

DIAMOND OFFSHORE DRILLING, INC.
Form 10-Q
November 05, 2018

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 September 30, 2018

OR

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

For the transition period from _____ to _____

Commission file number 1-13926

DIAMOND OFFSHORE DRILLING, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation
or organization)

76-0321760
(I.R.S. Employer
Identification No.)

15415 Katy Freeway

Houston, Texas

77094

(Address of principal executive offices)

(Zip Code)

(281) 492-5300

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

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):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

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

Yes No

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of November 1, 2018 Common stock, \$0.01 par value per share 137,434,702 shares

DIAMOND OFFSHORE DRILLING, INC.

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PART I. FINANCIAL INFORMATION**ITEM 1. Financial Statements.****DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(Unaudited)

(In thousands, except share and per share data)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 201,853	\$ 376,037
Marketable securities	274,690	
Accounts receivable, net of allowance for bad debts	198,701	256,730
Prepaid expenses and other current assets	139,191	157,625
Assets held for sale		96,261
Total current assets	814,435	886,653
Drilling and other property and equipment, net of accumulated depreciation	5,191,841	5,261,641
Other assets	62,047	102,276
Total assets	\$ 6,068,323	\$ 6,250,570
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 42,169	\$ 38,755
Accrued liabilities	151,359	154,655
Taxes payable	14,789	29,878
Total current liabilities	208,317	223,288
Long-term debt	1,973,488	1,972,225
Deferred tax liability	114,736	167,299
Other liabilities	110,643	113,497
Total liabilities	2,407,184	2,476,309
Commitments and contingencies (Note 9)		
Stockholders equity:		
Preferred stock (par value \$0.01, 25,000,000 shares authorized, none issued and outstanding)		
Common stock (par value \$0.01, 500,000,000 shares authorized;	1,444	1,441

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144,378,512 shares issued and 137,434,458 shares outstanding at September 30, 2018; 144,085,292 shares issued and 137,227,782 shares outstanding at December 31, 2017)		
Additional paid-in capital	2,015,430	2,011,397
Retained earnings	1,848,623	1,964,497
Accumulated other comprehensive income (loss)	(4)	(5)
Treasury stock, at cost (6,944,054 and 6,857,510 shares of common stock at September 30, 2018 and December 31, 2017, respectively)	(204,354)	(203,069)
Total stockholders' equity	3,661,139	3,774,261
Total liabilities and stockholders' equity	\$ 6,068,323	\$ 6,250,570

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

DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Revenues:				
Contract drilling	\$ 280,691	\$ 357,683	\$ 833,970	\$ 1,113,410
Revenues related to reimbursable expenses	5,631	8,340	16,723	26,128
Total revenues	286,322	366,023	850,693	1,139,538
Operating expenses:				
Contract drilling, excluding depreciation	188,456	198,072	562,466	597,812
Reimbursable expenses	5,574	8,220	16,458	25,488
Depreciation	81,884	83,281	245,534	262,492
General and administrative	33,308	17,806	70,057	54,299
Impairment of assets			27,225	71,268
Restructuring and separation costs	649		4,925	
(Gain) loss on disposition of assets	(506)	63	(1,066)	(2,085)
Total operating expenses	309,365	307,442	925,599	1,009,274
Operating (loss) income	(23,043)	58,581	(74,906)	130,264
Other income (expense):				
Interest income	2,364	776	6,001	1,347
Interest expense, net of amounts capitalized	(34,293)	(28,562)	(92,196)	(83,409)
Loss on extinguishment of senior notes		(35,366)		(35,366)
Foreign currency transaction (loss) gain	(743)	(677)	115	(517)
Other, net	(179)	1,447	664	1,322
(Loss) income before income tax benefit	(55,894)	(3,801)	(160,322)	13,641
Income tax benefit	4,782	14,600	59,257	36,646
Net (loss) income.	\$ (51,112)	\$ 10,799	\$ (101,065)	\$ 50,287
(Loss) earnings per share, Basic and Diluted	\$ (0.37)	\$ 0.08	\$ (0.74)	\$ 0.37
Weighted-average shares outstanding:				
Shares of common stock	137,434	137,227	137,386	137,208
Dilutive potential shares of common stock		14		29
Total weighted-average shares outstanding	137,434	137,241	137,386	137,237

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

DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

(Unaudited)

(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net (loss) income	\$ (51,112)	\$ 10,799	\$ (101,065)	\$ 50,287
Other comprehensive gains (losses), net of tax:				
Derivative financial instruments:				
Reclassification adjustment for gain included in net income	(2)	(1)	(5)	(4)
Investments in marketable securities:				
Unrealized holding gain	6		37	
Reclassification adjustment for gain included in net income	(31)		(31)	
Total other comprehensive gain (loss)	(27)	(1)	1	(4)
Comprehensive (loss) income	\$ (51,139)	\$ 10,798	\$ (101,064)	\$ 50,283

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

DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2018	2017
Operating activities:		
Net (loss) income	\$ (101,065)	\$ 50,287
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation	245,534	262,492
Loss on impairment of assets	27,225	71,268
Loss on extinguishment of senior notes		35,366
Restructuring and separation costs	1,817	
Gain on disposition of assets	(1,066)	(2,085)
Deferred tax provision	(69,109)	(73,873)
Stock-based compensation expense	4,036	4,806
Contract liabilities, net	(6,589)	8,379
Contract assets, net	(4,395)	
Deferred contract costs, net	34,901	32,701
Other assets, noncurrent	823	(2,806)
Other liabilities, noncurrent	(4,298)	(212)
Other	2,152	2,387
Changes in operating assets and liabilities:		
Accounts receivable	57,881	(25,743)
Prepaid expenses and other current assets	4,901	(4,831)
Accounts payable and accrued liabilities	(11,836)	17,787
Taxes payable	7,844	(9,288)
Net cash provided by operating activities	188,756	366,635
Investing activities:		
Capital expenditures	(159,751)	(100,613)
Proceeds from maturities of marketable securities	775,000	31
Purchase of marketable securities	(1,047,453)	
Proceeds from disposition of assets, net of disposal costs	69,533	4,017
Net cash used in investing activities	(362,671)	(96,565)
Financing activities:		
Redemption of senior notes		(500,000)
Payment of debt extinguishment costs		(34,395)
Proceeds from issuance of senior notes		496,360

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Debt issuance costs and arrangement fees	(234)	(7,226)
Net repayment of short-term borrowings		(104,200)
Other	(35)	(156)
Net cash used in financing activities	(269)	(149,617)
Net change in cash and cash equivalents	(174,184)	120,453
Cash and cash equivalents, beginning of period	376,037	156,233
Cash and cash equivalents, end of period	\$ 201,853	\$ 276,686

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

DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. General Information

The unaudited condensed consolidated financial statements of Diamond Offshore Drilling, Inc. and subsidiaries, which we refer to as Diamond Offshore, we, us or our, should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2017 (File No. 1-13926).

As of November 1, 2018, Loews Corporation owned approximately 53% of the outstanding shares of our common stock.

Interim Financial Information

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the U.S., or GAAP, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, pursuant to such rules and regulations, they do not include all disclosures required by GAAP for annual financial statements. The condensed consolidated financial information has not been audited but, in the opinion of management, includes all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of Diamond Offshore's condensed consolidated balance sheets, statements of operations, statements of comprehensive income and statements of cash flows at the dates and for the periods indicated. Results of operations for interim periods are not necessarily indicative of results of operations for the respective full years.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimated.

Changes in Accounting Principles

Revenue Recognition. In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), or ASU 2014-09, which supersedes the revenue recognition requirements in ASU Topic 605, Revenue Recognition. Under the new guidance, revenue is recognized when a customer obtains control of promised goods or services and in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services.

We adopted ASU 2014-09 and its related amendments, or collectively Topic 606, effective January 1, 2018 using the modified retrospective implementation method. Accordingly, we have applied the five-step method outlined in Topic 606 for determining when and how revenue is recognized to all contracts that were not completed as of the date of adoption. Revenues for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts have not been adjusted and continue to be reported under the previous revenue recognition guidance. For contracts that were modified before the effective date, we have considered the modification guidance within the new standard and determined that the revenue recognized and contract balances recorded prior to adoption for such contracts were not impacted. While Topic 606 requires additional disclosure of the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, its adoption has not had a material impact on the measurement or recognition of our revenues.

Our adoption of ASU 2014-09 represents a change in accounting principle and therefore, we have recorded the cumulative effect of adopting Topic 606 as an increase to opening retained earnings on January 1, 2018. This adjustment represents an accrual for the earned portion of demobilization revenue expected to be received for contracts not completed as of December 31, 2017, which was not recordable under previous revenue recognition guidance until completion of the demobilization activities. See Note 2.

Income Taxes. In October 2016, the FASB issued ASU No. 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*, or ASU 2016-16. ASU 2016-16 amends the guidance in Topic 740 with respect to the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. We have evaluated our historical intra-group transactions for impact under the provisions of ASU 2016-16 and have adopted the guidance thereof effective January 1, 2018 using the modified retrospective approach. We have recorded the \$17.4 million cumulative effect of applying the new standard as a decrease to opening retained earnings with an offset to deferred income tax liability. See Note 11.

The aggregate impact of the changes in accounting principles, as discussed above, to our unaudited Condensed Consolidated Balance Sheets on January 1, 2018 was as follows (in thousands):

	Retained Earnings	Prepaid Expenses and Other Current Assets	Other Assets	Deferred Tax Liability
Balance as of January 1, 2018 before adoption	\$ 1,964,497	\$ 157,625	\$ 102,276	\$ 167,299
Adjustments for adoption of:				
Topic 606	2,590	611	2,107	128
ASU 2016-16	(17,401)			17,401
Balance as of January 1, 2018 after adoption	\$ 1,949,686	\$ 158,236	\$ 104,383	\$ 184,828

Other Recently Adopted Accounting Pronouncements

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework Changes to the Disclosure Requirements for Fair Value Measurement*, or ASU 2018-13. ASU 2018-13 modifies the disclosure requirements for fair value measurements, including the (i) removal of certain disclosure requirements regarding transfers between Levels 1 and 2 of the fair value hierarchy and timing thereof and the valuation processes for Level 3 fair value measurements and (ii) a requirement to provide additional information regarding the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. We have early adopted the disclosure modifications in ASU 2018-13 as of September 30, 2018.

In February 2018, the FASB issued ASU No. 2018-02, *Income Statement Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*, or ASU 2018-02. ASU 2018-02 provides for entities to make a one-time election to reclassify the income tax effects of the Tax Cuts and Jobs Act enacted in December 2017, or the Tax Reform Act, on items within accumulated other comprehensive income to retained earnings. The guidance of ASU 2018-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within that reporting period. Early adoption of ASU 2018-02 is permitted. We have early adopted ASU 2018-02 and have reclassified the effect of the change in the U.S. federal corporate income tax rate on deferred tax-related items remaining in accumulated other comprehensive loss. The impact of adoption of ASU 2018-02 was not significant.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, or ASU 2016-15. ASU 2016-15 provides specific guidance on eight cash flow classification issues not specifically addressed by GAAP: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments; contingent consideration payments; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies; distributions from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The adoption of ASU 2016-15 did not have a significant impact on the presentation of cash receipts and cash payments within our condensed consolidated statements of cash flows.

