

HD Supply Holdings, Inc.
Form 10-Q
December 05, 2017
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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 October 29, 2017

- OR -

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

For the transition period from _____ to _____

Commission File
Number

Exact name of Registrant as specified in its charter, Address
of principal executive offices and Telephone number

State of incorporation I.R.S. Employer
Identification Number

001-35979

HD SUPPLY HOLDINGS, INC.

Delaware

26-0486780

3100 Cumberland Boulevard, Suite 1480

Atlanta, Georgia 30339

(770) 852-9000

333-159809

HD SUPPLY, INC.

Delaware

75-2007383

3100 Cumberland Boulevard, Suite 1480

Atlanta, Georgia 30339

(770) 852-9000

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.

HD Supply Holdings, Inc.	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>
HD Supply, Inc.	Yes <input type="checkbox"/> No <input checked="" type="checkbox"/>

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) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files).

HD Supply Holdings, Inc.	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>
HD Supply, Inc.	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act. (Check one):

HD Supply Holdings, Inc.	Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>
	Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)		
	Emerging growth company <input type="checkbox"/>		
HD Supply, Inc.	Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>
	Non-accelerated filer <input checked="" type="checkbox"/> (Do not check if a smaller reporting company)		
	Emerging growth company <input type="checkbox"/>		

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with new or revised financial accounting standards provide pursuant to Section 13(a) of the Exchange Act.

HD Supply Holdings, Inc.

HD Supply, Inc.

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

HD Supply Holdings, Inc.

Yes No

HD Supply, Inc.

Yes No

The number of shares of the Registrant's common stock outstanding as of December 1, 2017:

HD Supply Holdings, Inc.

185,678,183 shares of common stock, par value \$0.01 per share

HD Supply, Inc.

1,000 shares of common stock, par value \$0.01 per share, all of which were owned by HDS Holding Corporation, a wholly-owned subsidiary of HD Supply Holdings, Inc.

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EXPLANATORY NOTE

This Form 10-Q is a combined quarterly report being filed separately by two registrants: HD Supply Holdings, Inc. and HD Supply, Inc. Unless the context indicates otherwise, any reference in this report to Holdings refers to HD Supply Holdings, Inc., any reference to HDS refers to HD Supply, Inc., the indirect wholly-owned subsidiary of Holdings, and any references to HD Supply, the Company, we, us and our refer to HD Supply Holdings, Inc. together with its direct and indirect subsidiaries, including HDS. Each registrant hereto is filing on its own behalf all of the information contained in this quarterly report that relates to such registrant. Each registrant hereto is not filing any information that does not relate to such registrant, and therefore makes no representation as to any such information.

FORWARD-LOOKING STATEMENTS AND INFORMATION

This quarterly report includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Some of the forward-looking statements can be identified by the use of forward-looking terms such as believes, expects, may, will, should, could, intends, plans, estimates, anticipates or other comparable terms. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this report and include statements regarding our intentions, beliefs or current expectations concerning, among other things, our results of operations, financial condition, liquidity, prospects, growth strategies and the industries in which we operate.

Forward-looking statements are subject to known and unknown risks and uncertainties, many of which may be beyond our control. We caution you that forward-looking statements are not guarantees of future performance and that our actual results of operations, financial condition and liquidity, and the development of the industries in which we operate may differ materially from those made in or suggested by the forward-looking statements contained in this report. In addition, even if our results of operations, financial condition and liquidity, and the development of the industries in which we operate are consistent with the forward-looking statements contained in this report, those results or developments may not be indicative of results or developments in subsequent periods. A number of important factors could cause actual results to differ materially from those contained in or implied by the forward-looking statements, including those factors discussed in Item 1A, Risk Factors in our annual report on Form 10-K for the fiscal year ended January 29, 2017 and those described from time to time in our other filings with the U.S. Securities and Exchange Commission (the SEC). Factors that could cause actual results to differ from those reflected in forward-looking statements relating to our results of operations, financial condition and liquidity, and the development of industries in which we operate include:

- inherent risks of the maintenance, repair and operations market and the non-residential and residential construction markets;
- our ability to maintain profitability;
- our ability to service our debt and to refinance all or a portion of our indebtedness;

- limitations and restrictions in the agreements governing our indebtedness;
- the competitive environment in which we operate and demand for our products and services in highly competitive and fragmented industries;
- the loss of any of our significant customers;
- competitive pricing pressure from our customers;
- our ability to identify and acquire suitable acquisition candidates on favorable terms;
- cyclical and seasonality of the maintenance, repair and operations market and the non-residential and residential construction markets;

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- our ability to identify and develop relationships with a sufficient number of qualified suppliers and to maintain our supply chains;
- our ability to manage fixed costs;
- the development of alternatives to distributors in the supply chain;
- our ability to manage our working capital through product purchasing and customer credit policies;
- potential material liabilities under our self-insured programs;
- our ability to attract, train and retain highly qualified associates and key personnel;
- risks related to legal proceedings to which we are a party, including existing securities and shareholder derivative lawsuits;
- limitations on our income tax net operating loss carryforwards in the event of an ownership change; and
- our ability to identify and integrate new products.

You should read this report completely and with the understanding that actual future results may be materially different from expectations. All forward-looking statements made in this report are qualified by these cautionary statements. These forward-looking statements are made only as of the date of this report and we do not undertake any obligation, other than as may be required by law, to update or revise any forward-looking statements to reflect changes in assumptions, the occurrence of unanticipated events, changes in future operating results over time or otherwise. Comparisons of results for current and any prior periods are not intended to express any future trends or indications of future performance, unless expressed as such, and should only be viewed as historical data.

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****HD SUPPLY HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME***Amounts in millions, except share and per share data, unaudited*

	Three Months Ended		Nine Months Ended	
	October 29, 2017	October 30, 2016	October 29, 2017	October 30, 2016
Net Sales	\$ 1,370	\$ 1,275	\$ 3,938	\$ 3,734
Cost of sales	828	763	2,373	2,240
Gross Profit	542	512	1,565	1,494
Operating expenses:				
Selling, general and administrative	336	329	1,008	954
Depreciation and amortization	21	21	63	63
Restructuring	3	3	3	14
Total operating expenses	360	353	1,074	1,031
Operating Income	182	159	491	463
Interest expense	36	65	134	219
Interest income	(1)		(1)	
Loss on extinguishment & modification of debt	78	59	81	174
Income from Continuing Operations Before Provision for Income Taxes	69	35	277	70
Provision for income taxes	23	15	92	30
Income from Continuing Operations	46	20	185	40
Income from discontinued operations, net of tax	406	40	794	104
Net Income	\$ 452	\$ 60	\$ 979	\$ 144
Other comprehensive income (loss) foreign currency translation adjustment	1	(1)	(1)	1
Total Comprehensive Income	\$ 453	\$ 59	\$ 978	\$ 145
Weighted Average Common Shares Outstanding (thousands)				
Basic	185,651	199,593	194,704	199,217
Diluted	186,652	202,007	196,258	201,786
Basic Earnings Per Share(I):				
Income from Continuing Operations	\$ 0.25	\$ 0.10	\$ 0.95	\$ 0.20
Income from Discontinued Operations	\$ 2.19	\$ 0.20	\$ 4.08	\$ 0.52
Net Income	\$ 2.43	\$ 0.30	\$ 5.03	\$ 0.72
Diluted Earnings Per Share(I):				
Income from Continuing Operations	\$ 0.25	\$ 0.10	\$ 0.94	\$ 0.20
Income from Discontinued Operations	\$ 2.18	\$ 0.20	\$ 4.05	\$ 0.52

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Net Income	\$	2.42	\$	0.30	\$	4.99	\$	0.71
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(1) *May not foot due to rounding.*

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**HD SUPPLY HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS***Amounts in millions, except share and per share data, unaudited*

	October 29, 2017	January 29, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 461	\$ 75
Receivables, less allowance for doubtful accounts of \$11 and \$9	689	559
Inventories	662	606
Current assets of discontinued operations		575
Other current assets	38	32
Total current assets	1,850	1,847
Property and equipment, net	298	253
Goodwill	1,807	1,807
Intangible assets, net	93	102
Deferred tax asset	298	556
Non-current assets of discontinued operations		1,122
Other assets	19	20
Total assets	\$ 4,365	\$ 5,707
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 405	\$ 320
Accrued compensation and benefits	84	98
Current installments of long-term debt	11	14
Current liabilities of discontinued operations		259
Other current liabilities	161	152
Total current liabilities	661	843
Long-term debt, excluding current installments	2,087	3,798
Non-current liabilities of discontinued operations		20
Other liabilities	123	86
Total liabilities	2,871	4,747
Stockholders equity:		
Common stock, par value \$0.01; 1 billion shares authorized; 186.3 million and 201.4 million shares issued and outstanding at October 29, 2017 and January 29, 2017, respectively	2	2
Paid-in capital	4,018	3,962
Accumulated deficit	(1,956)	(2,969)
Accumulated other comprehensive loss	(16)	(15)
Treasury stock, at cost, 17.4 million and 0.6 million shares at October 29, 2017 and January 29, 2017, respectively	(554)	(20)
Total stockholders equity	1,494	960
Total liabilities and stockholders equity	\$ 4,365	\$ 5,707

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**HD SUPPLY HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS***Amounts in millions, unaudited*

	Nine Months Ended	
	October 29, 2017	October 30, 2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 979	\$ 144
Reconciliation of net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	73	76
Provision for uncollectibles	6	5
Non-cash interest expense	11	13
Payment of discounts upon extinguishment of debt	(6)	
Loss on extinguishment & modification of debt	81	174
Stock-based compensation expense	19	15
Deferred income taxes	316	93
(Gain) loss on sales of businesses, net	(930)	7
Other		(2)
Changes in assets and liabilities, net of the effects of acquisitions & dispositions:		
(Increase) decrease in receivables	(249)	(236)
(Increase) decrease in inventories	(116)	(119)
(Increase) decrease in other current assets	1	
(Increase) decrease in other assets	1	
Increase (decrease) in accounts payable and accrued liabilities	132	134
Increase (decrease) in other long-term liabilities	2	
Net cash provided by (used in) operating activities	320	304
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(65)	(59)
Proceeds from sales of property and equipment	2	2
Proceeds from sales of businesses, net	2,450	28
Net cash provided by (used in) investing activities	2,387	(29)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock under employee benefit plans	37	23
Purchase of treasury shares	(555)	(24)
Borrowings of long-term debt	113	1,547
Repayments of long-term debt	(1,526)	(2,435)
Borrowings on long-term revolver debt	624	510
Repayments on long-term revolver debt	(989)	
Debt issuance costs	(26)	(19)
Other financing activities	1	(1)
Net cash provided by (used in) financing activities	(2,321)	(399)
Effect of exchange rates on cash and cash equivalents		1
Increase (decrease) in cash and cash equivalents	\$ 386	\$ (123)
Cash and cash equivalents at beginning of period	75	269
Cash and cash equivalents at end of period	\$ 461	\$ 146

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**HD SUPPLY, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME***Amounts in millions, unaudited*

	Three Months Ended		Nine Months Ended	
	October 29, 2017	October 30, 2016	October 29, 2017	October 30, 2016
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Cost of sales	828	763	2,373	2,240
Gross Profit	542	512	1,565	1,494
Operating expenses:				
Selling, general and administrative	336	329	1,008	954
Depreciation and amortization	21	21	63	63
Restructuring	3	3	3	14
Total operating expenses	360	353	1,074	1,031
Operating Income	182	159	491	463
Interest expense	36	65	134	219
Interest income	(1)		(1)	
Loss on extinguishment & modification of debt	78	59	81	174
Income from Continuing Operations Before Provision for Income Taxes	69	35	277	70
Provision for income taxes	23	15	92	30
Income from Continuing Operations	46	20	185	40
Income from discontinued operations, net of tax	406	40	794	104
Net Income	\$ 452	\$ 60	\$ 979	\$ 144
Other comprehensive income (loss) foreign currency translation adjustment	1	(1)	(1)	1
Total Comprehensive Income	\$ 453	\$ 59	\$ 978	\$ 145

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**HD SUPPLY, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS***Amounts in millions, except share and per share data, unaudited*

	October 29, 2017	January 29, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 461	\$ 73
Receivables, less allowance for doubtful accounts of \$11 and \$9	689	559
Inventories	662	606
Current assets of discontinued operations		575
Other current assets	37	32
Total current assets	1,849	1,845
Property and equipment, net	298	253
Goodwill	1,807	1,807
Intangible assets, net	93	102
Deferred tax asset	298	556
Non-current assets of discontinued operations		1,122
Other assets	19	20
Total assets	\$ 4,364	\$ 5,705
LIABILITIES AND STOCKHOLDER S EQUITY		
Current liabilities:		
Accounts payable	\$ 405	\$ 320
Accrued compensation and benefits	84	98
Current installments of long-term debt	11	14
Current liabilities of discontinued operations		259
Other current liabilities	159	152
Total current liabilities	659	843
Long-term debt, excluding current installments	2,087	3,798
Non-current liabilities of discontinued operations		20
Other liabilities	123	86
Total liabilities	2,869	4,747
Stockholder s equity:		
Common stock, par value \$0.01; authorized 1,000 shares; issued and outstanding 1,000 shares at October 29, 2017 and January 29, 2017		
Paid-in capital	3,308	3,806
Accumulated deficit	(1,797)	(2,833)
Accumulated other comprehensive loss	(16)	(15)
Total stockholder s equity	1,495	958
Total liabilities and stockholder s equity	\$ 4,364	\$ 5,705

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**HD SUPPLY, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS***Amounts in millions, unaudited*

	Nine Months Ended	
	October 29, 2017	October 30, 2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 979	\$ 144
Reconciliation of net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	73	76
Provision for uncollectibles	6	5
Non-cash interest expense	11	13
Payment of discounts upon extinguishment of debt	(6)	
Loss on extinguishment & modification of debt	81	174
Stock-based compensation expense	19	15
Deferred income taxes	316	93
(Gain) loss on sales of businesses, net	(930)	7
Other		(2)
Changes in assets and liabilities, net of the effects of acquisitions & dispositions:		
(Increase) decrease in receivables	(249)	(236)
(Increase) decrease in inventories	(116)	(119)
(Increase) decrease in other current assets	1	
(Increase) decrease in other assets	1	
Increase (decrease) in accounts payable and accrued liabilities	132	134
Increase (decrease) in other long-term liabilities	2	
Net cash provided by (used in) operating activities	320	304
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(65)	(59)
Proceeds from sales of property and equipment	2	2
Proceeds from sales of businesses, net	2,450	28
Net cash provided by (used in) investing activities	2,387	(29)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Equity distribution	(516)	
Borrowings of long-term debt	113	1,547
Repayments of long-term debt	(1,526)	(2,435)
Borrowings on long-term revolver debt	624	510
Repayments on long-term revolver debt	(989)	
Debt issuance costs	(26)	(19)
Other financing activities	1	(1)
Net cash provided by (used in) financing activities	(2,319)	(398)
Effect of exchange rates on cash and cash equivalents		1
Increase (decrease) in cash and cash equivalents	\$ 388	\$ (122)
Cash and cash equivalents at beginning of period	73	266
Cash and cash equivalents at end of period	\$ 461	\$ 144

The accompanying notes are an integral part of these consolidated financial statements.

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HD SUPPLY HOLDINGS, INC. AND SUBSIDIARIES

HD SUPPLY, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 NATURE OF BUSINESS AND BASIS OF PRESENTATION

Nature of Business

HD Supply Holdings, Inc. (Holdings) indirectly owns all of the outstanding common stock of HD Supply, Inc. (HDS).

Holdings, together with its direct and indirect subsidiaries, including HDS (HD Supply or the Company), is one of the largest industrial distribution companies in North America. The Company specializes in two distinct market sectors: Maintenance, Repair & Operations and Specialty Construction. Through approximately 220 branches and 44 distribution centers, in the U.S. and Canada, the Company serves these markets with an integrated go-to-market strategy. HD Supply has approximately 11,000 associates delivering localized, customer-tailored products, services and expertise. The Company serves approximately 500,000 customers, which include contractors, maintenance professionals, industrial businesses, and government entities. HD Supply's broad range of end-to-end product lines and services includes approximately 500,000 stock-keeping units (SKUs) of quality, name-brand and proprietary-brand products as well as value-add services supporting the entire life-cycle of a project from construction to maintenance, repair and operations.

HD Supply is managed primarily on a product line basis and reports results of operations in two reportable segments: Facilities Maintenance and Construction & Industrial. In addition, the consolidated financial statements include Corporate, which is comprised of enterprise-wide functional departments.

