

HD Supply Holdings, Inc.
Form 10-Q
December 04, 2018
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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 28, 2018

- OR -

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

For the transition period from to

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Commission File Number 001-35979	Exact name of Registrant as specified in its charter, Address of principal executive offices and Telephone number HD SUPPLY HOLDINGS, INC.	State of incorporation Delaware	I.R.S. Employer Identification Number 26-0486780
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3400 Cumberland Boulevard SE

Atlanta, Georgia 30339

(770) 852-9000

333-159809	HD SUPPLY, INC.
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Delaware

75-2007383

3400 Cumberland Boulevard SE

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit 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, a 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"/>		
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"/>		
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 November 30, 2018:

HD Supply Holdings, Inc.

178,112,256 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 28, 2018 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 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;
- cyclicalities 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 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;
- interruptions in the proper functioning of our information technology, or IT systems, including from cybersecurity threats;
- potential material liabilities under our self-insured programs;
- our ability to attract, train and retain highly-qualified associates and key personnel;
- new and/or proposed trade policies could make sourcing product from foreign countries more difficult and more costly;
- 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 28, 2018	October 29, 2017	October 28, 2018	October 29, 2017
Net Sales	\$ 1,612	\$ 1,370	\$ 4,601	\$ 3,938
Cost of sales	983	828	2,798	2,373
Gross Profit	629	542	1,803	1,565
Operating expenses:				
Selling, general and administrative	391	336	1,147	1,008
Depreciation and amortization	25	21	72	63
Restructuring		3	9	3
Total operating expenses	416	360	1,228	1,074
Operating Income	213	182	575	491
Interest expense	32	36	101	134
Interest (income)		(1)	(1)	(1)
Loss on extinguishment & modification of debt	69	78	69	81
Income from Continuing Operations Before Provision for Income Taxes	112	69	406	277
Provision for income taxes	30	23	105	92
Income from Continuing Operations	82	46	301	185
Income from discontinued operations, net of tax		406	1	794
Net Income	\$ 82	\$ 452	\$ 302	\$ 979
Other comprehensive income (loss):				
Foreign currency translation adjustment		1	2	(1)
Unrealized loss on cash flow hedge, net of tax of \$1, \$-, \$1, and \$-	(4)		(4)	
Total Comprehensive Income	\$ 78	\$ 453	\$ 300	\$ 978
Weighted Average Common Shares Outstanding (thousands)				
Basic	182,730	185,651	183,349	194,704
Diluted	183,579	186,652	184,192	196,258
Basic Earnings Per Share(1):				
Income from Continuing Operations	\$ 0.45	\$ 0.25	\$ 1.64	\$ 0.95
Income from Discontinued Operations	\$	\$ 2.19	\$ 0.01	\$ 4.08
Net Income	\$ 0.45	\$ 2.43	\$ 1.65	\$ 5.03
Diluted Earnings Per Share(1):				
Income from Continuing Operations	\$ 0.45	\$ 0.25	\$ 1.63	\$ 0.94

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Income from Discontinued Operations	\$		\$	2.18	\$	0.01	\$	4.05
Net Income	\$	0.45	\$	2.42	\$	1.64	\$	4.99

(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 28, 2018	January 28, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 52	\$ 558
Receivables, less allowance for doubtful accounts of \$19 and \$12	860	612
Inventories	803	674
Other current assets	46	31
Total current assets	1,761	1,875
Property and equipment, net	356	325
Goodwill	1,993	1,807
Intangible assets, net	197	91
Deferred tax asset	94	205
Other assets	17	15
Total assets	\$ 4,418	\$ 4,318
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 483	\$ 377
Accrued compensation and benefits	105	95
Current installments of long-term debt	11	11
Other current liabilities	261	138
Total current liabilities	860	621
Long-term debt, excluding current installments	1,888	2,090
Other liabilities	70	141
Total liabilities	2,818	2,852
Stockholders' equity:		
Common stock, par value \$0.01; 1 billion shares authorized; 181.4 million and 185.7 million shares issued and outstanding at October 28, 2018 and January 28, 2018, respectively	2	2
Paid-in capital	4,055	4,029
Accumulated deficit	(1,663)	(1,966)
Accumulated other comprehensive loss	(20)	(17)
Treasury stock, at cost, 23.2 and 18.2 million shares at October 28, 2018 and January 28, 2018, respectively	(774)	(582)
Total stockholders' equity	1,600	1,466
Total liabilities and stockholders' equity	\$ 4,418	\$ 4,318

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 28, 2018	October 29, 2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 302	\$ 979
Reconciliation of net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	78	73
Provision for uncollectibles	9	6
Non-cash interest expense	15	11
Payment of discounts upon extinguishment of debt	(4)	(6)
Loss on extinguishment of debt	69	81
Stock-based compensation expense	19	19
Deferred income taxes	97	316
(Gain) on sales of businesses, net		(930)
Other	(1)	
Changes in assets and liabilities, net of the effects of acquisitions & dispositions:		
(Increase) decrease in receivables	(204)	(249)
(Increase) decrease in inventories	(94)	(116)
(Increase) decrease in other current assets	(3)	1
(Increase) decrease in other assets		1
Increase (decrease) in accounts payable and accrued liabilities	95	132
Increase (decrease) in other long-term liabilities	1	2
Net cash provided by (used in) operating activities	379	320
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(79)	(65)
Proceeds from sales of property and equipment		2
Proceeds from sales of businesses, net		2,450
Payments for businesses acquired, net of cash acquired	(362)	
Net cash provided by (used in) investing activities	(441)	2,387
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock under employee benefit plans	7	37
Purchase of treasury shares	(166)	(555)
Tax withholdings on stock-based awards	(6)	
Borrowings of long-term debt	930	113
Repayments of long-term debt	(1,240)	(1,526)
Borrowings on long-term revolver debt	100	624
Repayments on long-term revolver debt	(49)	(989)
Debt issuance costs	(18)	(26)
Other financing activities	(2)	1
Net cash provided by (used in) financing activities	(444)	(2,321)
Effect of exchange rates on cash and cash equivalents		
Increase (decrease) in cash and cash equivalents	\$ (506)	\$ 386
Cash and cash equivalents at beginning of period	558	75
Cash and cash equivalents at end of period	\$ 52	\$ 461

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 28, 2018	October 29, 2017	October 28, 2018	October 29, 2017
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Cost of sales	983	828	2,798	2,373
Gross Profit	629	542	1,803	1,565
Operating expenses:				
Selling, general and administrative	391	336	1,147	1,008
Depreciation and amortization	25	21	72	63
Restructuring		3	9	3
Total operating expenses	416	360	1,228	1,074
Operating Income	213	182	575	491
Interest expense	32	36	101	134
Interest (income)		(1)	(1)	(1)
Loss on extinguishment & modification of debt	69	78	69	81
Income from Continuing Operations Before Provision for Income Taxes	112	69	406	277
Provision for income taxes	30	23	105	92
Income from Continuing Operations	82	46	301	185
Income from discontinued operations, net of tax		406	1	794
Net Income	\$ 82	\$ 452	\$ 302	\$ 979
Other comprehensive income (loss):				
Foreign currency translation adjustment		1	2	(1)
Unrealized gain (loss) on cash flow hedge, net of tax of \$1, \$-, \$1, and \$-	(4)		(4)	
Total Comprehensive Income	\$ 78	\$ 453	\$ 300	\$ 978

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 28, 2018	January 28, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 45	\$ 558
Receivables, less allowance for doubtful accounts of \$19 and \$12	860	612
Inventories	803	674
Other current assets	46	31
Total current assets	1,754	1,875
Property and equipment, net	356	325
Goodwill	1,993	1,807
Intangible assets, net	197	91
Deferred tax asset	94	205
Other assets	17	15
Total assets	\$ 4,411	\$ 4,318
LIABILITIES AND STOCKHOLDER S EQUITY		
Current liabilities:		
Accounts payable	\$ 483	\$ 377
Accrued compensation and benefits	105	95
Current installments of long-term debt	11	11
Other current liabilities	241	138
Total current liabilities	840	621
Long-term debt, excluding current installments	1,888	2,090
Other liabilities	70	141
Total liabilities	2,798	2,852
Stockholder s equity:		
Common stock, par value \$0.01; authorized 1,000 shares; issued and outstanding 1,000 shares at October 28, 2018 and January 28, 2018		
Paid-in capital	3,137	3,290
Accumulated deficit	(1,504)	(1,807)
Accumulated other comprehensive loss	(20)	(17)
Total stockholder s equity	1,613	1,466
Total liabilities and stockholder s equity	\$ 4,411	\$ 4,318

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*

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Depreciation and amortization	78	73
Provision for uncollectibles	9	6
Non-cash interest expense	15	11
Payment of discounts upon extinguishment of debt	(4)	(6)
Loss on extinguishment of debt	69	81
Stock-based compensation expense	19	19
Deferred income taxes	97	316
(Gain) on sales of businesses, net		(930)
Other	(1)	
Changes in assets and liabilities, net of the effects of acquisitions & dispositions:		
(Increase) decrease in receivables	(204)	(249)
(Increase) decrease in inventories	(94)	(116)
(Increase) decrease in other current assets	(3)	1
(Increase) decrease in other assets		1
Increase (decrease) in accounts payable and accrued liabilities	95	132
Increase (decrease) in other long-term liabilities	1	2
Net cash provided by (used in) operating activities	379	320
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(79)	(65)
Proceeds from sales of property and equipment		2
Proceeds from sales of businesses, net		2,450
Payments for businesses acquired, net of cash acquired	(362)	
Net cash provided by (used in) investing activities	(441)	2,387
CASH FLOWS FROM FINANCING ACTIVITIES:		
Equity distribution to Parent	(172)	(516)
Borrowings of long-term debt	930	113
Repayments of long-term debt	(1,240)	(1,526)
Borrowings on long-term revolver debt	100	624
Repayments on long-term revolver debt	(49)	(989)
Debt issuance costs	(18)	(26)
Other financing activities	(2)	1
Net cash provided by (used in) financing activities	(451)	(2,319)
Effect of exchange rates on cash and cash equivalents		
Increase (decrease) in cash and cash equivalents	\$ (513)	\$ 388
Cash and cash equivalents at beginning of period	558	73
Cash and cash equivalents at end of period	\$ 45	\$ 461

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 270 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 650,000 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. The reportable segments are Facilities Maintenance and Construction & Industrial. In addition, the consolidated financial statements include Corporate and Eliminations, which is comprised of enterprise-wide functional departments.

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 January 28, 2018, 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. The fiscal year ending February 3, 2019 (fiscal 2018) includes 53 weeks and the fiscal year ended January 29, 2018 (fiscal 2017) includes 52 weeks. The three months ended October 28, 2018 (third quarter 2018) and October 29, 2017 (third quarter 2017) both include 13 weeks. The nine months ended October 28, 2018 and October 29, 2017 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 is self-insured for certain legal claims and 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 28, 2018 and January 28, 2018, self-insurance reserves totaled approximately \$55 million and \$51 million, respectively.

NOTE 2 ACQUISITIONS

HD Supply enters into strategic acquisitions from time to time to expand into new markets, new platforms, and new geographies in an effort to better service existing customers and attract new ones. In accordance with the acquisition method of accounting under Accounting Standards Codification (ASC) 805, Business Combinations (ASC 805), the results of acquisitions completed by HD Supply are reflected in the Company's consolidated financial statements from the date of acquisition forward.