Recent Accounting Pronouncements Not Yet Adopted

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, or ASU 2016-02, which (i) requires lessees to recognize a right of use asset and a lease liability on the balance sheet for virtually all leases, (ii) updates

previous accounting standards for lessors to align certain requirements with the updates to lessee accounting standards and the revenue recognition accounting standards and (iii) requires enhanced disclosure of qualitative and quantitative information about the entity's leasing arrangements. This update is effective for annual and interim periods beginning after December 15, 2018, with early adoption permitted. During our evaluation of ASU 2016-02, we concluded that our drilling contracts contain a lease component based on the updated definition of a lease. In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements*, which provides for (i) an optional new transition method for adoption of ASU 2016-02 that results in initial recognition of a cumulative effect adjustment to retained earnings in the year of adoption and (ii) a practical expedient for lessors, under certain circumstances, to combine the lease and non-lease components and account for the combined component under Topic 606, *Revenue from Contracts with Customers*. We expect to apply the new transition method and are still evaluating the application of the practical expedient to combine the lease and service components of our drilling contracts.

With respect to leases whereby we are the lessee, we expect to recognize lease liabilities and offsetting right of use assets corresponding to our currently identified future minimum lease commitments of between \$130 million and \$150 million, primarily related to certain leased subsea equipment. However, we are still evaluating the overall impact and will continue to refine our estimate prior to adoption of the ASU. We currently expect to elect the transition practical expedient package available in the ASU whereby we will not reassess (i) whether any of our expired or existing contracts contain a lease, (ii) the classification for any expired or existing leases and (iii) initial direct costs for any existing leases.

2. Revenue from Contracts with Customers

The activities that primarily drive the revenue earned from our drilling contracts include (i) providing a drilling rig and the crew and supplies necessary to operate the rig, (ii) mobilizing and demobilizing the rig to and from the drill site and (iii) performing rig preparation activities and/or modifications required for the contract. Consideration received for performing these activities may consist of dayrate drilling revenue, mobilization and demobilization revenue, contract preparation revenue and reimbursement revenue. We account for these integrated services provided within our drilling contracts as a single performance obligation satisfied over time and comprised of a series of distinct time increments in which we provide drilling services.

Consideration for activities that are not distinct within the context of our contracts and do not correspond to a distinct time increment within the contract term are allocated across the single performance obligation and recognized ratably as time elapses over the initial term of the contract (which is the period we estimate to be benefited from the corresponding activities and generally ranges from two to 60 months). Consideration for activities that correspond to a distinct time increment within the contract term is recognized in the period when the services are performed. The total transaction price is determined for each individual contract by estimating both fixed and variable consideration expected to be earned over the term of the contract. See below for further discussion regarding the allocation of the transaction price to the remaining performance obligations.

The amount estimated for variable consideration may be constrained (reduced) and is only included in the transaction price to the extent that it is probable that a significant reversal of previously recognized revenue will not occur throughout the term of the contract. When determining if variable consideration should be constrained, management considers whether there are factors outside of our control that could result in a significant reversal of revenue as well as the likelihood and magnitude of a potential reversal of revenue. These estimates are re-assessed each reporting period as required.

Dayrate Drilling Revenue. Our drilling contracts generally provide for payment on a dayrate basis, with higher rates for periods when the drilling unit is operating and lower rates or zero rates for periods when drilling operations are interrupted or restricted. The dayrate invoices billed to the customer are typically determined based on the varying rates applicable to the specific activities performed on an hourly basis. Such dayrate consideration is allocated to the distinct hourly increment it relates to within the contract term, and therefore, recognized in line with the contractual rate billed for the services provided for any given hour.

Mobilization/Demobilization Revenue. We may receive fees (on either a fixed lump-sum or variable dayrate basis) for the mobilization and demobilization of our rigs. These activities are not considered to be distinct within the context of the contract and therefore, the associated revenue is allocated to the overall performance obligation and recognized ratably over the initial term of the related drilling contract. We record a contract liability for mobilization fees received, which is amortized ratably to contract drilling revenue as services are rendered over the initial term of the related drilling contract. Demobilization revenue expected to be received upon contract completion is estimated as part of the overall transaction price at contract inception and recognized in earnings ratably over the initial term of the contract with an offset to an accretive contract asset.

In some contracts, there is uncertainty as to the likelihood and amount of expected demobilization revenue to be received. For example, contractual provisions may require that a rig demobilize a certain distance before the demobilization revenue is payable or the amount may vary dependent upon whether or not the rig has additional contracted work within a certain distance from the wellsite. Therefore, the estimate for such revenue may be constrained, as described above, depending on the facts and circumstances pertaining to the specific contract. We assess the likelihood of receiving such revenue based on past experience and knowledge of the market conditions.

Contract Preparation Revenue. Some of our drilling contracts require downtime before the start of the contract to prepare the rig to meet customer requirements. At times, we may be compensated by the customer for such work (on either a fixed lump-sum or variable dayrate basis). These activities are not considered to be distinct within the context of the contract. We record a contract liability for contract preparation fees received, which is amortized ratably to contract drilling revenue over the initial term of the related drilling contract.

Capital Modification Revenue. From time to time, we may receive fees from our customers for capital improvements or upgrades to our rigs to meet contractual requirements (on either a fixed lump-sum or variable dayrate basis). The activities related to these capital modifications are not considered to be distinct within the context of our contracts. We record a contract liability for such fees and recognize them ratably as contract drilling revenue over the initial term of the related drilling contract.

Revenues Related to Reimbursable Expenses. We generally receive reimbursements from our customers for the purchase of supplies, equipment, personnel services and other services provided at their request in accordance with a drilling contract or other agreement. Such reimbursable revenue is variable and subject to uncertainty, as the amounts received and timing thereof are highly dependent on factors outside of our influence. Accordingly, reimbursable revenue is fully constrained and not included in the total transaction price until the uncertainty is resolved, which typically occurs when the related costs are incurred on behalf of a customer. We are generally considered a principal in such transactions and record the associated revenue at the gross amount billed to the customer, as Revenues related to reimbursable expenses in our unaudited Condensed Consolidated Statements of Operations. Such amounts are recognized ratably over the period within the contract term during which the corresponding goods and services are to be consumed.

Contract Balances

Accounts receivable are recognized when the right to consideration becomes unconditional based upon contractual billing schedules. Payment terms on invoiced amounts are typically 30 days. Contract asset balances consist primarily of demobilization revenue that we expect to receive and is recognized ratably throughout the contract term, but invoiced upon completion of the demobilization activities. Once the demobilization revenue is invoiced, the corresponding contract asset is transferred to accounts receivable. Contract liabilities include payments received for mobilization as well as rig preparation and upgrade activities which are allocated to the overall performance obligation and recognized ratably over the initial term of the contract.

Contract balances are netted at a contract level, such that deferred revenue for mobilization, contract preparation and capital modifications (contract liabilities) is netted with any accrued demobilization revenue (contract asset) for each applicable contract.

The following table provides information about receivables, contract assets and contract liabilities from our contracts with customers (in thousands):

	September 30, 2018	January 1, 2018
Trade receivables	\$ 189,348	\$ 247,453
Current contract assets ⁽¹⁾	5,006	611
Noncurrent contract assets ⁽¹⁾	2,107	2,107
Current contract liabilities (deferred revenue) ⁽¹⁾	(2,986)	(11,371)
Noncurrent contract liabilities (deferred revenue) ⁽¹⁾	(10,767)	(8,972)

⁽¹⁾ Contract assets and contract liabilities may reflect balances that have been netted together on a contract basis. Net current contract asset and liability balances are included in Prepaid expenses and other current assets and Accrued liabilities, respectively, and net noncurrent contract asset and liability balances are included in Other assets and Other liabilities, respectively, in our unaudited Condensed Consolidated Balance Sheets as of September 30, 2018.

Significant changes in the contract assets and the contract liabilities balances during the period are as follows (in thousands):

	Net Contract Balances
Contract assets at January 1, 2018	\$ 2,718
Contract liabilities at January 1, 2018	(20,343)
Net balance at January 1, 2018	(17,625)
Decrease due to amortization of revenue that was included in the beginning contract liability balance	18,396
Increase due to cash received, excluding amounts recognized as revenue during the period	(11,944)
Increase due to revenue recognized during the period but contingent on future performance	5,006
Decrease due to transfer to receivables during the period	(611)
Adjustments	138
Net balance at September 30, 2018	\$ (6,640)
Contract assets at September 30, 2018	\$ 7,113
Contract liabilities at September 30, 2018	(13,753)

Deferred Contract Costs

Certain direct and incremental costs incurred for upfront preparation, initial mobilization and modifications of contracted rigs represent costs of fulfilling a contract as they relate directly to a contract, enhance resources that will be used in satisfying our performance obligations in the future and are expected to be recovered. Such costs are deferred and amortized ratably to contract drilling expense as services are rendered over the initial term of the related drilling contract. Such deferred contract costs in the amount of \$54.3 million and \$16.7 million are reported in Prepaid expenses and other current assets and Other assets, respectively, in our unaudited Condensed Consolidated Balance Sheets at September 30, 2018. During the three-month and nine-month periods ended September 30, 2018, the amount of amortization of such costs was \$28.3 million and \$55.6 million, respectively. There was no impairment loss in relation to capitalized costs.

Costs incurred for the demobilization of rigs at contract completion are recognized as incurred during the demobilization process. Costs incurred for rig modifications or upgrades required for a contract, which are considered to be capital improvements, are capitalized as drilling and other property and equipment and depreciated over the estimated useful life of the improvement.

Transaction Price Allocated to Remaining Performance Obligations

The following table reflects revenue expected to be recognized in the future related to unsatisfied performance obligations as of September 30, 2018 (in thousands):

For the Years Ending December 31,				
2019	2020	2021	2022	Total

	2018					
	(1)					
Mobilization and contract preparation revenue	\$ 3,106	\$ 5,935	\$ 391	\$ 511	\$ 83	\$ 10,026
Capital modification revenue	3,383	10,588	4,297			18,268
Demobilization revenue	694					694
Other deferred revenue	977	3,878	3,878	1,105		9,838
Total	\$ 8,160	\$ 20,401	\$ 8,566	\$ 1,616	\$ 83	\$ 38,826

(1) Represents the three-month period beginning October 1, 2018.

The revenue included above consists primarily of expected fixed mobilization, demobilization, and upgrade revenue for both wholly and partially unsatisfied performance obligations as well as expected variable mobilization, demobilization, and upgrade revenue for partially unsatisfied performance obligations, which has been estimated for purposes of allocating across the entire corresponding performance obligations. The amounts are derived from the specific terms within drilling contracts that contain such provisions, and the expected timing for recognition of such revenue is based on the estimated start date and duration of each respective contract based on information known at September 30, 2018. The actual timing of recognition of such amounts may vary due to factors outside of our control.

We have applied the disclosure practical expedient in Accounting Standards Codification 606-10-50-14A(b) and have not included estimated variable consideration related to wholly unsatisfied performance obligations or to distinct future time increments within our contracts, including dayrate revenue.

Impact of Topic 606 on Financial Statement Line Items

Our revenue recognition pattern under Topic 606 is similar to revenue recognition under the previous guidance, except for the recognition of demobilization revenue. Such revenue, which was recognized upon completion of a contract under the previous guidance, is now estimated at contract inception and recognized ratably as contract drilling revenue over the term of the contract with an offset to a contract asset under Topic 606.

