 445 | — | 31,384 |
| Net income (loss) | \$17,617 | \$(75,957) | \$(1,331) | \$(5) | \$(59,676) |

CONDENSED CONSOLIDATING UNAUDITED STATEMENTS OF CASH FLOWS

| | Three Months Ended March 31, 2016 | | | | |
|--|-----------------------------------|---------------------------|-------------------------------|--------------|--------------|
| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| | (in thousands) | | | | |
| Net cash provided by (used in) operating activities | \$— | \$(31,902) | \$ 1,838 | \$ — | \$(30,064) |
| Cash flows from investing activities: | | | | | |
| Capital expenditures | — | (2,701) | — | — | (2,701) |
| Intercompany notes and accounts | — | 21,596 | — | (21,596) | — |
| Other investing activities, net | — | 7,435 | — | — | 7,435 |
| Net cash provided by investing activities | — | 26,330 | — | (21,596) | 4,734 |
| Cash flows from financing activities: | | | | | |
| Repayments of long-term debt | (787) | — | — | — | (787) |
| Restricted stock | (18,605) | — | — | — | (18,605) |
| Repurchases of common stock | (143) | — | — | — | (143) |
| Intercompany notes and accounts | (21,596) | — | — | 21,596 | — |
| Other financing activities, net | (2,508) | — | — | — | (2,508) |
| Net cash used in financing activities | (43,639) | — | — | 21,596 | (22,043) |
| Effect of changes in exchange rates on cash | — | — | (1,277) | — | (1,277) |
| Net increase (decrease) in cash and cash equivalents | (43,639) | (5,572) | 561 | — | (48,650) |
| Cash and cash equivalents at beginning of period | 191,065 | 10,024 | 3,265 | — | 204,354 |
| Cash and cash equivalents at end of period | \$147,426 | \$ 4,452 | \$ 3,826 | \$ — | \$ 155,704 |

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CONDENSED CONSOLIDATING UNAUDITED STATEMENTS OF CASH FLOWS

| | Three Months Ended March 31, 2015 | | | | |
|---|-----------------------------------|---------------------------|-------------------------------|--------------|--------------|
| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| | (in thousands) | | | | |
| Net cash used in operating activities | \$— | \$ (1,409) | \$ (1,255) | \$ — | \$ (2,664) |
| Cash flows from investing activities: | | | | | |
| Capital expenditures | — | (18,327) | (668) | — | (18,995) |
| Intercompany notes and accounts | — | 16,132 | — | (16,132) | — |
| Other investing activities, net | — | 3,290 | — | — | 3,290 |
| Net cash provided by (used in) investing activities | — | 1,095 | (668) | (16,132) | (15,705) |
| Cash flows from financing activities: | | | | | |
| Proceeds from borrowings on revolving credit facility | 91,000 | — | — | — | 91,000 |
| Repayments on revolving credit facility | (61,000) | — | — | — | (61,000) |
| Payment of deferred financing costs | (125) | — | — | — | (125) |
| Repurchases of common stock | (210) | — | — | — | (210) |
| Intercompany notes and accounts | (16,132) | — | — | 16,132 | — |
| Other financing activities, net | (2,840) | — | — | — | (2,840) |
| Net cash provided by financing activities | 10,693 | — | — | 16,132 | 26,825 |
| Effect of changes in exchange rates on cash | — | — | 159 | — | 159 |
| Net increase (decrease) in cash and cash equivalents | 10,693 | (314) | (1,764) | — | 8,615 |
| Cash and cash equivalents at beginning of period | 19,949 | 450 | 6,905 | — | 27,304 |
| Cash and cash equivalents at end of period | \$30,642 | \$ 136 | \$ 5,141 | \$ — | \$ 35,919 |

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

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 and Russia. In addition, we have a technology development and control systems business based in Canada. The following discussion and analysis should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and related notes as of and for the three months ended March 31, 2016 and 2015, included elsewhere herein, and the audited consolidated financial statements and notes thereto included in our 2015 Form 10-K and Part 1A. Risk Factors of our 2015 Form 10-K.

We operate in five business segments; 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 managing our U.S. and International business segments. See "Note 15. Segment Information" in "Item 1. Financial Statements" of Part I of this report for a summary of our business segments.

