

Thomson StreetEventsSM



Conference Call Transcript

IO - Q3 2011 ION Geophysical Corp Earnings Conference Call

Event Date/Time: Nov 03, 2011 / 02:00PM GMT



Nov 03, 2011 / 02:00PM GMT, IO - Q3 2011 ION Geophysical Corp Earnings Conference Call

CORPORATE PARTICIPANTS

Jack Lascar

Ion Geophysical Corp - DRG&E

Bob Peebler

Ion Geophysical Corp - CEO

Brian Hanson

Ion Geophysical Corp - President, COO & CFO

CONFERENCE CALL PARTICIPANTS

Daniel Burke

Johnson Rice & Co - Analyst

PRESENTATION

Operator

Welcome to the ION Geophysical third quarter earning conference call. During today's presentation, all participants will be in a listen-only mode. Following the presentation, the conference will be open for questions. Today's conference is being recorded, November 3, 2011. I would now like to turn the conference over to Jack Lascar. Please go ahead.

Jack Lascar - *Ion Geophysical Corp - DRG&E*

Thank you, Alicia. Good morning, and welcome to the ION Geophysical Corporation's third quarter earning conference call. We appreciate you joining us today. Your hosts are Bob Peebler, Chief Executive Officer and Brian Hanson, President, Chief Operating Officer and Chief Financial Officer. Before I turn the call over to management, I have a few items to cover. If you would like to be on our email distribution list to receive future news releases or if you experienced a technical problem and didn't receive your news release yesterday, please call DRGNL at 713-529-6600 and let us know.

If you would like to listen to a replay of today's call, it is available via webcast by going to the Investor Relations section of the Company's website at www.iongeo.com. Or via recorded instant replay until November 17. The information was provided in yesterday's earnings release. I should also point out that we'll be using some PowerPoint slides to accompany today's call. They're accessible via a link on the Investor Relations page of ION's website. Information reported on this call speaks only as of today, November 3, 2011, and therefore you are advised that time-sensitive information may no longer be accurate at the time of any replay.

Before we begin, let me remind you that certain statements made by management during this call may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on management's current expectations and include known and unknown risks, uncertainties, and other factors, many of which the Company's unable to predict or control, that may cause the Company's actual results or performance to differ materially from any future results or performance expressed or implied by those statements. These risks and uncertainties includes the risk factors disclosed by the Company from time to time in its filing with the SEC, including in its annual report on form 10-K and its quarterly reports on form 10-Q. Furthermore, as we start this call, please refer to the statement regarding forward-looking statements incorporated in our press release issued yesterday and please note that the contents of our conference call this morning are covered by these statements. I will now turn the call over to Bob Peebler.

Bob Peebler - *Ion Geophysical Corp - CEO*

Thanks, Jack, and good morning to everyone. As you know, this is my last earnings conference call as CEO of ION. I'm pleased that the transition is going very smoothly, and I'm looking forward to Brian taking over the reins on January 1, as I become Executive Chairman. I'm also pleased that we had a solid quarter. As expected, we are seeing the business build as we close out the year. As mentioned last quarter, the 2 main

2



Nov 03, 2011 / 02:00PM GMT, IO - Q3 2011 ION Geophysical Corp Earnings Conference Call

business issues for 2011 have been the significant impact of the Macondo oil spill has had on the Gulf of Mexico data processing business and the slower than expected land equipment business for our joint venture, INOVA.

As previously stated, we are still seeing a slow but steady recovery of our GXT data processing business. At the same time, we are taking steps to more rapidly expand our business in regions around the world and as a result we still expect that we should be at or near capacity going into 2012. Our INOVA joint venture has experienced a tough year financially but a successful year for the R&D product development. When we formed the joint venture, we looked forward to increasing the BGP equipment business in the short term and also BGP's involvement with the finding specifications and helping test new equipment so our land equipment could be more competitive in strategically important areas such as the Middle East.