The following tables summarize the impacts of adopting Topic 606 on our selected unaudited Condensed Consolidated Balance Sheets, Statements of Operations and Statements of Cash Flows information, as of and for the nine months ended September 30, 2018 (in thousands, except per share data):

	September 30, 2018		
	Balances as reported	Adjustments	Balances without adoption of Topic 606
<i>Unaudited Condensed Consolidated Balance Sheets</i>			
Prepaid and other current assets	\$ 139,191	\$ (3,390)	\$ 135,801
Other assets	62,047	(2,107)	59,940
Deferred tax liability	114,736	(712)	114,024
Retained earnings	1,848,623	(4,785)	1,843,838
<i>Unaudited Condensed Consolidated Statements of Operations</i>			
Contract drilling revenues	\$ 833,970	\$ (2,779)	\$ 831,191
Income tax benefit	59,257	584	59,841
Loss per share, basic and diluted	(0.74)	(0.02)	(0.76)
<i>Unaudited Condensed Consolidated Statements of Cash Flows</i>			
Cash flow from operating activities:			
Net loss	\$ (101,065)	\$ (2,195)	\$ (103,260)
Adjustments to reconcile net loss to net cash			
Deferred tax provision	(69,109)	(584)	(69,693)
Contract assets	(4,395)	2,779	(1,616)

3. Assets Held for Sale and Impairment of Assets

Assets Held for Sale

We reported the \$96.3 million carrying value of two of our rigs, the *Ocean Scepter* and *Ocean Victory*, as Assets held for sale in our unaudited Condensed Consolidated Balance Sheets at December 31, 2017. The *Ocean Victory*, which had a carrying value of \$1.2 million, was sold in January 2018. The *Ocean Scepter* was sold in July 2018, subsequent to recognizing an additional impairment loss in the second quarter of 2018. We reported an aggregate net pre-tax gain of \$0.1 million on the sale of these rigs during the nine-month period ended September 30, 2018. See *Asset*

Impairments.

Asset Impairments

2018 Impairment. During the second quarter of 2018, we recorded an impairment loss of \$27.2 million to recognize a reduction in fair value of the *Ocean Scepter*. We estimated the fair value of the impaired rig using a market approach based on a signed agreement to sell the rig, including estimated costs to sell. We consider this valuation approach to be a Level 3 fair value measurement due to the level of estimation involved as the sale had not yet been completed at the time of our analysis.

During the third quarter of 2018, we evaluated two of our drilling rigs with indicators of impairment. Based on our assumptions and analysis at that time, we determined that the undiscounted probability-weighted cash flow for each rig was in excess of its respective carrying value. As a result, we concluded that no impairment of these rigs had occurred at September 30, 2018.

As of September 30, 2018, there were 11 rigs in our drilling fleet not previously written down to scrap, for which there were no current indicators that their carrying amounts may not be recoverable and, thus, were not evaluated for impairment. If market fundamentals in the offshore oil and gas industry deteriorate further or a projected market recovery is further delayed, we may be required to recognize additional impairment losses in future periods.

2017 Impairments. During the second quarter of 2017, we evaluated seven of our drilling rigs with indicators of impairment and determined that the carrying values of two floaters were impaired (we collectively refer to these two rigs as the 2017 Impaired Rigs).

We estimated the fair value of the 2017 Impaired Rigs using an income approach, whereby the fair value of each rig was estimated based on a calculation of the rig's future net cash flows. These calculations utilized significant unobservable inputs, including estimated proceeds that may be received on ultimate disposition of the rig, and are representative of Level 3 fair value measurements due to the significant level of estimation involved and lack of transparency as to the inputs used. During the second quarter of 2017, we recorded an impairment loss of \$71.3 million related to our 2017 Impaired Rigs.

4. Supplemental Financial Information

Condensed Consolidated Balance Sheets Information

Accounts receivable, net of allowance for bad debts, consist of the following (in thousands):

	September 30, 2018	December 31, 2017
Trade receivables	\$ 189,348	\$ 247,453
Value added tax receivables	14,176	14,067
Related party receivables	109	205
Other	527	464
	204,160	262,189
Allowance for bad debts	(5,459)	(5,459)
Total	\$ 198,701	\$ 256,730

Prepaid expenses and other current assets consist of the following (in thousands):

	September 30, 2018	December 31, 2017
Rig spare parts and supplies	\$ 21,514	\$ 28,383
Deferred contract costs	54,322	51,297
Prepaid BOP lease	3,873	3,873

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Prepaid insurance	3,448	3,091
Prepaid taxes	46,422	67,212
Other	9,612	3,769
Total	\$ 139,191	\$ 157,625

Accrued liabilities consist of the following (in thousands):

	September 30, 2018	December 31, 2017
Rig operating expenses	\$ 33,796	\$ 48,894
Payroll and benefits	42,238	46,560
Deferred revenue	2,986	11,371
Accrued capital project/upgrade costs	19,763	3,698
Interest payable	36,813	28,234
Personal injury and other claims	6,090	5,699
Other	9,673	10,199
Total	\$ 151,359	\$ 154,655

Accrued liabilities includes \$1.8 million and \$13.6 million in accrued costs at September 30, 2018 and December 31, 2017, respectively, related to a restructuring plan that was implemented in late 2017. See Note 10.

Condensed Consolidated Statements of Cash Flows Information

Noncash investing activities excluded from the unaudited Condensed Consolidated Statements of Cash Flows and other supplemental cash flow information is as follows (in thousands):

	Nine Months Ended September 30, 2018		2017
Accrued but unpaid capital expenditures at period end	\$ 19,413	\$ 3,338	
Common stock withheld for payroll tax obligations (1)	1,285	481	
Cash interest payments	76,219	60,253	
Cash income taxes paid, net of (refunds):			
Foreign	5,941	37,884	
U.S. federal	(7,389)		
State	2	94	

- (1) Represents the cost of 86,544 shares and 29,241 shares of common stock withheld to satisfy payroll tax obligations incurred as a result of the vesting of restricted stock units in the nine months ended September 30, 2018 and 2017, respectively. These costs for the nine months ended September 30, 2018 are presented as a deduction from stockholders' equity in Treasury stock in our unaudited Condensed Consolidated Balance Sheets at September 30, 2018.

5. Earnings (Loss) Per Share

A reconciliation of the numerators and the denominators of our basic and diluted per-share computations is as follows (in thousands, except per share data):

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net (loss) income basic and diluted numerator	\$ (51,112)	\$ 10,799	\$ (101,065)	\$ 50,287
Weighted average shares basic (denominator):	137,434	137,227	137,386	137,208
Dilutive effect of stock-based awards		14		29
Weighted average shares including conversions diluted (denominator)	137,434	137,241	137,386	137,237
(Loss) earnings per share:				
Basic	\$ (0.37)	\$ 0.08	\$ (0.74)	\$ 0.37
Diluted	\$ (0.37)	\$ 0.08	\$ (0.74)	\$ 0.37

The following table sets forth the share effects of stock-based awards excluded from the computations of diluted (loss) earnings per share, as the inclusion of such potentially dilutive shares would have been antidilutive for the periods presented (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Employee and director:				
Stock options				1
Stock appreciation rights	1,071	1,297	1,161	1,330
Restricted stock units	1,182	1,061	1,150	977

6. Marketable Securities

We report our investments as current assets in our unaudited Condensed Consolidated Balance Sheets in Marketable securities, representing the investment of cash available for current operations. See Note 7.

Our investments in marketable securities are classified as available for sale and are summarized as follows (in thousands):

	September 30, 2018		
	Amortized	Unrealized	Market
	Cost	Gain	Value
U.S. Treasury bills (due within one year)	\$ 274,683	\$ 7	\$ 274,690

Proceeds from maturities of U.S. Treasury bills were \$475.0 million and \$775.0 million during the three-month and nine-month periods ended September 30, 2018. There were no sales of U.S. Treasury bills during the three-month and nine-month periods ended September 30, 2018.

7. Financial Instruments and Fair Value Disclosures

Financial instruments that potentially subject us to significant concentrations of credit or market risk consist primarily of periodic temporary investments of excess cash, trade accounts receivable and investments in debt securities. We generally place our excess cash investments in U.S. Treasury bills and U.S. government-backed short-term money market instruments through several financial institutions. We periodically evaluate the relative credit standing of these financial institutions as part of our investment strategy.

Concentrations of credit risk with respect to our trade accounts receivable are limited primarily due to the entities comprising our customer base. Since the market for our services is the offshore oil and gas industry, this customer base has consisted primarily of major and independent oil and gas companies and government-owned oil companies. Based on our current customer base and the geographic areas in which we operate, we do not believe that we have any significant concentrations of credit risk at September 30, 2018.

In general, before working for a customer with whom we have not had a prior business relationship and/or whose financial stability may be uncertain to us, we perform a credit review on that company. Based on that analysis, we may require that the customer present a letter of credit, prepay or provide other credit enhancements. We record a provision for bad debts on a case-by-case basis when facts and circumstances indicate that a customer receivable may not be collectible and, historically, losses on our trade receivables have been infrequent occurrences.

Fair Values

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy prescribed by GAAP requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices for identical instruments in active markets. Level 1 assets include short-term investments such as money market funds and U.S. Treasury bills. Our Level 1 assets at September 30, 2018 consisted of cash held in money market funds of \$162.2 million, time deposits of \$20.9 million and investments in U.S. Treasury bills of \$274.7 million. Our Level 1 assets at December 31, 2017 consisted of cash held in money market funds of \$337.1 million and time deposits of \$20.9 million.

Level 2 Quoted market prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets. We had no Level 2 assets or liabilities as of September 30, 2018 or December 31, 2017.

Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable. Level 3 assets and liabilities generally include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation or for which there is a lack of transparency as to the inputs used. Our Level 3 assets at December 31, 2017 consisted of nonrecurring measurements of certain of our drilling rigs for which we recorded impairment losses during 2017. We had no Level 3 assets as of September 30, 2018.

Certain of our assets and liabilities are required to be measured at fair value on a recurring basis in accordance with GAAP. In addition, certain assets and liabilities may be recorded at fair value on a nonrecurring basis. Generally, we record assets at fair value on a nonrecurring basis as a result of impairment charges. We recorded impairment charges related to certain of our drilling rigs, which were measured at fair value on a nonrecurring basis, during the nine-month period ended September 30, 2018 and the year ended December 31, 2017 of \$27.2 million and \$99.3 million, respectively.

Assets and liabilities measured at fair value are summarized below (in thousands).

	September 30, 2018			Assets at Fair Value	Total Losses for Period Ended ⁽¹⁾
	Level 1	Level 2	Level 3		
Recurring fair value measurements:					
Assets:					
Short-term investments	\$ 457,811	\$	\$	\$ 457,811	
Nonrecurring fair value measurements:					
Assets:					

Impaired assets	\$	\$	\$	\$	\$ 27,225
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(1) Represents impairment loss of \$27.2 million recognized during the second quarter of 2018 related to a drilling rig whose carrying value was impaired and was subsequently sold. See Note 3.