On March 5, 2018, the Company completed the acquisition of A.H. Harris Construction Supply (A.H. Harris) for a purchase price of approximately \$362 million, net of cash acquired and subject to a final working capital adjustment. A.H. Harris is a leading specialty construction distributor serving the northeast and mid-Atlantic regions. This acquisition expands Construction & Industrial's market presence in the northeastern United States.

In accordance with ASC 805, the Company provisionally recorded the following assets and liabilities at fair value as of the date of the A.H. Harris acquisition: \$186 million in goodwill, \$123 million in definite-lived intangible assets, \$12 million in property & equipment, \$57 million in net working capital, and \$17 million in deferred tax liabilities. The total amount of goodwill expected to be deductible for tax purposes is \$19 million. The definite-lived intangible assets are comprised of \$110 million in customer relationships and \$13 million of trade names that will be amortized over a period of 12 years and 5 years, respectively.

From March 5, 2018 to October 28, 2018, A.H. Harris generated approximately \$277 million in Net sales. During third quarter 2018 and the first nine months of fiscal 2018, the Company incurred approximately \$2 million and \$5 million of costs, respectively, related to the acquisition and integration of A.H. Harris. The Company expects to incur a total of \$8 million to \$10 million of acquisition and integration costs during fiscal 2018.

NOTE 3 DISCONTINUED OPERATIONS

In August 2017, the Company completed the sale of its Waterworks business. In accordance with ASC 205-20, Discontinued Operations and Accounting Standards Update (ASU) 2014-08, Reporting discontinued operations and disclosure of disposals of components of an entity, the results of Waterworks are classified as a discontinued operation. 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 and Comprehensive Income. All Consolidated Statements of Operations and Comprehensive Income presented have been revised to reflect this presentation.

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. In connection with presenting the Waterworks business unit as a discontinued operation in the second quarter of fiscal 2017, a net deferred tax asset of \$323 million and corresponding income tax benefit for the difference in the Company's stock basis versus its book carrying value of the Waterworks subsidiary was recorded in the second quarter of fiscal 2017. Upon recording the gain on the sale of Waterworks in the third quarter of fiscal 2017, the Company recognized a tax expense in discontinued operations, which included \$323 million related to utilizing the deferred tax asset originally recorded in the second quarter of fiscal 2017.

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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.

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 28, 2018	October 29, 2017	October 28, 2018	October 29, 2017
Net sales	\$	\$	10	\$ 1,413
Cost of sales			8	1,100
Gross Profit			2	313
Operating expenses:				
Selling, general and administrative		1		198
Depreciation and amortization				6
Total operating expenses		1		204
Operating Income		1		109
(Gain) Loss on sales of businesses, net		(934)	(1)	(930)
Other (Income) expense, net		1		1
Income before provision for income taxes		934	1	1,038
Provision (benefit) for income taxes		528		244
Income from discontinued operations, net of tax	\$	\$	406	\$ 794

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 28, 2018	October 29, 2017
Net cash flows provided by operating activities	\$	\$ 28
Cash flows from investing activities:		
Capital expenditures		(5)
Proceeds from sales of businesses, net		2,450
Proceeds from sales of property and equipment, net		2
Net cash flows provided by (used in) investing activities	\$	\$ 2,447

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HDS's long-term debt as of October 28, 2018 and January 28, 2018 consisted of the following (dollars in millions):

	October 28, 2018		January 28, 2018	
	Outstanding Principal	Interest Rate %(1)	Outstanding Principal	Interest Rate %(1)
Senior ABL Facility due 2022	\$ 105	3.61	\$ 58	2.86
Term B-3 Loans due 2021			534	3.94
Term B-4 Loans due 2023			544	4.19
Term B-5 Loans due 2023	1,070	4.03		
October 2018 Senior Unsecured Notes due 2026	750	5.375		
April 2016 Senior Unsecured Notes due 2024			1,000	5.75
Total gross long-term debt	\$ 1,925		\$ 2,136	
Less unamortized discount	(4)		(6)	
Less unamortized deferred financing costs	(22)		(29)	
Total net long-term debt	\$ 1,899		\$ 2,101	
Less current installments	(11)		(11)	
Total net long-term debt, excluding current installments	\$ 1,888		\$ 2,090	

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

2018 Refinancing Transactions

On October 22, 2018, HDS entered into a Sixth Amendment (the "Sixth Amendment") to the credit agreement governing HDS's existing Senior Term Facility, as defined below. Pursuant to the Sixth Amendment, HDS amended its existing Senior Term Facility, to, among other things, refinance all the outstanding term loans in an aggregate principal of \$530 million due August 2021 (the "Term B-3 Loans") and an aggregate principal of \$540 million due October 2023 (the "Term B-4 Loans") with a new tranche of term loans (the "Term B-5 Loans") in an original aggregate principal of \$1,070 million.

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Pursuant to the Sixth Amendment, the Term B-5 Loans bear interest at the rate of LIBOR plus 1.75% or base rate plus 0.75%. The Term B-5 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 Sixth Amendment also provides for a prepayment premium equal to 1.00% of the aggregate principal of the applicable Term Loans, as defined below, being prepaid if, on or prior to April 22, 2019, the Company enters into certain repricing transactions.

In connection with the Sixth Amendment, the Company paid approximately \$5 million in consent fees. The consent fees are reflected as deferred financing costs in the Consolidated Balance Sheets and will be amortized into interest expense over the term of the loans. The Company incurred a modification and extinguishment charge of approximately \$5 million, which includes financing fees and other costs of approximately \$3 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 October 11, 2018, HDS issued \$750 million of 5.375% Senior Unsecured Notes due 2026 (the October 2018 Senior Unsecured Notes) at par. HDS received approximately \$741 million in proceeds, net of transaction fees. The transaction fees of \$9 million are reflected as deferred financing costs in the Consolidated Balance Sheets and will be amortized into interest expense over the term of the October 2018 Senior Unsecured Notes.

HDS used the net proceeds from the October 2018 Senior Unsecured Notes issuance, together with available cash and borrowings on HDS's Senior Asset Based Lending Facility due 2022 (the Senior ABL Facility), to redeem all of the outstanding \$1,000 million aggregate principal of the 5.75% Senior Unsecured Notes due 2024 (the April 2016 Senior Unsecured Notes), pay a \$56 million make-whole premium calculated in accordance with the terms

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of the indenture governing such notes and pay \$28 million of accrued but unpaid interest. As a result, the Company incurred a \$64 million loss on extinguishment of the debt, which includes the \$56 million make-whole premium and write-off of \$8 million of unamortized deferred financing costs, in accordance with ASC 470-50, Debt Modifications and Extinguishments.

Senior Credit Facilities

Senior ABL Facility

The Senior ABL Facility provides for senior secured revolving loans and letters of credit of up to a maximum aggregate principal amount of \$1,000 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 28, 2018, HDS had \$868 million of Excess Availability (as defined in the Senior ABL Facility agreement) under the Senior ABL Facility (after giving effect to the borrowing base limitations and approximately \$27 million in letters of credit issued and including \$175 million of borrowings available on qualifying cash balances). As of October 28, 2018, approximately \$45 million of the 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 Excess Availability.

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

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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 in an original aggregate principal amount of \$1,070 million. The Term B-5 Loans will mature on October 17, 2023. The Term B-5 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 balance payable at the maturity date. The Term B-5 Loans bear interest at the applicable margin for borrowings of 1.75% for LIBOR borrowings and 0.75% 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 the Consolidated Financial Statements of our Form 10-K for the fiscal year ended January 28, 2018.

Unsecured Notes

5.375% Senior Unsecured Notes due 2026

HDS issued \$750 million aggregate principal amount of the October 2018 Senior Unsecured Notes under an Indenture, dated as of October 11, 2018 (the "October 2018 Senior Unsecured Notes Indenture") among HDS, certain subsidiaries of HDS as guarantors (the "Subsidiary Guarantors") and the Trustee. The October 2018 Senior Unsecured Notes bear interest at a rate of 5.375% per annum and will mature on October 15, 2026. Interest is paid semi-annually on April 15th and October 15th of each year with the first interest payment due April 15, 2019.

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The October 2018 Senior Unsecured Notes are unsecured senior indebtedness of HDS and rank equal in right of payment with all of HDS' s existing and future senior indebtedness, senior in right of payment to all of HDS' s existing and future subordinated indebtedness, and effectively subordinated to all of HDS' s existing and future secured indebtedness, including, without limitation, indebtedness under the Senior Credit Facilities, to the extent of the value of the collateral securing each indebtedness.

The October 2018 Senior Unsecured Notes are guaranteed, on a senior unsecured basis, by each of HDS' s direct and indirect domestic existing and future subsidiaries that is a wholly owned domestic subsidiary (other than certain excluded subsidiaries), and by each other domestic subsidiary that is a borrower under the Senior ABL Facility or that guarantees HDS' s obligations under any credit facility or capital market securities. These guarantees are subject to release under customary circumstances as stipulated in the October 2018 Senior Unsecured Notes Indenture.

Redemption

HDS may redeem the October 2018 Senior Unsecured Notes, in whole or in part, at any time (1) prior to October 15, 2021, 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 October 2018 Senior Unsecured Notes Indenture and (2) on and after October 15, 2021, 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 October 15 of the year set forth below.

Year	Percentage
2021	102.688%
2022	101.344%
2022 and thereafter	100.000%

In addition, at any time prior to October 15, 2021, HDS may redeem on one or more occasions up to 40% of the aggregate principal amount of the October 2018 Senior Unsecured Notes with the proceeds of certain equity offerings at a redemption price of 105.375% of the principal amount in respect of the October 2018 Senior Unsecured Notes being redeemed, plus accrued and unpaid interest to the redemption date, provided, however, that if the October 2018 Senior Unsecured Notes are redeemed, an aggregate principal amount of the October 2018 Senior Unsecured Notes equal to at least 50% of the original aggregate principal amount of October 2018 Senior Unsecured Notes must remain outstanding immediately after each such redemption of October 2018 Senior Unsecured Notes.

5.75% Senior Unsecured Notes due 2024

HDS's April 2016 Senior Unsecured Notes bore interest at a rate of 5.75% per annum with a maturity date of April 15, 2024. Interest was paid semi-annually in arrears on April 15th and October 15th of each year, prior to the October 11, 2018 redemption of all of the outstanding \$1,000 million aggregate principal amount of the April 2016 Senior Unsecured Notes.

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 28, 2018, HDS was in compliance with all such covenants that were in effect on such date.

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NOTE 5 DERIVATIVE INSTRUMENTS

Hedge Strategy and Accounting Policy

The Company enters into derivative financial instruments for hedging purposes. In hedging the exposure to variable cash flows on forecasted transactions, deferral accounting is applied when the derivative reduces the risk of the underlying hedged item effectively as a result of high inverse correlation with the value of the underlying exposure. If a derivative instrument either initially fails or later ceases to meet the criteria for deferral accounting, any subsequent gains or losses are recognized currently in income. Cash flows resulting from derivative financial instruments are classified in the same category as the cash flows from the items being hedged.