We have seen an improvement in sales year over year, mainly due to increased BGP purchases, which have represented approximately 50% of 2011 INOVA sales year-to-date. What is more important for the future of INOVA is the fact that as a result of their significant and continuing R&D program, they are now in the process of field testing with a plan of commercially introducing a whole new suite of products during 2012. The new products include FireFly version 3.0, a new product line called Hawk, which is our version of Land Nodes, and a new LAN cable system, which has been specifically designed to meet BGP's needs in the Middle East and Africa and other potential customers as well. Our expectations are that the combination of new products, continuing improvement in the LAN seismic acquisition business, and increasing BGP market share should have a significant and growing positive impact on INOVA's business. The combination of the weaker than expected data processing business and a slower than expected recovery in the LAN seismic acquisition business and related equipment sales for INOVA have impacted our 2011 business by approximately \$0.20 per share compared to our original business plan. The good news is, we are finishing up the year in an improving situation and entering 2012 in a much stronger position than a year ago in both our data processing and INOVA businesses. Also, the strength of our multi-client business in 2011 is helping offset some of these short-term business issues.

I would now like to review some of our third-quarter highlights. Starting with our Geoventures multi-client business, we're having an excellent year so far with both our new venture programs and data library sales. We entered 2011 with a strategy of further diversifying our marine data library business by establishing a new beachhead and land. We're making significant progress this year, with approximately 25% of our capital spend in our LAN scans, which are focused on the shale plays starting in North America. By the end of 2011, we will have completed 1 large project in the Marcellus and will have 2 other projects in progress during Q4.

We are pleased with the full wave data quality from the FireFly system and are having growing confidence that we'll have a strong shale play business that will be highly differentiated due to our technical approach using full wave acquisition and processing. In addition to establishing geoventures on land, we also have recently announced exciting news concerning our marine Arctic spans. Due to our recognized excellence in Arctic acquisition technology and operations, we were approached by the Russian Federation Subsoil Resources Management Agency to acquire data for Russia in the 2011 Arctic Expedition at the Exclusive Economic Zone of the Russian Federation. Working closely with the Russian State Research Navigation and Hydrographic Institute, we acquired approximately 6,000 kilometers over 57 days this summer, culminating in the acquisition of data at the distance of less than 300 kilometers of the North Pole. We believe that our recent Greenland regional program in this new acquisition of the Russian High Arctic served as future validation of our proprietary Arctic acquisition technology and bodes well for continued success in the Arctic, now including Russia.

Our marine business, including our software division concept systems, again finished with a good quarter. We continue to see strength in our Digi-[positioning] products and are currently in C-trial mode of our 12-streamer system with BGP. We also sense some optimism from our marine customers, that they are expecting stronger acquisition activities in the Gulf of Mexico due to increased steel flow and are hopeful that increases in the Gulf of Mexico will help offset increased capacity coming into the market. Our sensor geophone business is also regaining traction in the market with our lower cost, lower price geophone offering and are also seeing increased steel flow in the Middle East that will likely carry over into 2012.

Before I hand the call over to Brian, I would like to thank our investors and analysts, who have worked closely with us over the last few years, and I look forward to supporting Brian in his new CEO role next year. Here's Brian.

Brian Hanson - Ion Geophysical Corp - President, COO & CFO

Thank you, Bob. Good morning, everyone. Let me begin by sharing a few of the financial highlights for the third quarter. We delivered \$0.06 of diluted EPS for the third quarter, as the strong performance by our systems segment and another steady performance by our software segment offset lower revenues from our solutions segment. The third quarter of 2010 was a robust quarter for new venture activity as we completed a tremendous amount of work heavily focused in the Arctic. 2011 new venture activity is more distributed across the third and fourth quarters, as



we are not only working in the Arctic but are much more diversified in scope this year with other marine projects and the addition of our LAN scan offering and North America shales.