December 31, 2017
Fair Value Measurements Using

	Level 1	Level 2	Level 3	Assets at Fair Value	Total Losses for Year Ended (1)
Recurring fair value measurements:					
Assets:					
Short-term investments	\$ 358,019	\$	\$	\$ 358,019	
Nonrecurring fair value measurements:					
Assets:					
Impaired assets (2)	\$	\$	\$ 97,261	\$ 97,261	\$ 99,313

(1) Represents impairment losses of \$71.3 million and \$28.0 million recognized during the second and fourth quarters of 2017, respectively, related to three drilling rigs whose carrying values were impaired. See Note 3.

(2) Represents the total book value as of December 31, 2017 of two floaters, which were written down to their estimated fair values during the second quarter of 2017, and one jack-up rig, which was written down to its estimated fair value during the fourth quarter of 2017. Of the total fair value, \$96.3 million and \$1.0 million were reported as Assets held for sale and Drilling and other property and equipment, net of accumulated depreciation, respectively, in our unaudited Condensed Consolidated Balance Sheets at December 31, 2017. See Note 3.

We believe that the carrying amounts of our other financial assets and liabilities (excluding long-term debt), which are not measured at fair value in our unaudited Condensed Consolidated Balance Sheets, approximate fair value based on the following assumptions:

Cash and cash equivalents The carrying amounts approximate fair value because of the short maturity of these instruments.

Accounts receivable and accounts payable The carrying amounts approximate fair value based on the nature of the instruments.

We consider our senior notes to be Level 2 liabilities under the GAAP fair value hierarchy and, accordingly, the fair value of our senior notes was derived using a third-party pricing service at September 30, 2018 and December 31, 2017. We perform control procedures over information we obtain from pricing services and brokers to test whether prices received represent a reasonable estimate of fair value. These procedures include the review of pricing service or broker pricing methodologies and comparing fair value estimates to actual trade activity executed in the market for these instruments occurring generally within a 10-day period of the report date. Fair values and related carrying values of our senior notes are shown below (in millions).

	September 30, 2018		December 31, 2017	
	Fair Value	Carrying Value	Fair Value	Carrying Value
3.45% Senior Notes due 2023	\$ 218.9	\$ 249.4	\$ 223.1	\$ 249.4

7.875% Senior Notes due 2025	519.4	496.8	523.1	496.5
5.70% Senior Notes due 2039	401.3	497.2	405.0	497.2
4.875% Senior Notes due 2043	549.4	748.9	547.5	748.9

We have estimated the fair value amounts by using appropriate valuation methodologies and information available to management. Considerable judgment is required in developing these estimates, and accordingly, no assurance can be given that the estimated values are indicative of the amounts that would be realized in a free market exchange.

8. Drilling and Other Property and Equipment

Cost and accumulated depreciation of drilling and other property and equipment are summarized as follows (in thousands):

	September 30, 2018	December 31, 2017
Drilling rigs and equipment	\$ 8,133,948	\$ 7,971,406
Land and buildings	63,692	63,309
Office equipment and other	91,129	82,691
Cost	8,288,769	8,117,406
Less: accumulated depreciation	(3,096,928)	(2,855,765)
Drilling and other property and equipment, net	\$ 5,191,841	\$ 5,261,641

9. Commitments and Contingencies

Various claims have been filed against us in the ordinary course of business, including claims by offshore workers alleging personal injuries. With respect to each claim or exposure, we have made an assessment, in accordance with GAAP, of the probability that the resolution of the matter would ultimately result in a loss. When we determine that an unfavorable resolution of a matter is probable and such amount of loss can be reasonably estimated, we record a liability for the amount of the reasonably estimated loss at the time that both of these criteria are met. Our management believes that we have recorded adequate accruals for any liabilities that may reasonably be expected to result from these claims.

Patent Litigation. On August 30, 2017, an affiliate of Transocean Ltd., or Transocean, an offshore drilling contractor, filed a lawsuit against us and one of our subsidiaries in the United States District Court for the Southern District of Texas, alleging that we infringed certain United States patents previously owned by Transocean or its affiliates or employees pertaining to certain dual-activity drilling operations. The lawsuit alleged that we infringed the patents by the unauthorized sale, offer for sale, and importation and use of four of our drilling rigs (*Ocean BlackHawk*, *Ocean BlackHornet*, *Ocean BlackRhino* and *Ocean BlackLion*). On June 1, 2018, we filed petitions with the Patent Trial and Appeal Board to challenge the validity of each of the Transocean patents through an administrative process referred to as an *Inter Partes* Review. In September 2018, we reached an agreement with Transocean to settle the lawsuit and the *Inter Partes* Review on mutually agreeable terms, and both proceedings were dismissed in October 2018. We expensed the settlement charge in the nine-month period ended September 30, 2018.

Asbestos Litigation. We are one of several unrelated defendants in lawsuits filed in Louisiana state courts alleging that defendants manufactured, distributed or utilized drilling mud containing asbestos and, in our case, allowed such drilling mud to have been utilized aboard our drilling rigs. The plaintiffs seek, among other things, an award of unspecified compensatory and punitive damages. The manufacture and use of asbestos-containing drilling mud had already ceased before we acquired any of the drilling rigs addressed in these lawsuits. We believe that we are not liable for the damages asserted in the lawsuits pursuant to the terms of our 1989 asset purchase agreement with Diamond M Corporation. We are unable to estimate our potential exposure, if any, to these lawsuits at this time but do not believe that our ultimate liability, if any, resulting from this litigation will have a material effect on our consolidated financial condition, results of operations or cash flows.

Other Litigation. We have been named in various other claims, lawsuits or threatened actions that are incidental to the ordinary course of our business, including a claim by one of our customers in Brazil, *Petróleo Brasileiro S.A.*, or *Petrobras*, that it will seek to recover from its contractors, including us, any taxes, penalties, interest and fees that it must pay to the Brazilian tax authorities for our applicable portion of withholding taxes related to *Petrobras* charter agreements with its contractors. We intend to defend these matters vigorously; however, litigation is inherently unpredictable, and the ultimate outcome or effect of any claim, lawsuit or action cannot be predicted with certainty. As a result, there can be no assurance as to the ultimate outcome of any litigation matter. Any claims against us, whether meritorious or not, could cause us to incur significant costs and expenses and require significant amounts of management and operational time and resources. In the opinion of our management, no pending or known threatened claims, actions or proceedings against us are expected to have a material adverse effect on our consolidated financial position, results of operations or cash flows.

Personal Injury Claims. Under our current insurance policies, which renewed effective May 1, 2018, our deductibles for marine liability insurance coverage with respect to personal injury claims not related to named windstorms in the U.S. Gulf of Mexico, which primarily result from Jones Act liability in the U.S. Gulf of Mexico, are \$10.0 million for the first occurrence, with no aggregate deductible, and vary in amounts ranging between \$5.0 million and, if aggregate claims exceed certain thresholds, up to \$100.0 million for each subsequent occurrence, depending on the nature, severity and frequency of claims that might arise during the policy year. Our deductibles for personal injury claims arising due to named windstorms in the U.S. Gulf of Mexico are \$25.0 million for the first occurrence, with no

aggregate deductible, and vary in amounts ranging between \$25.0 million and, if aggregate claims exceed certain thresholds, up to \$100.0 million for each subsequent occurrence, depending on the nature, severity and frequency of claims that might arise during the policy year.

The Jones Act is a federal law that permits seamen to seek compensation for certain injuries during the course of their employment on a vessel and governs the liability of vessel operators and marine employers for the work-related injury or death of an employee. We engage outside consultants to assist us in estimating our aggregate liability for personal injury claims based on our historical losses and utilizing various actuarial models. We allocate a portion of the aggregate liability to Accrued liabilities based on an estimate of claims expected to be paid within the next twelve months with the residual recorded as Other liabilities. At September 30, 2018 our estimated liability for personal injury claims was \$29.1 million, of which \$5.3 million and \$23.8 million were recorded in Accrued liabilities and Other liabilities, respectively, in our unaudited Condensed Consolidated Balance Sheets. At December 31, 2017 our estimated liability for personal injury claims was \$30.9 million, of which \$5.2 million and \$25.7 million were recorded in Accrued liabilities and Other liabilities, respectively, in our Consolidated Balance Sheets. The eventual settlement or adjudication of these claims could differ materially from our estimated amounts due to uncertainties such as:

the severity of personal injuries claimed;

significant changes in the volume of personal injury claims;

the unpredictability of legal jurisdictions where the claims will ultimately be litigated;

inconsistent court decisions; and

the risks and lack of predictability inherent in personal injury litigation.

Letters of Credit and Other. We were contingently liable as of September 30, 2018 in the amount of \$19.9 million under certain performance, tax, bid and customs bonds and letters of credit. Agreements relating to approximately \$14.2 million of tax and customs bonds can require collateral at any time. As of September 30, 2018, we had not been required to make any collateral deposits with respect to these agreements. The remaining agreements cannot require collateral except in events of default. Banks have issued letters of credit on our behalf securing certain of these bonds.

10. Restructuring and Separation Costs

In late 2017, our management approved and initiated a plan to restructure our worldwide operations, which included a reduction in workforce at our corporate facilities and onshore bases that we refer to as the 2017 Reduction Plan. During the three-month and nine-month periods ended September 30, 2018, we incurred an additional \$0.7 million and \$4.9 million, respectively, in severance and related costs for redundant employees identified in 2018. As of September 30, 2018, accrued costs related to severance payments to former employees were \$1.8 million, of which \$0.3 million is payable during the remainder of 2018 and \$1.5 million is payable in 2019.

11. Income Taxes

Effective January 1, 2018, we adopted ASU 2016-16, which required us to record the income tax consequences of two historical intra-entity transfers of rigs, for which previous accounting guidance precluded us from recognizing such income tax effects. We adopted the new accounting guidance using the modified retrospective approach, whereby we recorded the \$17.4 million cumulative effect of applying the new standard as an adjustment to opening retained earnings with an offset to a deferred income tax liability. See Note 1.

Additionally, in response to our interpretation of the Tax Reform Act, which was signed into law in late December 2017, we recorded a provisional net tax expense of \$1.1 million during the fourth quarter of 2017, which included a charge relating to the one-time mandatory repatriation of previously deferred earnings of certain non-U.S. subsidiaries that are owned either wholly or partially by our U.S. subsidiaries, inclusive of the utilization of certain tax attributes offset by a provisional liability for uncertain tax positions related to such attributes. Due to the timing of the enactment of the Tax Reform Act, there has been and continues to be a significant amount of uncertainty as to the appropriate application of a number of the underlying provisions, pending further guidance and clarification from the relevant authorities. In 2018, the U.S. Department of the Treasury and Internal Revenue Service issued additional guidance which we believe clarified certain of our tax positions taken in 2017 and, consequently, during the first quarter of 2018, we reversed a \$43.3 million liability for an uncertain tax position related to the toll charge in accordance with the Securities and Exchange Commission's Staff Accounting Bulletin No. 118, or SAB 118. SAB 118 allowed companies to report the income tax effects of the Tax Reform Act as a provisional amount based on a reasonable estimate, subject to adjustment during a reasonable measurement period, not to exceed twelve months, until the accounting and analysis under Topic 740 is complete.

We are still in the process of evaluating our estimate as it relates to the tax effect of (i) the mandatory, deemed repatriation aspect of the Tax Reform Act, (ii) the amount of deferred tax assets and liabilities subject to the income tax rate change from 35% to 21% and (iii) the ability to more likely than not realize the benefit of deferred tax assets, including net operating losses and foreign tax credits. We will continue to monitor developments in these areas and adjust our estimates throughout 2018, as and if necessary, if additional guidance and clarification becomes available.