Cash Flow Hedge

On October 24, 2018, the Company entered into an interest rate swap agreement with a notional amount of \$750 million, designated as a cash flow hedge in accordance with ASC 815, Derivatives and Hedging, to hedge the variability of cash flows in interest payments associated with the Company's variable-rate debt. The interest rate swap agreement swaps a LIBOR rate for a fixed rate of 3.07% and matures on October 17, 2023. The swap effectively converts a portion of the Company's Term B-5 Loans from a rate of LIBOR plus 1.75% to a 4.82% fixed rate.

As of October 28, 2018, the fair value of the Company's interest rate swap was a liability of \$5 million and was classified as an other liability in the Consolidated Balance Sheet. Changes in the fair value of interest rate swap agreements designated as cash flow hedges are recorded as a component of Accumulated Other Comprehensive Income (Loss) (OCI) within Stockholders' Equity in the Consolidated Balance Sheets and are reclassified into earnings in the same period or periods during which the hedged transactions affect earnings. As of October 28, 2018, Accumulated OCI related to the interest rate swap agreement was a net unrealized loss of approximately \$4 million, net of tax. The first monthly settlement will occur on November 30, 2018.

NOTE 6 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.

As of October 28, 2018 and January 28, 2018, the fair value measurement of the financial liability associated with the Company's interest rate swap contract was \$5 million and zero, respectively. The Company utilized Level 2 inputs, as defined in the fair value hierarchy, to measure the fair value of the interest rate swap. See Note 5 Derivative Instruments for further information on the Company's interest rate swap contract.

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The Company's financial instruments that are not reflected at fair value on the Consolidated Balance Sheets were as follows as of October 28, 2018 and January 28, 2018 (amounts in millions):

	As of October 28, 2018		As of January 28, 2018	
	Recorded Amount(1)	Estimated Fair Value	Recorded Amount(1)	Estimated Fair Value
Senior ABL Facility	\$ 105	\$ 105	\$ 58	\$ 57
Term Loans and Notes	1,820	1,806	2,078	2,158
Total	\$ 1,925	\$ 1,911	\$ 2,136	\$ 2,215

(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 7 INCOME TAXES

For the nine months ended October 28, 2018, the Company's combined federal, state, and foreign effective tax rate for continuing operations was 25.9%. The effective rate for continuing operations for the nine months ended October 29, 2017 was 33.2%.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the "Tax Act") was signed into law making significant changes to the Internal Revenue Code. The Tax Act lowered the Company's federal statutory rate from 35% to 21%. 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 future audits.

As of October 28, 2018 and January 28, 2018, the Company's unrecognized tax benefits in accordance with the income taxes principles of GAAP (ASC 740, "Income Taxes") were \$16 million. The Company's ending net accrual for interest and penalties related to unrecognized tax benefits as of October 28, 2018 and January 28, 2018 was zero. As of October 28, 2018 and January 28, 2018, the Company's valuation allowance on its U.S. deferred tax assets was approximately \$7 million. Each reporting period, the Company assesses available positive and negative evidence

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and estimates if sufficient future taxable income will be generated to utilize the existing deferred tax assets.

As of July 29, 2018, the Company completed its evaluation of its indefinite reinvestment assertion as a result of the Tax Act and has asserted that its Canadian earnings are permanently reinvested until such time that the Canadian borrowings under the Senior ABL Facility, which was initially drawn on during fiscal 2016, are paid off. No provision for U.S. federal and state income taxes or foreign withholding taxes has been made in the Company's current year consolidated financial statements for those non-U.S. subsidiaries whose earnings are considered to be permanently reinvested.

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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 28, 2018 and October 29, 2017 was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 28, 2018	October 29, 2017	October 28, 2018	October 29, 2017
Weighted-average common shares	182,730	185,651	183,349	194,704
Effect of potentially dilutive stock plan securities	849	1,001	843	1,554
Diluted weighted-average common shares	183,579	186,652	184,192	196,258
Stock plan securities excluded from dilution (1)	1,460	2,414	1,900	1,966

(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, restricted stock units, and performance share units) granted under Holdings stock-based compensation plans.

NOTE 9 SUPPLEMENTAL BALANCE SHEET AND CASH FLOW INFORMATION**Receivables**

Receivables as of October 28, 2018 and January 28, 2018 consisted of the following (amounts in millions):

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	October 28, 2018	January 28, 2018
Trade receivables, net of allowance for doubtful accounts	\$ 774	\$ 540
Vendor rebate receivables	68	58
Other receivables	18	14
Total receivables, net	\$ 860	\$ 612

Other Current Liabilities

Other current liabilities as of October 28, 2018 and January 28, 2018 consisted of the following (amounts in millions):

	HD Supply Holdings, Inc.		HD Supply, Inc.	
	October 28, 2018	January 28, 2018	October 28, 2018	January 28, 2018
Corporate headquarters financing liability	\$ 87	\$ 27	\$ 87	\$ 27
Accrued non-income taxes	42		42	
Unsettled share repurchases	20			
Refund liability(1)	16		16	
Accrued interest	3	21	3	21
Other	93	90	93	90
Total other current liabilities	\$ 261	\$ 138	\$ 241	\$ 138

(1) This amount represents the Company's sales return estimate as of October 28, 2018 classified as a Current liability within the Consolidated Balance Sheet as required per ASC 606, Revenue from Contracts with Customers. The sales return estimate as of January 28, 2018 was approximately \$12 million and was classified within Net receivables within the Consolidated Balance Sheet.

Supplemental Cash Flow Information

Cash paid for interest in the nine months ended October 28, 2018 and October 29, 2017 was \$103 million and \$148 million, respectively. During the nine months ended October 28, 2018 and October 29, 2017, the Company paid \$4 million and \$6 million, respectively, of original issue discounts related to the extinguishment of debt.

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Cash paid for income taxes, net of refunds, in the nine months ended October 28, 2018 and October 29, 2017 was approximately \$9 million and \$27 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.

During the nine months ended October 28, 2018, HDS executed a cash equity distribution of \$172 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 August 25, 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. During the nine months ended October 28, 2018, under this plan, Holdings repurchased 4,682,396 shares of its common stock for approximately \$178 million.

In combination with the 2014 authorized share repurchase plan (utilizing proceeds from employee stock option exercises), Holdings repurchased a total of 4,847,933 shares of its common stock during the nine months ended October 28, 2018 for approximately \$185 million.

Significant Non-Cash Transactions

Build-to-Suit Lease

In February 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. In accordance with ASC 840, 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 construction costs incurred by the landlord.

The lease commenced in February 2018, with the leased asset and corresponding financing liability valued at \$87 million each. In accordance with the sale and leaseback criteria of GAAP, the build-to-suit arrangement and subsequent lease failed to qualify as a sale. Therefore, the transaction is accounted for as a financing arrangement, whereby both the leased asset and the financing liability remain on the Company's

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Consolidated Balance Sheet. The asset is depreciated as if the Company is the legal owner and rental payments are allocated between interest expense and principal repayment of the financing liability.

In April 2018, the Company exercised its option to purchase the leased asset in February 2019 for \$87 million. As a result, the financing liability is classified as a Current liability within the Consolidated Balance Sheet.

NOTE 10 - RESTRUCTURING ACTIVITIES

Fiscal 2017 Plan

As a result of the sale of the Waterworks business in fiscal 2017, management evaluated the Company's alignment and functional support strategies. During fiscal 2017, the Company initiated a restructuring plan that included reducing workforce personnel, realigning talent, and closing a Construction & Industrial branch. In addition, the Company relocated its headquarters in first quarter 2018. During the three and nine months ended October 28, 2018, the Company recognized zero and \$9 million, respectively, of restructuring charges, primarily related to property lease obligations upon exiting the Company's previous headquarters location, and, to a lesser extent, severance and other employee-related costs.

During fiscal 2017, the Company recognized \$6 million of restructuring charges under this plan. Activities under this plan were completed in the second quarter of fiscal 2018 and no further charges are expected under this plan. As of October 28, 2018, remaining unpaid costs associated with the restructuring plan are immaterial.

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NOTE 11 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 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 September 19, 2018, the Court granted in part and denied in part Defendants' motion to dismiss. The matter is now in discovery.

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. On October 22, 2018, upon joint motion of the parties, the Court entered an order continuing the continued conditional stay of proceedings and administratively closing the matter until after any summary judgment motion filed in the securities litigation is adjudicated.

On August 29, 2018, a shareholder derivative complaint was filed in Delaware Chancery Court 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 complaint generally alleges 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 supply chain corrective actions. The complaint asserts various common law breach of fiduciary duty claims against the individual defendants and claims of unjust enrichment and insider selling. The complaint seeks to recover any damages sustained by the Company as a result of the individual defendants' allegedly wrongful actions, seeks certain actions by the Company to modify its corporate governance and internal procedures, and seeks to recover attorneys' fees and other costs. Defendants moved to dismiss the complaint on November 2, 2018. That motion is pending.

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

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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 consolidated 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 12 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 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 incurs 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. All Corporate overhead costs are allocated to the reportable segments. Eliminations include the adjustments necessary to

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eliminate intercompany transactions.

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

	Facilities Maintenance		Construction & Industrial		Eliminations		Total Continuing Operations
<u>Three Months Ended October 28, 2018</u>							
Net sales	\$	810	\$	803	\$	(1)	\$ 1,612
Adjusted EBITDA		149		99			248
Depreciation(1) & Software Amortization		10		12			22
Other Intangible Amortization		2		3			5
<u>Three Months Ended October 29, 2017</u>							
Net sales	\$	754	\$	617	\$	(1)	\$ 1,370
Adjusted EBITDA		144		70			214
Depreciation(1) & Software Amortization		9		10			19
Other Intangible Amortization		1		2			3

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(Unaudited)

	Facilities Maintenance	Construction & Industrial	Eliminations	Total Continuing Operations
Nine Months Ended October 28, 2018				
Net sales	\$ 2,353	\$ 2,250	\$ (2)	\$ 4,601
Adjusted EBITDA	422	262		684
Depreciation(1) & Software Amortization	28	34		62
Other Intangible Amortization	6	10		16
Nine Months Ended October 29, 2017				
Net sales	\$ 2,205	\$ 1,737	\$ (4)	\$ 3,938
Adjusted EBITDA	397	182		579
Depreciation(1) & Software Amortization	26	31		57
Other Intangible Amortization	6	3		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 28, 2018	October 29, 2017	October 28, 2018	October 29, 2017
Total Adjusted EBITDA	\$ 248	\$ 214	\$ 684	\$ 579
Depreciation and amortization(1)	27	22	78	66
Stock-based compensation	7	7	19	19
Restructuring		3	9	3
Acquisition and integration costs(2)	2		5	
Other	(1)		(2)	
Operating income	213	182	575	491
Interest expense	32	36	101	134
Interest (income)		(1)	(1)	(1)
Loss on extinguishment & modification of debt(3)	69	78	69	81
Income from Continuing Operations Before Provision for Income Taxes	112	69	406	277
Provision for income taxes	30	23	105	92
Income from continuing operations	82	46	301	185
Income from discontinued operations, net of tax		406	1	794
Net income	\$ 82	\$ 452	\$ 302	\$ 979

- (1) *Depreciation and amortization includes amounts recorded within Cost of sales in the Consolidated Statements of Operations.*
- (2) *Represents the cost incurred in the acquisition and integration of A.H. Harris Construction Supplies.*
- (3) *Represents the loss on extinguishment of debt including premium paid to repurchase or call the debt as well as 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.*

On March 5, 2018, the Company completed the acquisition of A.H. Harris for a purchase price of approximately \$362 million, net of cash acquired. The acquisition reduced total assets of the Corporate reportable segment by the purchase price and increased total assets of the Construction & Industrial reportable segment by approximately \$414 million.