PERFORMANCE MEASURES

The Baker Hughes U.S. rig count data, which is publicly available on a weekly basis, is often used as an indicator of overall Exploration and Production ("E&P") company spending and broader oilfield activity. In assessing overall activity in the U.S. onshore oilfield service industry in which we operate, we believe that the Baker Hughes U.S. land drilling rig count is the best available barometer of E&P companies' capital spending and resulting activity levels. Historically, our activity levels have been highly correlated to U.S. onshore capital spending by our E&P company customers as a group.

| | WTI Cushing Oil(1) | NYMEX Henry Hub Natural Gas(1) | Average Baker Hughes U.S. Land Drilling Rigs(2) |
|----------------|--------------------|--------------------------------|---|
| 2016: | | | |
| First Quarter | \$ 33.35 | \$ 1.99 | 524 |
| 2015: | | | |
| First Quarter | \$ 48.49 | \$ 2.90 | 1,353 |
| Second Quarter | \$ 57.85 | \$ 2.75 | 876 |
| Third Quarter | \$ 46.49 | \$ 2.76 | 833 |
| Fourth Quarter | \$ 41.94 | \$ 2.12 | 744 |

(1) Represents the average of the monthly average prices for each of the periods presented. Source: EIA and Bloomberg

(2) Source: www.bakerhughes.com

Internally, we measure activity levels for our well servicing operations primarily through our rig and trucking hours. Generally, as capital spending by E&P companies increases, demand for our services also rises, resulting in increased rig and trucking services and more hours worked. Conversely, when activity levels decline due to lower spending by E&P companies, we generally provide fewer rig and trucking services, which results in lower hours worked.

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In the U.S., our rig activity occurs primarily on weekdays during daylight hours. Accordingly, we track U.S. rig activity on a “per U.S. working day” basis. Key’s U.S. working days per quarter, which exclude national holidays, are indicated in the table below. Our international rig activity and domestic trucking activity tend to occur on a 24/7 basis. Accordingly, we track our international rig activity and our domestic trucking activity on a “per calendar day” basis. The following table presents our quarterly rig and trucking hours from 2015 through the first quarter of 2016:

| | Rig Hours | | Total | Trucking Hours | Key’s U.S. Working Days(1) |
|----------------|-----------|---------------|-----------|----------------|----------------------------|
| 2016: | U.S. | International | Total | | |
| First Quarter | 153,417 | 5,715 | 159,132 | 217,429 | 63 |
| Total 2016 | 153,417 | 5,715 | 159,132 | 217,429 | 63 |
| 2015: | | | | | |
| First Quarter | 271,005 | 36,950 | 307,955 | 418,032 | 62 |
| Second Quarter | 232,169 | 25,555 | 257,724 | 342,271 | 63 |
| Third Quarter | 226,953 | 13,330 | 240,283 | 309,601 | 64 |
| Fourth Quarter | 203,252 | 8,279 | 211,531 | 247,979 | 62 |
| Total 2015 | 933,379 | 84,114 | 1,017,493 | 1,317,883 | 251 |

(1) Key’s U.S. working days are the number of weekdays during the quarter minus national holidays.

MARKET CONDITIONS AND OUTLOOK**Market and Business Conditions — Quarter Ended March 31, 2016**

Our core businesses depend on our customers’ willingness to make expenditures to produce, develop and explore for oil and natural gas. Industry conditions are influenced by numerous factors, such as the supply of and demand for oil and natural gas, domestic and worldwide economic conditions, and political instability in oil producing countries. Oil and natural gas prices began a rapid and substantial decline in the fourth quarter of 2014. Depressed commodity price conditions persisted and worsened during 2015 and that trend has continued into 2016. As a result, the rig count and demand for our products and services has declined substantially, and the prices we are able to charge our customers for our products and services have also declined substantially.

Further deterioration in oil prices early in the first quarter drove another sequential decline in oilfield services activity. While we have sought to anticipate incremental activity declines and have undertaken to reshape our organizational and cost structure to mitigate the negative impact of these declines, we have continued to experience negative operating results and cash flows from operations. During the first quarter of 2016, we recorded a net loss of \$81.6 million and had negative cash flows from operating activities of \$30.1 million. If industry conditions do not improve, we are likely to continue to suffer net losses and negative cash flows from operations.