12. Segments and Geographic Area Analysis

Although we provide contract drilling services with different types of offshore drilling rigs and also provide such services in many geographic locations, we have aggregated these operations into one reportable segment based on the similarity of economic characteristics due to the nature of the revenue-earning process as it relates to the offshore drilling industry over the operating lives of our drilling rigs.

Our drilling rigs are highly mobile and may be moved to other markets throughout the world in response to market conditions or customer needs. At September 30, 2018, our active drilling rigs were located offshore three countries in addition to the United States. Revenues by geographic area are presented by attributing revenues to the individual country or areas where the services were performed.

The following tables provide information about disaggregated revenue by equipment-type and primary geographical market (in thousands):

	Three Months Ended September 30, 2018				
	Floater Rigs	Jack-up Rigs	Total Contract Drilling Revenues	Revenues Related to Reimbursable Expenses	Total
United States	\$ 155,695	\$	\$ 155,695	\$ 1,916	\$ 157,611
South America	49,410		49,410	(32)	49,378
Europe	30,809		30,809	1,996	32,805
Australia/Asia	44,777		44,777	1,751	46,528
Total	\$ 280,691	\$	\$ 280,691	\$ 5,631	\$ 286,322

	Nine Months Ended September 30, 2018				
	Floater Rigs	Jack-up Rigs ⁽¹⁾	Total Contract Drilling Revenues	Revenues Related to Reimbursable Expenses	Total
United States	\$ 473,924	\$ 8,413	\$ 482,337	\$ 5,224	\$ 487,561
South America	129,966		129,966	(31)	129,935
Europe	60,938		60,938	5,116	66,054
Australia/Asia	160,729		160,729	6,414	167,143
Total	\$ 825,557	\$ 8,413	\$ 833,970	\$ 16,723	\$ 850,693

(1) Loss-of-hire insurance proceeds related to early contract terminations for two jack-up rigs.

Three Months Ended September 30, 2017

Total

	Floater Rigs	Jack-up Rigs	Total Contract Drilling Revenues	Revenues Related to Reimbursable Expenses	
United States	\$ 163,136	\$	\$ 163,136	\$ 2,191	\$ 165,327
South America	58,750		58,750	(21)	58,729
Europe	48,680		48,680	1,702	50,382
Australia/Asia	80,543		80,543	3,835	84,378
Mexico		6,574	6,574	633	7,207
Total	\$ 351,109	\$ 6,574	\$ 357,683	\$ 8,340	\$ 366,023

Nine Months Ended September 30, 2017

	Floater Rigs	Jack-up Rigs	Total Contract Drilling Revenues	Revenues Related to Reimbursable Expenses	Total
United States	\$ 455,805	\$	\$ 455,805	\$ 6,647	\$ 462,452
South America	272,929		272,929	(243)	272,686
Europe	148,948		148,948	4,861	153,809
Australia/Asia	219,103		219,103	13,844	232,947
Mexico		16,625	16,625	1,019	17,644
Total	\$ 1,096,785	\$ 16,625	\$ 1,113,410	\$ 26,128	\$ 1,139,538

13. Subsequent Events*Amendment to Existing Credit Agreement*

On October 2, 2018, Diamond Offshore Drilling, Inc., or DODI, entered into Amendment No. 6 and Consent to Credit Agreement and Successor Agency Agreement, or the Amendment, which amended our 5-year revolving credit agreement, dated as of September 28, 2012, as amended (which we refer to as the Existing Credit Agreement). As a result of the Amendment, the aggregate principal amount of commitments under the Existing Credit Agreement was reduced to \$325.0 million, of which \$40.0 million of the commitments mature on March 17, 2019, \$60.0 million of the commitments mature on October 22, 2019 and \$225.0 million of the commitments mature on October 22, 2020.

As of November 2, 2018, no borrowings or letters of credit were outstanding under the Existing Credit Agreement.

New Credit Agreement

On October 2, 2018, DODI, as the U.S. borrower, and Diamond Foreign Asset Company, or DFAC, as the foreign borrower, entered into a senior 5-year revolving credit agreement with a syndicate of lenders and Wells Fargo Bank, National Association, as administrative agent, or the New Credit Agreement. The maximum amount of borrowings available under the New Credit Agreement is \$950.0 million and may be used for general corporate purposes, including investments, acquisitions and capital expenditures. The New Credit Agreement, which matures on October 2, 2023, provides for a swingline subfacility of \$100.0 million and a letter of credit subfacility in the amount of \$250.0 million.

The entire amount of borrowings available under the New Credit Agreement will be available for loans to DFAC, and a portion of such amount will be available for loans to DODI, based on a ratio as specified in the agreement. The obligations of DODI and DFAC under the New Credit Agreement are each guaranteed by certain subsidiaries of DODI and DFAC, and 65% of the equity interest in DFAC is pledged as collateral.

The New Credit Agreement includes restrictions on borrowing if, after giving effect to any such borrowings and the application of the proceeds thereof, the aggregate amount of available cash, as defined in the New Credit Agreement, would exceed \$500.0 million. In addition, the ability to borrow revolving loans under the New Credit Agreement is conditioned on there being no unused commitments to advance loans under the Existing Credit Agreement.

The New Credit Agreement contains certain financial covenants, including (i) maintenance of a ratio of consolidated indebtedness to total capitalization not to exceed 60% at the end of each fiscal quarter, (ii) maintenance of a ratio of (A) the value of certain rigs directly wholly owned by the borrowers and subsidiary guarantors to (B) the aggregate value of substantially all rigs owned by us of not less than 80% at the end of each fiscal quarter and (iii) maintenance

of a ratio of (A) the sum of the aggregate value of all marketed rigs, as defined in the New Credit Agreement, wholly owned directly by DFAC and certain foreign guarantors, as specified in the New Credit Agreement, plus the value of the *Ocean Valiant* at any time when it is a marketed rig owned by a guarantor to (B) the sum of commitments under the New Credit Agreement, the outstanding loans and letter of credit exposures under the Existing Credit Agreement plus certain other indebtedness of DFAC and certain foreign guarantors, as specified in the New Credit Agreement, of not less than 3:00 to 1:00 at the end of each fiscal quarter.

The New Credit Agreement also contains additional covenants generally applicable to DODI and its subsidiaries that we consider usual and customary for an agreement of this type, including a limit on the payment of dividends if certain minimum cash balances are not maintained. The New Credit Agreement provides for customary events of default including, among others, a cross-default provision with respect to DODI's and its subsidiaries' other indebtedness in excess of \$100.0 million.

As of November 2, 2018, no borrowings had been made or letters of credit issued under the New Credit Agreement.

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

The following discussion should be read in conjunction with our unaudited condensed consolidated financial statements (including the notes thereto) included in Item 1 of Part I of this report and our audited consolidated financial statements (including the notes thereto), Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 1A, Risk Factors included in our Annual Report on Form 10-K for the year ended December 31, 2017. References to Diamond Offshore, we, us or our mean Diamond Offshore Drilling, Inc., a Delaware corporation, and its subsidiaries.

We provide contract drilling services to the energy industry around the globe with a fleet of 17 floaters, of which four rigs are currently cold-stacked. During the third quarter of 2018, we are currently reactivating the *Ocean Endeavor*, which was cold stacked in 2016. The *Ocean Endeavor* is expected to begin drilling under contract in the North Sea during the second quarter of 2019. See Contract Drilling Backlog.

Market Overview

Oil prices continued to rise during the third quarter of 2018, with Brent crude closing above \$80-per-barrel at the end of September 2018. Despite the increase in commodity price, the recovery of the offshore contract drilling market has lagged with floater utilization and dayrates remaining at low levels, compared to the most recent peak cycle in the offshore contract drilling market. Many market analysts expect that with current market fundamentals and a continuation of rig scrapping activity, floater utilization and dayrates will increase in the next 12-24 months. As dayrates increase, offshore drillers with more available floaters and/or unpriced options for currently committed rigs will be better positioned to take advantage of the market recovery as it materializes.

Capital spending for offshore exploration and development remained at a relatively low level during the first nine months of 2018 and is likely to remain flat through the end of 2018. However, many market analysts predict that the stage is set for higher offshore activity either in 2019, or more likely in 2020, given the recent and, thus far, sustained increase in oil prices above the \$50-per-barrel level, combined with a robust worldwide demand for oil consumption and shrinking oil reserves, resulting from both low exploration activity and new discovery rates. To date, we have seen an increase in contract tenders for late 2019 and 2020 project commencements, primarily for work in the North Sea and Australia floater markets. Many of these tenders are limited to single-well jobs, with options for future wells. Although some geographic areas appear to be improving, other markets show little or no sign of recovery at this time.

Even with the increase in contract tendering activity, the recovery of the offshore contract drilling industry continues to be challenged by an oversupply of drilling rigs. Industry reports indicate that there remain approximately 30 newbuild floaters on order or under construction with scheduled deliveries between 2018 and 2021, most of which have not yet been contracted for future work. In addition, contract rollovers of currently contracted rigs are expected to add to the oversupply of rigs, if options for future work are not exercised or further work is not secured for these rigs. Industry analysts currently report that there could be nearly 30 contract rollovers in the fourth quarter of 2018. In addition, certain drilling contractors have announced the reactivation of stacked rigs or plans to reactivate certain rigs if contracts are awarded. This supply-and-demand imbalance will continue to impact dayrates until the oversupply is equalized by an increase in demand or through the retirement of rigs.

See Contract Drilling Backlog for future commitments of our rigs during 2018 through 2022.

Contract Drilling Backlog

Contract drilling backlog, as presented below, includes only firm commitments (typically represented by signed contracts) and is calculated by multiplying the contracted operating dayrate by the firm contract period. Our calculation also assumes full utilization of our drilling equipment for the contract period (excluding scheduled shipyard and survey days); however, the amount of actual revenue earned and the actual periods during which revenues are earned will be different than the amounts and periods shown in the tables below due to various factors. Utilization rates, which generally approach 92-98% during contracted periods, can be adversely impacted by downtime due to various operating factors including, but not limited to, weather conditions and unscheduled repairs and maintenance. Contract drilling backlog excludes revenues for mobilization, demobilization, contract preparation and customer reimbursables.

No revenue is generally earned during periods of downtime for regulatory surveys. Changes in our contract drilling backlog between periods are generally a function of the performance of work on term contracts, as well as the extension or modification of existing term contracts and the execution of additional contracts. In addition, under certain circumstances, our customers may seek to terminate or renegotiate our contracts, which could adversely affect our reported backlog.

The backlog information presented below does not, nor is it intended to, align with the disclosures related to revenue expected to be recognized in the future related to unsatisfied performance obligations, which are presented in Note 2

Revenue from Contracts with Customers to our unaudited condensed consolidated financial statements included in Item 1 of Part I of this report. Contract drilling backlog includes only future dayrate revenue as described above, while the disclosure in Note 2 excludes dayrate revenue and reflects expected future revenue for mobilization, demobilization and capital modifications to our rigs, which are related to non-distinct promises within our signed contracts. See Important Factors That May Impact Our Operating Results, Financial Condition or Cash Flows.

The following table reflects our contract drilling backlog as of October 1, 2018 (based on information available at that time), January 1, 2018 (the date reported in our Annual Report on Form 10-K for the year ended December 31, 2017), and October 1, 2017 (the date reported in our Quarterly Report on Form 10-Q for the quarter ended September 30, 2017) (in thousands).