NOTE 13 SUBSIDIARY GUARANTORS

HDS (the Debt Issuer) has outstanding October 2018 Senior Unsecured Notes, which are guaranteed by 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 October 2018 Senior Unsecured Notes (the Non-guarantor Subsidiaries) are direct or indirect wholly-owned subsidiaries of HDS and primarily include HDS's operations in Canada.

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The Debt Issuer's payment obligations under the October 2018 Senior Unsecured Notes are jointly and severally guaranteed by the Subsidiary Guarantors and all guarantees are full and unconditional.

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

- (i) such Subsidiary Guarantor is (or, substantially concurrently with the release of the Subsidiary Guarantee of such Subsidiary Guarantor or if as a result of the release of the Subsidiary Guarantee of such Subsidiary Guarantor, will be) released from all of its obligations under all of its Guarantees of payment of any Indebtedness of HDS or any Subsidiary Guarantor under the agreements governing the Senior Credit Facilities and other capital markets securities (including by reason of ceasing to be a borrower under the Senior ABL Facility agreement);
- (ii) such Subsidiary Guarantor ceases to be a domestic subsidiary of HDS pursuant to the terms of the Indenture under the indenture governing the October 2018 Senior Unsecured Notes;
- (iii) in the event of a sale or other disposition, by way of merger, consolidation or otherwise, of all the capital stock of such Subsidiary Guarantor to any person that is not, or is not required to become, a Subsidiary Guarantor of HDS under the indenture governing the October 2018 Senior Unsecured Notes; and;
- (iv) upon legal or covenant defeasance of the October 2018 Senior Unsecured Notes or the satisfaction and discharge of the indenture governing the October 2018 Senior Unsecured Notes.

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.

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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 statements of operations and comprehensive income, the condensed balance sheets and the condensed cash flow statements for the Debt Issuer, for the Subsidiary Guarantors and the Non-guarantor Subsidiaries and total consolidated Debt Issuer and subsidiaries (amounts in millions).

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(Unaudited)

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

	Three Months Ended October 28, 2018					
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Consolidating Adjustments	Total HDS	
Net Sales	\$	\$ 1,573	\$ 40	\$ (1)	\$	1,612
Cost of sales		963	21	(1)		983
Gross Profit		610	19			629
Operating expenses:						
Selling, general and administrative	16	362	13			391
Depreciation and amortization	5	19	1			25
Restructuring						
Total operating expenses	21	381	14			416
Operating Income (Loss)	(21)	229	5			213
Interest expense	30	1		1		32
Interest (income)		1		(1)		
Loss on extinguishment & modification of debt	69					69
Net (earnings) of equity affiliates	(230)			230		
Income from Continuing Operations Before Provision for Income Taxes	110	227	5	(230)		112
Provision for income taxes	28	2				30
Income from Continuing Operations	82	225	5	(230)		82
Income from discontinued operations, net of tax						
Net Income	\$ 82	\$ 225	\$ 5	\$ (230)	\$	82
Other comprehensive income (loss):						
Foreign currency translation adjustment						
Unrealized (loss) on derivatives, net of tax of \$1	(4)		(4)	4		(4)
Total Comprehensive Income	\$ 78	\$ 225	\$ 1	\$ (226)	\$	78

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CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (CONTINUED)

Three Months Ended October 29, 2017

	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Consolidating Adjustments	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) of equity affiliates	(189)			189	
Income from Continuing Operations Before Provision for Income Taxes	73	179	6	(189)	69
Provision for income taxes	24	(2)	1		23
Income from Continuing Operations	49	181	5	(189)	46
Income from discontinued operations, net of tax	403		3		406
Net Income	\$ 452	\$ 181	\$ 8	\$ (189)	\$ 452
Other comprehensive income (loss):					
Foreign currency translation adjustment	1		1	(1)	1
Unrealized (loss) on derivatives, net of tax of \$-					
Total Comprehensive Income	\$ 453	\$ 181	\$ 9	\$ (190)	\$ 453

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CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (CONTINUED)

	Nine Months Ended October 28, 2018					
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Consolidating Adjustments	Total HDS	
Net Sales	\$	\$ 4,485	\$ 118	\$ (2)	\$	4,601
Cost of sales		2,737	63	(2)		2,798
Gross Profit		1,748	55			1,803
Operating expenses:						
Selling, general and administrative	53	1,053	41			1,147
Depreciation and amortization	14	57	1			72
Restructuring	5	4				9
Total operating expenses	72	1,114	42			1,228
Operating Income (Loss)	(72)	634	13			575
Interest expense	103	22	1	(25)		101
Interest (income)	(22)	(4)		25		(1)
Loss on extinguishment & modification of debt	69					69
Net (earnings) of equity affiliates	(620)			620		
Income from Continuing Operations Before Provision for Income Taxes	398	616	12	(620)		406
Provision for income taxes	97	6	2			105
Income from Continuing Operations	301	610	10	(620)		301
Income from discontinued operations, net of tax	1					1
Net Income	\$ 302	\$ 610	\$ 10	\$ (620)	\$	302
Other comprehensive income (loss):						
Foreign currency translation adjustment	2		2	(2)		2
Unrealized gain (loss) on derivatives, net of tax of \$1	(4)		(4)	4		(4)
Total Comprehensive Income	\$ 300	\$ 610	\$ 8	\$ (618)	\$	300

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CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (CONTINUED)

Nine Months Ended October 29, 2017						
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Consolidating Adjustments	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)
Loss on extinguishment & modification of debt	81					81
Net (earnings) of equity affiliates	(583)			583		
Income from Continuing Operations Before Provision for Income Taxes	369	481	10	(583)		277
Provision for income taxes	90		2			92
Income from Continuing Operations	279	481	8	(583)		185
Income from discontinued operations, net of tax	700	91	3			794
Net Income	\$ 979	\$ 572	\$ 11	\$ (583)	\$	979
Other comprehensive income (loss):						
Foreign currency translation adjustment	(1)		(1)	1		(1)
Unrealized (loss) on derivatives, net of tax of \$-						
Total Comprehensive Income	\$ 978	\$ 572	\$ 10	\$ (582)	\$	978

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

CONDENSED CONSOLIDATING BALANCE SHEETS

	As of October 28, 2018					
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Consolidating Adjustments	Total HDS	
ASSETS						
Current assets:						
Cash and cash equivalents	\$ 22	\$ 20	\$ 3	\$	\$	45
Receivables, net	3	832	25			860
Inventories		782	21			803
Intercompany receivables		1		(1)		
Other current assets	16	30				46
Total current assets	41	1,665	49	(1)		1,754
Property and equipment, net	151	202	3			356
Goodwill		1,993				1,993
Intangible assets, net		196	1			197
Deferred tax asset	174		2	(82)		94
Investment in subsidiaries	4,292			(4,292)		
Intercompany notes receivable	189	1,193		(1,382)		
Other assets	18	4		(5)		17
Total assets	\$ 4,865	\$ 5,253	\$ 55	\$ (5,762)	\$	4,411
LIABILITIES AND STOCKHOLDER S EQUITY (DEFICIT)						
Current liabilities:						
Accounts payable	\$ 10	\$ 457	\$ 16	\$	\$	483
Accrued compensation and benefits	36	66	3			105
Current installments of long-term debt	11					11
Intercompany payables			1	(1)		
Other current liabilities	110	124	7			241
Total current liabilities	167	647	27	(1)		840
Long-term debt, excluding current installments	1,843	9	45	(9)		1,888
Deferred tax liabilities		82		(82)		
Intercompany notes payable (1)	1,193	189		(1,382)		
Other liabilities	50	16	1	3		70
Total liabilities	3,253	943	73	(1,471)		2,798
Stockholder s equity (deficit)	1,612	4,310	(18)	(4,291)		1,613
Total liabilities and stockholder s equity (deficit)	\$ 4,865	\$ 5,253	\$ 55	\$ (5,762)	\$	4,411

(1) During the nine months ended October 28, 2018, the Parent completed a non-cash debt contribution to the Guarantor Subsidiaries of approximately \$958 million.

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CONDENSED CONSOLIDATING BALANCE SHEETS (CONTINUED)

	As of January 28, 2018					
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Consolidating Adjustments	Total HDS	
ASSETS						
Current assets:						
Cash and cash equivalents	\$ 539	\$ 15	\$ 4	\$	\$	558
Receivables, net	7	584	21			612
Inventories		654	20			674
Intercompany receivables		2		(2)		
Other current assets	15	15	1			31
Total current assets	561	1,270	46	(2)		1,875
Property and equipment, net	152	170	3			325
Goodwill		1,807				1,807
Intangible assets, net		90	1			91
Deferred tax asset	264		2	(61)		205
Investment in subsidiaries	2,811			(2,811)		
Intercompany notes receivable	1,005	1,083		(2,088)		
Other assets	12	3				15
Total assets	\$ 4,805	\$ 4,423	\$ 52	\$ (4,962)	\$	4,318
LIABILITIES AND STOCKHOLDER S EQUITY (DEFICIT)						
Current liabilities:						
Accounts payable	\$ 11	\$ 353	\$ 13	\$	\$	377
Accrued compensation and benefits	34	57	4			95
Current installments of long-term debt	11					11
Intercompany payables			2	(2)		
Other current liabilities	43	88	7			138
Total current liabilities	99	498	26	(2)		621
Long-term debt, excluding current installments	2,032		58			2,090
Deferred tax liabilities		61		(61)		
Intercompany notes payable	1,083	1,005		(2,088)		
Other liabilities	125	16				141
Total liabilities	3,339	1,580	84	(2,151)		2,852
Stockholder s equity (deficit)	1,466	2,843	(32)	(2,811)		1,466
Total liabilities and stockholder s equity (deficit)	\$ 4,805	\$ 4,423	\$ 52	\$ (4,962)	\$	4,318

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(Unaudited)

CONDENSED CONSOLIDATING CASH FLOW STATEMENTS

	Nine Months Ended October 28, 2018					
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Consolidating Adjustments	Total HDS	
Net cash flows from operating activities	\$ 366	\$ 4	\$ 9	\$	\$	379
Cash flows from investing activities						
Capital expenditures	(20)	(58)	(1)			(79)
Payments for businesses acquired, net			(362)			(362)
Proceeds from sales of property and equipment						
Purchases of investments	(7)			7		
Investments in equity affiliates (1)	(365)		(3)	368		
Proceeds from (payments of) intercompany notes		46		(46)		
Net cash flows from investing activities	\$ (392)	\$ (12)	\$ (366)	\$ 329	\$	(441)
Cash flows from financing activities						
Equity contribution (distribution) (1)	(172)	3	365	(368)		(172)
Borrowings of (repayments of) intercompany notes	(46)			46		
Borrowings of long-term debt	930	10		(10)		930
Repayments of long-term debt	(1,240)					(1,240)
Borrowings on long-term revolver debt	90		10			100
Repayments on long-term revolver debt	(30)		(19)			(49)
Debt issuance costs	(18)					(18)
Other financing activities	(5)			3		(2)
Net cash flows from financing activities	(491)	13	356	(329)		(451)
Effect of exchange rates on cash						
Net increase (decrease) in cash & cash equivalents	\$ (517)	\$ 5	\$ (1)	\$	\$	(513)
Cash and cash equivalents at beginning of period	539	15	4			558
Cash and cash equivalents at end of period	\$ 22	\$ 20	\$ 3	\$	\$	45

(1) During the nine months ended October 28, 2018, the Parent completed a cash contribution of approximately \$365 million to a Non-Guarantor Subsidiary to execute the purchase of A.H. Harris. Subsequent to the acquisition, the A.H. Harris entities became Guarantor Subsidiaries.