See Note 2 Discontinued Operations for further information on the sale of the Waterworks business.

Basis of Presentation

In management's opinion, the unaudited financial information for the interim periods presented includes all adjustments necessary for a fair statement of the results of operations, financial position, and cash flows. All adjustments are of a normal recurring nature unless otherwise disclosed. Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year. For a more complete discussion of the Company's significant accounting policies and other information, you should read this report in conjunction with the Company's annual report on Form 10-K for the year ended

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January 29, 2017, which includes all disclosures required by generally accepted accounting principles in the United States of America (GAAP).

Fiscal Year

HD Supply s fiscal year is a 52- or 53-week period ending on the Sunday nearest to January 31. Fiscal years ending January 28, 2018 (fiscal 2017) and January 29, 2017 (fiscal 2016) both include 52 weeks. The three months ended October 29, 2017 (third quarter 2017) and October 30, 2016 (third quarter 2016) both include 13 weeks. The nine months ended October 29, 2017 and October 30, 2016 both include 39 weeks.

Principles of Consolidation

The consolidated financial statements of Holdings present the results of operations, financial position and cash flows of Holdings and its wholly-owned subsidiaries, including HDS. The consolidated financial statements of HDS present the results of operations, financial position and cash flows of HDS and its wholly-owned subsidiaries. All material intercompany balances and transactions are eliminated. Results of operations of businesses acquired are included from their respective dates of acquisition. The results of operations of all discontinued operations have been separately reported as discontinued operations for all periods presented.

Estimates

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities, and reported amounts of revenues and expenses in preparing these consolidated financial statements in conformity with GAAP. Actual results could differ from these estimates.

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HD SUPPLY HOLDINGS, INC. AND SUBSIDIARIES

HD SUPPLY, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Self-Insurance

HD Supply has a high deductible insurance program for most losses related to general liability, product liability, environmental liability, automobile liability, workers' compensation and certain legal claims, and is self-insured for medical claims, while maintaining per employee stop loss coverage. The expected ultimate cost for claims incurred as of the balance sheet date is not discounted and is recognized as a liability. Self-insurance losses for claims filed and claims incurred but not reported are accrued based upon estimates of the aggregate liability for uninsured claims using loss development factors and actuarial assumptions followed in the insurance industry and historical loss development experience. At October 29, 2017 and January 29, 2017, self-insurance reserves for continuing operations totaled approximately \$57 million and \$56 million, respectively. At January 29, 2017, self-insurance reserves classified as discontinued operations totaled approximately \$23 million. See Note 2 Discontinued Operations for further information on the sale of the Waterworks business.

NOTE 2 DISCONTINUED OPERATIONS

In August 2017, the Company completed the sale of its Waterworks business and received cash proceeds of approximately \$2.4 billion, net of transaction cost payments of approximately \$38 million. In the nine months ended October 29, 2017, the Company recognized a gain on the sale of the Waterworks business of approximately \$725 million, net of tax of \$202 million. The sale is subject to a post-closing working capital adjustment which the Company expects to settle in fiscal 2017.

In accordance with ASC 740, Income Taxes, a deferred tax asset should be recognized for the excess of the tax basis over the financial reporting carrying value of an investment in a subsidiary (outside basis difference) when it is apparent that the temporary difference will reverse in the foreseeable future. In connection with presenting the Waterworks business unit as a discontinued operation in the second quarter of fiscal 2017, the Company was required to re-evaluate its position related to the recognition of a deferred tax asset or liability for the outside basis difference of the Waterworks corporate subsidiary being sold. In prior years, and as required under ASC 740, deferred taxes for such outside basis difference had not been recognized because the outside basis difference was deemed permanent in nature. Due to the pending sale of the Waterworks business in the second quarter of fiscal 2017, the outside basis difference was no longer deemed to be permanent in nature and was expected to reverse in the foreseeable future. As a result, a net deferred tax asset of \$323 million and a corresponding income tax benefit for the difference in the Company's stock basis versus its book carrying value of the Waterworks corporate subsidiary was recorded in the second quarter of fiscal 2017. Since the deferred tax asset was settled by HD Supply, the deferred tax asset was not included in the assets held for sale as of July 30, 2017. However, the income statement benefit associated with recording the \$323 million deferred tax asset was recorded as discontinued operations. At the completion of the sale, the Company recognized a tax expense of approximately \$525 million in discontinued operations in the third quarter of fiscal 2017, which included \$323 million related to utilizing the deferred tax asset recorded in the second quarter. The Company estimates that it will utilize approximately \$266 million of tax-effected federal and state net operating loss carryforwards as a result of the sale of the Waterworks business.

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In October 2017, the Company recognized a \$3 million gain due to the expiration of indemnification for tax positions related to the Canadian operations of the Power Solutions business whose sale was completed by the Company in October 2015.

In May 2016, the Company completed the sale of its Interior Solutions business.

Summary Financial Information

In accordance with Accounting Standards Codification (ASC) 205-20, Discontinued Operations, as amended, the results of Waterworks and Interior Solutions are classified as discontinued operations. The presentation of discontinued operations includes revenues and expenses of the discontinued operations and gain/loss on the disposition of businesses, net of tax, as one line item on the Consolidated Statements of Operations

Table of Contents**HD SUPPLY HOLDINGS, INC. AND SUBSIDIARIES****HD SUPPLY, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

and Comprehensive Income. All Consolidated Statements of Operations and Comprehensive Income presented have been revised to reflect this presentation.

The following table provides additional detail related to the results of operations of the discontinued operations (amounts in millions):

	Three Months Ended		Nine Months Ended	
	October 29, 2017	October 30, 2016	October 29, 2017	October 30, 2016
Net sales	\$ 10	\$ 733	\$ 1,413	\$ 2,155
Cost of sales	8	563	1,100	1,657
Gross Profit	2	170	313	498
Operating expenses:				
Selling, general and administrative	1	95	198	308
Depreciation and amortization		3	6	9
Restructuring Charges				1
Total operating expenses	1	98	204	318
Operating Income	1	72	109	180
(Gain) loss on disposal of discontinued operations	(934)	4	(930)	7
Other (income) expense, net	1		1	
Income before provision for income taxes	934	68	1,038	173
Provision for income taxes	528	28	244	69
Income from discontinued operations, net of tax	\$ 406	\$ 40	\$ 794	\$ 104

At October 29, 2017 and January 29, 2017, the carrying amounts of major classes of assets and liabilities of discontinued operations included in the Consolidated Balance Sheets were as follows (amounts in millions):

	October 29, 2017	January 29, 2017
Current assets:		
Receivables, less allowance for doubtful accounts of \$0 and \$4	\$	\$ 346
Inventories		225
Other current assets		4
Total current assets		575
Property and equipment, net		51
Goodwill		1,061
Intangible assets, net		10

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Total non-current assets			1,122
Total assets of discontinued operations	\$	\$	1,697
Current Liabilities:			
Accounts payable	\$	\$	212
Accrued compensation and benefits			42
Other current liabilities			5
Total current liabilities			259
Other non-current liabilities			20
Total non-current liabilities			20
Total liabilities of discontinued operations	\$	\$	279

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The following table provides additional detail related to the net cash provided by operating and investing activities of the discontinued operations (amounts in millions):

	Nine Months Ended	
	October 29, 2017	October 30, 2016
Net cash flows provided by operating activities	\$ 28	\$ 124
Cash flows from investing activities:		
Capital expenditures	(5)	(7)
Proceeds from sales of businesses, net	2,450	28
Proceeds from sales of property and equipment, net	2	1
Net cash flows provided by investing activities	\$ 2,447	\$ 22

NOTE 3 DEBT

HDS's long-term debt as of October 29, 2017 and January 29, 2017 consisted of the following (dollars in millions):

	October 29, 2017		January 29, 2017	
	Outstanding Principal	Interest Rate %(1)	Outstanding Principal	Interest Rate %(1)
Senior ABL Facility due 2022	\$ 57	2.57	\$ 421	2.38
Term B-1 Loans due 2021			639	3.75
Term B-2 Loans due 2023			549	3.75
Term B-3 Loans due 2021	535	3.58		
Term B-4 Loans due 2023	546	3.83		
December 2014 First Priority Notes due 2021			1,250	5.25
April 2016 Senior Unsecured Notes due 2024	1,000	5.75	1,000	5.75
Total gross long-term debt	\$ 2,138		\$ 3,859	
Less unamortized discount	(6)		(9)	
Less unamortized deferred financing costs	(34)		(38)	
Total net long-term debt	\$ 2,098		\$ 3,812	
Less current installments	(11)		(14)	
	\$ 2,087		\$ 3,798	

Total net long-term debt, excluding
current installments

(1) *Represents the stated rate of interest, without including the effect of discounts or premiums.*

2017 Refinancing Transactions

On September 1, 2017, HDS used a portion of the net proceeds from the sale of the Waterworks business to redeem all of the outstanding \$1,250 million in aggregate principal amount of 5.25% Senior Secured First Priority Notes due 2021 (the December 2014 First Priority Notes) for an aggregate redemption price of approximately \$1,325 million. The redemption price included an approximately \$62 million make-whole premium calculated in accordance with terms of the indenture governing the December 2014 First Priority Notes (the 2014 indenture) and \$14 million of accrued but unpaid interest to the redemption date. In connection with the redemption, the 2014 indenture, was satisfied and discharged and the liens securing the December 2014 First Priority Notes were released in accordance with the terms of the 2014 indenture. As a result of the redemption, the Company incurred a \$73 million loss on extinguishment of debt, which includes the \$62 million make-whole premium and the write-off of \$11 million of unamortized deferred financing costs, in accordance with ASC 470-50, Debt Modifications and Extinguishments.

On August 31, 2017, HDS entered into a Fifth Amendment (the Fifth Amendment) to the credit agreement governing HDS' s existing Term Loan Facility, as defined below. Pursuant to the Fifth Amendment, HDS amended its existing Term Loan Facility to, among other things, (i) refinance all the outstanding term loans in an original

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aggregate principal amount of \$842 million (the Term B-1 Loans) with a new tranche of term loans (the Term B-3 Loans) in an aggregate principal amount of \$535 million, (ii) refinance all the outstanding term loans in an original aggregate principal of \$550 million (the Term B-2 Loans) with a new tranche of term loans (the Term B-4 Loans) in an aggregate principal amount of \$546 million and (iii) amend the definition of Permitted Payments contained in the credit agreement to permit an additional category of Permitted Payments permitting Restricted Payments (as defined in the credit agreement) at any time in an aggregate amount not to exceed (x) \$500,000,000 and (y) thereafter, upon full use of such capacity set forth in clause (x), an additional amount, if any, such that, after giving pro forma effect to such Restricted Payment, the Company's Consolidated Total Leverage Ratio (as defined in the credit agreement) does not exceed 3.00 to 1.00.

The Fifth Amendment also provides for a prepayment premium equal to 1.00% of the aggregate principal amount of the applicable Term Loans, as defined below, being prepaid if, on or prior to March 2, 2018, the Company enters into certain repricing transactions.

In connection with the Fifth Amendment, the Company paid approximately \$1 million in consent fees and incurred a modification and extinguishment charge of approximately \$3 million, which includes financing fees and other costs of approximately \$1 million and the write-off of approximately \$2 million of a portion of the related unamortized discount and deferred financing costs, in accordance with ASC 470-50, Debt Modifications and Extinguishments.

On August 25, 2017, HDS entered into the Second Supplemental Indenture (the Second Supplemental Indenture) which amends and supplements the Indenture, dated as of April 11, 2016, as amended and supplemented by the First Supplemental Indenture, dated as of April 11, 2016 (together, the 2016 indenture). Holders of a majority in aggregate principal amount of the outstanding April 2016 Senior Unsecured Notes consented to the proposed amendments included in the Second Supplemental Indenture.

The Second Supplemental Indenture (a) amends the definition of Permitted Payments contained in the 2016 indenture to permit an additional category of Permitted Payments permitting Restricted Payments (as defined in the Indenture) at any time in an aggregate amount not to exceed (x) \$500,000,000 and (y) thereafter, upon full use of such capacity set forth in clause (x), an additional amount, if any, such that, after giving pro forma effect to such Restricted Payment, the Company's Consolidated Total Leverage Ratio (as defined in the Indenture) does not exceed 3.00 to 1.00; (b) increase the interest rate for the April 2016 Senior Unsecured Notes to 7.00% per annum commencing April 15, 2019, to the extent the April 2016 Senior Unsecured Notes remain outstanding after April 15, 2019; (c) amend the definition of Net Available Cash contained in the Indenture to provide that proceeds from the sale of the Waterworks business unit consummated on August 1, 2017 (other than proceeds to be applied to redeem the December 2014 First Priority Notes) shall be excluded and accordingly, the Company will not be required to apply the remaining net proceeds in accordance with the provision of the Sale of Assets covenant of the Indenture and (d) amend the definition of Consolidated EBITDA contained in the 2016 indenture to provide that while the Company may continue to include in the calculation thereof projected cost savings, it may only do so with respect those realized as a result of actions taken or to be taken in connection with a purchase of assets from, or a sale of assets to, a third party (excluding the Waterworks Sale (as defined in the Second Supplemental Indenture)).

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As a result of entering into the Second Supplemental Indenture, the Company paid approximately \$15 million in consent fees to holders of the outstanding April 2016 Senior Unsecured Notes, which are capitalized as deferred financing costs and amortized over the expected life of the April 2016 Senior Unsecured Notes. Additionally, the Company incurred a modification charge of approximately \$3 million for financing fees, in accordance with ASC 470-50, Debt Modifications and Extinguishments.

On April 18, 2017, HDS used cash and available borrowings under its Senior ABL Facility, as defined below, to repay \$100 million aggregate principal of its Term B-1 Loans. As a result, the Company incurred a \$2 million loss on extinguishment of debt, which included write-offs of unamortized original issue discount and unamortized deferred financing costs for \$1 million each, in accordance with ASC 470-50, Debt Modifications and Extinguishments.

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On April 5, 2017, HDS entered into a Third Amendment (the **Third Amendment**) to the credit agreement governing its existing Senior ABL Facility. The Third Amendment, among other things, reduced the applicable margin for borrowings under the Senior ABL Facility, reduced the applicable commitment fee, and extended the maturity date of the Senior ABL Facility until April 5, 2022. As a result, the Company recorded a \$1 million loss on extinguishment of debt, in accordance with ASC 470-50, **Debt Modifications and Extinguishments**, for the write-off of \$1 million of unamortized deferred financing costs.

Senior Credit Facilities

Senior ABL Facility

HDS's Senior Asset Based Lending Facility due 2022 (the **Senior ABL Facility**) provides for senior secured revolving loans and letters of credit of up to a maximum aggregate principal amount of \$1,500 million (subject to availability under a borrowing base). Extensions of credit under the Senior ABL Facility are limited by a borrowing base calculated periodically based on specified percentages of the value of eligible inventory and eligible accounts receivable, subject to certain reserves and other adjustments. A portion of the Senior ABL Facility is available for letters of credit and swingline loans. As of October 29, 2017, HDS had \$899 million of additional available borrowings under the Senior ABL Facility (after giving effect to the borrowing base limitations and approximately \$27 million in letters of credit issued and including \$155 million of borrowings available on qualifying cash balances). As of October 29, 2017, all outstanding borrowings on the Senior ABL Facility are Canadian borrowings.

At HDS's option, the interest rates applicable to the loans under the Senior ABL Facility are based (i) in the case of U.S. dollar-denominated loans, either at London Interbank Offered Rate (**LIBOR**) plus an applicable margin, or Prime Rate plus an applicable margin and (ii) in the case of Canadian dollar-denominated loans, either the banker's acceptance (**BA**) rate plus an applicable margin, or the Canadian Prime Rate plus an applicable margin. The margins applicable for each elected interest rate are subject to a pricing grid, as defined in the agreement governing the Senior ABL Facility, based on average excess availability for the previous fiscal quarter. The Senior ABL Facility also contains a letter of credit fee computed at a rate per annum equal to the Applicable Margin (as defined in the Senior ABL Facility agreement) then in effect for LIBOR Loans and an unused commitment fee subject to a pricing grid, included in the agreement governing the Senior ABL Facility, based on the Average Daily Used Percentage (as defined in the Senior ABL Facility).

The Senior ABL Facility also permits HDS to add one or more incremental term loan facilities to be included in the Senior ABL Facility or one or more revolving credit facility commitments to be included in the Senior ABL Facility.