	October 1, 2018 ⁽¹⁾	January 1, 2018	October 1, 2017
Contract Drilling Backlog			
Floaters	\$ 2,040,000	\$ 2,417,000	\$ 2,612,000
Jack-ups			5,000
Total	\$ 2,040,000	\$ 2,417,000	\$ 2,617,000

- (1) Contract drilling backlog as of October 1, 2018 excludes future commitment amounts totaling \$135.0 million payable by a customer in the form of a guarantee of gross margin to be earned on future contracts or by direct payment, pursuant to terms of an existing contract.

The following table reflects the amount of our contract drilling backlog by year as of October 1, 2018 (in thousands).

	Total	For the Years Ending December 31,			
		2018 ⁽¹⁾	2019	2020	2021-2022 ⁽²⁾
Contract Drilling Backlog (3)	\$ 2,040,000	\$ 233,000	\$ 856,000	\$ 674,000	\$ 277,000

- (1) Represents the three-month period beginning October 1, 2018.

- (2) Represents aggregate contract drilling backlog for the years 2021 and 2022.

- (3) Contract drilling backlog as of October 1, 2018 excludes future commitment amounts of \$30.0 million for 2019, \$30.0 million for 2020 and \$75.0 million for the 2021 through 2023 period payable by a customer in the form of a guarantee of gross margin to be earned on future contracts or by direct payment at the end of each of the three respective periods, pursuant to terms of an existing contract.

The following table reflects the percentage of rig days committed by year as of October 1, 2018. The percentage of rig days committed is calculated as the ratio of total days committed under contracts, as well as scheduled shipyard, survey and mobilization days for all rigs in our fleet, to total available days (number of rigs, including cold-stacked rigs, multiplied by the number of days in a particular year).

	For the Years Ending December 31,			
	2018 ⁽¹⁾	2019	2020	2021-2022 ⁽²⁾
Rig Days Committed (3)	66%	57%	46%	9%

- (1) Represents the three-month period beginning October 1, 2018.
- (2) Represents percentage of rig days committed for the aggregate two-year period presented.
- (3) As of October 1, 2018, includes approximately 285, 445 and 95 currently known, scheduled days for contract preparation, mobilization of rigs, surveys and extended repair and maintenance projects for the remainder of 2018 and for the years 2019 and 2020, respectively.

Important Factors That May Impact Our Operating Results, Financial Condition or Cash Flows

Revenue Recognition. Effective January 1, 2018, we adopted Accounting Standards Update, or ASU, No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), or ASU 2014-09, which supersedes the revenue recognition requirements in ASU Topic 605, *Revenue Recognition*. Under the new guidance, revenue is recognized when a customer obtains control of promised goods or services and in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. Revenues for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts have not been adjusted and continue to be reported under the previous revenue recognition guidance.

Revenue recognition under ASU 2014-09 differs from our previous revenue recognition pattern only as it relates to demobilization revenue. Such revenue, which was previously recognized upon completion of a contract, will be estimated at contract inception and recognized ratably over the term of the contract under the new revenue recognition guidance. See *Critical Accounting Policies*, Note 1 *General Information Changes in Accounting Principles - Revenue Recognition* and Note 2 *Revenue from Contracts with Customers* to our unaudited condensed consolidated financial statements included in Item 1 of Part I of this report.

Regulatory Surveys and Planned Downtime. Our operating income is negatively impacted when we perform certain regulatory inspections, which we refer to as a special survey, that are due every five years for most of our rigs. The inspection interval for our North Sea rigs is two-and-one-half years. During the remainder of 2018, we expect to spend approximately 265 days for contract preparation, mobilization of rigs, upgrades and surveys, including 90 days for mobilization and contract preparation for the *Ocean GreatWhite*, 90 days for a special survey, reactivation activities and contract preparation for the *Ocean Endeavor* and 35 days for a special survey and rig upgrades for the *Ocean Apex*. In 2019, we expect to spend approximately an aggregate of 150 additional days for contract preparation for the *Ocean GreatWhite* and *Ocean Endeavor* prior to their contract commencements, an aggregate of 200 days for special surveys and rig upgrades for the *Ocean BlackHawk* and *Ocean BlackHornet*, 60 days for a special survey for the *Ocean Courage* and an aggregate of 35 days for the mobilization of the *Ocean Apex* and the *Ocean Monarch*. We can provide no assurance as to the exact timing and/or duration of downtime associated with regulatory inspections, planned rig mobilizations and other shipyard projects. See *Contract Drilling Backlog*.

Physical Damage and Marine Liability Insurance. We are self-insured for physical damage to rigs and equipment caused by named windstorms in the U.S. Gulf of Mexico, as defined by the relevant insurance policy. If a named windstorm in the U.S. Gulf of Mexico causes significant damage to our rigs or equipment, it could have a material adverse effect on our financial condition, results of operations and cash flows. Under our current insurance policy, which renewed effective May 1, 2018, we carry physical damage insurance for certain losses other than those caused by named windstorms in the U.S. Gulf of Mexico for which our deductible for physical damage is \$25.0 million per occurrence. We do not typically retain loss-of-hire insurance policies to cover our rigs.

In addition, we carry marine liability insurance covering certain legal liabilities, including coverage for certain personal injury claims, and generally covering liabilities arising out of or relating to pollution and/or environmental risk. We believe that the policy limit for our marine liability insurance is within the range that is customary for companies of our size in the offshore drilling industry and is appropriate for our business. Our deductibles for marine liability coverage related to insurable events arising due to named windstorms in the U.S. Gulf of Mexico are \$25.0 million for the first occurrence, with no aggregate deductible, and vary in amounts ranging between \$25.0 million and, if aggregate claims exceed certain thresholds, up to \$100.0 million for each subsequent occurrence, depending on the nature, severity and frequency of claims that might arise during the policy year. Our deductibles for other marine liability coverage, including personal injury claims not related to named windstorms in the U.S. Gulf of Mexico, are \$10.0 million for the first occurrence and vary in amounts ranging between \$5.0 million and, if aggregate claims exceed certain thresholds, up to \$100.0 million for each subsequent occurrence, depending on the nature, severity and frequency of claims that might arise during the policy year.

Critical Accounting Policies

Our significant accounting policies are discussed in Note 1 of our notes to audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017. Effective January 1, 2018, we adopted ASU 2014-09, which supersedes the revenue recognition requirements in ASU Topic 605, Revenue Recognition, and ASU No. 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*. See Important Factors That May Impact Our Operating Results, Financial Condition or Cash Flows and Note 1 General Information *Changes in Accounting Principles*, Note 2 Revenue from Contracts with Customers and Note 11 Income Taxes to our unaudited condensed consolidated financial statements included in Item 1 of Part I of this report. There were no other material changes to these policies during the nine months ended September 30, 2018.

Results of Operations

Our operating results for contract drilling services are dependent on three primary metrics or key performance indicators: revenue-earning days, rig utilization and average daily revenue. The following table presents these three key performance indicators and other comparative data relating to our revenues and operating expenses for the three-month and nine-month periods ended September 30, 2018 and 2017.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017	2018	2017	2018
	(In thousands, except day amounts and percentages)			
REVENUE-EARNING DAYS ⁽¹⁾				
Floaters	841	984	2,474	2,953
Jack-ups		88		222
UTILIZATION ⁽²⁾				
Floaters	54%	46%	53%	47%
Jack-ups		95%		60%
AVERAGE DAILY REVENUE ⁽³⁾				
Floaters	\$ 333,400	\$ 357,000	\$ 333,600	\$ 371,400
Jack-ups		75,000		74,900
REVENUE RELATED TO CONTRACT DRILLING SERVICES	\$ 280,691	\$ 357,683	\$ 833,970	\$ 1,113,410
REVENUE RELATED TO REIMBURSABLE EXPENSES	5,631	8,340	16,723	26,128
TOTAL REVENUES	\$ 286,322	\$ 366,023	\$ 850,693	\$ 1,139,538
CONTRACT DRILLING EXPENSE, EXCLUDING DEPRECIATION	\$ 188,456	\$ 198,072	\$ 562,466	\$ 597,812
REIMBURSABLE EXPENSES	\$ 5,574	\$ 8,220	\$ 16,458	\$ 25,488
OPERATING (LOSS) INCOME				
Contract drilling services, net	\$ 92,235	\$ 159,611	\$ 271,504	\$ 515,598
Reimbursable expenses, net	57	120	265	640
Depreciation	(81,884)	(83,281)	(245,534)	(262,492)
General and administrative expense	(33,308)	(17,806)	(70,057)	(54,299)
Impairment of assets			(27,225)	(71,268)
Restructuring and separation costs	(649)		(4,925)	
Gain (loss) on disposition of assets	506	(63)	1,066	2,085
Total Operating (Loss) Income	\$ (23,043)	\$ 58,581	\$ (74,906)	\$ 130,264
Other income (expense):				
Interest income	2,364	776	6,001	1,347
Interest expense, net of amounts capitalized	(34,293)	(28,562)	(92,196)	(83,409)
Foreign currency transaction (gain) loss	(743)	(677)	115	(517)
Loss on early extinguishment of senior notes		(35,366)		(35,366)
Other, net	(179)	1,447	664	1,322

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(Loss) income before income tax benefit	(55,894)	(3,801)	(160,322)	13,641
Income tax benefit	4,782	14,600	59,257	36,646
NET (LOSS) INCOME	\$ (51,112)	\$ 10,799	\$ (101,065)	\$ 50,287

- (1) A revenue-earning day is defined as a 24-hour period during which a rig earns a dayrate after commencement of operations and excludes mobilization, demobilization and contract preparation days.
- (2) Utilization is calculated as the ratio of total revenue-earning days divided by the total calendar days in the period for all specified rigs in our fleet (including four and eleven cold-stacked floater rigs at September 30, 2018 and 2017, respectively).
- (3) Average daily revenue is defined as total contract drilling revenue for all of the specified rigs in our fleet per revenue-earning day.

Three Months Ended September 30, 2018 and 2017

Net results for the third quarter of 2018 decreased \$61.9 million compared to the third quarter of 2017, reflecting lower margins from our contract drilling services, primarily driven by lower contract drilling revenue. Contract drilling services contributed operating income of \$92.2 million during the third quarter of 2018, compared to \$159.6 million in the third quarter of 2017. Our results for the third quarter of 2018 were also negatively impacted by a lower tax benefit recognized, compared to the prior year quarter, and costs associated with legal settlements. During the third quarter of 2017, we recognized a \$35.4 million loss on the early extinguishment of our senior notes that were due in 2019.

Operating Results. Contract drilling revenue decreased \$77.0 million during the third quarter of 2018 compared to the third quarter of 2017, primarily due to 231 fewer revenue-earning days (\$76.6 million). Comparing the two quarters, revenue-earning days decreased due to fewer revenue-earning days for a previously-owned rig that operated during the third quarter of 2017 (88 days) and incremental downtime for planned shipyard projects (179 days), including related mobilization days, partially offset by the favorable impact of fewer non-productive days (36 days).