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CONDENSED CONSOLIDATING CASH FLOW STATEMENTS (CONTINUED)

	Nine Months Ended October 29, 2017					
	Debt Issuer	Subsidiary Guarantors	Non- Guarantor Subsidiaries	Consolidating Adjustments	Total HDS	
Net cash flows from operating activities	\$ 260	\$ 55	\$ 5	\$	\$	320
Cash flows from investing activities						
Capital expenditures	(18)	(47)				(65)
Proceeds from sale 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 contribution	(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

NOTE 14 REVENUE

The Company's revenues are earned from contracts with customers. Contracts include written agreements, as well as arrangements that are implied by customary practices or law.

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The Company adopted the provisions of ASC 606, Revenue from Contracts with Customers, and related amendments (ASC 606) using the modified retrospective method on January 29, 2018 (the first day of fiscal 2018). The Company concluded that most of its contracts with customers consist of a single performance obligation to transfer promised goods or services and therefore are not impacted by the adoption of ASC 606. The adoption of ASC 606 impacted the Company's method of recognizing certain installation income, which was generally recognized when the customer order was fully installed. ASC 606 requires installation income to be recognized as each performance obligation within a contract is completed. The Company's installation contracts are typically completed in less than 90 days. Due to the seasonal nature of the Company's installation business, recognized revenue could shift between quarters within the year. The adoption of ASC 606 did not have a material impact on the Company's financial position, results of operations or cash flows. As such, the Company did not make any adjustments to its financial position upon adoption.

Nature of Products and Services

Both Facilities Maintenance and Construction & Industrial serve unique end markets. Facilities Maintenance offers products that serve the maintenance, repair and operations (MRO) end market as well as value-added services. Construction & Industrial offers products used broadly across both the residential and non-residential construction end markets as well as light remodeling supplies for small remodeling contractors and trade professionals. For additional information regarding the nature of products and services offered by the Company's reportable segments, see Description of segments within Item 2 of this report on Form 10-Q.

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The Company recognizes revenue, net of allowances for returns and discounts and any taxes collected from the customer, when an identified performance obligation is satisfied by the transfer of control of promised products or services to the customer. The Company ships products to customers by internal fleet and third-party carriers. Transfer of control to the customer for products generally occurs at the point of destination (i.e., upon transfer of title and risk of loss of product). Transfer of control to the customer for services occurs when the customer has the right to direct the use of and obtain substantially all the remaining benefits of the asset that is created or enhanced from the service. The Company accounts for shipping and handling costs associated with outbound freight as a fulfillment cost. Such costs are included in Selling, general and administrative expenses.

Disaggregation of Revenue

The Company elected to disaggregate the revenue of Facilities Maintenance by its demand types: MRO and Property Improvement, and Construction & Industrial by its end markets: Non-Residential Construction, Residential Construction, and Other. The Company believes this disaggregation appropriately meets the objective to depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors.

The table below represents disaggregated revenue for Facilities Maintenance and Construction & Industrial with Inter-segment eliminations (amounts in millions):

	Three Months Ended		Nine Months Ended	
	October 28, 2018	October 29, 2017	October 28, 2018	October 29, 2017
Facilities Maintenance				
Maintenance, Repair, and Operations	\$ 718	\$ 668	\$ 2,076	\$ 1,954
Property Improvement	92	86	277	251
Total Facilities Maintenance Net Sales	810	754	2,353	2,205
Construction & Industrial				
Non-Residential Construction	569	405	1,567	1,131
Residential Construction	189	169	553	489
Other	45	43	130	117
Total Construction & Industrial Net Sales	803	617	2,250	1,737

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Inter-segment Eliminations		(1)		(1)		(2)		(4)
Total HD Supply Net Sales	\$	1,612	\$	1,370	\$	4,601	\$	3,938

Contract Balances

The timing of satisfaction of identified performance obligations may differ from the timing of invoicing to customers for certain installation contracts, which may result in the recognition of a contract asset or liability. The Company records a contract asset when it recognizes revenue prior to invoicing, or a contract liability when revenue is recognized subsequent to invoicing. Contract assets are reclassified as accounts receivable upon invoicing and contract liabilities are relieved upon recognition of revenue. As of October 28, 2018, the Company's contract assets and contract liabilities, which are included in Other Current Assets and Other Current Liabilities, respectively, within the Consolidated Balance Sheets, are not material.

Payment terms and conditions vary by contract type, although terms generally include a requirement for payment within 45 days. As such, in instances where the timing of revenue recognition differs from the timing of invoicing, the Company has concluded that its contracts with customers do not include a significant financing component because customer payments for goods and services are received in less than one year. All remaining performance obligations as of October 28, 2018 are not material.

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NOTE 15 RECENT ACCOUNTING PRONOUNCEMENTS

Recently Adopted Accounting Pronouncements

Derivatives and Hedging In August 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This update expands and refines hedge accounting for both nonfinancial and financial risk components and reduces complexity in fair value hedges of interest rate risk. It eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item. It also eases certain documentation and assessment requirements and modifies the accounting for components excluded from assessment of hedge effectiveness. In addition, the new guidance requires expanded disclosures as it pertains to the effect of hedging on individual income statement lines, including the effects of components excluded from the assessment of effectiveness. ASU 2017-12 is effective for annual and interim periods beginning after December 15, 2018 with early adoption permitted. Companies with cash flow or net investment hedges existing at the date of adoption are required to apply the amendments in this update on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The amended presentation and disclosure guidance is required only prospectively. The Company adopted this guidance on January 29, 2018 (the first day of fiscal 2018) with no adjustment to retained earnings.

Stock Compensation In May 2017, the FASB issued ASU No. 2017-09, Compensation Stock Compensation (Topic 718): Scope of Modification Accounting (ASU 2017-09). This update provides 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. ASU 2017-09 is effective for annual and interim periods beginning after December 15, 2017. The amendments in this update are required to be applied prospectively to awards modified on or after the adoption date. The Company adopted this guidance on January 29, 2018 (the first day of fiscal 2018) with no impact to the Company's financial position, results of operations or cash flows.

Business Combinations In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business (ASU 2017-01). This update clarifies the definition of a business with the objective of adding guidance to assist companies to evaluate whether transactions should be accounted for as

acquisitions (or disposals) of assets or businesses. ASU 2017-01 is effective for annual and interim periods beginning after December 15, 2017. The amendments in this update are required to be applied prospectively with no required disclosure at the transition date. The Company adopted this guidance on January 29, 2018 (the first day of fiscal 2018) with no material impact to 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. The amendments in this update are required to be applied retrospectively to all periods presented. The Company adopted this guidance retrospectively on January 29, 2018 (the first day of fiscal 2018) with no material impact on the Company's financial position, results of operations or cash flows. On a prospective basis, ASU 2016-18 will only impact the Company's financial position and cash flows 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. The amendments in this update were required to 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 Company adopted this guidance on January 29, 2018 (the first day of fiscal 2018) with no adjustment to retained earnings.

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HD SUPPLY HOLDINGS, INC. AND SUBSIDIARIES

HD SUPPLY, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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. The amendments in this update were required to be applied retrospectively to all periods presented, unless deemed impracticable, in which case, prospective application was permitted. The Company adopted this guidance retrospectively on January 29, 2018 (the first day of fiscal 2018) with no revision to prior periods.

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*, ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*, ASU 2017-13, *Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842)*, and ASU 2017-14, *Income Statement-Reporting Comprehensive Income (Topic 220), Revenue Recognition (Topic 605), and Revenue from Contracts with Customers (Topic 606)*. 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 adopted 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) using the modified retrospective method. See Note 14, *Revenue* for the Company's revenue accounting policies and disclosures.

Recently Issued Accounting Pronouncements Not Yet Adopted

Cloud Computing Arrangements In August 2018, the FASB issued ASU No. 2018-15, *Intangibles – Goodwill and Other Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract* (a consensus of the FASB Emerging Issues Task Force) (ASU 2018-15). The new guidance aligns the requirements for capitalizing implementation costs in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The update also provides for additional disclosure requirements regarding the nature of an entity’s hosting arrangements that are service contracts. The ASU is effective for annual and interim periods beginning after December 15, 2019. Early adoption is permitted in any interim period. The amendments in this update should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. The Company is currently evaluating the impact of adopting ASU 2018-15.

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.

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HD SUPPLY HOLDINGS, INC. AND SUBSIDIARIES

HD SUPPLY, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Financial Instruments In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (ASU 2016-13). The amended guidance modifies the measurement of expected credit losses of certain financial instruments, including trade receivables. The amended guidance also prescribes additional disclosure requirements for certain financial instruments. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019. Early adoption is permitted for annual and interim periods beginning after December 15, 2018. It is to be adopted using a modified retrospective approach. The Company is currently evaluating the impact of adopting ASU 2016-13.

Leases In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (ASU 2016-02), amended by ASU 2017-13, *Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842)*, ASU 2018-01, *Leases (Topic 842)-Land Easement Practical Expedient for Transition to Topic 842*, ASU 2018-10, *Codification Improvements to Topic 842, Leases*, and ASU 2018-11, *Leases (Topic 842) Targeted Improvements*. The amended 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. Prior to ASU 2018-11, a modified retrospective transition was required for financing or operating leases existing at or entered into after the beginning of the earliest comparative period presented in the financial statements. ASU 2018-11 allows entities an additional transition method to the existing requirements whereby an entity could adopt the provisions of ASU 2016-02 by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption without adjustment to the financial statements for periods prior to adoption. The Company expects the adoption of ASU 2016-02 will have a material impact on the consolidated balance sheets related to recording right-of-use assets and corresponding lease liabilities. The Company is currently in the process of evaluating the impact of adoption on the consolidated statements of operations and cash flows, but does not expect the impact to be material and will represent a timing difference in recognition of lease expense over the lease term of certain lease contracts. The Company does not expect the adoption of ASU 2016-02 to have an impact on its debt covenant compliance under its current debt and indenture agreements.

NOTE 16 SUBSEQUENT EVENT

On November 30, 2018, the Company's Board of Directors authorized a new share repurchase program for the repurchase of up to an aggregate \$500 million of its common stock. The Company will conduct repurchases under the share repurchase program in the open market and through broker negotiated purchases in compliance with Rule 10b5-1 and Rule 10b-18 of the Securities Exchange Act of 1934, and subject to market conditions, restrictive covenants contained in existing debt agreements, applicable legal requirements, and other relevant factors. This share repurchase program does not obligate the Company to acquire any particular amount of its common stock, and it may be terminated at any time.

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at the Company's discretion. As of November 30, 2018, the Company has approximately \$656 million remaining under its new and previous share repurchase authorizations.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

HD SUPPLY

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 270 branches and 44 distribution centers, in the U.S. and Canada, we serve 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 650,000 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 industries 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.

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 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.

In addition to the reportable segments, the Company's consolidated financial results include Corporate. Corporate incurs 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. All Corporate overhead costs are allocated to the reportable segments. Eliminations include the adjustments necessary to eliminate intercompany transactions.