Senior Term Loan Facility

HDS's Senior Term Facility (the Senior Term Facility) consists of a senior secured term loan facility (the Term Loan Facility, and the term loans thereunder, the Term Loans) providing for Term Loans with remaining aggregate principal amount of \$1,081 million. Term B-3 Loans will mature on August 13, 2021 and Term B-4 Loans will mature on October 17, 2023. Both Term B-3 Loans and Term B-4 Loans amortize in equal quarterly installments in aggregate annual amounts equal to 1.00% of the original principal amount of the Term Loans with the balances payable on their respective maturity dates. Term B-3 Loans bear interest at the applicable margin for borrowings of 2.25% for LIBOR borrowings and 1.25% for base rate borrowings. Term B-4 Loans bear interest at the applicable margin for borrowings of 2.50% for LIBOR borrowings and 1.50% for base rate borrowings.

For additional information on our Senior ABL Facility or Senior Term Facility (collectively, the Senior Credit Facilities), including guarantees and security, please refer to the Notes to Consolidated Financial Statements in our annual report on Form 10-K for the fiscal year ended January 29, 2017.

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Secured Notes

5.25% Senior Secured First Priority Notes due 2021

HDS's December 2014 First Priority Notes bore interest at 5.25% per annum with a maturity date of December 15, 2021. Interest was paid semi-annually in arrears on June 15th and December 15th of each year, prior to the September 1, 2017 redemption described above under 2017 Refinancing Transactions.

Unsecured Notes

5.75% Senior Unsecured Notes due 2024

HDS's 5.75% Senior Unsecured Notes due 2024 (the April 2016 Senior Unsecured Notes) bear interest at a rate of 5.75% until April 15, 2019 and 7.00% from April 15, 2019 until maturity on April 15, 2024. Interest is paid semi-annually in arrears on April 15th and October 15th of each year.

Redemption

HDS may redeem the April 2016 Senior Unsecured Notes, in whole or in part, at any time (1) prior to April 15, 2019, at a price equal to 100% of the principal amount thereof, plus accrued and unpaid interest, if any, to the redemption date, plus the applicable make-whole premium set forth in the Indenture and (2) on and after April 15, 2019, at the applicable redemption price set forth below (expressed as a percentage of principal amount), plus accrued and unpaid interest, if any, to the relevant redemption date, if redeemed during the 12-month period commencing on April 15 of the year set forth below.

Year

Percentage

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2019	104.313%
2020	102.875%
2021	101.438%
2022 and thereafter	100.000%

In addition, at any time prior to April 15, 2019, HDS may redeem on one or more occasions up to 40% of the aggregate principal amount of the April 2016 Senior Unsecured Notes with the proceeds of certain equity offerings at a redemption price of 105.75% of the principal amount in respect of the April 2016 Senior Unsecured Notes being redeemed, plus accrued and unpaid interest to the redemption date, provided, however, that if the April 2016 Senior Unsecured Notes are redeemed, an aggregate principal amount of April 2016 Senior Unsecured Notes equal to at least 50% of the original aggregate principal amount of April 2016 Senior Unsecured Notes must remain outstanding immediately after each such redemption of April 2016 Senior Unsecured Notes.

For additional information on the April 2016 Senior Unsecured Notes, including guarantees and security, please refer to 2017 Refinancing Transactions, above, and the Notes to Consolidated Financial Statements in our annual report on Form 10-K for the fiscal year ended January 29, 2017.

Debt covenants

HDS's outstanding debt agreements contain various restrictive covenants including, but not limited to, limitations on the incurrence of additional indebtedness and dividend payments and restrictions on the use of proceeds from asset dispositions. As of October 29, 2017, HDS was in compliance with all such covenants that were in effect on such date.

NOTE 4 FAIR VALUE MEASUREMENTS

The fair value measurements and disclosure principles of GAAP, ASC 820, Fair Value Measurements and Disclosures, define fair value, establish a framework for measuring fair value and provide disclosure requirements about fair value measurements. These principles define a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

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Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 Quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs (other than quoted prices) that are observable for the asset or liability, either directly or indirectly;

Level 3 Unobservable inputs in which little or no market activity exists.

The Company's financial instruments that are not reflected at fair value on the Consolidated Balance Sheets were as follows as of October 29, 2017 and January 29, 2017 (amounts in millions):

	As of October 29, 2017		As of January 29, 2017	
	Recorded Amount(1)	Estimated Fair Value	Recorded Amount(1)	Estimated Fair Value
Senior ABL Facility	\$ 57	\$ 57	\$ 421	\$ 410
Term Loans and Notes	2,081	2,171	3,438	3,572
Total	\$ 2,138	\$ 2,228	\$ 3,859	\$ 3,982

(1) These amounts do not include accrued interest; accrued interest is classified as Other current liabilities in the accompanying Consolidated Balance Sheets. These amounts do not include any related discounts, premiums, or deferred financing costs.

The Company utilized Level 2 inputs, as defined in the fair value hierarchy, to measure the fair value of the long-term debt. Management's fair value estimates were based on quoted prices for recent trades of HDS's long-term debt, recent similar credit facilities initiated by companies with like credit quality in similar industries, quoted prices for similar instruments, and inquiries with certain investment communities.

NOTE 5 INCOME TAXES

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For the nine months ended October 29, 2017, the Company's combined federal, state, and foreign effective tax rate for continuing operations was an expense of 33.2%. The effective rate for continuing operations for the nine months ended October 30, 2016 was an expense of 42.9%.

The Company's effective tax rate will vary based on a variety of factors, including overall profitability, the geographical mix of income before taxes and the related tax rates in the jurisdictions where it operates, restructuring and other one-time charges, as well as discrete events, such as settlements of audits. For the nine months ended October 29, 2017, the application of stock-based compensation expense guidance in Accounting Standards Update (ASU) No. 2016-09 resulted in discrete tax benefits of \$14 million from the exercise and vesting of stock based awards, which lowered the effective tax rate by 510 basis points. For additional information on the Company's adoption of ASU No. 2016-09, see Note 12 - Recent Accounting Pronouncements.

As of January 29, 2017, the Company's unrecognized tax benefits in accordance with the income taxes principles of GAAP, ASC 740, Income Taxes, were \$10 million. As of October 29, 2017, the Company's unrecognized tax benefits decreased by \$2 million. The Company's ending net accrual for interest and penalties related to unrecognized tax benefits as of January 29, 2017 was zero and remained unchanged as of October 29, 2017. As of January 29, 2017, the Company's valuation allowance on its U.S. deferred tax assets was approximately \$5 million and remained unchanged as of October 29, 2017. Each reporting period we assess available positive and negative evidence and estimate if sufficient future taxable income will be generated to utilize the existing deferred tax assets.

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The following basic and diluted weighted average common shares information is provided for Holdings.

The reconciliation of basic to diluted weighted average common shares for the three and nine months ended October 29, 2017 and October 30, 2016 was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 29, 2017	October 30, 2016	October 29, 2017	October 30, 2016
Weighted-average common shares	185,651	199,593	194,704	199,217
Effect of potentially dilutive stock plan securities	1,001	2,414	1,554	2,569
Diluted weighted-average common shares	186,652	202,007	196,258	201,786
Stock plan securities excluded from dilution (1)	2,414	1,327	1,966	1,885

(1) *Represents securities not included in the computation of diluted earnings per share because their effect would have been anti-dilutive.*

Stock plan securities consist of securities (stock options, restricted stock and restricted stock units) granted under Holdings stock-based compensation plans.

NOTE 7 SUPPLEMENTAL BALANCE SHEET AND CASH FLOW INFORMATION**Receivables**

Receivables as of October 29, 2017 and January 29, 2017 consisted of the following (amounts in millions):

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	October 29, 2017		January 29, 2017	
Trade receivables, net of allowance for doubtful accounts	\$	614	\$	499
Vendor rebate receivables		60		50
Other receivables		15		10
Total receivables, net	\$	689	\$	559

Other Current Liabilities

Other current liabilities as of October 29, 2017 and January 29, 2017 consisted of the following (amounts in millions):

	HD Supply Holdings, Inc.				HD Supply, Inc.			
	October 29, 2017		January 29, 2017		October 29, 2017		January 29, 2017	
Accrued interest	\$	6	\$	30	\$	6	\$	30
Accrued non-income taxes		37		30		37		30
Unsettled share repurchases		2						
Other		116		92		116		92
Total other current liabilities	\$	161	\$	152	\$	159	\$	152

Supplemental Cash Flow Information

Cash paid for interest in the nine months ended October 29, 2017 and October 30, 2016 was \$148 million and \$249 million, respectively. During the nine months ended October 29, 2017, the Company paid \$6 million of original issue discounts related to the \$100 million payment on the Term B-1 Loans and the Fifth Amendment to the Term Loan Facility.

Cash paid for income taxes, net of refunds, in the nine months ended October 29, 2017 and October 30, 2016 was approximately \$27 million and \$12 million, respectively. Cash paid for income taxes in the nine months ended October 29, 2017 includes \$13 million in taxes paid related to the sale of the Waterworks business.

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During the nine months ended October 29, 2017, HDS executed an equity cash distribution of \$516 million to Holdings, via HDS's direct parent, HDS Holding Corporation. The equity distribution from HDS and return of capital recognized by Holdings were eliminated in consolidation of Holdings and its wholly-owned subsidiaries, including HDS.

On June 3, 2017, Holdings' Board of Directors authorized the Company to enter into a share repurchase program for the repurchase of up to an aggregate amount of \$500 million of Holdings' common stock. As of October 29, 2017, under this plan, Holdings has completed the repurchase of all \$500 million of common stock authorized, purchasing 15,940,337 shares of its common stock.

On August 25, 2017, Holdings' Board of Directors authorized the Company to enter into a new share repurchase program for the repurchase of up to an aggregate amount of \$500 million of Holdings' common stock. As of October 29, 2017, under this plan, Holdings has repurchased 477,991 shares of its common stock for approximately \$17 million.

In combination with the 2014 authorized share repurchase plan, Holdings has repurchased a total of 17,453,713 shares of its common stock during the first nine months of fiscal 2017 for \$556 million, of which \$2 million remain unsettled as of October 29, 2017.

Significant Non-Cash Transactions

During the nine months ended October 29, 2017, Holdings retired 611,433 shares of its common stock (Retired Shares) held as treasury shares by Holdings in the amount of \$23 million. All of these shares were repurchased by Holdings pursuant to the publicly announced share repurchase program previously authorized by Holdings' board of directors. Holdings reinstated the Retired Shares to the status of authorized but unissued shares of common stock, par value \$0.01 per share, effective as of the date of retirement. In accordance with ASC 505-30,

Equity-Treasury Stock, Holdings reversed the \$0.01 par value of the Retired Shares and the excess of the cost of the Retired Shares over par value to Retained Earnings.

Build-to-Suit Lease

On February 4, 2016, the Company entered into a build-to-suit arrangement for a leadership development and headquarters facility in Atlanta, Georgia, which began construction in 2016. The lease commences upon completion of construction which is anticipated to be early 2018.

In accordance with ASC 850, Leases, for build-to-suit arrangements where the Company is involved in the construction of structural improvements prior to the commencement of the lease or takes some level of construction risk, the Company is considered the owner of the assets and land during the construction period. Accordingly, during construction activities, the Company recorded a Construction in progress asset within Property and equipment and a corresponding financing liability on the Consolidated Balance Sheet for contributions by the landlord toward construction. Once the construction is completed, if the lease meets certain sales-leaseback criteria, the Company will remove the asset and related financial obligation from the Consolidated Balance Sheet and treat the building lease as an operating lease. If upon completion of construction, the lease does not meet the sales-leaseback criteria, the leased property will be treated as a capital lease and included in Property and equipment on the Consolidated Balance Sheet. As of October 29, 2017, the Consolidated Balance Sheet includes \$65 million of build-to-suit assets in Construction in progress, and the corresponding financial obligation of \$65 million in Other long-term liabilities in the Consolidated Balance Sheet.

NOTE 8 RESTRUCTURING ACTIVITIES

Fiscal 2017 Restructuring Plan

As a result of the sale of the Waterworks business in third quarter 2017, management evaluated the Company's talent alignment and functional support strategies. During the third quarter of fiscal 2017, management initiated a restructuring plan that included reducing workforce personnel, resulting in the recognition of \$3 million of restructuring charges, primarily related to severance and other employee-related costs.

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In addition to actions already taken, management expects to further restructure workforce personnel, close a C&I branch, and relocate the Company's headquarters in early 2018. Management expects to incur a total of \$10 million to \$15 million under this plan, and expects a payback of the employee-related costs via a permanent reduction in personnel costs over the next one to two years.

The expected charges include approximately \$6 million related to property lease obligations upon exiting the Company's current headquarters location. The Company will actively pursue buyout options or subleasing opportunities for the leased property prior to its lease expiration in October 2020.

Payments for the charges incurred in the third quarter of fiscal 2017 are expected to be substantially complete in the next twelve months. As of October 29, 2017, the liability for these restructuring activities was \$2 million and is included in Other current liabilities in the Consolidated Balance Sheets.

Fiscal 2015 Restructuring Plan

As a result of the sale of the Power Solutions business unit in fiscal 2015, management evaluated the Company's talent alignment and functional support strategies. Consequently, during fiscal 2015, the Company initiated a restructuring plan to strategically align its leadership and functional support teams. During the nine months ended October 30, 2016, the Company incurred \$14 million of restructuring charges under this plan. The Company completed the activities under this plan in fiscal 2016 and does not expect to incur any additional charges. As of October 29, 2017 and January 29, 2017, the Company's liability balance for these restructuring activities was \$2 million and \$4 million respectively, and is included in Other current liabilities in the Consolidated Balance Sheets. Payments for these charges are expected to be substantially complete by the end of fiscal 2017.

NOTE 9 COMMITMENTS AND CONTINGENCIES

Legal Matters

On July 10, 2017 and August 8, 2017, shareholders filed putative class action complaints in the U.S. District Court for the Northern District of Georgia, alleging that HD Supply and certain senior members of its management (collectively, the defendants) made certain false or misleading

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public statements in violation of the federal securities laws between November 9, 2016 and June 5, 2017, inclusive (the original securities complaints). Subsequently, the two securities cases were consolidated, and, on November 16, 2017, the lead plaintiffs appointed by the Court filed a Consolidated Amended Class Action Complaint (the Amended Complaint) against the defendants on behalf of all persons other than defendants who purchased or otherwise acquired the Company s common stock between November 9, 2016 and June 5, 2017, inclusive. The Amended Complaint alleges that defendants made certain false or misleading public statements, primarily relating to the Company s progress in addressing certain supply chain disruption issues encountered in the Company s Facilities Maintenance business unit. The Amended Complaint asserts claims against the defendants under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, and seeks class certification under the Federal Rules of Civil Procedure, as well as unspecified monetary damages, pre-judgment and post-judgment interest, and attorneys fees and other costs.

On August 8, 2017, two shareholder derivative complaints were filed naming the Company as a nominal defendant and certain members of its senior management and board of directors (collectively, the individual defendants) as defendants. The complaints generally allege that the individual defendants caused the Company to issue false and misleading statements concerning the Company s business, operations, and financial prospects, including misrepresentations regarding operating leverage and supply chain corrective actions. The complaints assert claims against the individual defendants under Section 14(a) of the Securities Exchange Act of 1934, and allege breaches of fiduciary duties, unjust enrichment, corporate waste, and insider selling. The complaints assert a claim to recover any damages sustained by the Company as a result of the individual defendants allegedly wrongful actions, seek certain actions by the Company to modify its corporate governance and internal procedures, and seek to recover attorneys fees and other costs. In October 2017, the Court consolidated the two derivative

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actions and granted the parties joint scheduling order request. The plaintiffs have until December 18, 2017, to file or designate a consolidated amended complaint.

The Company intends to defend these lawsuits vigorously. Given the stage of the complaints and the claims and issues presented in the above matters, the Company cannot reasonably estimate at this time the possible loss or range of loss, if any, that may arise from these unresolved lawsuits.

HD Supply is involved in various legal proceedings arising in the normal course of its business. The Company establishes reserves for litigation and similar matters when those matters present loss contingencies that it determines to be both probable and reasonably estimable in accordance with ASC 450, Contingencies. In the opinion of management, based on current knowledge, all reasonably estimable and probable matters are believed to be adequately reserved for or covered by insurance and are not expected to have a material adverse effect on the Company's consolidated financial condition, results of operations or cash flows. For all other matters management believes the possibility of losses from such matters is not probable, the potential loss from such matters is not reasonably estimable, or such matters are of such kind or involve such amounts that would not have a material adverse effect on the financial position, results of operations or cash flows of the Company if disposed of unfavorably. For material matters that are reasonably possible and reasonably estimable, including matters that are probable and estimable but for which the amount that is reasonably possible is in excess of the amount that the Company has accrued for, management has estimated the aggregate range of potential loss as \$0 to \$10 million. If a material loss is probable or reasonably possible, and in either case estimable, the Company has considered it in the analysis and it is included in the discussion set forth above.