Contract drilling expense, excluding depreciation, decreased \$9.6 million during the third quarter of 2018 compared to the same quarter in 2017, reflecting reduced costs for currently cold-stacked and previously-owned rigs, which had incurred contract drilling expense in the third quarter of 2017 (\$10.5 million). Contract drilling expense for our current floater fleet remained flat comparing the two quarters as higher costs associated with rig maintenance, repair and inspections (\$4.6 million), amortized mobilization and other rig moving costs (\$8.7 million) and other rig operating expenses (\$1.2 million), were offset by reductions in labor and related costs (\$8.6 million), overhead and shorebase support costs (\$3.5 million) and agency fees (\$1.5 million) as a result of the termination of our agency arrangement in Brazil in December 2017.

General and administrative expense increased \$15.5 million, primarily due to a \$17.5 million charge for settlement of a previously pending legal claim, partially offset by the favorable effect of lower administrative payroll costs resulting from restructuring initiatives.

Interest Expense, Net of Amounts Capitalized. Interest expense increased \$5.7 million during the third quarter of 2018 compared to the same period of 2017, as a result of interest charges related to foreign customs and payroll tax assessments (\$4.5 million), combined with incremental interest expense associated with our senior notes issued in August 2017 at a higher interest rate than the senior notes that were retired during the third quarter of 2017 (\$1.2 million).

Income Tax Benefit. We recorded a net income tax benefit of \$4.8 million for the third quarter of 2018, compared to an income tax benefit of \$14.6 million for the same quarter of 2017. The difference was in large part due to the mix of our domestic and international pre-tax earnings and losses for the periods, increased taxation in certain international jurisdictions, combined with the effects of the Tax Cuts and Jobs Act enacted in December 2017, or the Tax Reform Act.

Nine Months Ended September 30, 2018 and 2017

Net results for the first nine months of 2018 decreased \$151.4 million compared to the first nine months of 2017, primarily due to lower contract drilling revenue, higher interest expense and other non-operating charges. These negative factors were partially offset by the favorable impact of reduced depreciation expense, a lower impairment charge and a higher income tax benefit recorded during the first nine months of 2018, combined with the absence of a \$35.4 million loss on extinguishment of our senior notes recognized during the 2017 period. Contract drilling services contributed operating income of \$271.5 million for the first nine months of 2018, compared to operating income of \$515.6 million in the same period of 2017, reflecting a challenged contract drilling market during 2018.

Operating Results. Contract drilling revenue decreased \$279.4 million during the first nine months of 2018 compared to the same period of 2017, primarily due to 701 fewer revenue-earning days (\$245.7 million), combined with the effect of lower average daily revenue earned (\$42.1 million). Revenue-earning days decreased during the first nine months of 2018, primarily due to fewer revenue-earning days for previously-owned rigs that operated during the first nine months of 2017 (377 days), incremental downtime for planned shipyard projects, including related mobilization days (211 days), incremental downtime attributable to the warm stacking of rigs between contracts (95 days) and an increase in non-productive days (18 days). Average daily revenue decreased during the first nine months of 2018, compared to the same period of 2017, primarily due to lower dayrates earned by several of our rigs as a result of the renegotiation of existing contracts under mutually favorable terms and new contracts at lower dayrates than previously contracted during 2017. The decrease in revenue was partially offset by \$8.4 million in loss-of-hire insurance proceeds received during the first nine months of 2018 related to contract terminations for two jack-up rigs in a prior year.

Contract drilling expense, excluding depreciation, decreased \$35.3 million during the first nine months of 2018 compared to the same period in 2017, primarily due to reduced costs for currently cold-stacked and previously-owned rigs, which had incurred contract drilling expense in the first nine months of 2017 (\$44.4 million), partially offset by increased costs for our current rig fleet. Contract drilling expense for our current fleet increased a net \$9.1 million during the first nine months of 2018, reflecting increased costs for fuel, repairs and maintenance, inspections, mobilization of rigs and equipment rentals. Contract drilling expense for our current fleet during the 2018 period also reflected reductions in labor and personnel costs, agency fees and shorebase support costs and overhead, primarily as a result of our continuing cost control initiatives and the deferral of costs associated with contract preparation activities on certain of our rigs as they prepare for new contracts. Depreciation expense decreased \$17.0 million during the first nine months of 2018 compared to the same period of 2017, primarily due to a lower depreciable asset base as a result of asset impairments recognized during 2017.

General and administrative expense increased \$15.8 million, primarily due to a \$17.5 million charge for settlement of a previously pending legal claim, partially offset by the favorable effect of lower administrative payroll costs resulting from restructuring initiatives.

Impairment of Assets. During the second quarter of 2018, we recorded an impairment loss of \$27.2 million to recognize a reduction in fair value (less costs to sell) of the *Ocean Scepter*, a jack-up rig that was reported in *Assets held for sale* in our audited Consolidated Balance Sheets at December 31, 2017 and sold in July 2018. During the second quarter of 2017, we recognized an aggregate impairment charge of \$71.3 million with respect to the carrying values of two floaters, one of which was sold during the first quarter of 2018. See Notes 1 and 3 to our unaudited condensed consolidated financial statements included in Item 1 of Part I of this report.

Restructuring and Separation Costs. In late 2017, our management approved and initiated a plan to restructure our worldwide operations, which also included a reduction in workforce at our corporate facilities and onshore bases. During the first nine months of 2018, we recognized \$4.9 million in restructuring and other employee separation related costs for additional redundant employees that were identified in 2018.

Interest Expense, Net of Amounts Capitalized. Interest expense increased \$8.8 million during the first nine months of 2018 compared to the same period of 2017, primarily as a result of incremental interest expense associated with our senior notes issued in August 2017 (\$6.5 million) and interest charges related to foreign customs and payroll tax assessments (\$4.6 million), partially offset by the reversal of accrued interest on assessments due to the expiry of statutes of limitations in certain tax jurisdictions.

Income Tax Benefit. We recorded a net income tax benefit of \$59.3 million for the nine-month period ended September 30, 2018, compared to \$36.6 million for the comparable 2017 period. Income tax benefit for the 2018 period included a tax benefit of \$43.3 million due to the reversal of an uncertain tax position related to the toll charge recognized in the fourth quarter of 2017 for the deemed repatriation of previously deferred earnings of our non-U.S. subsidiaries in response to the Tax Reform Act. Further guidance issued by the Internal Revenue Service in 2018 clarified certain of our tax positions taken and, consequently, in accordance with the Securities and Exchange Commission's Staff Accounting Bulletin No. 118, we reversed our liability for an uncertain tax position related to the toll charge. Notwithstanding the reversal of the uncertain tax position, the difference in the amount of income tax benefit recognized in the 2018 period, compared to the comparable period of 2017, was in large part due to the mix of our domestic and international pre-tax earnings and losses for the periods, combined with the effects of the Tax Reform Act, the income tax treatment of impairment losses recognized in the second quarters of 2018 and 2017 and increased taxation in certain international jurisdictions.

Liquidity and Capital Resources

We principally rely on our cash flows from operations and cash reserves to meet our liquidity needs. We may also utilize borrowings under our credit agreements that provide for maximum borrowings of up to \$1.275 billion, all of which was available to us as of November 2, 2018. See Amendment to Existing Credit Agreement and New Credit Agreement. In addition, as of October 1, 2018, our contractual backlog was \$2.0 billion of which \$0.2 billion is expected to be realized during the remainder of 2018.

Certain of our international rigs are owned and operated, directly or indirectly, by our Cayman Islands subsidiary Diamond Foreign Asset Company, or DFAC. As of December 31, 2017, all unremitted earnings of DFAC were deemed repatriated as a result of the Tax Reform Act, and U.S. taxes were provided for those earnings. We intend to indefinitely reinvest earnings of DFAC and its foreign subsidiaries to finance our foreign activities. Earnings of DFAC subsequent to December 31, 2017 could become subject to U.S. income tax if remitted, or if deemed remitted as a dividend; however, it is not practical to estimate this potential liability.

To the extent available, we expect to utilize the operating cash flows generated by and cash reserves of DFAC and the operating cash flows available to and cash reserves of Diamond Offshore Drilling, Inc. to meet each entity's respective working capital requirements and capital commitments. At September 30, 2018 and December 31, 2017, we had cash available for current operations of \$201.9 million and \$376.0 million, respectively. We also had investments in U.S. Treasury bills of \$274.7 million at September 30, 2018, which mature at various times through November 2018.

We have historically invested a significant portion of our cash flows in the enhancement of our drilling fleet. The amount of cash required to meet our capital commitments is determined by evaluating the need to upgrade our rigs to meet specific customer requirements and our ongoing rig equipment enhancement/replacement programs. We make periodic assessments of our capital spending programs based on current and expected industry conditions and make adjustments thereto if required.

Based on our cash available for current operations and contractual backlog, we believe future capital spending and debt service requirements will be funded from our cash and cash equivalents, future operating cash flows and borrowings under our credit agreements, as needed. See Sources and Uses of Cash *Capital Expenditures*.

We pay dividends at the discretion of our Board of Directors, or Board, and any determination to declare a dividend, as well as the amount of any dividend that may be declared, will be based on the Board's consideration of our financial position, earnings, earnings outlook, capital spending plans, outlook on current and future market conditions and business needs, contractual obligations and other factors that our Board considers relevant at that time. We did not pay any dividends in 2017 or during the first nine months of 2018.

Depending on market conditions, we may, from time to time, purchase shares of our common stock in the open market or otherwise. We did not purchase any shares of our outstanding common stock during the nine-month periods ended September 30, 2018 and 2017.

We may, from time to time, issue debt or equity securities, or a combination thereof, to finance capital expenditures, the acquisition of assets and businesses or for general corporate purposes. Our ability to access the capital markets by issuing debt or equity securities will be dependent on our results of operations, our current financial condition, current credit ratings, current market conditions and other factors beyond our control.

Sources and Uses of Cash

During the nine-month period ended September 30, 2018, our primary sources of cash were an aggregate \$188.8 million generated by operating activities and proceeds of \$69.5 million, primarily from the sale of the *Ocean Scepter* in July 2018 and the *Ocean Victory* in January 2018. Cash usage during the nine-month period ended September 30, 2018 was primarily \$272.5 million for purchases of marketable securities, net of maturities, and for capital expenditures aggregating \$159.8 million.

Cash Flow from Operations. Cash flow from operations for the nine-month period ended September 30, 2018 decreased \$177.9 million compared to the nine-month period ended September 30, 2017, primarily due to lower cash receipts for contract drilling services (\$219.9 million), partially offset by a net decrease in cash expenditures for contract drilling services and other working capital requirements (\$2.6 million) and lower income tax payments, net of refunds (\$39.4 million).

Capital Expenditures. As of the date of this report, we expect total capital expenditures for 2018 to aggregate approximately \$220 million for our capital maintenance and replacement programs.

At September 30, 2018, we had no significant purchase obligations, except for those related to our direct rig operations, which arise during the normal course of business.

Other Obligations. As of September 30, 2018, the total net unrecognized tax benefits related to uncertain tax positions was \$63.9 million. Due to the high degree of uncertainty regarding the timing of future cash outflows associated with the liabilities recognized in these balances, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authorities.

Amendment to Existing Credit Agreement

On October 2, 2018, we amended our 5-year revolving credit agreement, dated as of September 28, 2012, as amended, or the Existing Credit Agreement, which, among other things, reduced the maximum availability under the agreement to \$325.0 million. As of September 30, 2018, we were in compliance with all covenant requirements under the Existing Credit Agreement.