In addition, although improving sequentially, the data processing business continued to feel the lagging impact of the Gulf of Mexico oil spill as compared to the same quarter prior year. As we expected, these overall results are sequential improvement over the first and second quarter's results, illustrating signs of momentum as we head into the fourth quarter. Excluding the revenues of our Legacy LAN business, revenues increased 10% to \$295 million for the first 9 months of 2011, compared to \$269 million for the prior year period. Our solutions multi-client business delivered year-to-date revenues of \$117 million, up 29% over the same period of the prior year, driven by our customer's demand for data from our multi-client programs in Greenland, Brazil, Africa, and the Marcellus shale.

Solutions backlog for the third quarter was \$106 million, and has averaged \$110 million for the first 3 quarters of the year. Our software segment delivered its best quarter ever of operating income on a pound sterling basis as it achieved major milestone with the fiftieth installation of Orca software. Our system segment year-to-date revenues increased 20% to \$86 million as a result of continued strong demand of marine positioning equipment.

With that overview, let's take a look at trailing 12-month revenues followed by an in-depth look at each of our segments. Excluding the impact of our Legacy LAN business, revenues for the trailing 12 months of 2011 were \$453 million, or 26% higher than the same period of 2010. Solutions segment revenues increased 32%, with higher sales from data libraries and new venture projects offsetting lower data processing revenues. Software segment revenues increased 4%, as systems segment revenues increased 22% over the prior period due to solid demand for tote streamer marine equipment. Our solutions multi-client business delivered a strong performance on a year-to-date basis with revenues of \$180 million, compared to \$170 million for the prior period. Data library and new venture revenues improved \$21 million and \$6 million, respectively, over the prior year, offsetting a reduction in data processing revenues, up \$17 million due to the Gulf of Mexico oil spill.

The good news is the data processing business is sequentially improving and we expect it to be back to or near capacity levels of late 2010 by the end of the year. During the third quarter, the Gulf of Mexico sales pipeline has increased by approximately 35%, which is a sequential improvement over the 24% increase experienced during the second quarter. We remained focused on international growth, the data processing centers around the world, including our recently established joint venture in Rio de Janeiro and Brazil. Our solution backlog has averaged \$110 million for the last 3 quarters. Current backlog of \$106 million exceeds the historical range of \$70 million to \$90 million, which is a positive indication of the strength of our sales pipeline and will result in a positive impact to our solutions revenues during the fourth quarter of the year.

This next slide takes a closer look at the relationship between our CapEx investment and our multi-client data library and the associated new venture revenues. A multi-client project can last anywhere from 10 to 16 months. The process begins with conceptualization, followed by sanctioning and permitting. During this period, we identify interested customers and obtain pre-funding. Once the necessary preparations have been made, the data acquisition phase of the project begins, which typically lasts 2 to 4 months, depending on the size and nature of the survey. Acquired data is then processed and interpreted. Upon completion of the multi-client seismic survey, the survey data is sold off the shelf, and data is licensed to customers on a non-exclusive basis.

While the entire process is lengthy, the period in which the majority of the new venture revenue is recognized is relatively short and related primarily to the data acquisition period. As this slide illustrates, the level of new venture revenues is consistently correlated to the annual level of new multi-client investment. Similar to the annual trend, this next slide illustrates how the relationship between new venture revenues and multi-client data libraries is also evident by quarter on average. Since 2006, the highest levels of new venture activity have been concentrated to the third quarter. This was of particularly true of the third quarter of 2010, when the bulk of our new venture projects took place in the Arctic with a season for acquiring seismic data generally occurs from July to September due to ice conditions.

During 2011, we have continued to leverage our leading technological and operational expertise related to seismic surveys in the Arctic as we completed a third survey in northeast Greenland as well as a scientific survey for the Russian government in the high Arctic. In addition to our regional 2D basin scan projects, we have also made significant progress acquiring 3D multi-client seismic data on North American shales, which we call ResSCANS. Most notably, in this first year of our ResSCAN program, we have completed phase 1 of a LAN project in the Marcellus shale and we are now moving into phase 2. We currently have underwriting commitments for 3 other LAN projects in North America, which are expected to start in the fourth quarter or early 2012. For the full-year 2011, we estimate that 1/3 of total multi-client investment will relate to ResSCAN projects with the remaining 2/3 related to basin scan projects. As we expand our portfolio of multi-client seismic surveys from primarily marine environments to also include land environments, we anticipate a smoothing of new venture revenues throughout the year with land projects continuing on in the winter months of the fourth quarter, during which we are timed out for Arctic projects.