Acquisitions

We enter into strategic acquisitions from time to time to expand into new markets, new platforms, and new geographies in an effort to better service existing customers and attract new ones. In accordance with the acquisition method of accounting under Accounting Standards Codification (ASC) 805, Business Combinations, the results of the acquisitions we completed are reflected in our consolidated financial statements from the date of acquisition forward.

On March 5, 2018, our Construction & Industrial business acquired A.H. Harris Construction Supplies (A.H. Harris) for a purchase price of approximately \$362 million in cash. A.H. Harris is a leading specialty construction distributor serving the northeast and mid-Atlantic regions. This acquisition expands Construction & Industrial's

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market presence in the northeastern United States. For additional detail related to the acquisition of A.H. Harris, see Note 2, Acquisition, in the Notes to the Consolidated Financial Statements within Item 1 of this quarterly report on Form 10-Q.

During the third quarter of fiscal 2018 and the first nine months of fiscal 2018, Construction & Industrial incurred approximately \$2 million and \$5 million of costs, respectively, related to the acquisition and integration of A.H. Harris. We expect to incur a total of \$8 million to \$10 million of acquisition and integration costs related to this acquisition during fiscal 2018.

Discontinued operations

On August 1, 2017, the Company completed the sale of its Waterworks business. 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 sale of the Waterworks business and the results of operations of discontinued operations, see Note 3, Discontinued Operations, in the Notes to the 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. The fiscal year ending February 3, 2019 (fiscal 2018) includes 53 weeks and the fiscal year ended January 29, 2018 (fiscal 2017) includes 52 weeks. The three months ended October 28, 2018 (third quarter 2018) and October 29, 2017 (third quarter 2017) both include 13 weeks. The nine months ended October 28, 2018 and October 29, 2017 both include 39 weeks.

Key business metrics

Net sales

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We earn our Net sales primarily from the sale of construction, maintenance, repair and operations, and renovation and improvement-related products and our provision of related services to approximately 500,000 customers, including contractors, government entities, maintenance professionals, home builders and industrial businesses. We recognize sales, net of sales tax and allowances for returns and discounts, when an identified performance obligation is satisfied by transfer of the promised goods or services to the customer. 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 control of the products and services are 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. We account for shipping and handling costs associated with outbound freight as a fulfillment cost. Such costs 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

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expenses within operating expenses. Our Gross profit may not be comparable to those of other companies, as other companies may include all of the costs related to their distribution networks 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 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 \$100 million and 10% of the lesser of (A) the Borrowing Base and (B) the Total Facility Commitment. Adjusted EBITDA is defined as Net income (loss) less Income from discontinued operations, net of tax, plus (i) Interest expense and Interest income, net, (ii) Provision for income taxes, (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 and Senior ABL Facility 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 28, 2018.

Adjusted net income is defined as Net income 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.

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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.

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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
- 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 28, 2018	October 29, 2017	October 28, 2018	October 29, 2017
Net income	\$ 82	\$ 452	\$ 302	\$ 979
Less income from discontinued operations, net of tax		406	1	794
Income from continuing operations	82	46	301	185
Interest expense, net	32	35	100	133
Provision for income taxes	30	23	105	92
Depreciation and amortization(1)	27	22	78	66
Loss on extinguishment & modification of debt(2)	69	78	69	81
Restructuring charges(3)		3	9	3
Stock-based compensation	7	7	19	19
Acquisition and integration costs(4)	2		5	
Other	(1)		(2)	
Adjusted EBITDA	\$ 248	\$ 214	\$ 684	\$ 579

-
- (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 premium paid to repurchase or call the debt as well as 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.*
- (3) *Represents the costs related to exiting the Company's previous corporate headquarters and the costs incurred for strategic alignment of our workforce. These costs include severance, relocation costs and other related costs. For additional information, see Note 10, Restructuring Activities, in the Notes to the Consolidated Financial Statements within Item 1 of this quarterly report on Form 10-Q.*
- (4) *Represents the costs incurred in the acquisition and integration of A.H. Harris Construction Supplies.*

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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 28, 2018	October 29, 2017	October 28, 2018	October 29, 2017
Net income	\$ 82	\$ 452	\$ 302	\$ 979
Less income from discontinued operations, net of tax		406	1	794
Income from continuing operations	82	46	301	185
Plus: Provision for income taxes	30	23	105	92
Less: Cash income taxes	(4)	(4)	(9)	(14)
Plus: Amortization of acquisition-related intangible assets (other than software)	5	3	16	9
Plus: Loss on extinguishment & modification of debt(1)	69	78	69	81
Plus: Restructuring charges(2)		3	9	3
Plus: Acquisition and integration costs(3)	2		5	
Adjusted Net Income	\$ 184	\$ 149	\$ 496	\$ 356

(1) Represents the loss on extinguishment of debt including the premium paid to repurchase or call the debt as well as 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.

(2) Represents the costs related to existing the Company's previous corporate headquarters and the costs incurred for strategic alignment of our workforce. These costs include severance, relocation costs and other related costs. For additional information, see Note 10, Restructuring Activities, in the Notes to the Consolidated Financial Statements within Item 1 of this quarterly report on Form 10-Q.

(3) Represents the costs incurred in the acquisition and integration of A.H. Harris Construction Supplies.

Consolidated results of operations

	Three Months Ended		Percentage	Nine Months Ended		Percentage
Dollars in millions	October 28, 2018	October 29, 2017	Increase (Decrease)	October 28, 2018	October 29, 2017	Increase (Decrease)
Net sales	\$ 1,612	\$ 1,370	17.7%	\$ 4,601	\$ 3,938	16.8%
Gross Profit	629	542	16.1	1,803	1,565	15.2
Operating expenses:						
Selling, general and administrative	391	336	16.4	1,147	1,008	13.8
Depreciation and amortization	25	21	19.0	72	63	14.3
Restructuring Charges		3	*	9	3	*
Total operating expenses	416	360	15.6	1,228	1,074	14.3
Operating Income	213	182	17.0	575	491	17.1
Interest expense	32	36	(11.1)	101	134	(24.6)
Interest (income)		(1)	*	(1)	(1)	*

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Loss on extinguishment & modification of debt	69	78	(11.5)	69	81	(14.8)
Income from Continuing Operations Before Provision for Income Taxes	112	69	62.3	406	277	46.6
Provision for income taxes	30	23	30.4	105	92	14.1
Income from Continuing Operations	82	46	78.3	301	185	62.7
Income from discontinued operations, net of tax		406	*	1	794	*
Net Income	\$ 82	\$ 452	(81.9)	\$ 302	\$ 979	(69.2)
Non-GAAP financial data:						
Adjusted EBITDA	\$ 248	\$ 214	15.9	\$ 684	\$ 579	18.1
Adjusted net income	\$ 184	\$ 149	23.5	\$ 496	\$ 356	39.3

* Not meaningful

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	% of Net Sales Three Months Ended			% of Net Sales Nine Months Ended		
	October 28, 2018	October 29, 2017	Basis Point Increase (Decrease)	October 28, 2018	October 29, 2017	Basis Point Increase (Decrease)
Net sales	100.0%	100.0%		100.0%	100.0%	
Gross Profit	39.0	39.6	(60)	39.2	39.7	(50)
Operating expenses:						
Selling, general and administrative	24.3	24.5	(20)	24.9	25.6	(70)
Depreciation and amortization	1.5	1.6	(10)	1.6	1.5	10
Restructuring Charges		0.2	(20)	0.2	0.1	10
Total operating expenses	25.8	26.3	(50)	26.7	27.2	(50)
Operating Income	13.2	13.3	(10)	12.5	12.5	
Interest expense	2.0	2.6	(60)	2.2	3.4	(120)
Interest (income)		(0.1)	10			*
Loss on extinguishment & modification of debt	4.3	5.7	(140)	1.5	2.1	(60)
Income from Continuing Operations Before Provision for Income Taxes	6.9	5.1	180	8.8	7.0	180
Provision for income taxes	1.8	1.7	10	2.3	2.3	
Income from Continuing Operations	5.1	3.4	170	6.5	4.7	180
Income from discontinued operations, net of tax		29.6	*	0.1	20.2	*
Net Income	5.1	33.0	*	6.6	24.9	*
Non-GAAP financial data:						
Adjusted EBITDA	15.4	15.6	(20)	14.9	14.7	20
Adjusted net income	11.4	10.9	50	10.8	9.0	180

* Not meaningful

Highlights

Net sales in third quarter 2018 increased \$242 million, or 17.7%, as compared to third quarter 2017. Operating income in third quarter 2018 increased \$31 million, or 17.0%, as compared to third quarter 2017. Net income in third quarter 2018 decreased \$370 million to \$82 million as compared to third quarter 2017 due primarily to a \$406 million decrease in Income from discontinued operations, net of tax. Adjusted EBITDA in third quarter 2018 increased \$34 million, or 15.9%, as compared to third quarter 2017. Adjusted net income in third quarter 2018 increased \$35 million, or 23.5%, as compared to third quarter 2017 due primarily to growth in operations, and, to a lesser extent, a decline in interest expense as a result of lower outstanding debt balances. As of October 28, 2018, our total liquidity was \$920 million. See Liquidity and Capital Resources External Financing of this Item 2 of this quarterly report on Form 10-Q for further information.

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. In connection with presenting the Waterworks business unit as a discontinued operation in the second quarter of fiscal 2017, 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 subsidiary was recorded in the second quarter of fiscal 2017. The income tax benefit was reflected within Income from discontinued operations, net of tax. Upon recording the gain on sale of Waterworks in the third quarter of fiscal 2017, the Company recognized a tax expense in discontinued operations, which included \$323 million related to utilizing the deferred tax asset originally recorded in the second quarter of fiscal 2017.

As a result of the sale of the Waterworks business in fiscal 2017, management evaluated the Company's talent alignment and functional support strategies. Consequently, during the second half of fiscal 2017, management initiated a restructuring plan that included reducing workforce personnel and realigning talent. In addition, the Company relocated its corporate headquarters. Management completed the activities under this plan during second quarter 2018, resulting in a total of \$15 million in charges incurred during fiscal 2017 and fiscal 2018.

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

Net sales

Net sales in third quarter 2018 increased \$242 million, or 17.7%, compared to third quarter 2017 and \$663 million, or 16.8%, in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017.

Both of our reportable segments delivered an increase in Net sales in third quarter 2018 and in the first nine months of fiscal 2018 as compared to the same periods in fiscal 2017. The Net sales increases were primarily due to increases in market volume and growth initiatives at each of our businesses and the acquisition of A.H. Harris by Construction & Industrial. Growth initiatives contributed approximately \$78 million and \$235 million in third quarter 2018 and the first nine months of fiscal 2018, respectively. Organic sales growth was \$129 million, or 9.4% for third quarter 2018 as compared to third quarter 2017 and \$386 million, or 9.8% for the first nine months of fiscal 2018 as compared to the same period in fiscal 2017.

Gross profit

Gross profit increased \$87 million, or 16.1%, during third quarter 2018 as compared to third quarter 2017 and \$238 million, or 15.2%, during the first nine months of fiscal 2018 as compared to the same period in fiscal 2017.