Additionally, our liquidity declined by approximately \$50 million during the first quarter of 2016 as we made two interest payments on our outstanding debt instruments totaling approximately \$32 million and placed approximately \$19 million of cash into restricted cash in order to maintain the borrowing base under our asset-based credit facility.

Market and Business Outlook

Although oil prices have improved more recently, we have not experienced an uptick in activity levels commensurate with that of oil prices. We believe that our customers need some level of confidence that oil will stay in a reasonably economic range in order to materially resume activity. We believe that as activity picks up in the oilfield, our production services businesses will benefit from the backlog of deferred maintenance on existing wells. However, each of our customers will act independently, with different economics thresholds and spending cycles, so the timing associated with a material activity improvement is difficult to predict.

As a result, in light of the current conditions in our industry, our significant negative cash flow, our levels of indebtedness and 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 transactions and alternatives to address our level of indebtedness and liquidity. These matters are discussed more fully below under “Liquidity and

Capital Resources.”

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RESULTS OF OPERATIONS

The following table shows our consolidated results of operations for the three months ended March 31, 2016 and 2015, respectively (in thousands):

| | 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) |

Consolidated Results of Operations — Three Months Ended March 31, 2016 and 2015

Revenues

Our revenues for the three months ended March 31, 2016 decreased \$156.7 million, or 58.5%, to \$111.1 million from \$267.8 million for the three months ended March 31, 2015, due to lower spending from our customers as a result of lower oil prices. These market conditions resulted in reduced customer activity and a reduction in the price received for our services. Internationally, we had lower revenue as a result of reduced customer activity in Russia and the exit of operations in the Middle East and South America. See “Segment Operating Results — Three Months Ended March 31, 2016 and 2015” below for a more detailed discussion of the change in our revenues.

Direct Operating Expenses

Our direct operating expenses decreased \$113.9 million, to \$90.6 million (81.6% of revenues), for the three months ended March 31, 2016, compared to \$204.5 million (76.4% of revenues) for the three months ended March 31, 2015. The decrease is primarily related to a decrease in employee compensation costs, fuel expense and repair and maintenance expense as we sought to reduce our cost structure and as a result of lower activity levels.

Depreciation and Amortization Expense

Depreciation and amortization expense decreased \$11.5 million, or 24.3%, to \$35.8 million during the three months ended March 31, 2016, compared to \$47.2 million for the three months ended March 31, 2015. The decrease is primarily attributable to the impairment of certain fixed assets and decreases in capital expenditures.

General and Administrative Expenses

General and administrative expenses decreased \$21.4 million, to \$46.2 million (41.6% of revenues), for the three months ended March 31, 2016, compared to \$67.6 million (25.3% of revenues) for the three months ended March 31, 2015. The decrease is primarily due to lower employee compensation costs due to reduced staffing levels and reduction in wages and a decrease in expenses related to FCPA investigations.

Impairment Expense

No impairment was recorded during the three months ended March 31, 2016. During the three months ended March 31, 2015, we recorded a \$21.7 million impairment of goodwill in our Coiled Tubing Services segment related to the finalization of our 2014 goodwill impairment testing.

Interest Expense, Net of Amounts Capitalized

Interest expense increased \$8.2 million, or 61.8%, to \$21.6 million for the three months ended March 31, 2016, compared to \$13.3 million for the same period in 2015. The increase is primarily related to increased borrowings and interest rate under the new Term Loan Facility for the three months ended March 31, 2016 compared to the same period in 2015.

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Other (Income) Loss, Net

During the three months ended March 31, 2016, we recognized other income, net, of \$1.2 million, compared to other loss, net, of \$4.4 million for the three months ended March 31, 2015. A \$4.0 million allowance for the collectibility of our notes receivable related to the sale of our operations in Argentina was recorded in the first quarter of 2015. Our foreign exchange (gain) loss relates to U.S. dollar-denominated transactions in our foreign locations and fluctuations in exchange rates between local currencies and the U.S. dollar.

