

ION GEOPHYSICAL CORP

Form 10-Q

November 03, 2011

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**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, 2011
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
(State or other jurisdiction of
incorporation or organization)

22-2286646
(I.R.S. Employer Identification No.)

2105 CityWest Blvd.
Suite 400
Houston, Texas
(Address of principal executive offices)

77042-2839
(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 Smaller reporting company
(Do not check if a 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, 2011, there were 155,203,656 shares of common stock, par value \$0.01 per share, outstanding.

ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
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FOR THE QUARTER ENDED SEPTEMBER 30, 2011

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CONDENSED CONSOLIDATED BALANCE SHEETS**

	September 30, 2011 (unaudited)	December 31, 2010
	(In thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 43,290	\$ 84,419
Short-term investments	28,000	
Accounts receivable, net	87,923	77,576
Unbilled receivables	45,378	70,590
Inventories	94,240	66,882
Prepaid expenses and other current assets	13,021	13,165
Total current assets	311,852	312,632
Deferred income tax asset	13,180	8,998
Property, plant and equipment, net	22,478	20,145
Multi-client data library, net	146,781	112,620
Investment in INOVA Geophysical	86,894	95,173
Goodwill	51,576	51,333
Intangible assets, net	16,674	20,317
Other assets	10,754	3,224
Total assets	\$ 660,189	\$ 624,442
 LIABILITIES AND EQUITY		
Current liabilities:		
Current maturities of long-term debt	\$ 4,859	\$ 6,073
Accounts payable	29,848	30,940
Accrued expenses	56,382	59,835
Accrued multi-client data library royalties	15,523	18,667
Deferred revenue	36,917	17,851
Total current liabilities	143,529	133,366
Long-term debt, net of current maturities	98,921	102,587
Other long-term liabilities	7,429	8,042
Total liabilities	249,879	243,995
Equity:		
Cumulative convertible preferred stock	27,000	27,000

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Common stock, \$0.01 par value; authorized 200,000,000 shares; outstanding 155,195,407 and 152,870,679 shares at September 30, 2011 and December 31, 2010, respectively, net of treasury stock	1,552	1,529
Additional paid-in capital	839,161	822,399
Accumulated deficit	(435,963)	(448,386)
Accumulated other comprehensive loss	(15,064)	(15,530)
Treasury stock, at cost, 849,539 shares both at September 30, 2011 and December 31, 2010	(6,565)	(6,565)
Total stockholders' equity	410,121	380,447
Noncontrolling interest	189	
Total equity	410,310	380,447
Total liabilities and equity	\$ 660,189	\$ 624,442

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2011	2010	2011	2010
	(In thousands, except per share data)			
Product revenues	\$ 41,760	\$ 34,299	\$ 113,163	\$ 113,974
Service revenues	73,894	87,295	181,575	171,725
Total net revenues	115,654	121,594	294,738	285,699
Cost of products	21,568	17,354	53,831	68,421
Cost of services	50,028	55,292	132,079	117,902
Gross profit	44,058	48,948	108,828	99,376
Operating expenses:				
Research, development and engineering	6,325	5,532	18,070	19,748
Marketing and sales	8,199	7,768	23,079	21,323
General and administrative	11,038	12,279	34,312	39,929
Total operating expenses	25,562	25,579	75,461	81,000
Income from operations	18,496	23,369	33,367	18,376
Interest expense, net	(1,382)	(1,861)	(4,184)	(28,877)
Loss on disposition of land division				(38,115)
Fair value adjustment of warrant				12,788
Equity in losses of INOVA Geophysical	(4,811)	(8,004)	(9,844)	(8,183)
Other income (expense)	199	(3,229)	(2,303)	(811)
Income (loss) before income taxes	12,502	10,275	17,036	(44,822)
Income tax expense (benefit)	3,484	(1,934)	4,716	12,400
Net income (loss)	9,018	12,209	12,320	(57,222)
Net income attributable to noncontrolling interest	34		103	
Net income (loss) attributable to ION	9,052	12,209	12,423	(57,222)
Preferred stock dividends	338	338	1,014	1,598
Net income (loss) applicable to common shares	\$ 8,714	\$ 11,871	\$ 11,409	\$ (58,820)
Net income (loss) per share:				
Basic	\$ 0.06	\$ 0.08	\$ 0.07	\$ (0.42)

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Diluted	\$ 0.06	\$ 0.08	\$ 0.07	\$ (0.42)
Weighted average number of common shares outstanding:				
Basic	155,166	152,344	154,648	141,483
Diluted	162,227	152,690	156,095	141,483

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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

	Nine Months Ended September 30,	
	2011	2010
	(In thousands)	
Cash flows from operating activities:		
Net income (loss)	\$ 12,320	\$ (57,222)
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Depreciation and amortization (other than multi-client library)	10,649	20,439
Amortization of multi-client library	55,166	54,358
Stock-based compensation expense related to stock options, nonvested stock and employee stock purchases	4,177	5,471
Amortization of debt discount		8,656
Write-off of unamortized debt issuance costs		10,121
Fair value adjustment of warrant		(12,788)
Loss on disposition of land division		38,115
Equity in losses of INOVA Geophysical	9,844	8,183
Deferred income taxes	(7,254)	9,269
Change in operating assets and liabilities:		
Accounts receivable	(10,842)	27,546
Unbilled receivables	25,212	(43,447)
Inventories	(30,539)	(867)
Accounts payable, accrued expenses and accrued royalties	(1,108)	(723)
Deferred revenue	19,046	(428)
Other assets and liabilities	(527)	(11,929)
Net cash provided by operating activities	86,144	54,754
Cash flows from investing activities:		
Purchase of property, plant and equipment	(9,024)	(7,014)
Investment in multi-client data library	(91,594)	(58,866)
Purchase of short-term investments	(80,000)	
Proceeds from sale of short-term investments	52,000	
Investment in a convertible note	(6,500)	
Proceeds from disposition of land division, net of fees paid		99,790
Other investing activities	50	(521)
Net cash provided by (used in) investing activities	(135,068)	33,389
Cash flows from financing activities:		
Borrowings under revolving line of credit		101,000
Repayments under revolving line of credit		(190,429)
Net proceeds from the issuance of debt		105,695
Net proceeds from the issuance of stock		38,039

