OCEANEERING INTERNATIONAL INC
Form 10-Q
November 05, 2008

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

(Mark One)

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

For the quarterly period ended September 30, 2008

OR

o **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, 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 þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company 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 October 31, 2008 was 54,475,444.

Oceaneering International, Inc.
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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	Sept. 30, 2008	Dec. 31, 2007
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 25,128	$ 27,110
Accounts receivable, net of allowances for doubtful accounts of $1,117 and $1,024	446,416	370,612
Inventory and other current assets	318,245	272,847
Total current assets	789,789	670,569
Property and Equipment, at cost	1,366,386	1,247,262
Less accumulated depreciation	660,902	609,155
Net property and equipment	705,484	638,107
Other Assets:		
Goodwill	133,677	111,951
Investments in unconsolidated affiliates	64,560	64,655
Other	43,201	46,158
Total other assets	241,438	222,764
TOTAL ASSETS	$ 1,736,711	$ 1,531,440
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 90,897	$ 76,841
Accrued liabilities	224,788	235,748
Income taxes payable	32,078	26,386
Total current liabilities	347,763	338,975
Long-term Debt	303,000	200,000
Other Long-term Liabilities	104,639	77,155
Commitments and Contingencies		

Shareholders Equity	981,309	915,310
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 1,736,711	$ 1,531,440

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

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

	For the Three Months Ended Sept. 30,		For the Nine Months Ended Sept. 30,	
	2008	2007	2008	2007
Revenue	$ 515,795	$ 485,424	$ 1,451,730	$ 1,261,469
Cost of Services and Products	388,199	367,911	1,107,178	958,344
Gross margin	127,596	117,513	344,552	303,125
Selling, General and Administrative Expense	37,899	31,908	108,620	87,686
Income from operations	89,697	85,605	235,932	215,439
Interest Income	304	316	512	568
Interest Expense, net of amounts capitalized	(3,070)	(4,400)	(9,882)	(11,502)
Equity Earnings of Unconsolidated Affiliates	444	1,022	1,897	3,263
Other Expense, Net	(2,887)	(69)	(276)	(242)
Income before income taxes	84,488	82,474	228,183	207,526
Provision for Income Taxes	29,513	28,621	79,806	72,634
Net Income	$ 54,975	$ 53,853	$ 148,377	$ 134,892
Basic Earnings per Share	$ 1.00	$ 0.98	$ 2.69	$ 2.47
Diluted Earnings per Share	$ 0.99	$ 0.96	$ 2.65	$ 2.42
Weighted average number of common shares	55,087	54,979	55,108	54,689
Incremental shares from stock equivalents	707	842	839	995
Weighted average number of common shares and equivalents	55,794	55,821	55,947	55,684

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 Nine Months Ended Sept. 30,	
	2008	2007
Cash Flows from Operating Activities:		
Net income	$ 148,377	$ 134,892
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	82,007	68,666
Gain on sales of property and equipment	(5,171)	(4,198)
Noncash compensation	6,001	4,087
Undistributed earnings of unconsolidated affiliates	95	(18)
Excluding the effects of acquisitions, increase (decrease) in cash from:		
Accounts receivable	(71,600)	(100,327)
Inventory and other current assets	(45,398)	(95,973)
Other assets	3,349	2,511
Currency translation effect on working capital	(16,147)	8,949
Current liabilities	5,185	88,146
Other long-term liabilities	27,594	2,670
Total adjustments to net income	(14,085)	(25,487)
Net Cash Provided by Operating Activities	134,292	109,405
Cash Flows from Investing Activities:		
Business acquisitions, less cash acquired	(42,976)	(25,116)
Purchases of property and equipment	(155,451)	(151,585)
Proceeds on sales of property and equipment	5,586	5,222
Net Cash Used in Investing Activities	(192,841)	(171,479)
Cash Flows from Financing Activities:		
Net proceeds from revolving credit, net of expenses	123,000	88,561
Payments of 6.72% Senior Notes	(20,000)	(20,000)
Proceeds from issuance of common stock	1,726	5,118
Excess tax benefits from stock-based compensation	6,770	5,669
Purchases of treasury stock	(54,929)	

Net Cash Provided by Financing Activities	56,567	79,348
Net Increase (Decrease) in Cash and Cash Equivalents	(1,982)	17,274
Cash and Cash Equivalents Beginning of Period	27,110	26,228
Cash and Cash Equivalents End of Period	$ 25,128	$ 43,502

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 accounting principles generally accepted in the United States. These financial statements reflect all adjustments that we believe are necessary to present fairly our financial position at September 30, 2008 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, 2007. 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.

Certain amounts from prior periods have been reclassified to conform to the current year presentation.

2. Investments in Unconsolidated Affiliates

Our investments in unconsolidated affiliates consisted of the following:

	Sept. 30, 2008	Dec. 31, 2007
	(in thousands)	
Medusa Spar LLC	$ 63,097	$ 63,183
Other	1,463	1,472
Total	$ 64,560	$ 64,655

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). 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. Medusa Spar LLC prepaid the remaining debt during the quarter ended June 30, 2008. 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 No. (FIN) 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.