The following table summarizes the components of 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 |

Income Tax Benefit

We recorded an income tax benefit of \$0.2 million on a pre-tax loss of \$81.9 million for the three months ended March 31, 2016, compared to an income tax benefit of \$31.4 million on a pre-tax loss of \$91.1 million for the same period in 2015. Our effective tax rate was 0.3% for the three months ended March 31, 2016, compared to 34.5% for the three months ended March 31, 2015. Our effective tax rates for such periods differ from the U.S. statutory rate of 35% due to a number of factors, including the mix of profit and loss between domestic and international taxing jurisdictions and the impact of permanent items, including goodwill impairment expense and expenses subject to statutorily imposed limitations such as meals and entertainment expenses, that affect book income but do not affect taxable income and discrete tax adjustments, such as valuation allowances against deferred tax assets and tax expense or benefit recognized for uncertain tax positions.

Segment Operating Results — Three Months Ended March 31, 2016 and 2015

The following table shows operating results for each of our segments for the three months ended March 31, 2016 and 2015 (in thousands):

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 | Total |
|----------------------------------|----------------------|---------------------------------|------------------------------|--------------------------------------|---------------|-----------------------|-----------|
| Revenues from external customers | \$58,988 | \$ 22,670 | \$ 9,531 | \$16,283 | \$ 3,616 | \$ — | \$111,088 |
| Operating expenses | 65,354 | 28,942 | 15,680 | 20,295 | 8,676 | 33,648 | 172,595 |
| Operating loss | (6,366) | (6,272) | (6,149) | (4,012) | (5,060) | (33,648) | (61,507) |

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 | Total |
|----------------------------------|----------------------|---------------------------------|------------------------------|--------------------------------------|---------------|-----------------------|-----------|
| Revenues from external customers | \$120,822 | \$ 50,755 | \$31,017 | \$42,690 | \$ 22,515 | \$ — | \$267,799 |
| Operating expenses | 112,822 | 49,279 | 54,839 | 42,746 | 32,126 | 49,273 | 341,085 |
| Operating income (loss) | 8,000 | 1,476 | (23,822) | (56) | (9,611) | (49,273) | (73,286) |

U.S. Rig Services

Revenues for our U.S. Rig Services segment decreased \$61.8 million, or 51.2%, to \$59.0 million for the three months ended March 31, 2016, compared to \$120.8 million for the three months ended March 31, 2015. The decrease for this segment is primarily due to lower spending from our customers as a result of lower oil prices. These market

conditions resulted in reduced customer activity and a reduction in the price received for our services.

Operating expenses for our U.S. Rig Services segment were \$65.4 million for the three months ended March 31, 2016, which represented a decrease of \$47.5 million, or 42.1%, compared to \$112.8 million for the same period in 2015.

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expenses decreased primarily as a result of a decrease in employee compensation costs and equipment expense as we sought to reduce our cost structure and as a result of lower activity levels.

Fluid Management Services

Revenues for our Fluid Management Services segment decreased \$28.1 million, or 55.3%, to \$22.7 million for the three months ended March 31, 2016, compared to \$50.8 million for the three months ended March 31, 2015. The decrease for this segment is primarily due to lower spending from our customers as a result of lower oil prices. These market conditions resulted in reduced customer activity and a reduction in the price received for our services.

Operating expenses for our Fluid Management Services segment were \$28.9 million for the three months ended March 31, 2016, which represented a decrease of \$20.3 million, or 41.3%, compared to \$49.3 million for the same period in 2015. These expenses decreased primarily as a result of a decrease in equipment expense and employee compensation costs as we sought to reduce our cost structure and as a result of lower activity levels.

Coiled Tubing Services

Revenues for our Coiled Tubing Services segment decreased \$21.5 million, or 69.3%, to \$9.5 million for the three months ended March 31, 2016, compared to \$31.0 million for the three months ended March 31, 2015. The decrease for this segment is primarily due to lower spending from our customers as a result of lower oil prices. These market conditions resulted in reduced customer activity and a reduction in the price received for our services.