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Payments on notes payable and long-term debt	(4,880)	(143,835)
Payment of preferred dividends	(1,014)	(1,598)
Contribution from noncontrolling interest	313	
Proceeds from exercise of stock options	13,047	
Other financing activities	352	255
Net cash provided by (used in) financing activities	7,818	(90,873)
Effect of change in foreign currency exchange rates on cash and cash equivalents	(23)	2,479
Net decrease in cash and cash equivalents	(41,129)	(251)
Cash and cash equivalents at beginning of period	84,419	16,217
Cash and cash equivalents at end of period	\$ 43,290	\$ 15,966
Non-cash items from investing and financing activities:		
Sale of rental equipment financed with a note receivable	\$ 3,578	\$
Transfer of inventory to rental equipment	2,978	3,635
Reduction in multi-client data library related to finalization of accrued liabilities	1,888	
Investment in multi-client data library financed through trade payables		3,429
Expiration of BGP Warrant		32,001
Conversion of BGP Domestic Convertible Note to equity		28,571
Investment in INOVA Geophysical		119,000
Exchange of RXT receivables into shares		9,516

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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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, 2010 has been derived from the Company's audited consolidated financial statements at that date. The condensed consolidated balance sheet at September 30, 2011, the condensed consolidated statements of operations for the three and nine months ended September 30, 2011 and 2010, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2011 and 2010 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, 2011 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, 2010, and the amendment thereto on Form 10-K/A that the Company filed in June 2011 that contains the separate consolidated financial statements of INOVA Geophysical Equipment Limited (INOVA Geophysical) for the fiscal year ended December 31, 2010.

(2) Segment Information

The Company evaluates and reviews its results based on four segments: Systems, Software, Solutions and Legacy Land Systems (INOVA). The Company measures segment operating results based on income from operations. The Legacy Land Systems (INOVA) segment represents the Company's disposed land division operations through March 25, 2010, the date of the formation of the INOVA Geophysical joint venture.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net revenues:				
Systems:				
Towed Streamer	\$ 22,219	\$ 20,185	\$ 60,000	\$ 50,096
Ocean Bottom		510	509	1,821
Other	10,065	5,036	25,210	19,721
Total	\$ 32,284	\$ 25,731	\$ 85,719	\$ 71,638
Software:				
Software Systems	\$ 9,476	\$ 8,567	\$ 27,444	\$ 25,824
Services	715	561	1,545	1,409
Total	\$ 10,191	\$ 9,128	\$ 28,989	\$ 27,233
Solutions:				
Data Processing	\$ 22,416	\$ 27,943	\$ 63,349	\$ 79,661

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New Venture	35,597	49,971	67,819	62,314
Data Library	15,166	8,821	48,862	28,342
Total	\$ 73,179	\$ 86,735	\$ 180,030	\$ 170,317
Legacy Land Systems (INOVA)	\$	\$	\$	\$ 16,511
Total	\$ 115,654	\$ 121,594	\$ 294,738	\$ 285,699

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Gross profit:				
Systems	\$ 13,397	\$ 11,202	\$ 40,752	\$ 29,141
Software	8,061	6,074	20,970	18,254
Solutions	22,600	31,672	47,106	52,965
Legacy Land Systems (INOVA)				(984)
Total	\$ 44,058	\$ 48,948	\$ 108,828	\$ 99,376
Gross margin:				
Systems	41%	44%	48%	41%
Software	79%	67%	72%	67%
Solutions	31%	37%	26%	31%
Legacy Land Systems (INOVA)	%	%	%	(6%)
Total	38%	40%	37%	35%
Income from operations:				
Systems	\$ 6,852	\$ 5,693	\$ 21,989	\$ 13,833
Software	7,117	5,451	18,409	16,513
Solutions	13,897	22,556	22,751	30,669
Legacy Land Systems (INOVA)				(9,623)
Corporate and other	(9,370)	(10,331)	(29,782)	(33,016)
Income from operations	18,496	23,369	33,367	18,376
Interest expense, net	(1,382)	(1,861)	(4,184)	(28,877)
Loss on disposition of land division				(38,115)
Fair value adjustment of warrant				12,788
Equity in losses of INOVA Geophysical	(4,811)	(8,004)	(9,844)	(8,183)
Other income (expense)	199	(3,229)	(2,303)	(811)
Income (loss) before income taxes	\$ 12,502	\$ 10,275	\$ 17,036	\$ (44,822)

In September 2011, INOVA Geophysical announced the launch of its next-generation products. These products are in process of field testing with plan of commercial introduction in 2012. The Company expects to see a one-time write-down of inventory based upon previous technologies to occur in INOVA Geophysical's third quarter and then reflected in the Company's fourth quarter results, as the Company records its share of earnings of INOVA Geophysical on a one fiscal quarter lag. The Company estimates that its 49% share of this one-time write-down to be in the range of \$6 million to \$8 million.

(3) Investments***Short-term Investments***

Short-term investments are comprised solely of bank certificates of deposit denominated in U.S. dollars with original maturities in excess of three months and represent the investment of excess cash that is available for current

operations. The Company recorded these investments on its