NOTE 10 SEGMENT INFORMATION

HD Supply's operating segments are based on management structure and internal reporting. Each segment offers different products and services to the end customer, except for Corporate, which provides general corporate overhead support. The Company determines its reportable segments in accordance with the principles of segment reporting within ASC 280, Segment Reporting. For purposes of evaluation under these segment reporting principles, the Chief Operating Decision Maker for HD Supply assesses HD Supply's ongoing performance based on the periodic review and evaluation of Net sales, Adjusted EBITDA and certain other measures for each of the operating segments.

HD Supply has two reportable segments, each of which is presented below:

- *Facilities Maintenance* Facilities Maintenance distributes maintenance, repair and operations (MRO) products, provides value-add services and fabricates custom products to multifamily, hospitality, healthcare and institutional facilities.
- *Construction & Industrial* Construction & Industrial distributes specialized hardware, tools, engineered materials and safety products to non-residential and residential contractors. Construction & Industrial also offers light remodeling and construction supplies, kitchen and bath cabinets, windows, plumbing materials, electrical equipment and other products, primarily to small remodeling contractors and trade professionals.

In addition to the reportable segments, the Company's consolidated financial results include Corporate. Corporate includes costs related to the Company's centralized support functions, which are comprised of finance, information technology, human resources, legal, supply chain and other support services, and removes inter-segment transactions.

See Note 2 Discontinued Operations for further information on the sale of the Waterworks business, a previous HD Supply reportable segment.

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The following tables present Net sales, Adjusted EBITDA, and other measures for each of the reportable segments and total continuing operations for the periods indicated (amounts in millions):

	Facilities Maintenance	Construction & Industrial	Corporate	Total Continuing Operations
Three Months Ended October 29, 2017				
Net sales	\$ 754	\$ 617	\$ (1)	\$ 1,370
Adjusted EBITDA	153	76	(15)	214
Depreciation(1) & Software Amortization	7	9	3	19
Other Intangible Amortization	1	1	1	3
Three Months Ended October 30, 2016				
Net sales	\$ 724	\$ 552	\$ (1)	\$ 1,275
Adjusted EBITDA	140	67	(19)	188
Depreciation(1) & Software Amortization	8	7	4	19
Other Intangible Amortization	1	1	1	3
Nine Months Ended October 29, 2017				
Net sales	\$ 2,205	\$ 1,737	\$ (4)	\$ 3,938
Adjusted EBITDA	426	200	(47)	579
Depreciation(1) & Software Amortization	19	27	11	57
Other Intangible Amortization	4	1	4	9
Nine Months Ended October 30, 2016				
Net sales	\$ 2,142	\$ 1,597	\$ (5)	\$ 3,734
Adjusted EBITDA	425	184	(51)	558
Depreciation(1) & Software Amortization	23	24	10	57
Other Intangible Amortization	4	1	4	9

(1) Depreciation includes amounts recorded within Cost of sales in the Consolidated Statements of Operations.

Reconciliation to Consolidated Financial Statements

	Three Months Ended		Nine Months Ended	
	October 29, 2017	October 30, 2016	October 29, 2017	October 30, 2016
Total Adjusted EBITDA	\$ 214	\$ 188	\$ 579	\$ 558
Depreciation and amortization(1)	22	22	66	66
Stock-based compensation	7	4	19	15

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Restructuring	3	3	3	14
Operating Income	182	159	491	463
Interest expense	36	65	134	219
Interest income	(1)		(1)	
Loss on extinguishment & modification of debt(2)	78	59	81	174
Income from Continuing Operations Before Provision for Income Taxes	69	35	277	70
Provision for income taxes	23	15	92	30
Income from Continuing Operations	46	20	185	40
Income from discontinued operations, net of tax	406	40	794	104
Net Income	\$ 452	\$ 60	\$ 979	\$ 144

(1) *Depreciation and amortization includes amounts recorded within Cost of sales in the Consolidated Statements of Operations.*

(2) *Represents the loss on extinguishment of debt including the write-off of unamortized deferred financing costs, original issue discount, and other assets or liabilities associated with such debt. Also includes the costs of debt modifications.*

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NOTE 11 SUBSIDIARY GUARANTORS

HDS (the Debt Issuer) has outstanding April 2016 Senior Unsecured Notes, which are guaranteed by certain of its subsidiaries (the Subsidiary Guarantors). The Subsidiary Guarantors are direct or indirect wholly-owned domestic subsidiaries of HDS. The subsidiaries of HDS that do not guarantee the April 2016 Senior Unsecured Notes (the Non-guarantor Subsidiaries) are direct or indirect wholly-owned subsidiaries of HDS and primarily include HDS's operations in Canada.

The Debt Issuer's payment obligations under the April 2016 Senior Unsecured Notes are jointly and severally guaranteed by the guarantors and all guarantees are full and unconditional.

These guarantees are subject to release under the circumstances as described below:

(i) concurrently with any direct or indirect sale or disposition (by merger or otherwise) of any Subsidiary Guarantor or any interest therein in accordance with the terms of the applicable indebtedness by HDS or a restricted subsidiary, following which such Subsidiary Guarantor is no longer a restricted subsidiary of HDS;

(ii) at any time that such Subsidiary Guarantor is released from all of its obligations under all of its guarantees of payment of any indebtedness of HDS or any Subsidiary Guarantor under all other indebtedness and is not a borrower under the Senior ABL Facility;

(iii) upon the merger or consolidation of any Subsidiary Guarantor with and into HDS or another Subsidiary Guarantor that is the surviving entity in such merger or consolidation, or upon the liquidation of such Subsidiary Guarantor following the transfer of all of its assets to HDS or another Subsidiary Guarantor;

(iv) concurrently with any Subsidiary Guarantor becoming an unrestricted subsidiary;

(v) during the period when the rating on the notes is changed to investment grade and certain covenants cease to apply while such investment grade rating is maintained, upon the merger or consolidation of any Subsidiary Guarantor with and into another subsidiary that is not a Subsidiary Guarantor with such other subsidiary being the surviving entity in such merger or consolidation, or upon liquidation of such Subsidiary Guarantor following the transfer of all of its assets to a subsidiary that is not a Subsidiary Guarantor;

(vi) upon legal or covenant defeasance of HDS's obligations under the applicable indebtedness, or satisfaction and discharge of the indenture governing the applicable indebtedness; or

(vii) subject to customary contingent reinstatement provisions, upon payment in full of the aggregate principal amount of all applicable indebtedness then outstanding and all other obligations guaranteed by a Subsidiary Guarantor then due and owing.

In addition, HDS has the right, upon 30 days' notice to the applicable trustee, to cause any Subsidiary Guarantor that has not guaranteed payment of any indebtedness of HDS or any Subsidiary Guarantor under all other indebtedness and is not a borrower under the Senior ABL Facility to be unconditionally released from all obligations under its Subsidiary Guarantee, and such Subsidiary Guarantee shall thereupon terminate and be discharged and of no further force or effect.

In connection with the issuance of the April 2016 Senior Unsecured Notes, HDS determined the need for compliance with Rule 3-10 of SEC Regulation S-X. In lieu of providing separate audited financial statements for the Guarantor Subsidiaries, HDS has included the accompanying Condensed Consolidating Financial Statements in accordance with Rule 3-10(f) of SEC Regulation S-X. The following supplemental financial information sets forth, on a consolidating basis under the equity method of accounting, the condensed consolidating statements of operations and comprehensive income (loss), the condensed consolidating balance sheets and the condensed consolidating cash flow statements for the Debt Issuer, for the Subsidiary Guarantors and the Non-guarantor Subsidiaries and total consolidated amount for the Debt Issuer and subsidiaries (amounts in millions).

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CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

	Three Months Ended October 29, 2017				
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Total HDS
Net Sales	\$	\$ 1,333	\$ 37	\$	\$ 1,370
Cost of sales		808	20		828
Gross Profit		525	17		542
Operating expenses:					
Selling, general and administrative	22	303	11		336
Depreciation and amortization	4	17			21
Restructuring	2	1			3
Total operating expenses	28	321	11		360
Operating Income (Loss)	(28)	204	6		182
Interest expense	43	33		(40)	36
Interest income	(33)	(8)		40	(1)
Loss on extinguishment & modification of debt	78				78
Net (earnings) loss of equity affiliates	(189)			189	
Income (Loss) from Continuing Operations Before Provision (Benefit) for Income Taxes	73	179	6	(189)	69
Provision (Benefit) for income taxes	24	(2)	1		23
Income (Loss) from Continuing Operations	49	181	5	(189)	46
Income from discontinued operations, net of tax	403		3		406
Net Income (Loss)	\$ 452	\$ 181	\$ 8	\$ (189)	\$ 452
Other comprehensive income (loss) foreign currency translation adjustment	1		1	(1)	1
Total Comprehensive Income (Loss)	\$ 453	\$ 181	\$ 9	\$ (190)	\$ 453

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CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS) (CONTINUED)

	Three Months Ended October 30, 2016				
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Total HDS
Net Sales	\$	\$ 1,244	\$ 31	\$	\$ 1,275
Cost of sales		747	16		763
Gross Profit		497	15		512
Operating expenses:					
Selling, general and administrative	20	298	11		329
Depreciation and amortization	4	17			21
Restructuring	1	2			3
Total operating expenses	25	317	11		353
Operating Income (Loss)	(25)	180	4		159
Interest expense	70	34	1	(40)	65
Interest income	(35)	(5)		40	
Loss on extinguishment of debt	59				59
Net (earnings) loss of equity affiliates	(200)			200	
Income (Loss) from Continuing Operations Before Provision (Benefit) for Income Taxes					
Provision (Benefit) for income taxes	81	151	3	(200)	35
Income (Loss) from Continuing Operations	16	(1)	3	(200)	15
Income (Loss) from Continuing Operations	65	152	3	(200)	20
Income (loss) from discontinued operations, net of tax	(5)	45			40
Net Income (Loss)	\$ 60	\$ 197	\$ 3	\$ (200)	\$ 60
Other comprehensive income (loss) foreign currency translation adjustment	(1)		(1)	1	(1)
Total Comprehensive Income (Loss)	\$ 59	\$ 197	\$ 2	\$ (199)	\$ 59

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CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS) (CONTINUED)

	Nine Months Ended October 29, 2017					
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Total HDS	
Net Sales	\$	\$ 3,834	\$ 105	\$ (1)	\$	3,938
Cost of sales		2,317	57	(1)		2,373
Gross Profit		1,517	48			1,565
Operating expenses:						
Selling, general and administrative	64	908	36			1,008
Depreciation and amortization	11	51	1			63
Restructuring	2	1				3
Total operating expenses	77	960	37			1,074
Operating Income (Loss)	(77)	557	11			491
Interest expense	155	99	1	(121)		134
Interest income	(99)	(23)		121		(1)
Net (earnings) loss of equity affiliates	(583)			583		
Loss on extinguishment & modification of debt	81					81
Income (Loss) from Continuing Operations Before Provision for Income Taxes						
Taxes	369	481	10	(583)		277
Provision for income taxes	90		2			92
Income (Loss) from Continuing Operations	279	481	8	(583)		185
Income from discontinued operations, net of tax	700	91	3			794
Net Income (Loss)	\$ 979	\$ 572	\$ 11	\$ (583)	\$	979
Other comprehensive income (loss) foreign currency translation adjustment	(1)		(1)	1		(1)
Total Comprehensive Income (Loss)	\$ 978	\$ 572	\$ 10	\$ (582)	\$	978

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CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS) (CONTINUED)

	Nine Months Ended October 30, 2016				
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Total HDS
Net Sales	\$	\$ 3,642	\$ 93	\$ (1)	\$ 3,734
Cost of sales		2,191	50	(1)	2,240
Gross Profit		1,451	43		1,494
Operating expenses:					
Selling, general and administrative	61	860	33		954
Depreciation and amortization	10	52	1		63
Restructuring	3	11			14
Total operating expenses	74	923	34		1,031
Operating Income (Loss)	(74)	528	9		463
Interest expense	231	104	1	(117)	219
Interest income	(104)	(13)		117	
Net (earnings) loss of equity affiliates	(545)			545	
Loss on extinguishment of debt	174				174
Income (Loss) from Continuing Operations Before Provision for Income Taxes	170	437	8	(545)	70
Provision for income taxes	28		2		30
Income (Loss) from Continuing Operations	142	437	6	(545)	40
Income from discontinued operations, net of tax	2	102			104
Net Income (Loss)	\$ 144	\$ 539	\$ 6	\$ (545)	\$ 144
Other comprehensive income (loss) foreign currency translation adjustment	1		1	(1)	1
Total Comprehensive Income (Loss)	\$ 145	\$ 539	\$ 7	\$ (546)	\$ 145

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CONDENSED CONSOLIDATING BALANCE SHEETS

	As of October 29, 2017					
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Total HDS	
ASSETS						
Current assets:						
Cash and cash equivalents	\$ 441	\$ 15	\$ 5	\$	\$ 461	
Receivables, net	5	662	22		689	
Inventories		643	19		662	
Intercompany receivables		1		(1)		
Other current assets	18	18	1		37	
Total current assets	464	1,339	47	(1)	1,849	
Property and equipment, net	122	173	3		298	
Goodwill		1,807			1,807	
Intangible assets, net		93			93	
Deferred tax asset	423		2	(127)	298	
Investment in subsidiaries	2,801			(2,801)		
Intercompany notes receivable	1,005	1,083		(2,088)		
Other assets	16	3			19	
Total assets	\$ 4,831	\$ 4,498	\$ 52	\$ (5,017)	\$ 4,364	
LIABILITIES AND STOCKHOLDER S EQUITY (DEFICIT)						
Current liabilities:						
Accounts payable	\$ 9	\$ 382	\$ 14	\$	\$ 405	
Accrued compensation and benefits	36	45	3		84	
Current installments of long-term debt	11				11	
Intercompany payables			1	(1)		
Other current liabilities	61	91	7		159	
Total current liabilities	117	518	25	(1)	659	
Long-term debt, excluding current installments	2,030		57		2,087	
Deferred tax liabilities		127		(127)		
Intercompany notes payable	1,083	1,005		(2,088)		
Other liabilities	106	17			123	
Total liabilities	3,336	1,667	82	(2,216)	2,869	
Stockholder s equity (deficit)	1,495	2,831	(30)	(2,801)	1,495	
Total liabilities and stockholder s equity (deficit)	\$ 4,831	\$ 4,498	\$ 52	\$ (5,017)	\$ 4,364	

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	As of January 29, 2017					
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Total HDS	
ASSETS						
Current assets:						
Cash and cash equivalents	\$ 51	\$ 17	\$ 5	\$	\$	73
Receivables, net	3	540	16			559
Inventories		588	18			606
Intercompany receivables		1		(1)		
Current assets of discontinued operations		575				575
Other current assets	13	17	2			32
Total current assets	67	1,738	41	(1)		1,845
Property and equipment, net	76	175	2			253
Goodwill		1,807				1,807
Intangible assets, net		101	1			102
Deferred tax asset	681		2	(127)		556
Non-current assets of discontinued operations		1,122				1,122
Investment in subsidiaries	2,451			(2,451)		
Intercompany notes receivable	2,192	584		(2,776)		
Other assets	16	4				20
Total assets	\$ 5,483	\$ 5,531	\$ 46	\$ (5,355)		\$ 5,705
LIABILITIES AND STOCKHOLDER S EQUITY (DEFICIT)						
Current liabilities:						
Accounts payable	\$ 13	\$ 296	\$ 11	\$	\$	320
Accrued compensation and benefits	36	60	2			98
Current installments of long-term debt	14					14
Intercompany payables			1	(1)		
Current liabilities of discontinued operations	2	257				259
Other current liabilities	52	94	6			152
Total current liabilities	117	707	20	(1)		843
Long-term debt, excluding current installments	3,737		61			3,798
Deferred tax liabilities		127		(127)		
Non-current liabilities of discontinued operations	20					20
Intercompany notes payable	584	2,192		(2,776)		
Other liabilities	67	17	2			86

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Total liabilities	4,525	3,043	83	(2,904)	4,747
Stockholder s equity (deficit)	958	2,488	(37)	(2,451)	958
Total liabilities and stockholder s equity (deficit)	\$ 5,483	\$ 5,531	\$ 46	\$ (5,355)	\$ 5,705