Both of our reportable segments delivered an increase in Gross profit in both periods 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 39.0% in third quarter 2018 as compared to 39.6% in third quarter 2017 and approximately 50 basis points to 39.2% in the first nine months of fiscal 2018 as compared to 39.7% in the same period in fiscal 2017. The acquisition of A.H. Harris contributed to the decline in gross margin in both periods, negatively impacting gross margin by approximately 40 basis points in both the third quarter 2018 and the first nine months of fiscal 2018 as compared to the same periods in fiscal 2017. Gross margins were also negatively impacted by the lower margin Construction & Industrial business growing Net sales organically at 11.8% and 13.6% in third quarter 2018 and the first nine months of fiscal 2018, respectively, compared to Facilities Maintenance Net sales growth rates of 7.4% and 6.7% in third quarter 2018 and the first nine months of fiscal 2018, respectively.

Operating expenses

Operating expenses increased \$56 million, or 15.6%, during third quarter 2018 as compared to third quarter 2017 and \$154 million, or 14.3%, in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017.

Selling, general and administrative expenses increased \$55 million, or 16.4%, in third quarter 2018 as compared to third quarter 2017 and \$139 million, or 13.8%, in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017. The increase in both periods was primarily a result of the acquisition of A.H. Harris, increases in variable expenses due to higher sales volume and increased investments in growth initiatives, primarily additional personnel.

Operating expenses as a percentage of Net sales decreased approximately 50 basis points to 25.8% in third quarter 2018 as compared to third quarter 2017 and approximately 50 basis points to 26.7%, in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017. Selling, general and administrative expenses as a percentage of Net sales, decreased approximately 20 basis points to 24.3% in third quarter 2018 as compared to third quarter 2017 and approximately 70 basis points to 24.9% in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017. The decrease in both periods was primarily a result of the leverage of fixed costs through sales volume increases, partially offset by increased investments in growth initiatives.

Operating income

Operating income increased \$31 million, or 17.0%, during third quarter 2018 as compared to third quarter 2017 and \$84 million or 17.1% in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017. The increase in both periods was primarily due to higher sales volume, including the acquisition of A.H. Harris, partially offset by the increase in operating expenses.

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Operating income as a percentage of Net sales decreased approximately 10 basis points to 13.2% during third quarter 2018 as compared to third quarter 2017 and remained flat at 12.5% during the first nine months of fiscal 2018 as compared to the same period in fiscal 2017. In both periods, the decline in gross margin and increased investments in growth initiatives were offset by the leverage of fixed costs through sales volume increases.

Interest expense

Interest expense decreased \$4 million, or 11.1%, during third quarter 2018 as compared to third quarter 2017 and \$33 million, or 24.6%, during the first nine months of fiscal 2018 as compared to the same period in fiscal 2017. The decrease in both periods was due to a lower outstanding balance as a result of using proceeds from the sale of a business to reduce indebtedness, partially offset by an increase in the average effective interest rate due to an increase in non-cash amortization of deferred financing costs.

Loss on extinguishment & modification of debt

During third quarter 2018 and the first nine months of fiscal 2018, our debt refinancing and redemption activities resulted in charges of \$69 million, recorded in accordance with ASC 470-50, Debt Modifications and Extinguishments.

On October 22, 2018, HDS amended its senior secured term loan facility (the Term Loan Facility), incurring a modification and extinguishment charge of approximately \$5 million, which includes financing fees and other costs of approximately \$3 million and the write-off of approximately \$2 million of unamortized discount and deferred financing costs.

On October 11, 2018, HDS used the net proceeds from the issuance of the 5.375% Senior Unsecured Notes due 2026 (the October 2018 Senior Unsecured Notes), together with available cash and borrowings on HDS's Senior Asset Based Lending Facility due 2022 (the Senior ABL Facility), to redeem all of the outstanding \$1,000 million aggregate principal of the 5.75% Senior Unsecured Notes due 2024 (the April 2016 Senior Unsecured Notes), incurring a \$64 million loss on extinguishment of debt, which includes a \$56 million make-whole premium and the write-off of \$8 million of unamortized deferred financing costs.

For further information on 2018 debt refinancing and redemption activity, please refer to Liquidity and Capital Resources External Financing.

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 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, 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.

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On August 31, 2017, HDS amended 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 the 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, 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 the Senior ABL Facility, incurring a \$1 million loss on extinguishment of debt.

For more information on 2017 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 28, 2018.

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Provision for income taxes

The provision 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 provision for income taxes from continuing operations in third quarter 2018 was \$30 million compared to \$23 million in third quarter 2017. The provision for income taxes in the first nine months of fiscal 2018 was \$105 million compared to \$92 million in the first nine months of fiscal 2017.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the Tax Act) was signed into law making significant changes to the Internal Revenue Code. The Tax Act significantly lowered the Company's federal statutory rate from 35% to 21%.

The effective rate for continuing operations for third quarter 2018 and the first nine months of fiscal 2018 was 26.8% and 25.9%, respectively. The effective rate for continuing operations for third quarter 2017 and the first nine months of fiscal 2017 was 33.3% and 33.2%, respectively. The effective rate in the third quarter 2017 and the first nine months of fiscal 2017 was lowered by approximately 290 basis points and 510 basis points, respectively, due to the exercise and vesting of stock-based awards.

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 October 28, 2018 and January 29, 2018, the Company's valuation allowance on its U.S. deferred tax assets was approximately \$7 million.

Adjusted EBITDA

Adjusted EBITDA increased \$34 million, or 15.9%, in third quarter 2018 as compared to third quarter 2017 and \$105 million, or 18.1%, in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017. Both of our reportable segments generated an increase in Adjusted EBITDA for third quarter 2018 as compared to third quarter 2017 and the first nine months of fiscal 2018 as compared to the same period in fiscal 2017.

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 decreased approximately 20 basis points to 15.4% in third quarter 2018 as compared to third quarter 2017 and increased approximately 20 basis points to 14.9% in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017. The decrease in third quarter 2018 as compared to third quarter 2017 was primarily due to the decline in gross margin and increased investments in growth initiatives, partially offset by the leverage of fixed costs through sales volume increases. The increase in the first nine months of fiscal 2018 was primarily due to the leverage of fixed costs through sales volume increases, partially offset by increased investments in growth initiatives and decline in gross margin.

Adjusted net income

Adjusted net income increased \$35 million, or 23.5%, in third quarter 2018 as compared to third quarter 2017 and \$140 million, or 39.3%, in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017. The increase in Adjusted net income in both periods was attributable to growth in operations and lower interest expense.

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Results of operations by reportable segment
Facilities Maintenance

Dollars in millions	Three Months Ended			Increase (Decrease)	Nine Months Ended			Increase (Decrease)
	October 28, 2018	October 29, 2017			October 28, 2018	October 29, 2017		
Net sales	\$ 810	\$ 754		7.4%	\$ 2,353	\$ 2,205		6.7%
Operating income	\$ 134	\$ 127		5.5%	\$ 373	\$ 351		6.3%
<i>% of Net sales</i>	<i>16.5%</i>	<i>16.8%</i>		<i>(30) bps</i>	<i>15.9%</i>	<i>15.9%</i>		
Depreciation and amortization	12	10		20.0%	34	32		6.3%
Other	3	7		(57.1)%	15	14		7.1%
Adjusted EBITDA	\$ 149	\$ 144		3.5%	\$ 422	\$ 397		6.3%
<i>% of Net sales</i>	<i>18.4%</i>	<i>19.1%</i>		<i>(70) bps</i>	<i>17.9%</i>	<i>18.0%</i>		<i>(10) bps</i>

* Not meaningful

Net Sales

Net sales increased \$56 million, or 7.4%, in third quarter 2018 as compared to third quarter 2017 and \$148 million, or 6.7%, in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017.

The increase in Net sales in both periods was primarily due to growth in the multifamily and hospitality industries and growth initiatives. 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 applications, and our enabling functions, such as supply chain and data analytics.

Adjusted EBITDA

Adjusted EBITDA increased \$5 million, or 3.5%, in third quarter 2018 as compared to third quarter 2017 and \$25 million, or 6.3%, in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017.

The increase in Adjusted EBITDA in both periods was primarily due to increased sales volume, partially offset by increased personnel costs including incentive compensation.

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Adjusted EBITDA as a percentage of Net sales decreased approximately 70 basis points in third quarter 2018 as compared to third quarter 2017 and decreased approximately 10 basis points in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017. The decrease in third quarter 2018 as compared to third quarter 2017 was primarily driven by an increase in Selling, general and administrative expenses due to investments in growth initiatives including personnel. Gross margins in third quarter 2018 remained flat as compared to third quarter 2017. The decrease in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017 was primarily driven by an increase in Selling, general and administrative expenses due to investments in growth initiatives including personnel, partially offset by improvement in gross margin of 10 basis points.

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Construction & Industrial

Dollars in millions	Three Months Ended			Increase (Decrease)	Nine Months Ended			Increase (Decrease)
	October 28, 2018	October 29, 2017			October 28, 2018	October 29, 2017		
Net sales	\$ 803	\$ 617		30.1%	\$ 2,250	\$ 1,737		29.5%
Operating income	\$ 79	\$ 55		43.6%	\$ 202	\$ 140		44.3%
<i>% of Net sales</i>	9.8%	8.9%		90 bps	9.0%	8.1%		90 bps
Depreciation and amortization	15	12		25.0%	44	34		29.4%
Other	5	3		66.7%	16	8		*
Adjusted EBITDA	\$ 99	\$ 70		41.4%	\$ 262	\$ 182		44.0%
<i>% of Net sales</i>	12.3%	11.3%		100 bps	11.6%	10.5%		110 bps

Net Sales

Net sales increased \$186 million, or 30.1%, in third quarter 2018 as compared to third quarter 2017 and \$513 million, or 29.5%, in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017. On an organic basis, excluding the sales of recently acquired A.H. Harris, sales growth was approximately 11.8% for third quarter 2018 as compared to third quarter 2017 and approximately 13.6% for the first nine months of fiscal 2018 as compared to the same period in fiscal 2017.

Growth initiatives contributed to the increase in Net sales in both periods driven by our 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. Net sales was positively impacted by end-market improvements in both non-residential and residential housing markets.

Adjusted EBITDA

Adjusted EBITDA increased \$29 million, or 41.4%, in third quarter 2018 as compared to third quarter 2017 and \$80 million, or 44.0%, in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017.

The increase in Adjusted EBITDA in both periods was primarily driven by growth initiatives and market volume. This increase was partially offset by increased Selling, general and administrative costs 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 100 basis points in third quarter 2018 as compared to third quarter 2017 and approximately 110 basis points in the first nine months of fiscal 2018 as compared to the same period in fiscal 2017. The increase in both periods was 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, partially offset by decreasing rebar margins. Rebar gross margin rates are declining due to an increase in steel costs impacted by tariffs and duties. We have increased our pricing of rebar to recover the increase in rebar costs, but not enough to maintain our gross margin rate, negatively affecting our overall margin rate, excluding A.H. Harris, by approximately 30 basis points in both third quarter

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2018 as compared to third quarter 2017 and the first nine months of fiscal 2018 as compared to the same period in fiscal 2017. Additionally, the acquisition of A.H. Harris negatively impacted gross margin by approximately 20 basis points in both third quarter 2018 and the first nine months of fiscal 2018 as compared to the same periods in fiscal 2017.

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 2018, the Company's use of cash was primarily driven by net repayments of debt, payment for business acquired, capital expenditures and purchases of treasury shares. These uses were partially offset by cash provided by operations.

