OCEANEERING INTERNATIONAL INC
Form 10-Q
August 08, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

[X] **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2007

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 **1-10945**
OCEANEERING INTERNATIONAL, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	**95-2628227**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
11911 FM 529	
Houston, Texas	**77041**
(Address of principal executive offices)	(Zip Code)

(713) 329-4500
(Registrant s telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 þ, No o.

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

The number of shares of the registrant s common stock outstanding as of July 27, 2007 was 54,963,158.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

OCEANEERING INTERNATIONAL, INC. & SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(in thousands)

	June 30, 2007	Dec. 31, 2006
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 26,012	$ 26,228
Accounts receivable, net of allowances for doubtful accounts of $87 and $114	396,198	315,255
Inventory and other current assets	244,789	182,162
Total current assets	666,999	523,645
Property and Equipment, at cost	1,144,453	1,040,042
Less accumulated depreciation	554,766	516,335
Net Property and Equipment	589,687	523,707
Other Assets:		
Goodwill	93,049	86,931
Investments in unconsolidated affiliates	64,522	64,496
Other	38,579	43,243
Total other assets	196,150	194,670
TOTAL ASSETS	$ 1,452,836	$ 1,242,022
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 77,065	$ 70,777
Accrued liabilities	223,234	180,073
Income taxes payable	35,120	28,856
Total current liabilities	335,419	279,706
Long-term Debt	245,000	194,000
Other Long-term Liabilities	79,383	71,552
Commitments and Contingencies		
Shareholders Equity	793,034	696,764

TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 1,452,836	$ 1,242,022

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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OCEANEERING INTERNATIONAL, INC. & SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(unaudited)
(in thousands, except per share amounts)

	For the Three Months Ended June 30, 2007	For the Three Months Ended June 30, 2006	For the Six Months Ended June 30, 2007	For the Six Months Ended June 30, 2006
Revenue	$ 432,041	$ 311,063	$ 776,045	$ 600,572
Cost of Services and Products	326,031	239,106	590,433	468,298
Gross margin	106,010	71,957	185,612	132,274
Selling, General and Administrative Expense	29,712	24,058	55,778	46,411
Income from operations	76,298	47,899	129,834	85,863
Interest Income	137	62	252	130
Interest Expense, net of amounts capitalized	(3,972)	(3,131)	(7,102)	(5,922)
Equity Earnings of Unconsolidated Affiliates	1,052	3,879	2,241	8,233
Other Expense, Net	(205)	(1,192)	(173)	(1,187)
Income before income taxes	73,310	47,517	125,052	87,117
Provision for Income Taxes	25,437	16,916	44,013	31,014
Net Income	$ 47,873	$ 30,601	$ 81,039	$ 56,103
Basic Earnings per Share	$ 0.88	$ 0.57	$ 1.49	$ 1.05
Diluted Earnings per Share	$ 0.86	$ 0.56	$ 1.46	$ 1.02
Weighted average number of common shares	54,622	53,756	54,542	53,651
Incremental shares from stock equivalents	1,056	1,332	1,051	1,281
Weighted average number of common shares and equivalents	55,678	55,088	55,593	54,932

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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OCEANEERING INTERNATIONAL, INC. & SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(in thousands)

	For the Six Months Ended June 30, 2007	2006
Cash Flows from Operating Activities:		
Net income	$ 81,039	$ 56,103
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	44,133	38,345
Gain on sales of property and equipment	(4,198)	
Noncash compensation and other	5,998	5,844
Undistributed earnings of unconsolidated affiliates	(26)	(2,870)
Increase (decrease) in cash from:		
Accounts receivable	(80,943)	(39,431)
Inventory and other current assets	(62,627)	(49,316)
Other assets	4,119	(803)
Current liabilities	55,714	48,559
Other long-term liabilities	6,238	3,995
Total adjustments to net income	(31,592)	4,323
Net Cash Provided by Operating Activities	49,447	60,426
Cash Flows from Investing Activities:		
Purchases of property and equipment and other, net	(110,276)	(89,815)
Proceeds on sales of property and equipment	5,222	
Net Cash Used in Investing Activities	(105,054)	(89,815)
Cash Flows from Financing Activities:		
Net proceeds of revolving credit and other long-term debt	50,662	21,000
Proceeds from issuance of common stock	3,663	5,103
Excess tax benefits from stock-based compensation	1,066	1,935
Net Cash Provided by Financing Activities	55,391	28,038

Net Decrease in Cash and Cash Equivalents	(216)	(1,351)
Cash and Cash Equivalents — Beginning of Period	26,228	26,308
Cash and Cash Equivalents — End of Period	$ 26,012	$ 24,957

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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OCEANEERING INTERNATIONAL, INC. & SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation and Significant Accounting Policies

We have prepared these unaudited consolidated financial statements pursuant to instructions for the quarterly report on Form 10-Q, which we are required to file with the Securities and Exchange Commission. These financial statements do not include all information and footnotes normally included in financial statements prepared in accordance with generally accepted accounting principles. These financial statements reflect all adjustments that we believe are necessary to present fairly our financial position at June 30, 2007 and our results of operations and cash flows for the periods presented. All such adjustments are of a normal and recurring nature. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in our annual report on Form 10-K for the year ended December 31, 2006. The results for interim periods are not necessarily indicative of annual results.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires that our management make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates.