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CONDENSED CONSOLIDATING CASH FLOW STATEMENTS

	Nine Months Ended October 29, 2017					
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Total HDS	
Net cash flows from operating activities	\$ 260	\$ 55	\$ 5	\$	\$	320
Cash flows from investing activities						
Capital expenditures	(18)	(47)				(65)
Proceeds from sales of property and equipment		2				2
Proceeds from sales of businesses, net	2,450					2,450
Proceeds from (payments of) intercompany notes		(12)		12		
Net cash flows from investing activities	\$ 2,432	\$ (57)	\$	\$ 12	\$	2,387
Cash flows from financing activities						
Equity distribution	(516)					(516)
Borrowings of (repayments of) intercompany notes	12			(12)		
Borrowings of long-term debt	113					113
Repayments of long-term debt	(1,526)					(1,526)
Borrowings on long-term revolver debt	621		3			624
Repayments on long-term revolver debt	(981)		(8)			(989)
Debt issuance costs	(26)					(26)
Other financing activities	1					1
Net cash flows from financing activities	(2,302)		(5)	(12)		(2,319)
Effect of exchange rates on cash						
Net increase (decrease) in cash & cash equivalents	\$ 390	\$ (2)	\$	\$	\$	388
Cash and cash equivalents at beginning of period	51	17	5			73
Cash and cash equivalents at end of period	\$ 441	\$ 15	\$ 5	\$	\$	461

	Nine Months Ended October 30, 2016					
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Eliminations	Total HDS	
Net cash flows from operating activities	\$ 355	\$ (54)	\$ 3	\$	\$	304
Cash flows from investing activities						
Capital expenditures	(14)	(45)				(59)
		2				2

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Proceeds from sale of property and equipment							
Proceeds from sales of businesses, net	28						28
Proceeds from (payments of) intercompany notes			101			(101)	
Net cash flows from investing activities	\$ 14	\$ 58	\$	\$	(101)	\$	(29)
Cash flows from financing activities							
Borrowings of (repayments of) intercompany notes	(101)				101		
Borrowings of long-term debt	1,547						1,547
Repayments of long-term debt	(2,435)						(2,435)
Borrowings of long-term revolver debt	510						510
Debt issuance costs	(19)						(19)
Other financing activities			(1)				(1)
Net cash flows from financing activities	(498)	(1)	(1)	101	(398)	(1)	(398)
Effect of exchange rates on cash					1		1
Net increase (decrease) in cash & cash equivalents	\$ (129)	\$ 3	\$ 4	\$	\$	\$	(122)
Cash and cash equivalents at beginning of period	233		18		15		266
Cash and cash equivalents at end of period	\$ 104	\$ 21	\$ 19	\$	\$	\$	144

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NOTE 12 RECENT ACCOUNTING PRONOUNCEMENTS

Stock Compensation In May 2017, the Financial Accounting Standards Board (FASB) issued ASU No. 2017-09, Compensation Stock Compensation (Topic 718): Scope of Modification Accounting (ASU 2017-09). The amendments in this update provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. The ASU is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted. The amendments in this update should be applied prospectively to an award modified on or after the adoption date. The Company is currently evaluating the impact of adopting of ASU 2017-09.

Goodwill In January 2017, the FASB issued ASU No. 2017-04, Intangibles Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment (ASU 2017-04). The new guidance eliminates the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge. Instead, entities will record an impairment charge based on the excess of a reporting unit s carrying amount over its fair value. The ASU is effective for annual and interim impairment tests performed in periods beginning after December 15, 2019. Early adoption is permitted for annual and interim goodwill impairment testing dates after January 1, 2017. The amendments in this update should be applied on a prospective basis. The adoption of ASU 2017-04 is not expected to have a material impact on the Company s financial position, results of operations or cash flows.

Statement of Cash Flows In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (ASU 2016-18). The new guidance is intended to reduce diversity in practice by adding or clarifying guidance on classification and presentation of changes in restricted cash on the statement of cash flows. ASU 2016-18 is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted. The amendments in this update should be applied retrospectively to all periods presented. On a prospective basis, the ASU will only impact the Company to the extent it has restricted cash.

Income Taxes In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-entity Transfers of Assets Other than Inventory (ASU 2016-16). The new guidance is intended to improve the accounting for intra-entity transfers of assets other than inventory by requiring recognition of income tax consequences of intra-entity transfers of assets other than inventory when the transfer occurs. ASU 2016-16 is effective for annual and interim

periods beginning after December 15, 2017. Early adoption is permitted. The amendments in this update should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The adoption of ASU 2016-16 is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Statement of Cash Flows In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Clarification of Certain Cash Receipts and Cash Payments* (ASU 2016-15). The new guidance is intended to reduce diversity in practice related to certain cash receipts and payments in the statement of cash flows by adding or clarifying guidance on eight specific cash flow issues. ASU 2016-15 is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted. The amendments in this update should be applied retrospectively to all periods presented, unless deemed impracticable, in which case, prospective application is permitted. The adoption of ASU 2016-15 is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Stock Compensation In March 2016, the FASB issued ASU No. 2016-09, *Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* (ASU 2016-09). The new guidance identifies areas for simplification involving several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities as well as certain classifications on the statement of cash flows. ASU 2016-09 is effective for annual and interim periods beginning after December 15, 2016.

The Company adopted the guidance from this amendment on January 30, 2017 (the first day of fiscal 2017) recording a \$56 million cumulative-effect adjustment to retained earnings in order to recognize a deferred tax asset on the excess deduction for stock option exercises over the expense recorded for book purposes. Beginning in the first quarter of fiscal 2017, the impact to the Company will be through a credit or charge to the tax provision

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reflecting the difference between the amount deductible for tax purposes and the amount expensed for book purposes as options are exercised.

Leases In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (ASU 2016-02). The new guidance requires companies to recognize all leases as assets and liabilities for the rights and obligations created by leased assets on the consolidated balance sheet. ASU 2016-02 is effective for annual and interim periods beginning after December 15, 2018. Early adoption is permitted. It is to be adopted using a modified retrospective approach. The Company is currently evaluating the impact of adopting ASU 2016-02.

Inventory In July 2015, the FASB issued ASU No. 2015-11, *Inventory, Simplifying the Measurement of Inventory* (ASU 2015-11). The amended guidance requires that inventory be measured at the lower of cost and net realizable value. The amended guidance is limited to inventory measured using the first-in, first-out (FIFO) or average cost methods and excludes inventory measured using last-in, first-out (LIFO) or retail inventory methods. ASU 2015-11 is effective for annual and interim periods beginning after December 15, 2016. The Company adopted this guidance on January 30, 2017 (the first day of fiscal 2017) with no material impact on the Company's financial position, results of operations or cash flows.

Revenue recognition In May 2014, the FASB issued ASU No. 2014-09, *Revenue from contracts with customers* (ASU 2014-09), amended by ASU 2016-10, *Revenue from contracts with customers (Topic 606): Identifying Performance Obligations and Licensing*, ASU 2016-12, *Revenue from contracts with customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, and ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*. The amended guidance outlines a single comprehensive revenue model for entities to use in accounting for revenue arising from contracts with customers. The guidance supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that an entity recognizes 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. The update requires significant additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments. Entities have the option of using either a full retrospective or modified approach to adopt the guidance. In July 2015, the FASB provided a one-year delay in the effective date of ASU 2014-09, to be effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, and a permission to early adopt for annual and interim periods beginning after December 15, 2016.

The Company has performed a review of the new revenue standard and is monitoring the activity of the FASB and the transition resource group as it relates to specific interpretative guidance. The Company is reviewing customer contracts and is in the process of applying the five-step model of the new standard to each contract category identified and will compare the results to current accounting practice. The Company has determined that the adoption of ASU 2014-09 will impact the Company's method of recognizing certain installation income, which is generally recognized when the customer order is fully installed. ASU 2014-09 requires installation income to be recognized as each performance obligation within a contract is completed by the Company. Our installation contracts are typically completed in less than 90 days. The Company may identify other impacted areas as it continues its evaluation of ASU 2014-09. The Company is also continuing to analyze the disclosure requirements, such as disaggregation of revenue, to comply with ASU 2014-09.

The Company plans to adopt ASU 2014-09, as well as other clarifications and technical guidance issued by the FASB related to this new revenue standard on January 29, 2018 (the first day of fiscal 2018). The Company plans to adopt the provisions of ASU 2014-09 using the modified retrospective method, which requires that the cumulative effect of initially applying the new guidance be recognized as an adjustment to the opening balance sheet of retained earnings at the date of initial application. The adoption of ASU 2014-09 is not expected to have a material impact on the Company's financial position, results of operations or cash flows; though it requires additional disclosures.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

This Management's Discussion and Analysis of Financial Condition and Results of Operations is combined for two registrants: HD Supply Holdings, Inc. and HD Supply, Inc. Unless the context indicates otherwise, any reference in this discussion and analysis to Holdings refers to HD Supply Holdings, Inc., any reference to HDS refers to HD Supply, Inc., the indirect wholly-owned subsidiary of Holdings, and any references to HD Supply, the Company, we, us and our refer to Holdings together with its direct and indirect subsidiaries, including HDS.

HD Supply is one of the largest industrial distributors in North America. We believe we have leading positions in the two distinct market sectors in which we specialize: Maintenance, Repair & Operations (MRO) and Specialty Construction. Through approximately 220 branches and 44 distribution centers in the U.S. and Canada, the Company serves these markets with an integrated go-to-market strategy. We have approximately 11,000 associates delivering localized, customer-tailored products, services and expertise. We serve approximately 500,000 customers, which include contractors, maintenance professionals, industrial businesses, and government entities. Our broad range of end-to-end product lines and services include approximately 500,000 stock-keeping units (SKUs) of quality, name-brand and proprietary-brand products as well as value-add services supporting the entire lifecycle of a project from construction to maintenance, repair and operations.

Description of segments

We operate our Company through two reportable segments: Facilities Maintenance and Construction & Industrial.

Facilities Maintenance. Facilities Maintenance distributes MRO products, provides value-add services and fabricates custom products. The markets that Facilities Maintenance serves include multifamily, hospitality, healthcare and institutional facilities. Products include electrical and lighting items, plumbing, HVAC products, appliances, janitorial supplies, hardware, kitchen and bath cabinets, window coverings, textiles and guest amenities, healthcare maintenance and water and wastewater treatment products. Facilities Maintenance operates a distribution center-based model that sells its products primarily through a professional sales force, e-commerce and print catalogs.

Construction & Industrial. Construction & Industrial distributes specialized hardware, tools and engineered materials to non-residential and residential contractors. Products include tilt-up brace systems, forming and shoring systems, concrete chemicals, hand and power tools, cutting tools, rebar, ladders, safety and fall arrest equipment, specialty screws and fasteners, sealants and adhesives, drainage pipe, geo-synthetics, erosion and sediment control equipment and other engineered materials used broadly across all types of non-residential and residential construction. Construction & Industrial reaches customers through a nationwide network of regionally organized branches as well as print catalogs and e-commerce. Construction & Industrial also includes Home Improvement Solutions which offers light remodeling and construction supplies, kitchen and bath cabinets, windows, plumbing materials, electrical

equipment and other products, primarily to small remodeling contractors and trade professionals through local retail outlets.

In addition to the reportable segments, our consolidated financial results include Corporate. Corporate includes costs related to our centralized support functions, which are comprised of finance, information technology, human resources, legal, supply chain and other support services, and removes inter-segment transactions.

Discontinued operations

On August 1, 2017, the Company completed the sale of its Waterworks business. For additional information on the sale of the Waterworks business, see Note 2 Discontinued Operations, in the Notes to Consolidated Financial Statements within Item 1 of this quarterly report on Form 10-Q.

On May 31, 2016, the Company completed the sale of its Interior Solutions business.

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The presentation of discontinued operations includes revenues and expenses of the discontinued operations, net of tax, as one line item on the Consolidated Statements of Operations and Comprehensive Income (Loss). Prior periods presented have been revised to reflect this presentation. For additional detail related to the results of operations of the discontinued operations, see Note 2 - Discontinued Operations, in the Notes to Consolidated Financial Statements within Item 1 of this quarterly report on Form 10-Q.

Seasonality

In a typical year, our operating results are impacted by seasonality. Historically, sales of our products have been higher in the second and third quarters of each fiscal year due to favorable weather and longer daylight conditions during these periods. Seasonal variations in operating results may also be significantly impacted by inclement weather conditions, such as cold or wet weather, which can delay construction projects.

Fiscal Year

HD Supply's fiscal year is a 52- or 53-week period ending on the Sunday nearest to January 31. Fiscal years ending January 28, 2018 (fiscal 2017) and January 29, 2017 (fiscal 2016) both include 52 weeks. The three months ended October 29, 2017 (third quarter 2017) and October 30, 2016 (third quarter 2016) both include 13 weeks. The nine months ended October 29, 2017 and October 30, 2016 both include 39 weeks.

Key business metrics

Net sales

We earn our Net sales primarily from the sale of construction, maintenance and renovation and improvement related products and our provision of related services to approximately 500,000 customers, including contractors, government entities, maintenance professionals and industrial businesses. We recognize sales, net of sales tax and allowances for returns and discounts, when persuasive evidence of an agreement exists, delivery has occurred or services have been rendered, price to the buyer is fixed and determinable and collectability is reasonably assured. Net sales in certain business units fluctuate with the price of commodities as we seek to minimize the effects of changing commodities prices by passing such increases in the prices of certain commodity-based products to our customers.

We ship products to customers by internal fleet and by third-party carriers. Net sales are recognized from product sales when title to the products is passed to the customer, which generally occurs at the point of destination.

We include shipping and handling fees billed to customers in Net sales. Shipping and handling costs associated with inbound freight are capitalized to inventories and relieved through Cost of sales as inventories are sold. Shipping and handling costs associated with outbound freight are included in Selling, general and administrative expenses.

Gross profit

Gross profit primarily represents the difference between the product cost from our suppliers (net of earned rebates and discounts) including the cost of inbound freight and the sale price to our customers. The cost of outbound freight, purchasing, receiving and warehousing are included in Selling, general and administrative expenses within operating expenses. Our Gross profits may not be comparable to those of other companies, as other companies may include all of the costs related to their distribution network in Cost of sales.

Operating expenses

Operating expenses are primarily comprised of Selling, general and administrative costs, which include payroll expenses (salaries, wages, employee benefits, payroll taxes and bonuses), outbound freight, rent, insurance, utilities, repair and maintenance and professional fees. In addition, operating expenses include depreciation and amortization and restructuring charges.

Adjusted EBITDA and Adjusted net income

Adjusted EBITDA and Adjusted net income are not recognized terms under generally accepted accounting principles in the United States of America (GAAP) and do not purport to be alternatives to Net income as a

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measure of operating performance. We present Adjusted EBITDA and Adjusted net income because each is a primary measure used by management to evaluate operating performance. In addition, we present Adjusted net income to measure our overall profitability as we believe it is an important measure of our performance. We believe the presentation of Adjusted EBITDA and Adjusted net income enhances our investors overall understanding of the financial performance of our business. We believe Adjusted EBITDA and Adjusted net income are helpful in highlighting operating trends, because each excludes the results of decisions that are outside the control of operating management and that can differ significantly from company to company depending on long-term strategic decisions regarding capital structure, the tax jurisdictions in which companies operate, age and book depreciation of facilities and capital investments.

Adjusted EBITDA is based on Consolidated EBITDA, a measure which is defined in HDS's Senior Credit Facilities and used in calculating financial ratios in several material debt covenants. Borrowings under these facilities are a key source of liquidity and our ability to borrow under these facilities depends upon, among other things, our compliance with such financial ratio covenants. In particular, both facilities contain restrictive covenants that can restrict our activities if we do not maintain financial ratios calculated based on Consolidated EBITDA. Our Senior ABL Facility requires us to maintain a minimum fixed charge coverage ratio of 1:1 if our specified excess availability (including an amount by which our borrowing base exceeds the outstanding amounts) under the Senior ABL Facility falls below the greater of (a) \$100 million and (b) 10% of the lesser of (i) the borrowing base and (ii) the aggregate commitments. Adjusted EBITDA is defined as Net income less Income from discontinued operations, net of tax, plus (i) Interest expense and Interest income, net, (ii) Provision for income taxes, and (iii) Depreciation and amortization and further adjusted to exclude loss on extinguishment of debt, non-cash items and certain other adjustments to Consolidated Net Income, including costs associated with capital structure enhancements, permitted in calculating Consolidated EBITDA under our Senior Credit Facilities. We believe that presenting Adjusted EBITDA is appropriate to provide additional information to investors about how the covenants in those agreements operate and about certain non-cash and other items. The Term Loan Facility, as defined below, and Senior ABL Facility, as defined below, permit us to make certain additional adjustments to Consolidated Net Income in calculating Consolidated EBITDA, such as projected net cost savings, which are not reflected in the Adjusted EBITDA data presented in this quarterly report on Form 10-Q. We may in the future reflect such permitted adjustments in our calculations of Adjusted EBITDA. These covenants are important to the Company as failure to comply with certain covenants would result in a default under our Senior Credit Facilities. The material covenants in our Senior Credit Facilities are discussed in our annual report on Form 10-K for the fiscal year ended January 29, 2017.