Operating expenses for our Coiled Tubing Services segment were \$15.7 million for the three months ended March 31, 2016, which represented a decrease of \$39.2 million, or 71.4%, compared to \$54.8 million for the same period in 2015. These expenses decreased primarily as a result of a decrease in employee compensation costs, repair and maintenance expense and fuel costs as we sought to reduce our cost structure and as a result of lower activity levels and no impairment expense compared to a \$21.7 million impairment in 2015.

Fishing and Rental Services

Revenues for our Fishing and Rental Services segment decreased \$26.4 million, or 61.9%, to \$16.3 million for the three months ended March 31, 2016, compared to \$42.7 million for the three months ended March 31, 2015. The decrease for this segment is primarily due to lower spending from our customers as a result of lower oil prices. These market conditions resulted in reduced customer activity and a reduction in the price received for our services.

Operating expenses for our Fishing and Rental Services segment were \$20.3 million for the three months ended March 31, 2016, which represented a decrease of \$22.5 million, or 52.5%, compared to \$42.7 million for the same period in 2015. These expenses decreased primarily as a result of a decrease in employee compensation costs, repair and maintenance expense and fuel costs as we sought to reduce our cost structure and as a result of lower activity levels.

International

Revenues for our International segment decreased \$18.9 million, or 83.9%, to \$3.6 million for the three months ended March 31, 2016, compared to \$22.5 million for the three months ended March 31, 2015. The decrease was primarily attributable to lower customer activity in Russia and the exit of operations in the Middle East and South America.

Operating expenses for our International segment decreased \$23.5 million, or 73.0%, to \$8.7 million for the three months ended March 31, 2016, compared to \$32.1 million for the three months ended March 31, 2015. These expenses decreased primarily as a result of a decrease in employee compensation costs and equipment expense, primarily due to lower activity.

Functional Support

Operating expenses for Functional Support, which represent expenses associated with managing our U.S. and International reporting segments, decreased \$15.6 million, or 31.7%, to \$33.6 million (30.3% of consolidated revenues) for the three months ended March 31, 2016 compared to \$49.3 million (18.4% of consolidated revenues) for the same period in 2015. The decrease is primarily due to lower employee compensation costs due to reduced staffing levels and a decrease in legal expenses related to the FCPA investigations.

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LIQUIDITY AND CAPITAL RESOURCES

Current Financial Condition and Liquidity

As of March 31, 2016, we had cash and cash equivalents of \$155.7 million compared to \$204.4 million as of December 31, 2015. Our working capital was \$213.8 million as of March 31, 2016, compared to \$265.9 million as of December 31, 2015. Our working capital decreased from the prior year end primarily as a result of a decrease in cash and cash equivalents and accounts receivable partially offset by a decrease in accounts payable and increase in restricted cash. Our cash balance declined by \$48.7 million during the first quarter of 2016 primarily as a result of our making two interest payments on our outstanding debt instruments totaling \$31.7 million and moving approximately \$18.6 million to restricted cash in order to maintain the borrowing base under our ABL Facility. As of March 31, 2016, we had no borrowings outstanding and \$45.8 million in committed letters of credit outstanding under our ABL Facility with borrowing capacity of \$25.9 million available subject to covenant constraints under that facility.

The following table summarizes our cash flows for the three months ended March 31, 2016 and 2015:

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2016 | 2015 |
| | (in thousands) | |
| Net cash used in operating activities | \$(30,064) | \$(2,664) |
| Cash paid for capital expenditures | (2,701) | (18,995) |
| Proceeds received from sale of fixed assets | 7,435 | 2,890 |
| Proceeds from notes receivable | — | 400 |
| 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) |
| Other financing activities, net | (2,651) | (3,050) |
| Effect of exchange rates on cash | (1,277) | 159 |
| Net increase (decrease) in cash and cash equivalents | \$(48,650) | \$8,615 |

Cash used in operating activities was \$30.1 million for the three months ended March 31, 2016 compared to cash used in operating activities of \$2.7 million for the three months ended March 31, 2015. Cash used by operating activities for the three months ended March 31, 2016 was primarily related to net loss adjusted for noncash items. Cash used by operating activities for the three months ended March 31, 2015 was primarily related to decrease in deferred tax liabilities partially offset by net loss adjusted for noncash items.