2. Investments in Unconsolidated Affiliates

Our investments in unconsolidated affiliates consisted of the following:

	June 30, 2007	Dec. 31, 2006
	(in thousands)	
Medusa Spar LLC	$ 63,181	$ 63,149
Other	1,341	1,347
Total	$ 64,522	$ 64,496

We own a 50% equity interest in Medusa Spar LLC. Medusa Spar LLC owns a 75% interest in a production spar platform in the Gulf of Mexico. Medusa Spar LLC s revenue is derived from processing oil and gas production for a fee based on the volumes processed through the platform (throughput). The majority working interest owner of the Medusa field, the spar s initial location, has committed to deliver a minimum throughput, which we expect will generate sufficient revenue to repay Medusa Spar LLC s bank debt. Medusa Spar LLC financed its acquisition of its 75% interest in the production spar platform using approximately 50% debt and 50% equity from its equity holders. We believe our maximum exposure to loss from our investment in Medusa Spar LLC is our $63 million investment. Medusa Spar LLC is a variable interest entity. As we are not the primary beneficiary under Financial Accounting Standards Board (FASB) Interpretation Number 46(R), *Consolidation of Variable Interest Entities,* we are accounting for our investment in Medusa Spar LLC under the equity method of accounting. Equity earnings from Medusa Spar LLC reflected in our financial statements are after amortization of our initial acquisition costs. The following are summarized 100% statements of income of Medusa Spar LLC.

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	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
	(in thousands)			
Medusa Spar LLC				
Condensed Statements of Income				
Revenue	$ 4,896	$ 9,693	$ 10,157	$ 20,726
Depreciation	(2,370)	(2,370)	(4,739)	(4,739)
General and Administrative	(17)	(60)	(33)	(76)
Interest	(378)	(506)	(784)	(997)
Net Income	$ 2,131	$ 6,757	$ 4,601	$ 14,914
Equity Earnings reflected in our financial statements	$ 1,036	$ 3,348	$ 2,241	$ 7,382

3. Inventory and Other Current Assets

Our inventory and other current assets consisted of the following:

	June 30, 2007	Dec. 31, 2006
	(in thousands)	
Inventory of parts for remotely operated vehicles	$ 78,823	$ 61,763
Other inventory, primarily raw materials	118,050	78,130
Deferred income taxes	19,930	18,618
Other	27,986	23,651
Total	$ 244,789	$ 182,162

We state our inventory at the lower of cost or market. We determine cost using the weighted-average method.

4. Debt

Our long-term debt consisted of the following:

	June 30, 2007	Dec. 31, 2006
	(in thousands)	
6.72% Senior Notes	$ 80,000	$ 80,000
Revolving credit facility	165,000	114,000
Total	$ 245,000	$ 194,000

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Scheduled maturities of our long-term debt as of June 30, 2007 were as follows:

	6.72% Notes	Revolving Credit	Total
		(in thousands)	
Remainder of 2007	$ 20,000	$	$ 20,000
2008	20,000		20,000
2009	20,000		20,000
2010	20,000		20,000
2011			
Thereafter		165,000	165,000
Total	$ 80,000	$ 165,000	$ 245,000

Maturities through June 30, 2008 are not classified as current as of June 30, 2007 because we are able and intend to extend the maturity by reborrowing under our revolving credit facility, which has a maturity date beyond one year. We capitalized interest charges of $518,000 and $47,000 in the six-month periods ended June 30, 2007 and 2006, respectively, and $150,000 and $47,000 in the three-month periods ended June 30, 2007 and 2006, respectively, as part of construction-in-progress.