New Credit Agreement

On October 2, 2018, Diamond Offshore Drilling, Inc., as the U.S. borrower, and DFAC, as the foreign borrower, entered into a senior 5-year revolving credit agreement with a syndicate of lenders and Wells Fargo Bank, National Association, as administrative agent, or the New Credit Agreement. The maximum amount of borrowings available under the New Credit Agreement is \$950.0 million and may be used for general corporate purposes, including investments, acquisitions and capital expenditures. The New Credit Agreement, which matures on October 2, 2023, provides for a swingline subfacility of \$100.0 million and a letter of credit subfacility in the amount of \$250.0 million.

See Note 13 *Subsequent Events* to our unaudited condensed consolidated financial statements included in Item 1 of Part I of this report.

As of November 2, 2018, no borrowings or letters of credit were outstanding under the Existing Credit Agreement or the New Credit Agreement.

Credit Ratings

On August 30, 2018, S&P Global Ratings, or S&P, downgraded our corporate credit rating to B from B+; the rating outlook from S&P remains negative. On August 1, 2018, Moody's Investor Services, or Moody's, downgraded our corporate credit rating to B2 from Ba3; the rating outlook from Moody's remains negative. Market conditions and other factors, many of which are outside of our control, could cause our credit ratings to be further lowered. Any further downgrade in our credit ratings could adversely impact our cost of issuing additional debt and the amount of additional debt that we could issue, and could further restrict our access to capital markets and our ability to raise funds by issuing additional debt. As a consequence, we may not be able to issue additional debt in amounts and/or with terms that we consider to be reasonable. One or more of these occurrences could limit our ability to pursue other business opportunities.

On October 5, 2018, Moody's downgraded our senior unsecured notes credit rating to B3 from B2; the rating outlook from Moody's remains negative. Any further downgrade in our credit ratings would cause an increase in the fees and interest rates we pay under our New Credit Agreement.

Other Commercial Commitments Letters of Credit

We were contingently liable as of September 30, 2018 in the amount of \$19.9 million under certain performance, tax, bid and customs bonds and letters of credit. Agreements relating to approximately \$14.2 million of tax and customs bonds can require collateral at any time. As of September 30, 2018, we had not been required to make any collateral deposits with respect to these agreements. The remaining agreements cannot require collateral except in events of default. Banks have issued letters of credit on our behalf securing certain of these bonds. The table below provides a list of these obligations in U.S. dollar equivalents and their time to expiration (in thousands).

		For the Years Ending December 31,			
	Total	2018	2019	2020	2021
Other Commercial Commitments					
Tax bonds	\$ 9,275	\$	\$ 6,110	\$	\$ 3,165
Custom bonds	6,204	810	5,394		
Bid bonds	3,200	3,200			
Performance bonds	1,000		1,000		
Other	232		232		
Total obligations	\$ 19,911	\$ 4,010	\$ 12,736	\$	\$ 3,165

Off-Balance Sheet Arrangements

At September 30, 2018 and December 31, 2017, we had no off-balance sheet debt or other off-balance sheet arrangements.

New Accounting Pronouncements

See Note 1 **General Information** to our unaudited condensed consolidated financial statements included in Item 1 of Part I of this report for a discussion of recently issued accounting pronouncements.

Forward-Looking Statements

We or our representatives may, from time to time, either in this report, in periodic press releases or otherwise, make or incorporate by reference certain written or oral statements that are **forward-looking statements** within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. Forward-looking statements include, without limitation, any statement that may project, indicate or imply future results, events, performance or achievements, and may contain or be identified by the words **expect, intend, plan, predict, anticipate, estimate, believe, should, could, might, will, will be, will continue, will likely result, project, forecast, budget** and similar expressions. If a statement concerning future financial performance (including, without limitation, future revenues, earnings or growth rates), ongoing business strategies or prospects, and possible actions taken by or against us, which may be provided by management, are also forward-looking statements as so defined. Statements made by us in this report that contain forward-looking statements may include, but are not limited to, information concerning our possible or assumed future results of operations and statements about the following subjects:

market conditions and the effect of such conditions on our future results of operations;

sources and uses of and requirements for financial resources and sources of liquidity;

contractual obligations and future contract negotiations;

interest rate and foreign exchange risk;

operations outside the United States;

business strategy;

growth opportunities;

competitive position, including without limitation, competitive rigs entering the market;

expected financial position;

cash flows and contract backlog;

future amounts payable by a customer in the form of a guarantee of gross margin to be earned on future contracts or by direct payment, pursuant to terms of an existing contract, including the timing and revenue associated therewith;

idling drilling rigs or reactivating stacked rigs;

outcomes of litigation and legal proceedings;

declaration and payment of dividends;

financing plans;

market outlook;

tax planning and effects of the Tax Reform Act;

debt levels and the impact of changes in the credit markets and credit ratings for our debt;

budgets for capital and other expenditures;

timing and duration of required regulatory inspections for our drilling rigs;

timing and cost of completion of capital projects;

delivery dates and drilling contracts related to capital projects or rig acquisitions;

plans and objectives of management;

scrapping retired rigs;

purchasing or constructing rigs;

asset impairments and impairment evaluations;

our internal controls and internal control over financial reporting;

performance of contracts;

purchases of our securities;

compliance with applicable laws; and

availability, limits and adequacy of insurance or indemnification.

These types of statements are based on current expectations about future events and inherently are subject to a variety of assumptions, risks and uncertainties, many of which are beyond our control, that could cause actual results to differ materially from those expected, projected or expressed in forward-looking statements. These risks and uncertainties include, among others, those described or referenced under Risk Factors in Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2017.

The risks and uncertainties referenced above are not exhaustive. Other sections of this report and our other filings with the Securities and Exchange Commission include additional factors that could adversely affect our business, results of operations and financial performance. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements. Forward-looking statements included in this report speak only as of the date of this report. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement to reflect any change in our expectations or beliefs with regard to the statement or any change in events, conditions or circumstances on which any forward-looking statement is based. In addition, in certain places in this report, we may refer to reports published by third parties that purport to describe trends or developments in energy production or drilling and exploration activity. While we believe that these reports are reliable, we have not independently verified the information included in such reports. We specifically disclaim any responsibility for the accuracy and completeness of such information and undertake no obligation to update such information.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk.

The information included in this Item 3 constitutes forward-looking statements for purposes of the statutory safe harbor provided in Section 27A of the Securities Act and Section 21E of the Exchange Act. See Management's Discussion and Analysis of Financial Condition and Results of Operations Forward-Looking Statements in Item 2 of Part I of this report.

At September 30, 2018, we had investments in U.S. Treasury bills of \$274.7 million, which expose us to interest rate risk arising from changes in the level or volatility of interest rates. We monitor our sensitivity to interest rate risk by evaluating the change in the value of our financial assets and liabilities due to fluctuations in interest rates. The evaluation is performed by applying an instantaneous change in interest rates by varying magnitudes on a static balance sheet to determine the effect such a change in rates would have on the recorded market value of our investments and the resulting effect on stockholders' equity. The analysis provides the sensitivity of the market value of our financial instruments to selected changes in market rates and prices which we believe are reasonably possible over a one-year period.

The sensitivity analysis estimates the change in the market value of our interest sensitive assets and liabilities that were held on September 30, 2018, due to instantaneous parallel shifts in the yield curve of 100 basis points, with all other variables held constant. Based on this analysis, our estimated market risk exposure related to our investment in U.S. Treasury bills would have been \$0.2 million.

The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Accordingly, the analysis may not be indicative of, is not intended to provide, and does not provide a precise forecast of the effect of changes in market interest rates on our earnings or stockholders' equity. Further, the computations do not contemplate any actions we could undertake in response to changes in interest rates.

There were no other material changes in our market risk components for the nine months ended September 30, 2018. See Quantitative and Qualitative Disclosures About Market Risk included in Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2017 for further information.

ITEM 4. Controls and Procedures.

We maintain a system of disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the federal securities laws, including this report, is recorded, processed, summarized and reported on a timely basis. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by us under the federal securities laws is accumulated and communicated to our management on a timely basis to allow decisions regarding required disclosure.

Our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, participated in an evaluation by our management of the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of September 30, 2018. Based on their participation in that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of September 30, 2018.

There were no changes in our internal control over financial reporting identified in connection with the foregoing evaluation that occurred during our third fiscal quarter of 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings.

Information related to certain legal proceedings is included in Note 9 to our unaudited condensed consolidated financial statements included in Item 1 of Part I of this report.

ITEM 1A. Risk Factors.

Our Annual Report on Form 10-K for the year ended December 31, 2017 includes a detailed discussion of certain material risk factors facing our company. No material changes have been made to such risk factors as of September 30, 2018.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Items 2(a) and 2(b) are not applicable.

(c) During the three months ended September 30, 2018, in connection with the vesting of restricted stock units held by our officers and certain of our employees, which were awarded under an equity incentive compensation plan, we acquired shares of our common stock in satisfaction of tax withholding obligations that were incurred on the vesting date. The date of acquisition, number of shares and average effective acquisition price per share were as follows:

Issuer Purchases of Equity Securities

Period	Total Number of		Maximum Number	
	Shares Acquired	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	of Shares that May Yet Be Purchased Under the Plans or Programs
July 1, 2018 through July 31, 2018	964	\$ 20.86	N/A	N/A
August 1, 2018 through August 31, 2018			N/A	N/A
September 1, 2018 through September 30, 2018			N/A	N/A
Total	964	\$ 20.86	N/A	N/A

ITEM 6. Exhibits.

Exhibit No.	Description of Exhibit
3.1	<u>Amended and Restated By-Laws (as amended through July 23, 2018) of Diamond Offshore Drilling, Inc. (incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K filed July 24, 2018).</u>
10.1	<u>5-Year Revolving Credit Agreement, dated as of October 2, 2018, among Diamond Offshore Drilling, Inc., as the U.S. borrower, Diamond Foreign Asset Company, as the foreign borrower, Wells Fargo Bank, National Association, as administrative agent and swingline lender, the issuing banks named therein and the lenders named therein (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed October 4, 2018).</u>

Exhibit No.	Description of Exhibit
10.2	<u>Amendment No. 6 and Consent to Credit Agreement and Successor Agency Agreement, dated as of October 2, 2018, among Diamond Offshore Drilling, Inc., as borrower, Wells Fargo Bank, National Association, as administrative agent, Wilmington Trust, National Association, as successor administrative agent, the lenders party thereto and the other parties thereto (incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K filed October 4, 2018).</u>
31.1*	<u>Rule 13a-14(a) Certification of the Chief Executive Officer.</u>
31.2*	<u>Rule 13a-14(a) Certification of the Chief Financial Officer.</u>
32.1*	<u>Section 1350 Certification of the Chief Executive Officer and Chief Financial Officer.</u>
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Calculation Linkbase Document.
101.LAB*	XBRL Taxonomy Label Linkbase Document.
101.PRE*	XBRL Presentation Linkbase Document.
101.DEF*	XBRL Definition Linkbase Document.

* Filed or furnished herewith.

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.

DIAMOND OFFSHORE DRILLING, INC.

(Registrant)

Date November 5, 2018

By: /s/ Scott Kornblau
Scott Kornblau
Senior Vice President and Chief Financial Officer

Date November 5, 2018

/s/ Beth G. Gordon
Beth G. Gordon
Vice President and Controller (Chief Accounting Officer)