Nov 03, 2011 / 02:00PM GMT, IO - Q3 2011 ION Geophysical Corp Earnings Conference Call

Software segment year-to-date revenues remain consistent at GBP18 million in sales compared to the same prior year period, as steady sales of Orca and Gator software licenses, including software license renewals, continues to demonstrate healthy demand for concept systems command and control software platforms. During the third quarter, concept systems delivered a record quarter of operating income on a pound-Sterling basis and achieved a significant milestone as 2 more 3D vessels were outfitted with the Orca platform, bringing total Orca installations to 50, or approximately 40% of the total market.

Systems segment year-to-date revenues were up 20% to \$86 million, compared to \$72 million for the same period of the prior year. This increase was primarily due to the sales of our marine products, particularly toad streamer positioning equipment, as our sensor geophone business has been slow to recover from the negative impact of geopolitical events in North Africa and the Middle East. However, the sensor geophone business is completing its migration to a low-cost manufacturing approach and experienced improved sales activity during the third quarter. Third-quarter sales of sensor geophones improved 146% over the third quarter of 2010, providing an indication of healing in the LAN seismic market and positioning our sensor geophone business for a solid fourth quarter for the first time since 2007. We continue to work closely with BGP on the mobilization and launch of its new vessel, as BGP prepares to shoot its first 3D marine seismic survey. C trials for the 12-streamer system sold to BGP recently commenced.

Moving on to the balance sheet, the asset side of our business, or the asset side of our balance sheet, continues to demonstrate our asset-light strategy, with the most significant investments in working capital and oil company-funded multi-client projects resulting in a data library to net book value of \$147 million. Total cash on hand was approximately \$72 million, which is \$32 million less than our total outstanding debt balance of \$104 million. As of the end of the third quarter, we had \$172 million of liquidity, comprised of \$72 million of cash and \$100 million of undrawn credit on a revolving credit facility. Operating cash flows, including cash flows from working capital, improved 50%, to \$86 million for the first 9 months of 2011 compared to the same period of the prior year. Year-to-date, we invested \$92 million in our pre-funded multi-client data libraries and \$9 million in PP&E.

As we mentioned in our second quarter call, we expected to start using some of our cash from operations as we moved into periods of heavy investment in multi-client work and to cover the timing between project execution expenses and the collection of underwriting. As you can see, investment in our pre-funded multi-client data libraries increased to approximately 56% over the prior period, and we continue to anticipate approximately \$20 million to \$40 million of additional investment in the fourth quarter. For the first 9 months of 2011, we experienced a free cash outflow of \$14 million, compared to \$9 million for the prior period as investment in multi-client data libraries and PP&E slightly out-paced cash in-flows from operations and working capital. INOVA estimates third quarter revenues to be in the range of approximately \$25 million to \$29 million, with an operating loss of approximately \$8 million to \$10 million and a net loss of approximately \$10 million to \$12 million. Similar to last quarter, we would expect to book 49% of this estimated net loss in our fourth quarter results. These numbers are estimates which we believe offer some visibility to the impact we expect the joint venture to have on our financial results. However, these are not final audited numbers.

INOVA year-to-date revenues increased approximately 45% over the same period of last year, as inventory levels remained stable and with credit line capacity of \$27 million to support 2012 growth. As Bob mentioned, in September, INOVA announced the launch of its next generation LAN seismic products, which we believe these new and improved technologies will attract significant customer interest because they are designed to deliver improved image quality to more productive delivery systems. Our full-year expected investment in our multi-client data libraries remains at a range of \$110 million to \$130 million. As a result of this unprecedented level of investment in our multi-client programs, combined with the probable recognition of revenue for the 12 streamer systems sold to BGP, the increasing momentum in our data processing business and the natural year-end CapEx budget available for data library sales, we expect solid fourth quarter results.