5. Shareholders Equity and Comprehensive Income

Our shareholders equity consisted of the following:

	June 30, 2007	Dec. 31, 2006
	(in thousands)	
Retained earnings, December 31, 2006	$ 472,525	$ 472,525
Adjustment to beginning retained earnings to implement FIN No. 48	(1,595)	
Net income for the period ended June 30, 2007	81,039	
Retained earnings, end of period	551,969	472,525
Common Stock, par value $0.25; 90,000,000 shares authorized; 54,726,758 and 54,440,488 shares issued	13,682	13,610
Additional paid-in capital	199,375	191,910
Other comprehensive income	28,008	18,719
Total	$ 793,034	$ 696,764

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN No. 48), *Accounting for Uncertainty in Income Taxes*. The interpretation became effective for us beginning January 1, 2007, and we made an adjustment of $1.6 million to our retained earnings account as of January 1, 2007 to record the effect of our adoption of this interpretation.

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Comprehensive income is the total of net income and all nonowner changes in equity. The amounts of comprehensive income for the periods indicated are as follows:

	For the Three Months Ended June 30, 2007	For the Three Months Ended June 30, 2006	For the Six Months Ended June 30, 2007	For the Six Months Ended June 30, 2006
	(in thousands)			
Net Income per Consolidated Statements of Income	$ 47,873	$ 30,601	$ 81,039	$ 56,103
Foreign Currency Translation Gains, net	6,748	6,537	9,348	9,441
Change in Pension Liability Adjustment, net of tax	15		15	566
Change in Fair Value of Hedge, net of tax	(4)	8	(74)	54
Total	$ 54,632	$ 37,146	$ 90,328	$ 66,164

Amounts comprising other elements of comprehensive income in Shareholders Equity are as follows:

	June 30, 2007	Dec. 31, 2006
	(in thousands)	
Accumulated Net Foreign Currency Translation Adjustments	$ 30,921	$ 21,573
Pension Liability Adjustment	(3,192)	(3,207)
Fair Value of Hedge	279	353
Total	$ 28,008	$ 18,719

6. Income Taxes

During interim periods, we provide for income taxes at our estimated effective tax rate, currently 35.6%, using assumptions as to (1) earnings and other factors that would affect the tax calculation for the remainder of the year and (2) the operations of foreign branches and subsidiaries that are subject to local income and withholding taxes. In the three-month period ended June 30, 2007, we recognized a Work Opportunity Tax Credit of $0.7 million under the Katrina Emergency Tax Relief Act of 2005. This credit reduced our effective tax rates to 34.7% and 35.2% for the three- and six-month periods ended June 30, 2007, respectively.

Effective January 1, 2007, we adopted FIN No. 48. This interpretation clarifies the criteria for recognizing income tax benefits under SFAS No. 109, and requires additional disclosures about uncertain tax positions. Under FIN 48 the financial statement recognition of the benefit for a tax position is dependent upon the benefit being more likely than not to be sustainable upon audit by the applicable taxing authority. If this threshold is met, the tax benefit is then measured and recognized at the largest amount that is greater than 50 percent likely of being realized upon ultimate settlement.

We account for any applicable interest and penalties on uncertain tax positions as a component of our provision for income taxes on our financial statements. We charged $0.3 million to income tax expense in the six months ended June 30, 2007 for penalties and interest taken on our financial statements on uncertain tax positions, which brought our total liabilities for penalties and interest on uncertain tax positions to $2.7 million on our balance sheet at June 30, 2007. Including penalties and interest, we have accrued a total of $6.4 million in the caption other long-term liabilities on our balance sheet for unrecognized tax benefits. All additions or reductions to the above liability affect our effective income tax rate in the respective period of change.

We do not believe that the total of unrecognized tax benefits will significantly increase or decrease in the next 12 months.

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The following lists the earliest tax years open to examination by tax authorities where we have significant operations:

Jurisdiction	Periods
United States	2003
United Kingdom	2004
Norway	2000
Angola	2002
Nigeria	2001
Brazil	2001

We conduct our operations in a number of locations that have varying laws and regulations with regard to income and other taxes, some of which are subject to interpretation. Our tax returns are subject to audit by taxing authorities in multiple jurisdictions. These audits often take years to complete and settle. Our management believes that adequate provisions have been made for all taxes that will ultimately be payable, although final determination of tax liabilities may differ from our estimates.

7. Business Segment Information

We supply a comprehensive range of technical services and specialty products to customers in a variety of industries. Our Oil and Gas business consists of five business segments: Remotely Operated Vehicles (ROVs); Subsea Products; Subsea Projects; Inspection; and Mobile Offshore Production Systems. Our Advanced Technologies business is a separate segment that provides project management, engineering services, products and equipment for applications outside the oil and gas industry. Unallocated Expenses are those not associated with a specific business segment. These consist of expenses related to our incentive and deferred compensation plans, including restricted stock and bonuses, as well as other general expenses.

There are no differences in the basis of segmentation or in the basis of measurement of segment profit or loss from those used in our consolidated financial statements for the year ended December 31, 2006. The following summarizes certain financial data by business segment:

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