Adjusted net income is defined as Net income (loss) less Income from discontinued operations, net of tax, further adjusted for loss on extinguishment of debt and certain non-cash, non-recurring, non-operational, or unusual items, net of tax.

We believe that Adjusted EBITDA and Adjusted net income are frequently used by securities analysts, investors and other interested parties in their evaluation of companies, many of which present an Adjusted EBITDA or Adjusted net income measure when reporting their results. We compensate for the limitations of using non-GAAP financial measures by using them to supplement GAAP results to provide a more complete understanding of the factors and trends affecting the business than GAAP results alone. Because not all companies use identical calculations, our presentation of Adjusted EBITDA and Adjusted net income may not be comparable to other similarly titled measures of other companies.

Adjusted EBITDA and Adjusted net income have limitations as analytical tools and should not be considered in isolation or as substitutes for analyzing our results as reported under GAAP. Some of these limitations are:

- Adjusted EBITDA and Adjusted net income do not reflect changes in, or cash requirements for, our working capital needs;

- Adjusted EBITDA does not reflect our interest expense, or the requirements necessary to service interest or principal payments on our debt;
- Adjusted EBITDA does not reflect our income tax expenses or the cash requirements to pay our taxes;
- Adjusted EBITDA and Adjusted net income do not reflect historical cash expenditures or future requirements for capital expenditures or contractual commitments; and

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- although depreciation and amortization charges are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements.

The following table presents a reconciliation of Net income and Income from continuing operations, the most directly comparable financial measures under GAAP, to Adjusted EBITDA for the periods presented (amounts in millions):

	Three Months Ended		Nine Months Ended	
	October 29, 2017	October 30, 2016	October 29, 2017	October 30, 2016
Net income	\$ 452	\$ 60	\$ 979	\$ 144
Less income from discontinued operations, net of tax	406	40	794	104
Income from continuing operations	46	20	185	40
Interest expense, net	35	65	133	219
Provision for income taxes	23	15	92	30
Depreciation and amortization (1)	22	22	66	66
Loss on extinguishment & modification of debt (2)	78	59	81	174
Restructuring charges (3)	3	3	3	14
Stock-based compensation	7	4	19	15
Adjusted EBITDA	\$ 214	\$ 188	\$ 579	\$ 558

(1) *Depreciation and amortization includes amounts recorded within Cost of sales in the Consolidated Statements of Operations.*

(2) *Represents the loss on extinguishment of debt including the write-off of unamortized deferred financing costs, original issue discount, and other assets or liabilities associated with such debt. Also includes the costs of debt modification.*

(3) *Represents the costs incurred for strategic alignment of our workforce. These costs include severance, relocation costs and other related costs.*

The following table presents a reconciliation of Net income and Income from continuing operations, the most directly comparable financial measures under GAAP, to Adjusted net income for the periods presented (amounts in millions):

	Three Months Ended		Nine Months Ended	
	October 29, 2017	October 30, 2016	October 29, 2017	October 30, 2016

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Net income	\$	452	\$	60	\$	979	\$	144
Less income from discontinued operations, net of tax		406		40		794		104
Income from continuing operations		46		20		185		40
Plus: Provision for income taxes		23		15		92		30
Less: Cash income taxes (1)		(4)		(6)		(14)		(12)
Plus: Amortization of acquisition-related intangible assets (other than software)		3		3		9		9
Plus: Loss on extinguishment & modification of debt (2)		78		59		81		174
Plus: Restructuring charges (3)		3		3		3		14
Adjusted Net Income	\$	149	\$	94	\$	356	\$	255

(1) Cash paid for income taxes in the three and nine months ended October 29, 2017 excludes \$13 million in tax payments related to the sale of the Waterworks business unit.

(2) Represents the loss on extinguishment of debt including the write-off of unamortized deferred financing costs, original issue discount, and other assets or liabilities associated with such debt. Also includes the costs of debt modification.

(3) Represents the costs incurred for strategic alignment of our workforce. These costs include severance, relocation costs and other related costs.

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	Three Months Ended		Percentage	Nine Months Ended		Percentage
	October 29, 2017	October 30, 2016	Increase (Decrease)	October 29, 2017	October 30, 2016	Increase (Decrease)
Net sales	\$ 1,370	\$ 1,275	7.5%	\$ 3,938	\$ 3,734	5.5%
Gross Profit	542	512	5.9	1,565	1,494	4.8
Operating expenses:						
Selling, general and administrative	336	329	2.1	1,008	954	5.7
Depreciation and amortization	21	21	*	63	63	*
Restructuring Charges	3	3	*	3	14	*
Total operating expenses	360	353	2.0	1,074	1,031	4.2
Operating Income	182	159	14.5	491	463	6.0
Interest expense	36	65	(44.6)	134	219	(38.8)
Interest income	(1)		*	(1)		*
Loss on extinguishment & modification of debt	78	59	32.2	81	174	(53.4)
Income from Continuing Operations Before Provision for Income Taxes	69	35	97.1	277	70	*
Provision for income taxes	23	15	53.3	92	30	*
Income from Continuing Operations	46	20	*	185	40	*
Income from discontinued operations, net of tax	406	40	*	794	104	*
Net Income	\$ 452	\$ 60	*	\$ 979	\$ 144	*
Non-GAAP financial data:						
Adjusted EBITDA	\$ 214	\$ 188	13.8	\$ 579	\$ 558	3.8
Adjusted net income	\$ 149	\$ 94	58.5	\$ 356	\$ 255	39.6

* Not meaningful

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	% of Net Sales Three Months Ended			% of Net Sales Nine Months Ended		
	October 29, 2017	October 30, 2016	Basis Point Increase (Decrease)	October 29, 2017	October 30, 2016	Basis Point Increase (Decrease)
Net sales	100.0%	100.0%		100.0%	100.0%	
Gross Profit	39.6	40.2	(60)	39.7	40.0	(30)
Operating expenses:						
Selling, general and administrative	24.5	25.9	(140)	25.6	25.5	10
Depreciation and amortization	1.6	1.6		1.5	1.7	(20)
Restructuring Charges	0.2	0.2		0.1	0.4	(30)
Total operating expenses	26.3	27.7	(140)	27.2	27.6	(40)
Operating Income	13.3	12.5	80	12.5	12.4	10
Interest expense	2.6	5.1	(250)	3.4	5.8	(240)
Interest income	(0.1)		(10)			
Loss on extinguishment & modification of debt	5.7	4.6	110	2.1	4.7	(260)
Income from Continuing Operations Before Provision for Income Taxes	5.1	2.8	230	7.0	1.9	*
Provision for income taxes	1.7	1.2	50	2.3	0.8	150
Income from Continuing Operations	3.4	1.6	180	4.7	1.1	360
Income from discontinued operations, net of tax	29.6	3.1	*	20.2	2.8	*
Net Income	33.0	4.7	*	24.9	3.9	*
Non-GAAP financial data:						
Adjusted EBITDA	15.6	14.7	90	14.7	14.9	(20)
Adjusted net income	10.9	7.4	350	9.0	6.8	220

* Not meaningful

Highlights

Net sales in third quarter 2017 increased \$95 million, or 7.5%, as compared to third quarter 2016. Both of our reportable segments delivered increases in Net sales. Operating income in third quarter 2017 increased \$23 million, or 14.5%, as compared to third quarter 2016. Net income in third quarter 2017 increased \$392 million to \$452 million as compared to \$60 million in third quarter 2016 due primarily to the completion of the sale of the Waterworks business. Adjusted EBITDA in third quarter 2017 increased \$26 million, or 13.8%, as compared to third quarter 2016. Adjusted net income in third quarter 2017 increased \$55 million, or 58.5%, as compared to third quarter 2016 due primarily to a decline in interest expense as a result of a lower effective interest rate and lower outstanding debt balances. As of October 29, 2017, our total liquidity was \$1.2 billion. See Liquidity and Capital Resources External Financing for further information.

Net sales

Net sales in third quarter 2017 increased \$95 million, or 7.5%, compared to third quarter 2016 and \$204 million, or 5.5%, in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016.

Both of our reportable segments delivered an increase in Net sales in third quarter 2017 and in the first nine months of fiscal 2017 as compared to the same periods in fiscal 2016. The Net sales increases were primarily due to increases in market volume and growth initiatives at both of our businesses. Growth initiatives contributed approximately \$58 million and \$102 million in third quarter 2017 and the first nine months of fiscal 2017, respectively. The increase in Net sales in both periods was also partially due to a favorable Canadian exchange rate, resulting in a \$2 million and \$1 million increase to Net sales in third quarter 2017 and the first nine months of fiscal 2017, respectively.

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Gross profit

Gross profit increased \$30 million, or 5.9%, during third quarter 2017 as compared to third quarter 2016 and \$71 million, or 4.8%, during the first nine months of fiscal 2017 as compared to the same period in fiscal 2016.

Both of our reportable segments delivered an increase in Gross profit primarily due to sales growth from increased market volume and initiatives.

Gross profit as a percentage of Net sales (gross margin) decreased approximately 60 basis points to 39.6% in third quarter 2017 as compared to 40.2% in third quarter 2016 and approximately 30 basis points to 39.7% in the first nine months of fiscal 2017 as compared to 40.0% in the same period in fiscal 2016. The decline in gross margin in both periods was primarily driven by decreasing rebar margins at our Construction & Industrial business and a shift in product mix at both Facilities Maintenance and Construction & Industrial.

Operating expenses

Operating expenses increased \$7 million, or 2.0%, during third quarter 2017 as compared to third quarter 2016 and \$43 million, or 4.2%, in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016.

Selling, general and administrative expenses increased \$7 million, or 2.1%, in third quarter 2017 as compared to third quarter 2017 and \$54 million, or 5.7%, in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016. The increase in both periods was primarily a result of increases in variable expenses due to higher sales volume and increased investments in growth initiatives, primarily additional personnel. Restructuring charges were flat in third quarter 2017 as compared to third quarter 2016 and decreased \$11 million in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016. The Company completed its Fiscal 2015 Restructuring Plan activities to strategically align its workforce in fiscal 2016. The Company initiated its Fiscal 2017 Restructuring Plan in third quarter 2017. For additional information, see Note 8 - Restructuring Activities, in the Notes to Consolidated Financial Statements within Item 1 of this quarterly report on Form 10-Q.

Operating expenses as a percentage of Net sales decreased approximately 140 basis points to 26.3% in third quarter 2017 and approximately 40 basis points to 27.2% in the first nine months of fiscal 2017 as compared to the same periods in fiscal 2016. Selling, general and administrative expenses as a percentage of Net sales decreased approximately 140 basis points to 24.5% in third quarter 2017 as compared to third quarter 2016 and increased approximately 10 basis points to 25.6% in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016. The decrease in third quarter 2017 as compared to third quarter 2016 is primarily due to the leverage of fixed costs through sales volume increases and the third quarter 2016 supply chain corrective action costs at Facilities Maintenance. The increase in the first nine months of fiscal 2017 as compared to the first nine months of fiscal 2016 was primarily a result of the increased investments in growth initiatives, partially offset by the leverage of fixed costs through sales volume increases.

Operating income

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Operating income increased \$23 million, or 14.5%, during third quarter 2017 as compared to third quarter 2016 and \$28 million, or 6.0%, in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016. The increase in both periods was primarily due to higher sales volume, partially offset by the decrease in gross margins and increase in Operating expenses.

Operating income as a percentage of Net sales increased approximately 80 basis points to 13.3% in third quarter 2017 and approximately 10 basis points during the first nine months of fiscal 2017 as compared to the same periods in fiscal 2016. In third quarter 2017, the decrease in Selling, general and administrative expense as a percentage of Net sales were offset by the decline in gross margins as a percentage of Net sales. In the first nine months of fiscal 2017, the increase in Selling, general and administrative expense as a percentage of Net sales and decline in margins were partially offset by a decline in depreciation and amortization and restructuring charges as a percentage of Net sales.

Interest expense

Interest expense decreased \$29 million, or 44.6%, during third quarter 2017 as compared to third quarter 2016 and \$85 million, or 38.8%, during the first nine months of fiscal 2017 as compared to the same period in fiscal 2016. The decrease in both periods was due to a lower average interest rate on our outstanding indebtedness due to debt

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refinancing transactions and a lower average outstanding balance as we continue to use cash flow from operations and proceeds from the sale of businesses to reduce indebtedness.

Interest income

Interest income during third quarter 2017 and the first nine months of fiscal 2017 was approximately \$1 million. The interest income was due to investment of a portion of the net proceeds from the sale of the Waterworks business in temporary cash investments.

Loss on extinguishment & modification of debt

During third quarter 2017 and the first nine months of fiscal 2017, our debt refinancing and redemption activities resulted in charges of \$78 million and \$81 million, respectively, recorded in accordance with Accounting Standards Codification (ASC) 470-50, Debt Modifications and Extinguishments.

On September 1, 2017, HDS redeemed all of the outstanding \$1,250 million in aggregate principal amount of its 5.25% Senior Secured First Priority Notes due 2021 (the December 2014 First Priority Notes), incurring a \$73 million loss on extinguishment of debt, which includes a \$62 million make-whole premium and the write-off of \$11 million of unamortized deferred financing costs.

On August 31, 2017, HDS amended its senior secured term loan facility (the Term Loan Facility), incurring a modification and extinguishment charge of approximately \$3 million, which includes financing fees and other costs of approximately \$1 million and the write-off of approximately \$2 million of unamortized discount and deferred financing costs.

On August 25, 2017, HDS amended its 5.75% Senior Unsecured Notes due 2024 (April 2016 Senior Unsecured Notes). As a result, the Company incurred a modification charge of approximately \$3 million for financing fees.

On April 18, 2017, HDS used cash and available borrowings under its Senior ABL Facility, as defined below, to repay \$100 million aggregate principal of its Term B-1 Loans, as defined below, incurring a \$2 million loss on extinguishment of debt, which included write-offs of unamortized original issue discount and unamortized deferred financing costs for \$1 million each.

On April 5, 2017, HDS amended its Senior Asset Based Lending Facility due 2022 (the Senior ABL Facility), incurring a \$1 million loss on extinguishment of debt.

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For further information on 2017 debt refinancing and redemption activity, please refer to [Liquidity and Capital Resources](#) [External Financing](#).

During third quarter 2016 and the first nine months of fiscal 2016, our debt refinancing and redemption activities resulted in charges of \$59 million and \$174 million, respectively, recorded in accordance with ASC 470-50, [Debt Modifications and Extinguishments](#).

On October 17, 2016, HDS redeemed all of the outstanding \$1,275 million aggregate principal of its 7.5% Senior Unsecured Notes due 2020, incurring a \$59 million loss on extinguishment of debt, which included a \$48 million premium payment and a write-off of \$11 million of unamortized deferred financing costs.

On April 27, 2016, HDS redeemed all of the outstanding \$1,000 million aggregate principal of its 11.5% Senior Unsecured Notes due 2020, incurring a \$115 million loss on extinguishment of debt, which included a \$106 million make-whole premium payment and a write-off of \$9 million of unamortized deferred financing costs.

For more information on 2016 debt refinancing and redemption activities, please refer to [Liquidity and Capital Resources](#) [External Financing](#) in [Item 5. Management's Discussion and Analysis on Financial Condition and Results of Operations](#) in our annual report on Form 10-K for the fiscal year ended January 29, 2017.

Provision (benefit) for income taxes

The provision (benefit) for income taxes during the period is calculated by applying an estimated annual tax rate for the full fiscal year to pre-tax income for the reported period plus or minus unusual or infrequent discrete items occurring within the period. The Company's income tax provision (benefit) recorded in interim periods can move from an income tax provision to income tax benefit (and vice versa) in situations in which the Company is experiencing changes between interim pre-tax income to pre-tax loss (and vice versa). The provision for income

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taxes from continuing operations in third quarter 2017 was an expense of \$23 million compared to \$15 million in third quarter 2016. The provision for income taxes in the first nine months of fiscal 2017 was an expense of \$92 million compared to \$30 million in the first nine months of fiscal 2016.

