

ION GEOPHYSICAL CORP
Form 10-Q
November 15, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2013
OR

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

COMMISSION FILE NUMBER: 1-12691

ION GEOPHYSICAL CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE 22-2286646
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

2105 CityWest Blvd.

Suite 400

Houston, Texas 77042-2839

(Address of principal executive offices) (Zip Code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (281) 933-3339

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

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

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

Large accelerated filer Accelerated filer

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

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

At October 28, 2013, there were 163,306,746 shares of common stock, par value \$0.01 per share, outstanding.

Table of Contents

ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
TABLE OF CONTENTS FOR FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2013

	PAGE
PART I. Financial Information	
Item 1. Financial Statements	<u>3</u>
Condensed Consolidated Balance Sheets as of September 30, 2013 and December 31, 2012	<u>3</u>
Condensed Consolidated Statements of Operations for the three- and nine-months ended September 30, 2013 and 2012	<u>4</u>
Condensed Consolidated Statements of Comprehensive Income (Loss) for the three- and nine-months ended September 30, 2013 and 2012	<u>5</u>
Condensed Consolidated Statements of Cash Flows for the nine-months ended September 30, 2013 and 2012	<u>6</u>
Notes to Unaudited Condensed Consolidated Financial Statements	<u>7</u>
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	<u>21</u>
Item 3. Quantitative and Qualitative Disclosures about Market Risk	<u>35</u>
Item 4. Controls and Procedures	<u>36</u>
PART II. Other Information	
Item 1. Legal Proceedings	<u>37</u>
Item 1A. Risk Factors	<u>39</u>
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	<u>41</u>
Item 5. Other Information	<u>41</u>
Item 6. Exhibits	<u>42</u>

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	September 30, 2013	December 31, 2012
	(In thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 88,585	\$ 60,971
Accounts receivable, net	62,901	127,136
Unbilled receivables	82,894	89,784
Inventories	61,404	70,675
Prepaid expenses and other current assets	25,698	25,605
Total current assets	321,482	374,171
Deferred income tax asset	—	28,414
Property, plant, equipment and seismic rental equipment, net	49,360	33,772
Multi-client data library, net	242,870	230,315
Equity method investments	69,624	73,925
Goodwill	55,322	55,349
Intangible assets, net	11,986	14,841
Other assets	15,199	9,796
Total assets	\$ 765,843	\$ 820,583
LIABILITIES AND EQUITY		
Current liabilities:		
Current maturities of long-term debt	\$ 5,193	\$ 3,496
Accounts payable	31,808	28,688
Accrued expenses	60,360	124,095
Accrued multi-client data library royalties	24,661	26,300
Deferred revenue	20,361	26,899
Total current liabilities	142,383	209,478
Long-term debt, net of current maturities	180,530	101,832
Other long-term liabilities	207,044	8,131
Total liabilities	529,957	319,441
Redeemable noncontrolling interest	1,881	2,123
Equity:		
Cumulative convertible preferred stock	—	27,000
Common stock, \$0.01 par value; authorized 200,000,000 shares; outstanding 163,298,996 and 156,356,949 shares at September 30, 2013 and December 31, 2012, respectively, net of treasury stock	1,633	1,564
Additional paid-in capital	877,891	848,669
Accumulated deficit	(625,976)	(360,297)
Accumulated other comprehensive loss	(13,300)	(11,886)
Treasury stock, at cost, 849,539 shares at both September 30, 2013 and December 31, 2012	(6,565)	(6,565)
Total stockholders' equity	233,683	498,485
Noncontrolling interests	322	534
Total equity	234,005	499,019

Total liabilities and equity	\$ 765,843	\$ 820,583
------------------------------	------------	------------

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (UNAUDITED)

	Three Months Ended September		Nine Months Ended September	
	30,		30,	
	2013	2012	2013	2012
	(In thousands, except per share data)			
Service revenues	\$44,679	\$93,023	\$224,231	\$232,501
Product revenues	35,159	43,300	106,259	120,746
Total net revenues	79,838	136,323	330,490	353,247
Cost of services	52,256	59,136	188,494	149,863
Cost of products	42,686	21,229	85,525	60,327
Gross profit (loss)	(15,104	) 55,958	56,471	143,057
Operating expenses:				
Research, development and engineering	10,288	7,504	28,665	25,536
Marketing and sales	8,416	8,091	25,364	24,162
General, administrative and other operating expenses	22,720	15,314	50,277	43,695
Total operating expenses	41,424	30,909	104,306	93,393
Income (loss) from operations	(56,528	) 25,049	(47,835	) 49,664
Interest expense, net	(4,281	) (1,237	) (8,103	) (4,119
Equity in earnings (losses) of investments	(5,192	) (1,684	) (10,414	) 4,561
Other expense, net	(74,301	) (936	) (180,392	) (727
Income (loss) before income taxes	(140,302	) 21,192	(246,744	) 49,379
Income tax expense	56,954	6,037	19,450	13,666
Net income (loss)	(197,256	) 15,155	(266,194	) 35,713
Net loss attributable to noncontrolling interest	498	42	515	436
Net income (loss) attributable to ION	(196,758	) 15,197	(265,679	) 36,149
Preferred stock dividends	338	338	1,014	1,014
Conversion payment of preferred stock	5,000	—	5,000	—
Net income (loss) applicable to common shares	\$(202,096	) \$14,859	\$(271,693	) \$35,135
Net income (loss) per share:				
Basic	\$(1.29	) \$0.10	\$(1.73	) \$0.23
Diluted	\$(1.29	) \$0.09	\$(1.73	) \$0.22
Weighted average number of common shares outstanding:				
Basic	157,143	155,918	156,842	155,698
Diluted	157,143	162,852	156,842	162,680