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The following are condensed 100% statements of income of Medusa Spar LLC:

	For the Three Months Ended Sept. 30,		For the Nine Months Ended Sept. 30,	
	2008	2007	2008	2007
	(in thousands)			
Medusa Spar LLC				
Condensed Statements of Income				
Revenue	$ 3,303	$ 4,381	$ 11,997	$ 14,538
Depreciation	(2,369)	(2,369)	(7,108)	(7,108)
General and administrative	(17)	(63)	(100)	(96)
Interest		(347)	(833)	(1,131)
Net Income	$ 917	$ 1,602	$ 3,956	$ 6,203
Equity Earnings reflected in our financial statements	$ 444	$ 771	$ 1,872	$ 3,012

Interest on Medusa Spar LLC s condensed statements of income for the nine-month period ended September 30, 2008 includes $284,000 of expense from the write off of unamortized loan costs and the unwinding of a hedge recognized upon the prepayment of debt during the second quarter of 2008.

3. Inventory and Other Current Assets

Our inventory and other current assets consisted of the following:

	Sept. 30, 2008	Dec. 31, 2007
	(in thousands)	
Inventory of parts for remotely operated vehicles	$ 106,352	$ 84,467
Other inventory, primarily raw materials	144,595	140,943
Income taxes, primarily deferred	30,591	13,576
Other	36,707	33,861
Total	$ 318,245	$ 272,847

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:

	Sept. 30, 2008	Dec. 31, 2007
	(in thousands)	
6.72% Senior Notes	$ 40,000	$ 60,000
Revolving credit facility	263,000	140,000
Total	$ 303,000	$ 200,000

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Scheduled maturities of our long-term debt as of September 30, 2008 were as follows:

	6.72% Notes	Revolving Credit	Total
		(in thousands)	
Remainder of 2008	$	$	$
2009	20,000		20,000
2010	20,000		20,000
2011			
2012		263,000	263,000
Total	$ 40,000	$ 263,000	$ 303,000

Maturities through September 30, 2009 are not classified as current as of September 30, 2008 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 $3,000 and $247,000 in the three-month periods ended September 30, 2008 and 2007, respectively, and $17,000 and $765,000 in the nine-month periods ended September 30, 2008 and 2007, respectively, as part of construction-in-progress.

We have interest rate hedges in place on $100 million of floating rate debt under our revolving credit facility for the period August 2008 to August 2011. The hedges fix three-month LIBOR at 3.07% until August 2009 and at 3.31% for the period August 2009 to August 2011.

In September 2008, we signed a one-year, unsecured term loan agreement providing for borrowings of up to $85 million. In October 2008, we borrowed the $85 million and used the proceeds to repay borrowings under our revolving credit facility.

5. Shareholders Equity and Comprehensive Income

Our shareholders equity consisted of the following:

	Sept. 30, 2008	Dec. 31, 2007
	(in thousands)	
Common Stock, par value $0.25; 180,000,000 shares authorized; 55,417,044 and 55,075,238 shares issued	$ 13,854	$ 13,769
Treasury Stock, 941,600 in 2008, at cost	(52,419)	
Additional paid-in capital	222,290	210,388
Retained earnings	799,681	651,304
Other comprehensive income	(2,097)	39,849
Total	$ 981,309	$ 915,310

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 Sept. 30,		For the Nine Months Ended Sept. 30,	
	2008	2007	2008	2007
		(in thousands)		
Net Income per consolidated statements of income	$ 54,975	$ 53,853	$ 148,377	$ 134,892

Foreign currency translation gains (losses), net	(49,688)	14,986	(41,167)	24,334
Change in pension liability adjustment, net of tax	1,043		(574)	15
Change in fair value of hedges, net of tax	(129)	(112)	(205)	(186)
Total	$ 6,201	$ 68,727	$ 106,431	$ 159,055

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

	Sept. 30, 2008	Dec. 31, 2007
	(in thousands)	
Accumulated net foreign currency translation adjustments	$ 1,417	$ 42,584
Pension liability adjustment	(3,385)	(2,811)
Fair value of hedges	(129)	76
Total	$ (2,097)	$ 39,849

6. Income Taxes

During interim periods, we provide for income taxes at our estimated effective tax rate, currently 35%, 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.

The financial statement recognition of the benefit for a tax position depends on 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 to be 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 $0.4 million and $0.4 million in the nine-month periods ended September 30, 2008 and 2007, respectively, for penalties and interest taken on our financial statements on uncertain tax positions. Our total liabilities for penalties and interest on uncertain tax positions were $3.2 million on our balance sheet at September 30, 2008. Including penalties and interest, we have accrued a total of $6.2 million in the caption other long-term liabilities on our September 30, 2008 balance sheet for unrecognized tax benefits. All additions or reductions to those liabilities affect our effective income tax rate in the periods of change.

We do not believe that the total of unrecognized tax benefits will significantly increase or decrease in the next 12 months. Since December 31, 2007, there has been no change to the earliest tax years open to examination by tax authorities where we have significant operations.

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 ultimately will 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 units, performance units and bonuses, as well as other general expenses.

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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, 2007. The following summarizes certain financial data by business segment:

	For the Three Months Ended			For the Nine Months Ended	
	Sept. 30, 2008	Sept. 30, 2007	June 30, 2008	Sept. 30, 2008	Sept. 30, 2007
			(in thousands)		
Revenue					
Oil and Gas					
ROVs	$ 161,710	$ 141,887	$ 159,229	$ 465,668	$ 385,436
Subsea Products	176,086	145,186	164,124	478,728	367,368
Subsea Projects	59,801	82,989	58,790	166,205	184,664
Inspection	65,336	58,182	67,969	192,856	161,019
Mobile Offshore					
Production Systems	9,687	13,366			