The effective rate for continuing operations for third quarter 2017 and the first nine months of fiscal 2017 was an expense of 33.3% and 33.2%, respectively. The effective rate for continuing operations for both third quarter 2016 and the first nine months of fiscal 2016 was an expense of 42.9%.

In third quarter 2017 and the first nine months of fiscal 2017, the application of stock-based compensation expense guidance in Accounting Standards Update (ASU) No. 2016-09 resulted in discrete tax benefits of \$2 million and \$14 million, respectively, from the exercise and vesting of stock-based awards, which lowered the effective tax rate by 290 and 510 basis points, respectively. For additional information on the adoption of ASU No. 2016-09, see Note 12 - Recent Accounting Pronouncements, in the Notes to Consolidated Financial Statements within Item 1 of this quarterly report on Form 10-Q.

We regularly assess the realization of our net deferred tax assets and the need for any valuation allowance. This assessment requires management to make judgments about the benefits that could be realized from future taxable income, as well as other positive and negative factors influencing the realization of deferred tax assets. As of January 29, 2017, the Company's valuation allowance on its U.S. deferred tax assets was approximately \$5 million and remained unchanged as of October 29, 2017.

Income from discontinued operations, net of tax

Income from discontinued operations, net of tax during third quarter 2017 was \$406 million, which included \$934 million of pre-tax income from discontinued operations and a \$528 million income tax expense.

Income from discontinued operations, net of tax during the first nine months of fiscal 2017 was \$794 million, which included \$1,038 million of pre-tax income from discontinued operations and a \$244 million income tax expense. In the nine months ended October 29, 2017, the Company recognized a gain on sale of the Waterworks business of \$725 million, net of tax of \$202 million. During second quarter 2017, the Company recorded a \$323 million tax benefit in Income from discontinued operations, net of tax, to recognize a net deferred tax asset for the difference between the Company's stock basis versus its book basis of the Waterworks business unit. On August 1, 2017, the Company completed the sale of the Waterworks business and utilized the \$323 million net deferred tax asset. For additional information, see Note 2 Discontinued Operations in the Notes to Consolidated Financial Statements within Item 1 of this quarterly report on Form 10-Q.

Adjusted EBITDA

Adjusted EBITDA increased \$26 million, or 13.8%, and \$21 million, or 3.8%, in third quarter 2017 and the first nine months of fiscal 2017 as compared to the same periods in fiscal 2016. Both of our reportable segments experienced an increase in Adjusted EBITDA in both periods.

The increase in Adjusted EBITDA in both periods was primarily due to the increase in sales volume, partially offset by the increase in Operating expenses. Adjusted EBITDA as a percentage of Net sales increased approximately 90 basis points to 15.6% in third quarter 2017 as compared to third quarter 2016 and decreased approximately 20 basis points to 14.7% in the first nine months of fiscal 2017 as compared to the first nine months of fiscal 2016. The increase in Adjusted EBITDA as a percentage of Net sales in third quarter 2017 as compared to third quarter 2016 was due to the leverage of fixed costs through sales volume increases, partially offset by a decline in gross margin. The decrease in Adjusted EBITDA as a percentage of Net sales in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016 was due to increased investment in growth initiatives and a decline in gross margin.

Adjusted net income

Adjusted net income increased \$55 million, or 58.5%, in third quarter 2017 as compared to third quarter 2016 and \$101 million, or 39.6%, in the first nine months of fiscal 2017 as compared to the first nine months of fiscal 2016. The increase in Adjusted net income in both periods was primarily attributable to lower interest expense and an increase in sales volume.

Table of Contents**Results of operations by reportable segment***Facilities Maintenance*

Dollars in millions	Three Months Ended			Nine Months Ended		
	October 29, 2017	October 30, 2016	Increase (Decrease)	October 29, 2017	October 30, 2016	Increase (Decrease)
Net sales	\$ 754	\$ 724	4.1%	\$ 2,205	\$ 2,142	2.9%
Operating income	\$ 144	\$ 129	11.6%	\$ 402	\$ 387	3.9%
<i>% of Net sales</i>	19.1%	17.8%	130bps	18.2%	18.1%	10bps
Depreciation and amortization	8	9	(11.1)%	23	27	(14.8)%
Restructuring	1	2	(50.0)%	1	11	*
Adjusted EBITDA	\$ 153	\$ 140	9.3%	\$ 426	\$ 425	0.2%
<i>% of Net sales</i>	20.3%	19.3%	100bps	19.3%	19.8%	(50)bps

* Not meaningful

Net Sales

Net sales increased \$30 million, or 4.1%, in third quarter 2017 as compared to third quarter 2016 and \$63 million, or 2.9%, in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016.

The increase in Net sales in both periods was primarily due to market growth in the multifamily and hospitality industries and growth initiatives, particularly in the third quarter of 2017. These growth initiatives consist of investments in personnel, products, and technology aligned with our selling channels, such as our sales force, e-commerce site and mobile application, and our enabling functions, such as supply chain and data analytics.

Adjusted EBITDA

Adjusted EBITDA increased \$13 million, or 9.3%, in third quarter 2017 as compared to third quarter 2016 and \$1 million, or 0.2%, in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016.

The increase in Adjusted EBITDA in third quarter 2017 as compared to third quarter 2016 was primarily due to increased sales volume and higher Selling, general and administrative expenses in third quarter 2016 driven by supply chain corrective action. The increase in Adjusted EBITDA in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016 was primarily due to increased sales volume,

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partially offset by increased Selling, general and administrative expenses due to costs incurred to increase distribution center capacity beginning in third quarter 2016 and higher personnel costs related to open positions in the first half of fiscal 2016 due to transitioning the business from San Diego to Atlanta.

Adjusted EBITDA as a percentage of Net sales increased approximately 100 basis points in third quarter 2017 as compared to third quarter 2016 and decreased approximately 50 basis points in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016. The increase in third quarter 2017 as compared to third quarter 2016 was primarily driven by a decrease in Selling, general and administrative expenses as a percentage of Net sales due to the leverage of fixed costs through sales volume increases and the third quarter 2016 supply chain corrective action costs, partially offset by a decrease in gross margin, due to product mix. The decrease in Adjusted EBITDA as a percentage of Net sales in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016 was primarily driven by an increase in Selling, general and administrative expenses as a percentage of Net sales due to costs incurred to increase distribution center capacity beginning in third quarter 2016 and open positions in the first half of fiscal 2016 due to transitioning the business to Atlanta.

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Dollars in millions	Three Months Ended			Nine Months Ended		
	October 29, 2017	October 30, 2016	Increase (Decrease)	October 29, 2017	October 30, 2016	Increase (Decrease)
Net sales	\$ 617	\$ 552	11.8%	\$ 1,737	\$ 1,597	8.8%
Operating income	\$ 66	\$ 59	11.9%	\$ 172	\$ 159	8.2%
<i>% of Net sales</i>	10.7%	10.7%		9.9%	10.0%	(10)bps
Depreciation and amortization	10	8	25.0%	28	25	12.0%
Adjusted EBITDA	\$ 76	\$ 67	13.4%	\$ 200	\$ 184	8.7%
<i>% of Net sales</i>	12.3%	12.1%	20bps	11.5%	11.5%	

Net Sales

Net sales increased \$65 million, or 11.8%, in third quarter 2017 as compared to third quarter 2016 and \$140 million, or 8.8%, in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016.

Growth initiatives contributed to the increase in Net sales in both periods driven by managed sales approach (MSA), new locations, and direct marketing initiatives. MSA is a structured approach to drive revenue at a regional level through analysis, tools and sales management. In addition, Net sales was positively impacted by end-market improvement in both non-residential and residential construction markets.

Adjusted EBITDA

Adjusted EBITDA increased \$9 million, or 13.4%, in third quarter 2017 as compared to third quarter 2016 and \$16 million, or 8.7%, in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016.

The increase in Adjusted EBITDA in both periods was primarily driven by growth initiatives and market volume. This increase was partially offset by lower gross margins and increased Selling, general and administrative expenses in both periods related to variable expenses and the hiring of additional associates to support the expanding business and drive future growth.

Adjusted EBITDA as a percentage of Net sales increased approximately 20 basis points in third quarter 2017 as compared to third quarter 2016 and remained flat in the first nine months of fiscal 2017 as compared to the same period in fiscal 2016. The increase in third quarter 2017 as compared to third quarter 2016 was driven by a decrease in Selling, general and administrative expenses as percentage of Net sales due to product mix, category management initiatives and the leverage of fixed costs through sales volume increases, partially offset by declines in rebar gross margins. Rebar margins are declining due to an increase in steel costs impacted by duties and the threat of duties on imported steel. We have been unable to pass along all of the cost increases to our customers due to the competitive environment. We expect rebar margins to remain under pressure for the remainder of the year.

Liquidity and capital resources

Sources and uses of cash

Our sources of funds, primarily from operations, cash on-hand, and, to the extent necessary, from readily available external financing arrangements, are sufficient to meet all current obligations on a timely basis. We believe that these sources of funds will be sufficient to meet the operating needs of our business for at least the next twelve months.

During the first nine months of fiscal 2017, the Company's generation of cash was primarily driven by cash receipts from operations, proceeds from the sale of the Waterworks business and proceeds from stock option exercises, partially offset by net debt repayments, the payment of interest on debt, capital expenditures and purchases of treasury shares.

As of October 29, 2017, our combined liquidity of approximately \$1.2 billion was comprised of \$461 million in cash and cash equivalents and \$744 million of additional available borrowings (excluding \$155 million of borrowings on available cash balances) under our Senior ABL Facility, based on qualifying inventory and receivables.

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Information about the Company's cash flows, by category, is presented in the Consolidated Statements of Cash Flows and is summarized as follows:

Net cash provided by (used for):

Amounts in millions	Nine Months Ended		Increase (Decrease)
	October 29, 2017	October 30, 2016	
Operating activities	\$ 320	\$ 304	\$ 16
Investing activities	2,387	(29)	2,416
Financing activities	(2,321)	(399)	(1,922)

Working capital

Working capital, excluding cash and cash equivalents, was \$728 million as of October 29, 2017, decreasing \$308 million as compared to \$1,036 million as October 30, 2016. Working capital, excluding the impact of discontinued operations and cash and cash equivalents increased \$56 million. The increase was driven by business growth, resulting in increases in Receivables and Inventory as well as a decrease in accrued interest as a result of reduced debt balances. These increases were partially offset by increases in Accounts Payable.

Operating activities

During the first nine months of fiscal 2017, cash provided by operating activities was \$320 million compared to \$304 million in the first nine months of fiscal 2016. Cash interest paid in the first nine months of fiscal 2017 was \$148 million, compared to \$249 million in the first nine months of fiscal 2016. Cash flows from operating activities included a payment of \$6 million of original issue discount related to the extinguishment of a portion of the Term Loans in the first nine months of fiscal 2017. During the first nine months of fiscal 2017, cash flows provided by operating activities for discontinued operations were \$28 million as compared to \$124 million during the first nine months of fiscal 2016. Excluding the cash interest payments in both periods and original issue discounts paid, cash flows from operating activities for continuing operations increased approximately \$16 million in the first nine months of fiscal 2017 as compared to the first nine months of fiscal 2016. The increase in operating cash flows excluding interest, original issue discount, and discontinued operations is attributable to growth in earnings of continuing operations, partially offset by investments in working capital for business growth.

Investing activities

During the first nine months of fiscal 2017, cash provided by investing activities was \$2,387 million, primarily comprised of \$2,450 million of cash proceeds from the sales of businesses, partially offset by \$65 million of capital expenditures. During the first nine months of fiscal 2016, cash used by investing activities was \$29 million, primarily comprised of \$59 million of capital expenditures, offset by \$28 million of cash proceeds from the sales of businesses.

Financing activities

During the first nine months of fiscal 2017, cash used in financing activities was \$2,321 million, primarily due to net debt repayments of \$1,778 million including premiums to redeem debt prior to maturity, purchases of treasury shares of \$555 million, and payments for debt issuance costs of \$26 million; partially offset by proceeds from employee stock option exercises of \$37 million.

During the first nine months of fiscal 2016, cash used in financing activities was \$399 million, primarily due to net debt repayments of \$378 million including premiums and make-whole payments to call or redeem debt prior to maturity, payments for debt issuance costs of \$19 million and purchases of treasury shares of \$24 million, partially offset by proceeds from employee stock option exercises of \$23 million.

External financing

As of October 29, 2017, we had an aggregate principal amount of \$2,098 million of outstanding indebtedness, net of unamortized discounts and unamortized deferred financing costs of \$6 million and \$34 million, respectively, and \$899 million of additional available borrowings under our Senior ABL Facility (after giving effect to the borrowing base limitations and approximately \$27 million in letters of credit issued and including \$155 million of borrowings

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available on qualifying cash balances). From time to time, depending on market conditions and other factors, the Company may seek to repay, redeem, repurchase or otherwise acquire or refinance all or a portion of our indebtedness. We may make such repurchases in privately negotiated transactions or otherwise.

On September 1, 2017, HDS used a portion of the net proceeds from the sale of the Waterworks business to redeem all of the outstanding \$1,250 million in aggregate principal amount of the December 2014 First Priority Notes for an aggregate redemption price of approximately \$1,325 million. The redemption price included an approximately \$62 million make-whole premium calculated in accordance with terms of the indenture governing the December 2014 First Priority Notes (the 2014 indenture) and \$14 million of accrued but unpaid interest to the redemption date. In connection with the redemption, the 2014 indenture was satisfied and discharged and the liens securing the December 2014 First Priority Notes were released in accordance with the terms of the 2014 indenture. As a result of the redemption, the Company incurred a \$73 million loss on extinguishment of debt, which includes the \$62 million make-whole premium and the write-off of \$11 million of unamortized deferred financing costs, in accordance with ASC 470-50, Debt Modifications and Extinguishments.

On August 31, 2017, HDS entered into a Fifth Amendment (the Fifth Amendment) to the credit agreement governing HDS's existing Term Loan Facility. Pursuant to the Fifth Amendment, HDS amended its existing Term Loan Facility to, among other things, (i) refinance all the outstanding term loans in an original aggregate principal amount of \$842 million (the Term B-1 Loans) with a new tranche of term loans (the Term B-3 Loans) in an aggregate principal amount of \$535 million, (ii) refinance all the outstanding term loans in an original aggregate principal of \$550 million (the Term B-2 Loans) with a new tranche of term loans (the Term B-4 Loans) in an aggregate principal amount of \$546 million and (iii) amend the definition of Permitted Payments contained in the credit agreement to permit an additional category of Permitted Payments permitting Restricted Payments (as defined in the credit agreement) at any time in an aggregate amount not to exceed (x) \$500,000,000 and (y) thereafter, upon full use of such capacity set forth in clause (x), an additional amount, if any, such that, after giving pro forma effect to such Restricted Payment, the Company's Consolidated Total Leverage Ratio (as defined in the credit agreement) does not exceed 3.00 to 1.00.

The Term B-3 Loans bear interest at the applicable margin for borrowings of 2.25% for LIBOR borrowings and 1.25% for base rate borrowings. The Term B-3 Loans amortize in equal quarterly installments in aggregate annual amounts equal to 1.00% of the original principal amount and will mature on August 13, 2021.

The Term B-4 Loans bear interest at the applicable margin for borrowings of 2.50% for LIBOR borrowings and 1.50% for base rate borrowings. The Term B-4 Loans amortize in equal quarterly installments in aggregate annual amounts equal to 1.00% of the original principal amount and will mature on October 17, 2023.

The Fifth Amendment also provides for a prepayment premium equal to 1.00% of the aggregate principal amount of the applicable Term Loans, as defined below, being prepaid if, on or prior to March 2, 2018, the Company enters into certain repricing transactions.

In connection with the Fifth Amendment, the Company paid approximately \$1 million in consent fees and incurred a modification and extinguishment charge of approximately \$3 million, which includes financing fees and other costs of approximately \$1 million and the write-off of approximately \$2 million of a portion of the related unamortized discount and deferred financing costs, in accordance with ASC 470-50, Debt Modifications and Extinguishments.

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On August 25, 2017, HDS entered into the Second Supplemental Indenture (the "Second Supplemental Indenture") which amends and supplements the Indenture, dated as of April 11, 2016, as amended and supplemented by the First Supplemental Indenture, dated as of April 11, 2016 (together, the "2016 indenture"). Holders of a majority in aggregate principal amount of the outstanding April 2016 Senior Unsecured Notes consented to the Proposed Amendments.