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
 (UNAUDITED)

	Three Months Ended September		Nine Months Ended September	
	30,		30,	
	2013	2012	2013	2012
	(In thousands)			
Net income (loss)	\$(197,256	) \$15,155	\$(266,194	) \$35,713
Other comprehensive income (loss), net of taxes, as appropriate:				
Foreign currency translation adjustments	2,513	2,707	(530	) 2,972
Equity interest in investees' other comprehensive income (loss)	(716	) (783	) (1,265	) (67
Unrealized gain (loss) on available-for-sale securities	—	(80	) (244	) 383
Other changes in other comprehensive income (loss)	27	63	625	36
Total other comprehensive income (loss), net of taxes	1,824	1,907	(1,414	) 3,324
Comprehensive net income (loss)	(195,432	) 17,062	(267,608	) 39,037
Comprehensive loss attributable to noncontrolling interest	498	42	515	436
Comprehensive net income (loss) attributable to ION	\$(194,934	) \$17,104	\$(267,093	) \$39,473

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30,	
	2013	2012
	(In thousands)	
Cash flows from operating activities:		
Net income (loss)	\$(266,194	) \$35,713
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Depreciation and amortization (other than multi-client data library)	13,146	11,532
Amortization of multi-client data library	50,892	66,911
Amortization of debt costs	928	187
Stock-based compensation expense	5,707	4,473
Equity in (earnings) losses of investments	10,414	(4,561
Gain on sale of cost-method investment	(3,591) —
Accrual for loss contingency related to legal proceedings	181,776	10,000
Write-down of multi-client data library	5,461	—
Write-down of receivables from OceanGeo	9,157	—
Write-down of excess and obsolete inventory	21,197	—
Deferred income taxes	7,768	795
Change in operating assets and liabilities:		
Accounts receivable	57,481	37,526
Unbilled receivables	6,890	(40,898
Inventories	(13,157	) (8,540
Accounts payable, accrued expenses and accrued royalties	(6,179	) 12,812
Deferred revenue	(6,527	) (12,316
Other assets and liabilities	3,346	(2,302
Net cash provided by operating activities	78,515	111,332
Cash flows from investing activities:		
Cash invested in multi-client data library	(86,346	) (105,600
Purchase of property, plant, equipment and seismic rental assets	(13,539	) (13,566
Net advances to INOVA Geophysical	(8,000) —
Investment in and advances to OceanGeo B.V. (formerly named GeoRXT B.V.)	(9,500) —
Proceeds from sale of a cost-method investment	4,150	—
Maturity of short-term investments	—	20,000
Investment in convertible note	(2,000	) (2,000
Other investing activities	76	—
Net cash used in investing activities	(115,159	) (101,166
Cash flows from financing activities:		
Proceeds from issuance of notes	175,000	—
Payments under amended revolving line of credit	(97,250	) (51,000
Borrowings under amended revolving line of credit	—	148,250
Repayment of term loan	—	(98,250
Payments on long-term debt	(3,296	) (2,776
Cost associated with issuance of notes	(6,731) —
Cost associated with debt amendment	—	(1,313
Payment of preferred dividends	(1,014	) (1,014
Conversion payment of preferred stock	(5,000) —

Edgar Filing: ION GEOPHYSICAL CORP - Form 10-Q

Proceeds from exercise of stock options	2,367	563	
Other financing activities	790	338	
Net cash provided by (used in) financing activities	64,866	(5,202)
Effect of change in foreign currency exchange rates on cash and cash equivalents	(608	)	113
Net increase in cash and cash equivalents	27,614	5,077	
Cash and cash equivalents at beginning of period	60,971	42,402	
Cash and cash equivalents at end of period	\$88,585	\$47,479	
See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.			