In summary, we are pleased with the results of the third quarter and anticipate a solid fourth quarter. With that, we'll open up the call for questions.

QUESTION AND ANSWER

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) And our first question comes from the line of Daniel Burke with Johnson Rice, please go ahead.

Daniel Burke - Johnson Rice & Co - Analyst



Nov 03, 2011 / 02:00PM GMT, IO - Q3 2011 ION Geophysical Corp Earnings Conference Call

Good morning. Bob, all the best as you make the transition.

Bob Peebler - Ion Geophysical Corp - CEO

Thank you.

Daniel Burke - Johnson Rice & Co - Analyst

Guys, couple different questions here. I appreciate the slides, indicating the correlation between multi-client spend and revenue recognition. But you know, this year, you've, so far -- no surprise, lagged in terms of revenue recognition against investment. Do you think that by year end 2011, you'll see, or we'll see, basically, equivalents between your multi-client spend and new venture revenue recognition?

Brian Hanson - Ion Geophysical Corp - President, COO & CFO

This is Brian. You know, I think historically, it has been highly correlated so I see no reason why it wouldn't.

Daniel Burke - Johnson Rice & Co - Analyst

Okay. All right. Then, sort of prospectively, good to see, staying with new ventures, good to see that backlog pretty consistent on the solutions side. You'll carry a lot of land activity into next year. Compared to this year's budget, the \$110 million to \$130 million, any early indications on where you'd be for 2012?

Brian Hanson - Ion Geophysical Corp - President, COO & CFO

Not -- it's still a little premature to give -- to talk about 2012. We're still in the middle of our planning process. And so I think -- internally we're not even going to have a handle on that until early December. But suffice to say, if you look at the way the business behaves historically, Q3 was typically a quarter where we would start eating through our backlog, and it would -- normally, we would be seeing a reduction in that backlog in Q3 and then a significant reduction by the end of Q4. So I think what's positive about 2011 is that backlog is demonstrating signs of sustaining itself because of the success of the ResSCAN program. So by not only having -- going into the second phase of the Marcellus, the reality is we have 3 more underwritten programs right on the heels, which just contributes to continuity of that business into 2012. So I think it bodes well for 2012.

Daniel Burke - Johnson Rice & Co - Analyst

Okay. That's good to see. Switching gears, on the systems side, I apologize if I missed this. But 2 questions. 1 on the third quarter, 1 on the fourth. It looked like the margin in systems weakened a little bit. Was curious, what were the drivers there? And then looking ahead to Q4 and assuming the sale of the streamers does close. Would we expect to see a margin similar to what you were able to achieve last year with the large sale in Q4?

Brian Hanson - Ion Geophysical Corp - President, COO & CFO

You know, Daniel, I don't have the margins for last year in front of me. I can tell you in general, the third quarter is purely mix issue. And so -- and as you know, it can move around, depending on what that mix looks like. But I really can't comment on the margin in the fourth quarter other than to say that we would expect to have, on a margin rate basis, some drag on it because that is a large ticket system that's going through.

Daniel Burke - Johnson Rice & Co - Analyst

Okay. Great. All right. Thank you guys for the time.



Nov 03, 2011 / 02:00PM GMT, IO - Q3 2011 ION Geophysical Corp Earnings Conference Call

Operator

Thank you. (Operator Instructions) One moment, please, for our next question. And I show no further questions in the queue at this time. I'd like to turn the conference back to Management.

Bob Peebler - Ion Geophysical Corp - CEO

Okay, well, thank you for taking the time to attend the conference call. We look forward to talking to you during our fourth quarter call.

Operator

Ladies and gentlemen, this concludes the ION Geophysical third quarter earnings conference call. Thank you for your participation. You may now disconnect.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

© 2011 Thomson Reuters. All Rights Reserved.