The Second Supplemental Indenture (a) amends the definition of "Permitted Payments" contained in the Indenture to permit an additional category of Permitted Payments permitting Restricted Payments (as defined in the Indenture) at any time in an aggregate amount not to exceed (x) \$500,000,000 and (y) thereafter, upon full use of such capacity set forth in clause (x), an additional amount, if any, such that, after giving pro forma effect to such Restricted Payment, the Company's Consolidated Total Leverage Ratio (as defined in the credit agreement) does not exceed 3.00 to 1.00; (b) increase the interest rate for the April 2016 Senior Unsecured Notes to 7.00% per annum

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commencing April 15, 2019, to the extent the April 2016 Senior Unsecured Notes remain outstanding after April 15, 2019; (c) amend the definition of Net Available Cash contained in the Indenture to provide that proceeds from the sale of the Waterworks business unit consummated on August 1, 2017 (other than proceeds to be applied to redeem the December 2014 First Priority Notes) shall be excluded and accordingly, the Company will not be required to apply the remaining net proceeds in accordance with the provision of the Sale of Assets covenant of the Indenture and (d) amend the definition of Consolidated EBITDA contained in the 2016 indenture to provide that while the Company may continue to include in the calculation thereof projected cost savings, it may only do so with respect those realized as a result of actions taken or to be taken in connection with a purchase of assets from, or a sale of assets to, a third party (excluding the Waterworks Sale (as defined in the Second Supplemental Indenture)).

As a result of entering into the Second Supplemental Indenture, the Company paid approximately \$15 million in consent fees to holders of the outstanding April 2016 Senior Unsecured Notes, which are capitalized as deferred financing costs and amortized over the expected life of the April 2016 Senior Unsecured Notes. Additionally, the Company incurred a modification charge of approximately \$3 million for financing fees in accordance with ASC 470-50, Debt Modifications and Extinguishments.

On April 18, 2017, HDS used cash and available borrowings under its Senior ABL Facility, to repay \$100 million aggregate principal of its Term B-1 Loans. As a result, the Company incurred a \$2 million loss on extinguishment of debt, which included write-offs of unamortized original issue discount and unamortized deferred financing costs for \$1 million each, in accordance with ASC 470-50, Debt Modifications and Extinguishments.

On April 5, 2017, HDS entered into a Third Amendment (the Third Amendment) to the credit agreement governing its existing Senior ABL Facility. The Third Amendment, among other things, reduced the applicable margin for borrowings under the Senior ABL Facility, reduced the applicable commitment fee, and extended the maturity date of the Senior ABL Facility until April 5, 2022. As a result, the Company recorded a \$1 million loss on extinguishment of debt, in accordance with ASC 470-50, Debt Modifications and Extinguishments, for the write-off of \$1 million of unamortized deferred financing costs.

As of October 29, 2017, all outstanding borrowings on the Senior ABL Facility are Canadian borrowings.

For additional information, see Note 3 Debt in the Notes to Consolidated Financial Statements within Item 1 of this quarterly report on Form 10-Q.

Rating agency actions

On September 5, 2017, Standard & Poor's (S&P) raised the credit ratings on HDS's Term Loan B-3 and Term Loan B-4 to BB+ from BB and revised its recovery rating on the Term Loans to 2, citing HDS's repayment of its December 2014 First Priority Notes on September 1, 2017 and increased flexibility in regards to use of the net proceeds from the sale of the Waterworks business.

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In March 2017, Moody's Investor's Service (Moody's) upgraded HDS's corporate family rating to Ba3, from B1. Moody's cited improved credit metrics and anticipated gains from all of our business units. In related rating actions, Moody's upgraded HDS's senior secured term loans and senior secured notes from Ba3 to B1 and senior unsecured notes to B2 from B3. Moody's rating outlook changed to stable from positive. Also in April 2017, S&P raised HDS's corporate credit rating to BB from BB-, assigned a BBB- rating to the Senior ABL Facility, upgraded senior secured debt to BB from BB-, and upgraded unsecured notes to B+ from B-. S&P cited meaningful credit ratio improvement in fiscal 2016 as well as our prioritization of free cash generation for debt reduction. S&P's outlook upgraded to stable.

Critical accounting policies

Our condensed consolidated financial statements have been prepared in accordance with GAAP. Preparation of these statements requires management to make judgments and estimates. Some accounting policies have a significant impact on amounts reported in these consolidated financial statements. The Company's critical accounting policies have not changed from those reported in Management's Discussion and Analysis of Financial Condition and Results of Operations in our annual report on Form 10-K for the fiscal year ended January 29, 2017.

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Recent accounting pronouncements

See Note 12 Recent Accounting Pronouncements in the Notes to Consolidated Financial Statements within Item 1 of this quarterly report on Form 10-Q.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risk associated with changes in interest rates, foreign currency exchange rate fluctuations and certain commodity prices. To reduce these risks, we selectively use financial instruments and other proactive management techniques. We do not use financial instruments for trading purposes or speculation. There have been no material changes in our market risk exposures as compared to those discussed in our annual report on Form 10-K for the fiscal year ended January 29, 2017.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures

HD Supply Holdings, Inc.

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer of HD Supply Holdings, Inc., we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the HD Supply Holdings, Inc. disclosure controls and procedures were effective as of October 29, 2017 (the end of the period covered by this report).

HD Supply, Inc.

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer of HD Supply, Inc., we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the HD Supply, Inc. disclosure controls and procedures were effective as of October 29, 2017 (the end of the period covered by this report).

(b) Changes in internal control

There were no changes in Holdings or HDS's internal control over financial reporting, as defined in the Exchange Act Rules 13a-15(f) or 15d-15(f), during the third quarter of fiscal 2017 that have materially affected, or are reasonably likely to materially affect, Holdings or HDS's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

On July 10, 2017 and August 8, 2017, shareholders filed putative class action complaints in the U.S. District Court for the Northern District of Georgia, alleging that HD Supply and certain senior members of its management (collectively, the defendants) made certain false or misleading public statements in violation of the federal securities laws between November 9, 2016 and June 5, 2017, inclusive (the original securities complaints). Subsequently, the two securities cases were consolidated, and, on November 16, 2017, the lead plaintiffs appointed by the Court filed a Consolidated Amended Class Action Complaint (the Amended Complaint) against the defendants on behalf of all persons other than defendants who purchased or otherwise acquired the Company s common stock between November 9, 2016 and June 5, 2017, inclusive. The Amended Complaint alleges that defendants made certain false or misleading public statements, primarily relating to the Company s progress in addressing certain supply chain disruption issues encountered in the Company s Facilities Maintenance business unit. The Amended Complaint asserts claims against the defendants under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, and seeks class certification under the Federal Rules of Civil Procedure, as well as unspecified monetary damages, pre-judgment and post-judgment interest, and attorneys fees and other costs.

On August 8, 2017, two shareholder derivative complaints were filed naming the Company as a nominal defendant and certain members of its senior management and board of directors (collectively, the individual defendants) as defendants. The complaints generally allege that the individual defendants caused the Company to issue false and misleading statements concerning the Company s business, operations, and financial prospects,

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including misrepresentations regarding operating leverage and supply chain corrective actions. The complaints assert claims against the individual defendants under Section 14(a) of the Securities Exchange Act of 1934, and allege breaches of fiduciary duties, unjust enrichment, corporate waste, and insider selling. The complaints assert a claim to recover any damages sustained by the Company as a result of the individual defendants' allegedly wrongful actions, seek certain actions by the Company to modify its corporate governance and internal procedures, and seek to recover attorneys' fees and other costs. In October 2017, the Court consolidated the two derivative actions and granted the parties' joint scheduling order request. The plaintiffs have until December 18, 2017, to file or designate a consolidated amended complaint.

The Company intends to defend these lawsuits vigorously. Given the stage of the complaints and the claims and issues presented in the above matters, the Company cannot reasonably estimate at this time the possible loss or range of loss, if any, that may arise from these unresolved lawsuits.

HD Supply is involved in various legal proceedings arising in the normal course of its business. The Company establishes reserves for litigation and similar matters when those matters present loss contingencies that it determines to be both probable and reasonably estimable in accordance with ASC 450, Contingencies. In the opinion of management, based on current knowledge, all reasonably estimable and probable matters are believed to be adequately reserved for or covered by insurance and are not expected to have a material adverse effect on the Company's consolidated financial condition, results of operations or cash flows. For all other matters management believes the possibility of losses from such matters is not probable, the potential loss from such matters is not reasonably estimable, or such matters are of such kind or involve such amounts that would not have a material adverse effect on the financial position, results of operations or cash flows of the Company if disposed of unfavorably. For material matters that are reasonably possible and reasonably estimable, including matters that are probable and estimable but for which the amount that is reasonably possible is in excess of the amount that the Company has accrued for, management has estimated the aggregate range of potential loss as \$0 to \$10 million. If a material loss is probable or reasonably possible, and in either case estimable, the Company has considered it in the analysis and it is included in the discussion set forth above.

Item 1A. Risk Factors

We discuss in our filings with the SEC various risks that may materially affect our business. There have been no material changes to the risk factors disclosed in our annual report on Form 10-K, for the fiscal year ended January 29, 2017.

The materialization of any risks and uncertainties identified in forward-looking statements contained in this report together with those previously disclosed in our annual report on Form 10-K for the fiscal year ended January 29, 2017 and our and HDS's other filings with the SEC or those that are presently unforeseen could result in significant adverse effects on our financial condition, results of operations and cash flows. See Forward-looking statements and information at the beginning of this report.

Table of Contents**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(c) Purchases of Equity Securities

On June 3, 2017, Holdings Board of Directors authorized the Company to enter into a share repurchase program for the repurchase of up to an aggregate amount of \$500 million of Holdings common stock in accordance with guidelines specified under Rule 10b5-1 of the Securities Exchange Act of 1934, as amended. As of August 8, 2017, Holdings has completed the repurchase of all \$500 million of common stock authorized under the share repurchase program, purchasing approximately 15.9 million shares at an average price of \$31.37 per share.

On August 25, 2017, Holdings Board of Directors authorized the Company to enter into a new share repurchase program for the repurchase of up to an aggregate amount of \$500 million of Holdings common stock in accordance with guidelines specified under Rule 10b5-1 of the Securities Exchange Act of 1934, as amended. As of October 29, 2017, Holdings has repurchased approximately 0.5 million shares at an average price of \$35.76 per share.

In fiscal 2014, Holdings Board of Directors authorized a share repurchase program to be funded from cash proceeds received from exercises of employee stock options, as was disclosed in our annual report on Form 10-K filed on March 25, 2014. This share repurchase program does not obligate Holdings to acquire any particular amount of common stock, and it may be terminated at any time at Holdings discretion.

Issuer Purchases of Equity Securities in each fiscal month of the third quarter of fiscal 2017 are set forth in the table below:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)
July 31 - August 27	2,491,191	\$ 31.88	2,491,191	\$ 501,203,519
August 28 - September 24	57,567	33.01	57,567	503,323,814
September 25 - October 29	637,032	35.82	637,032	482,913,640
Total	3,185,790	\$ 32.69	3,185,790	

(1) *The total dollar value of shares that may yet be purchased increases by the amount of cash proceeds received from the exercise of employee stock options as they occur.*

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During the nine months ended October 29, 2017, Holdings retired 611,433 shares of its common stock (Retired Shares) held as treasury shares by Holdings in the amount of \$23 million. All of these shares were repurchased by Holdings pursuant to the previously authorized share repurchase program. Holdings reinstated the Retired Shares to the status of authorized but unissued shares of common stock, par value \$0.01 per share, effective as of the date of retirement. In accordance with Accounting Standards Codification 505-30, Equity-Treasury Stock, Holdings reversed the \$0.01 par value of the Retired Shares and the excess of the cost of the Retired Shares over par value to Retained Earnings.

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Item 6. Exhibits

The following exhibits are filed or furnished with this quarterly report.

Exhibit Number	Exhibit Description
2.1	<u>Amended and Restated Agreement and Plan of Merger, dated as of July 14, 2017, by and among HD Supply Holdings, LLC, HD Supply GP & Management, Inc., HD Supply Waterworks Group, Inc., HD Supply Waterworks, Ltd., HD Supply, Inc., CD&R Plumb Buyer, LLC, CD&R Waterworks Merger Sub, LLC, CD&R WW, LLC, and CD&R WW Merger Sub, LLC (1)</u>
3.1	<u>Second Amended and Restated Certificate of Incorporation of HD Supply Holdings, Inc.(2)</u>
3.2	<u>Third Amended and Restated By-Laws of HD Supply Holdings, Inc. (2)</u>
3.3	<u>Certificate of Incorporation of HD Supply, Inc. (3)</u>
3.4	<u>Certificate of Amendment of Certificate of Incorporation of HD Supply, Inc. (4)</u>
3.5	<u>Amended and Restated By-Laws of HD Supply, Inc.(4)</u>
4.1	<u>Second Supplemental Indenture, dated as of August 25, 2017, by and among the Company, the subsidiary guarantors signatory thereto, and Wells Fargo Bank, National Association, as Trustee (5)</u>
10.1	<u>HD Supply Holdings, Inc. Omnibus Incentive Plan (as amended and restated effective May 17, 2017) (6)</u>
10.2	<u>HD Supply Holdings, Inc. Annual Incentive Plan for Executive Officers(6)</u>
10.3	<u>Fifth Amendment to Credit Agreement, dated as of August 31, 2017, among the Company, as borrower, certain of the Company's affiliates signatory thereto, as guarantors, Bank of America, N.A., as administrative agent, Bank of America, N.A., as collateral agent, Bank of America, N.A., as a Term B-3 Lender and Term B-4 Lender, and the other lenders party thereto. (7)</u>
31.1	<u>Certification of Chairman of the Board, President and Chief Executive Officer of HD Supply Holdings, Inc. pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.</u>
31.2	<u>Certification of Senior Vice President and Chief Financial Officer of HD Supply Holdings, Inc. pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.</u>
31.3	<u>Certification of Chairman of the Board, President and Chief Executive Officer of HD Supply, Inc. pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.</u>
31.4	<u>Certification of Senior Vice President and Chief Financial Officer of HD Supply, Inc. pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.</u>
32.1	<u>Certification of Chairman of the Board, President and Chief Executive Officer of HD Supply Holdings, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2	<u>Certification of Senior Vice President and Chief Financial Officer of HD Supply Holdings, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.3	<u>Certification of Chairman of the Board, President and Chief Executive Officer of HD Supply, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.4	<u>Certification of Senior Vice President and Chief Financial Officer of HD Supply, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101	Interactive data files pursuant to Rule 405 of Regulation S-T.

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- (1) Previously filed in Form 8-K of HD Supply Holdings, Inc. (File No. 001-35979) filed on August 7, 2017. *See* Exhibit 2.1.

- (2) Previously filed in Form S-8 of HD Supply Holdings, Inc. (File No. 333-189771) filed on July 2, 2013. *See* Exhibit 3.1 (Certificate of Incorporation) and Exhibit 3.2 (Bylaws).

- (3) Previously filed in Amendment No.1 to Form S-4/A of HD Supply, Inc. (File No. 333-159809) filed on July 10, 2009. *See* Exhibit 3.1.

- (4) Previously filed in Form 8-K of HD Supply, Inc. (File No. 333-159809) filed on July 9, 2013. *See* Exhibit 3.1 (Certificate of Incorporation) and Exhibit 3.2 (Bylaws).

- (5) Previously filed in Form 8-K of HD Supply, Inc. (File No. 333-159809) filed on August 25, 2017. *See* Exhibit 4.1.

- (6) Previously filed in Form 8-K of HD Supply Holdings, Inc. (File No. 001-35979) filed on May 19, 2017. *See* Exhibit 10.1 (Omnibus Incentive Plan) and Exhibit 10.2 (Annual Incentive Plan).

- (7) Previously filed in Form 8-K of HD Supply, Inc. (File No. 001-35979) filed on September 1, 2017. *See* Exhibit 10.1.

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SIGNATURES

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.

HD SUPPLY HOLDINGS, INC.

(Registrant)

December 4, 2017
(Date)

By: */s/ Joseph J. DeAngelo*
Joseph J. DeAngelo
Chairman of the Board, President and Chief Executive Officer

/s/ Evan J. Levitt
Evan J. Levitt
Senior Vice President, Chief Financial Officer and Chief Administrative Officer

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SIGNATURES

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.

HD SUPPLY, INC.
(Registrant)

December 4, 2017
(Date)

By: */s/ Joseph J. DeAngelo*
Joseph J. DeAngelo
Chairman of the Board, President and Chief Executive Officer

/s/ Evan J. Levitt
Evan J. Levitt
Senior Vice President, Chief Financial Officer and Chief Administrative Officer