6

Table of Contents

ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The condensed consolidated balance sheet of ION Geophysical Corporation and its subsidiaries (collectively referred to as the “Company” or “ION,” unless the context otherwise requires) at December 31, 2012 has been derived from the Company’s audited consolidated financial statements at that date. The condensed consolidated balance sheet at September 30, 2013, and the condensed consolidated statements of operations and comprehensive income (loss) for the three and nine months ended September 30, 2013 and 2012 and the condensed consolidated statements of cash flows for the nine months ended September 30, 2013 and 2012, are unaudited. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the operating results for a full year or of future operations.

These condensed consolidated financial statements have been prepared using accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q and applicable rules of Regulation S-X of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures normally included in annual financial statements presented in accordance with accounting principles generally accepted in the United States have been omitted. The accompanying condensed consolidated financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2012 and Amendment No. 1 thereto on Form 10-K/A, which was filed on April 17, 2013 and contains the separate consolidated financial statements of INOVA Geophysical Equipment Limited (“INOVA Geophysical”) for the fiscal year ended December 31, 2012.

The Company’s consolidated results of operations for the second and third quarters of 2013 were affected by certain additional contingent loss accruals, restructuring charges and impairments of certain assets. See Note 9 “Litigation” and Note 15 “Restructuring Activities” for additional information. The Company’s conclusion to record the restructuring and impairment charges was made in connection with the Company’s preparation of the financial statements included in this Quarterly Report on Form 10-Q.

In addition, also in connection with the Company’s preparation and review of its financial statements included in this Quarterly Report on Form 10-Q, the Company determined that it had incorrectly presented the investments in its multi-client seismic data libraries, or SPANs, in its condensed consolidated statements of cash flows for the three months ended March 31, 2013 and the six months ended June 30, 2013. The Company incorrectly included non-cash activity related to the investment in its multi-client seismic data libraries, which resulted in an understatement of its cash provided by operating activities and an understatement of its cash used in investing activities as previously reported for the interim periods ended March 31, 2013 and June 30, 2013. See Item 4. - Controls and Procedures for further discussion of the improvements to the Company’s controls and procedures implemented to address this incorrect presentation. As a result of this incorrect presentation, the Company restated its condensed consolidated statements of cash flows for the interim periods ended March 31, 2013 and June 30, 2013.

(2) Segment Information

The Company operates through three business segments – Solutions, Systems and Software. The Company measures segment operating results based on income from operations. In addition, the Company has equity ownership interests in two joint ventures: INOVA Geophysical and OceanGeo B.V. (formerly known as GeoRXT B.V.) (“OceanGeo”). See Note 3 “Equity Method Investments” for the summarized financial information for INOVA Geophysical and OceanGeo.

Table of Contents

A summary of segment information is as follows (in thousands):

	Three Months Ended September		Nine Months Ended September		
	30,	2012	30,	2012	
	2013		2013		
Net revenues:					
Solutions:					
New Venture	\$11,945	\$40,817	\$93,630	\$91,355	
Data Library	5,184	22,756	36,153	55,259	
Total multi-client revenues	17,129	63,573	129,783	146,614	
Data Processing	26,318	28,546	91,453	83,601	
Total	\$43,447	\$92,119	\$221,236	\$230,215	
Systems:					
Towed Streamer	\$15,342	\$17,529	\$41,461	\$47,060	
Ocean Bottom	159	7,969	7,307	13,104	
Other	10,766	5,616	33,194	30,475	
Total	\$26,267	\$31,114	\$81,962	\$90,639	
Software:					
Software Systems	\$8,892	\$12,186	\$24,297	\$30,107	
Services	1,232	904	2,995	2,286	
Total	\$10,124	\$13,090	\$27,292	\$32,393	
Total	\$79,838	\$136,323	\$330,490	\$353,247	
Gross profit (loss):					
Solutions	\$(8,487)	) \$33,142	\$33,600	\$81,031	
Systems	(13,987)	) 12,731	3,195	37,777	
Software	7,370	) 10,085	19,676	24,249	
Total	\$(15,104)	) \$55,958	\$56,471	\$143,057	
Gross margin:					
Solutions	(20	)% 36	% 15	% 35	%
Systems	(53	)% 41	% 4	% 42	%
Software	73	% 77	% 72	% 75	%
Total	(19	)% 41	% 17	% 40	%
Income (loss) from operations:					
Solutions	\$(18,163)	) \$22,341	\$215	\$49,381	
Systems	(23,610)	) 6,335	(21,172)	) 16,070	
Software	6,280	) 9,186	16,396	21,547	
Corporate and other	(21,035)	) (12,813)	) (43,274)	) (37,334))
Income (loss) from operations	(56,528)	) 25,049	(47,835)	) 49,664	
Interest expense, net	(4,281)	) (1,237)	) (8,103)	) (4,119))
Equity in earnings (losses) of investments					