Cash provided by investing activities was \$4.7 million for three months ended March 31, 2016 compared to cash used in investing activities of \$15.7 million for three months ended March 31, 2015. Cash inflows during these periods consisted primarily of proceeds from sales of fixed assets. Cash outflows during these periods consisted primarily of capital expenditures. Our capital expenditures through March 31, 2016 primarily relate to maintenance of our equipment.

Cash used in financing activities was \$22.0 million for the three months ended March 31, 2016 compared to cash provided by financing activities of \$26.8 million for the three months ended March 31, 2015. Overall financing cash outflows for 2016 primarily relate to the increase in restricted cash. Overall financing cash inflows for 2015 primarily relate to net proceeds from the borrowings under our prior revolving credit facility.

Sources of Liquidity and Capital Resources

Our sources of liquidity include our current cash and cash equivalents, availability under our ABL Facility, and internally generated cash flows from operations. However, as discussed above, we had negative cash from operating activities of \$22.4 million during 2015 and \$30.1 million during the first quarter of 2016, and, if industry conditions do not improve or worsen, we expect to continue to experience negative cash from operations for the foreseeable future.

As of March 31, 2016, our total outstanding debt of was \$965.4 million. We have no significant maturities of debt until 2020. Interest to be paid for the remainder of 2016 related to our 2021 Notes is approximately \$23 million and is due on September 1, 2016. Mandatory principal payments for the remainder of 2016 related to our Term Loan Facility, assuming we make no optional principal payments and without giving effect to the prepayment described below under “-Covenant Compliance,” is approximately \$2.4 million. Interest on our Term Loan Facility is due each quarter and, assuming we make no

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optional principal payments on the Term Loan Facility, quarterly interest payments are expected to be approximately \$8 million.

At March 31, 2016, our annual debt maturities for our 2021 Notes and Term Loan Facility were as follows:

| Year | Principal Payments (in thousands) |
|--------------------------|---|
| 2016 | \$ 2,363 |
| 2017 | 3,150 |
| 2018 | 3,150 |
| 2019 | 3,150 |
| 2020 and thereafter | 975,825 |
| Total principal payments | \$ 987,638 |

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.

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.

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. The Forbearance Agreement and Limited Consent are filed as exhibits 10.3 and 10.4, respectively, to this Current Report on Form 10-Q and reference is hereby made to such exhibits for their complete terms.

For more information, please read “-Liquidity Outlook” below.

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.

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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.

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

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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.

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.

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

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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 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. We were in compliance with covenants of the Facilities as of March 31, 2016. As of March 31, 2016, we have no borrowings outstanding 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.

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.

Liquidity Outlook

As of March 31, 2016, we had cash and cash equivalents of \$155.7 million and borrowing capacity of \$25.9 million, subject to covenant constraints under the ABL Facility. During the first quarter, we utilized existing cash balances to fund the Company's operations as our cash flow from operations was negative \$30.1 million. 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. 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, we have had negative cash flows from operations in recent fiscal periods, conditions in our industry remain depressed and our ability to generate cash from operations and maintain availability of cash and other sources of liquidity can be affected by events beyond our control, including commodity prices, demand for our services, the valuation of our assets, costs incurred in connection with resolving our FCPA investigation and other obligations as well as prevailing economic, financial and industry conditions. Additionally, and as more fully described below, each of our

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Facilities and our Indenture contain affirmative and negative covenants, including financial ratios and tests, and if we fail to remain in compliance with those covenants, our lenders and note holders may declare us to be in default and exercise a variety of remedies against us. These covenants include, among others, covenants that restrict our ability to take certain actions without the permission of the holders of our indebtedness, including the incurrence of debt, the granting of liens, the making of investments, the payment of dividends and the sale of assets, and the financial ratios and tests include, among others, a requirement that we comply with a Minimum Liquidity Covenant, an Asset Coverage Ratio and, during certain periods, a fixed charge coverage ratio.