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As of October 28, 2018, our combined liquidity of approximately \$920 million was comprised of \$52 million in cash and cash equivalents and \$868 million of additional available borrowings (excluding \$175 million of borrowings on available cash balances) under our Senior ABL Facility, based on qualifying inventory and receivables.

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 28, 2018	October 29, 2017	
Operating activities	\$ 379	\$ 320	\$ 59
Investing activities	(441)	2,387	(2,828)
Financing activities	(444)	(2,321)	1,877

Working capital

Working capital, excluding cash and cash equivalents, was \$849 million as of October 28, 2018, increasing \$121 million as compared to \$728 million as of October 29, 2017. The increase was primarily driven by business growth and the acquired working capital of A.H. Harris, resulting in increases in Receivables and Inventory, partially offset by increases in Accounts Payable, as well as an increase of \$87 million in Other current liabilities for the corporate headquarters financing liability.

Operating activities

During the first nine months of fiscal 2018, cash provided by operating activities was \$379 million compared to \$320 million in the first nine months of fiscal 2017. Cash interest paid in the first nine months of fiscal 2018 was \$103 million, compared to \$148 million in the first nine months of fiscal 2017. Cash flows from operating activities for the first nine months of fiscal 2018 the first nine months of fiscal 2017 included payments of \$4 million and \$6 million, respectively, of original issue discount related to the extinguishment of a portion of the Term Loans. Cash flows provided by operating activities for discontinued operations were zero and \$28 million during the first nine months of fiscal 2018 and the first nine months of fiscal 2017, respectively. Excluding the cash interest payments in both periods and original issue discounts paid, cash flows from operating activities for continuing operations increased approximately \$40 million in the first nine months of fiscal 2018 as compared to the first nine months of fiscal 2017. The increase in operating cash flows excluding interest, original issue discount, and discontinued operations is primarily attributable to growth in earnings of continuing operations.

Investing activities

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During the first nine months of fiscal 2018, cash used by investing activities was \$441 million, comprised of \$362 million for the acquisition of A.H. Harris and \$79 million of capital expenditures. 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.

Financing activities

During the first nine months of fiscal 2018, cash used in financing activities was \$444 million, primarily due to net debt repayments of \$259 million including premiums to redeem debt prior to maturity, purchases of treasury shares of \$166 million, payments of debt issuance costs of \$18 million, and tax withholdings on stock-based awards of \$6 million, partially offset by proceeds from employee stock option exercises of \$7 million.

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.

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External financing

As of October 28, 2018, we had an aggregate principal amount of \$1,899 million of outstanding indebtedness, net of unamortized discounts and unamortized deferred financing costs of \$4 million and \$22 million, respectively, and \$868 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 \$175 million of borrowings 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 October 24, 2018, the Company entered into an interest rate swap agreement, designated as a cash flow hedge on \$750 million of the Term B-5 Loans, as defined below, principal. The interest rate swap agreement swaps a LIBOR rate for a fixed rate of 3.07% and matures on October 17, 2023. The swap effectively converts a portion of the Company's Term B-5 Loans from a rate of LIBOR plus 1.75% to a 4.82% fixed rate. The fair value of the interest rate swap as of October 28, 2018 was approximately \$5 million.

On October 22, 2018, HDS entered into a Sixth Amendment (the "Sixth Amendment") to the credit agreement governing HDS's existing Term Loan Facility. Pursuant to the Sixth Amendment, HDS amended its existing Term Loan Facility, to, among other things, refinance all the outstanding term loans in an original aggregate principal of \$535 million (the "Term B-3 Loans") and an original aggregate principal of \$546 million (the "Term B-4 Loans") with a new tranche of term loans (the "Term B-5 Loans") in an original aggregate principal of \$1,070 million.

In connection with the Sixth Amendment, the Company paid approximately \$5 million in consent fees and incurred a modification and extinguishment charge of approximately \$5 million, which includes financing fees and other costs of approximately \$3 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 October 11, 2018, HDS issued \$750 million of the October 2018 Senior Unsecured Notes at par. HDS received approximately \$741 million of proceeds, net of transaction fees. The transaction fees of \$9 million are reflected as deferred financing costs in the Consolidated Balance Sheets and will be amortized into interest expense over the term of the notes. HDS used the net proceeds from the October 2018 Senior Unsecured Notes issuance, together with available cash and borrowings on the Senior ABL Facility, to redeem all of the outstanding \$1,000 million aggregate principal of the April 2016 Senior Unsecured Notes, and pay a \$56 million make-whole premium calculated in accordance with the terms of the indenture governing such notes and pay \$28 million of accrued but unpaid interest. As a result, the Company incurred a \$64 million loss on extinguishment of the debt, which includes the \$56 million make-whole premium and write-off of \$8 million of unamortized deferred financing costs, in accordance with ASC 470-50, "Debt Modifications and Extinguishments."

For additional information, see "Note 5, Debt," in the Notes to the Consolidated Financial Statements within Item 1 of this quarterly report on Form 10-Q.

Rating agency actions

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In October 2018, Moody's Investor's Service (Moody's) assigned a Ba3 rating on the October 2018 Senior Unsecured Notes. In related ratings actions, Moody's assigned a Ba2 rating on the Term B-5 Loans. Moody's affirmed its Ba2 Corporate Family Rating, Ba2-PD Probability of Default, and SGL-1 Speculative Grade Liquidity Rating. Moody's rating outlook remains stable.

In October 2018, Standard & Poor's Global Ratings (S&P) assigned a BB- issue-level rating and a recovery rating of 6 on the October 2018 Senior Unsecured Notes. In related ratings actions, S&P assigned a BBB- issue-level rating and a recovery rating of 1 on the Term B-5 Loans. S&P affirmed its other ratings on HDS, including the BB+ issuer rating. S&P's rating outlook remains stable.

In July 2018, Moody's upgraded HDS's Corporate Family Rating to Ba2 from Ba3 and its Probability of Default Rating to Ba2-PD from Ba3-PD. Moody's cited projected financial performance and resulting key debt credit metrics

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improving over the next to 12 to 18 months. Moody's also affirmed HDS's SGL-1 Speculative Grade Liquidity Rating and its rating outlook remains stable.

In April 2018, S&P upgraded HDS's Corporate Family Rating from BB Stable to BB+ Stable. Additionally, S&P affirmed its rating of the Senior ABL Facility as BBB-. S&P cited HDS's improved operating performance and credit metrics as rationale for the upgrades. S&P affirmed its ratings outlook as 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 Form 10-K for the fiscal year ended January 28, 2018, except for those related to the adoption of ASC 606, Revenue from Contracts with Customers. See Note 14 - Revenue in the Notes to the Consolidated Financial Statements within Item 1 of this quarterly report on Form 10-Q for further information.

Recent accounting pronouncements

See Note 15 - Recent Accounting Pronouncements in the Notes to the 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 28, 2018.

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 28, 2018 (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 28, 2018 (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 2018 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 September 19, 2018, the Court granted in part and denied in part Defendants' motion to dismiss. The matter is now in discovery.

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

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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. On October 22, 2018, upon joint motion of the parties, the Court entered an order continuing the continued conditional stay of proceedings and administratively closing the matter until after any summary judgment motion filed in the securities litigation is adjudicated.

On August 29, 2018, a shareholder derivative complaint was filed in Delaware Chancery Court 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 complaint generally alleges 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 supply chain corrective actions. The complaint asserts various common law breach of fiduciary duty claims against the individual defendants and claims of unjust enrichment and insider selling. The complaint seeks to recover any damages sustained by the Company as a result of the individual defendants' allegedly wrongful actions, seeks certain actions by the Company to modify its corporate governance and internal procedures, and seeks to recover attorneys' fees and other costs. Defendants moved to dismiss the complaint on November 2, 2018. That motion is pending.

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 consolidated 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 28, 2018.

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 28, 2018 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 August 25, 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 and Rule 10b-18 of the Securities Exchange Act of 1934, as amended. Under this plan, Holdings purchased approximately 4.7 million shares for approximately \$178 million during the nine months ended October 28, 2018.

On November 30, 2018, the Company's Board of Directors authorized a new share repurchase program for the repurchase of up to an aggregate \$500 million of its common stock. The Company will conduct repurchases under the share repurchase program in the open market and through broker negotiated purchases in compliance with Rule 10b5-1 and Rule 10b-18 of the Securities Exchange Act of 1934, and subject to market conditions, restrictive covenants contained in existing debt agreements, applicable legal requirements, and other relevant factors. This share repurchase program does not obligate the Company to acquire any particular amount of its common stock, and it may be terminated at any time at the Company's discretion.

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 24, 2015. 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.

Under the share repurchase plans, Holdings repurchased approximately 4.8 million shares of its common stock for approximately \$185 million during the nine months ended October 28, 2018.

Issuer Purchases of Equity Securities in each fiscal month of the second quarter of fiscal 2018 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 30 – August 26	38,117	\$ 43.42	38,117	\$ 371,475,545
August 27 – September 23	90,966	42.40	90,966	367,728,013
September 24 – October 28	2,292,709	37.95	2,292,709	280,807,269(2)
Total	2,421,792	\$ 38.20	2,421,792	

(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.*

(2) *As of October 28, 2018, the approximate dollar value of shares that may yet be repurchased under the plans or programs is entirely comprised of available repurchases related to the \$500 million share repurchase program authorized in August 2017.*

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Item 6. Exhibits

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

Exhibit Number	Exhibit Description
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.(1)</u>
3.4	<u>Certificate of Amendment of Certificate of Incorporation of HD Supply, Inc.(3)</u>
3.5	<u>Amended and Restated By-Laws of HD Supply, Inc.(3)</u>
4.1	<u>Indenture, dated as of October 11, 2018, by and among HD Supply, Inc., the subsidiary guarantors from time to time a party thereto, and Wells Fargo Bank, National Association relating to the 5.375% Senior Notes due 2026.</u>
4.2	<u>Form of 5.375% Senior Note due 2026 (included in Exhibit 4.1 hereto).</u>
10.1	<u>Sixth Amendment to Credit Agreement, dated as of October 22, 2018, by and among HD Supply Inc., Bank of America, N.A. as administrative agent, JP Morgan Chase Bank, N.A., as a Term B-5 Lender, and the other lenders party thereto.</u>
10.2#	<u>Separation Agreement and Release of Claims, dated as of September 28, 2018, by and between HD Supply Holdings, Inc. and William P. Stengel. (4)</u>
10.3#	<u>Letter of Employment, dated as of November 2, 2015, by and between HD Supply, Inc. and Bradley Paulsen.</u>
10.4#	<u>Letter of Employment, dated as of September 6, 2018, by and between HD Supply, Inc. and Bradley Paulsen.</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>

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32.4 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.

101 Interactive data files pursuant to Rule 405 of Regulation S-T.

(1) Previously filed in Amendment No.1 to Form S-4 of HD Supply, Inc. (File No. 333-159809) filed on July 10, 2009.

(2) Previously filed in Form S-8 of HD Supply Holdings, Inc. (File No. 333-189771) filed on July 2, 2013.

(3) Previously filed in Form 8-K of HD Supply, Inc. (File No. 333-159809) filed on July 9, 2013.

(4) Previously filed in Form 8-K of HD Supply Holdings, Inc. (File No. 001-35979) filed on October 2, 2018.

Management contract or compensatory plan or arrangement.

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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, 2018
(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, 2018
(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