Our ability to satisfy required financial covenants, ratios and tests in our debt agreements can be affected by events beyond our control, including commodity prices, demand for our services, the valuation of our assets, costs incurred in connection with resolving our FCPA investigation and other obligations as well as prevailing economic, financial and industry conditions, and we can offer no assurance that we will be able to comply with such covenants or that the holders of our indebtedness will not seek to assert that we are not in compliance with our covenants. For example, as described above under “-Covenant Compliance,” certain of the Term Loan Lenders have asserted that we were not in compliance with the Asset Coverage Ratio under the Term Loan Facility as of March 31, 2016. In addition to contesting the appraisal used by certain of the Term Loan Lenders as the basis for such assertion, we believe that we have cured the alleged defaults and achieved compliance with such covenant, as contemplated by the applicable agreements, through prepaying \$7.5 million under the Term Loan Facility and including collateral that was omitted from the appraisal used by such lenders to make such assertion. Additionally, such lenders and certain of the lenders under the ABL Facility have agreed to forbear exercising remedies against us related to this alleged non-compliance through June 6, 2016.

Even though we believe we were in compliance with the Asset Coverage Ratio as of March 31, 2016, we may have difficulty complying with this and other financial ratios and tests in future periods. For example, the Term Priority Collateral includes substantially all of our operating assets, and the value of these assets is susceptible to decline during periods of low activity. If the appraised value of these assets further declines and we are unable to repay amounts outstanding under the Term Loan Facility and/or provide additional Term Priority Collateral, we may be unable to comply with the Asset Coverage Ratio in the Facilities. Likewise, we are required to maintain Liquidity (as defined in the Facilities) of not 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. If we continue to experience negative cash from operations or are required to expend cash to repay additional amounts under the Term Loan Facility or to discharge other obligations, we may be unable to maintain compliance with the Minimum Liquidity Covenant under the Facilities.

Finally, under our ABL Facility, we 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 under the ABL Facility. 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. We have generated negative EBITDA in recent fiscal periods and therefore believe that, in the absence of a significant improvement in the conditions in our industry, we would not be in compliance with the fixed charge coverage ratio if our availability were to decrease to a level that resulted in such covenant becoming applicable. Availability under the ABL Facility is influenced primarily by our use of the facility and by the level of our accounts receivable. As of March 31, 2016, we had no borrowings outstanding but had \$45.8 million of committed letters of credit outstanding, resulting in availability under the ABL Facility of \$25.9 million subject to covenant constraints under that facility. Our accounts receivable have been decreasing as a result of the conditions in our industry, and, although we have been taking steps to seek to maintain the availability under our ABL Facility, such as by depositing cash with the ABL Lenders and seeking to cash collateralize certain letters of credit, we may not be able to maintain sufficient availability to avoid the application, and a potential breach, of the fixed charge coverage ratio. A breach of any of these covenants, ratios or tests would result in a default under our indebtedness. If we default, lenders under our ABL Facility will no longer be obligated to extend credit to us and they, as well as the trustee for the 2021 Notes and the Term Loan Administrative Agent, could declare all amounts of outstanding debt together with accrued interest, to be immediately due and payable. The results of such actions would

have a significant negative impact on our financial position and liquidity, and absent strategic alternatives such as refinancing or restructuring our indebtedness or capital structure, we would not have sufficient liquidity to repay all of our outstanding indebtedness.

As a result, 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

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liquidity. If we breach the covenants under our debt agreements or if we are 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, 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, we believe that 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 our company.

In addition, 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 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.

Future Capital Requirements

During the three months ended March 31, 2016, our capital expenditures totaled \$2.7 million, primarily related to the ongoing replacement to our rig service fleet, coiled tubing units, fluid transportation equipment and rental equipment. Our capital expenditure plan for 2016 contemplates spending up to approximately \$20.0 million, subject to market conditions. This is primarily related to equipment maintenance needs. Our capital expenditure program for 2016 is subject to market conditions, including activity levels, commodity prices, industry capacity and specific customer needs. Our focus for 2016 has been and continues to be the maximization of our current equipment fleet, but we may choose to increase our capital expenditures in 2016 to increase market share or expand our presence into a new market. We may also incur capital expenditures for strategic investments and acquisitions. We currently anticipate funding our 2016 capital expenditures through a combination of cash on hand, operating cash flow, and borrowings under our ABL Facility. Should our operating cash flows or activity levels prove to be insufficient to fund our currently planned capital spending levels, management expects it will adjust our capital spending plans accordingly. We may also incur capital expenditures for strategic investments and acquisitions.

Off-Balance Sheet Arrangements

At March 31, 2016 we did not, and we currently do not, have any off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in our quantitative and qualitative disclosures about market risk from those disclosed in our 2015 Form 10-K. More detailed information concerning market risk can be found in “Item 7A. Quantitative and Qualitative Disclosures about Market Risk” in our 2015 Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, management performed, with the participation of our Chief Executive Officer and our Chief Financial Officer, an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, to allow timely decisions regarding required disclosures. Based on this evaluation, management concluded that our disclosure controls and procedures are effective as of the end of the period covered by this report.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the first quarter of 2016 that materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

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PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to various suits and claims that have arisen in the ordinary course of business. We do not believe that the disposition of any of our ordinary course litigation will result in a material adverse effect on our consolidated financial position, results of operations or cash flows. For additional information on legal proceedings, see “Note 10. Commitments and Contingencies” in “Item 1. Financial Statements” of Part I of this report, which is incorporated herein by reference.

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 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.

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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.

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.

ITEM 1A. RISK FACTORS

Reference is made to Part I, Item 1A. Risk Factors of the 2015 Form 10-K for information concerning risk factors.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

During the three months ended March 31, 2016, we repurchased the shares shown in the table below to satisfy tax withholding obligations upon the vesting of restricted stock awarded to certain of our employees:

| Period | Number of Shares Purchased | Average Price Paid per Share(1) |
|--------------------------------------|-------------------------------|------------------------------------|
| January 1, 2016 to January 31, 2016 | 150,128 | \$ 0.32 |
| February 1 2016 to February 29, 2016 | 168,576 | 0.26 |
| March 1, 2016 to March 31, 2016 | 130,335 | 0.39 |
| Total | 449,039 | \$ 0.32 |

(1) The price paid per share with respect to the tax withholding repurchases was determined using the closing prices on the applicable vesting date, as quoted on the NYSE.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The Exhibit Index, which follows the signature pages to this report and is incorporated by reference herein, sets forth a list of exhibits to this report.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: May 13, 2016 By: /s/ J. MARSHALL
DODSON
J. Marshall
Dodson
Senior Vice
President and
Chief
Financial
Officer
(As duly
authorized
officer and
Principal
Financial
Officer)

EXHIBIT INDEX

Exhibit No. Description

- 3.1 Articles of Restatement of Key Energy Services, Inc. (Incorporated by reference to Exhibit 3.1 of our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, File No. 001-08038).
- 3.2 Unanimous consent of the Board of Directors of Key Energy Services, Inc. dated January 11, 2000, limiting the designation of the additional authorized shares to common stock. (Incorporated by reference to Exhibit 3.2 of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2000, File No. 001-08038).
- 3.3 Ninth Amended and Restated By-laws of Key Energy Services, Inc. as amended through August 21, 2015. (Incorporated by reference to Exhibit 3.1 of our Current Report on Form 8-K filed on August 24, 2015, File No. 001-08038).
- 10.1† Promotion Bonus Agreement (Incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on February 18, 2016, File No. 001-08038).
- 10.2†* Robert Drummond Amended and Restated Employment Agreement.
- 10.3* Forbearance Agreement dated as of May 11, 2016, among Key Energy Services, Inc., each of the guarantors party thereto, each of the Lenders party thereto and Cortland Capital Market Services LLC, as administrative agent for the Lenders.
- 10.4* Limited Consent to Loan Agreement and Forbearance Agreement, Dated May 11, 2016, among Key Energy Services, Inc., Key Energy Services, LLC, certain subsidiaries of the Borrowers as Guarantors, Lenders and Co-Collateral Agents party thereto and Bank of America, N.A., as administrative agent for the Lenders.
- 31.1* Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2* Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32** Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101* Interactive Data File.

† Indicates a management contract or compensatory plan, contract or arrangement in which any Director or any Executive Officer participates.

* Filed herewith

**Furnished herewith