OCEANEERING INTERNATIONAL INC
Form 10-Q
May 09, 2006

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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 March 31, 2006

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, 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 Act). Yes o, No þ.

The number of shares of the registrant s common stock outstanding as of May 2, 2006 was 26,878,194.

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)

	March 31, 2006	Dec. 31, 2005
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 39,386	$ 26,308
Accounts receivable, net of allowances for doubtful accounts of $112 and $112	276,095	269,497
Inventory and other	119,106	98,428
Total Current Assets	434,587	394,233
Property and Equipment, at cost	888,240	842,258
Less: Accumulated Depreciation	451,078	433,057
Net Property and Equipment	437,162	409,201
Goodwill	85,113	84,608
Investments in Unconsolidated Affiliates	63,807	61,598
Other	41,297	39,928
TOTAL ASSETS	$ 1,061,966	$ 989,568
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 84,857	$ 64,306
Accrued liabilities	143,336	142,168
Income taxes payable	24,531	16,193
Total Current Liabilities	252,724	222,667
Long-term Debt	180,000	174,000
Other Long-term Liabilities	60,747	56,783
Commitments and Contingencies		
Shareholders Equity	568,495	536,118
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 1,061,966	$ 989,568

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 March 31, 2006	2005
Revenue	$ 289,509	$ 210,737
Cost of Services and Products	229,192	177,534
Gross Margin	60,317	33,203
Selling, General and Administrative Expense	22,353	18,710
Income from Operations	37,964	14,493
Interest Income	68	61
Interest Expense, net of amounts capitalized	(2,791)	(2,194)
Equity Earnings of Unconsolidated Affiliates	4,354	4,092
Other Income (Expense), net	5	(30)
Income before Income Taxes	39,600	16,422
Provision for Income Taxes	14,098	5,830
Net Income	$ 25,502	$ 10,592
Basic Earnings per Share	$ 0.95	$ 0.41
Diluted Earnings per Share	$ 0.93	$ 0.40
Weighted Average Number of Common Shares	26,773	25,754
Incremental Shares from Stock Options and Restricted Stock	615	756
Weighted Average Number of Common Shares and Equivalents	27,388	26,510

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 Three Months Ended March 31, 2006	2005
Cash Flows from Operating Activities:		
Net income	$ 25,502	$ 10,592
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	19,595	18,229
Noncash compensation and other	2,858	939
Undistributed earnings of unconsolidated affiliates	(2,209)	(3,859)
Increase (decrease) in cash from:		
Accounts receivable	(6,598)	(150)
Inventory and other current assets	(20,678)	(5,252)
Other assets	(2,230)	207
Current liabilities	30,556	3,882
Other long-term liabilities	3,964	(1,337)
Total adjustments to net income	25,258	12,659
Net Cash Provided by Operating Activities	50,760	23,251
Cash Flows from Investing Activities:		
Business acquisitions, net of cash acquired		208
Purchases of property and equipment and other	(45,508)	(19,930)
Net Cash Used in Investing Activities	(45,508)	(19,722)
Cash Flows from Financing Activities:		
Net proceeds of revolving credit and other long-term debt	6,000	5,709
Proceeds from issuance of common stock	1,327	3,051
Excess tax benefits from stock option exercises	499	567
Net Cash Provided by Financing Activities	7,826	9,327
Net Increase in Cash and Cash Equivalents	13,078	12,856

Cash and Cash Equivalents	Beginning of Period		26,308		16,781
Cash and Cash Equivalents	End of Period	$	39,386	$	29,637

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 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 March 31, 2006 and our results of operations and cash flows for the periods presented. All such adjustments are of a normal and recurring nature. The 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, 2005. The results for interim periods are not necessarily indicative of annual results.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires us to 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.

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized over their service (vesting) periods in the income statement based on their estimated fair values. SFAS 123R became effective for most U.S. public companies, including us, on January 1, 2006. This statement applies to all awards granted after the required effective date and to awards modified, repurchased or canceled after that date, as well as the unvested portion of awards granted prior to the effective date of SFAS 123R. We have adopted the modified prospective transition method to apply SFAS 123R. Under this transition method, we recognized compensation costs relative to:

- stock options, restricted stock and restricted stock units granted, but not yet vested, prior to January 1, 2006 based on the grant-date fair value estimated in accordance with SFAS 123, *Accounting for Stock-Based Compensation* ; and

- restricted stock units granted in 2006 representing 116,000 shares.

We have not restated results for prior periods.

Our restricted stock and restricted stock unit awards granted before January 1, 2006 were subject to market conditions. These market conditions were met before January 1, 2006. All of our share-based compensation awards are and have been subject to service conditions. Information relative to the number of awards outstanding and their weighted average exercise price is in Note 8 to the consolidated financial statements included in our in our Annual Report on Form 10-K for the year ended December 31, 2005. During the quarter ended March 31, 2006, holders exercised 65,175 stock options with an estimated intrinsic value at the time of exercise of $1.8 million. During the quarter ended March 31, 2006, we granted 116,000 restricted stock units, and our common stock price on the date of the grants was $57.33.

Under the provisions of SFAS 123R, our stock-based compensation expense for the three months ended March 31, 2006 was $926,000, of which $816,000 related to outstanding restricted stock and restricted stock unit grants and $110,000 related to unvested outstanding stock option grants. Expenses related to tax-assistance liabilities were $2,218,000 and $700,000 for the periods ended March 31, 2006 and 2005, respectively, under restricted stock and restricted stock units granted prior to January 1, 2006. The restricted stock units granted in 2006 do not contain tax-assistance provisions. We estimate that stock-based compensation cost not yet recognized related to restricted stock and restricted stock unit grants, based on their grant-date fair value, was $9.3 million at March 31, 2006. This expense is being recognized on a staged-vesting basis over the next four years. Stock-based compensation expense not yet recognized pursuant to stock option grants as of March 31, 2006, based on the grant-date fair value, was $227,000, substantially all of which will be recognized on a straight-line basis by the end of 2006.

In light of the new accounting principles established by SFAS 123R, the Compensation Committee of our Board of Directors has expressed its intention to refrain from using stock options as a component of employee compensation for our executive officers and other employees for the foreseeable future, and the Board has expressed its intention to refrain from using stock options as a component of nonemployee director compensation for the foreseeable future.

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Before January 1, 2006, we used the intrinsic value method of accounting established by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, (APB 25) to account for our stock-based compensation programs. Accordingly, we did not recognize any compensation expense when the exercise price of an employee stock option was equal to the market price per share of our common stock on the grant date. The unvested portion of existing option grants caused us to recognize $110,000 more stock-based compensation expense for the quarter ended March 31, 2006 than we would have recognized under APB 25. The following illustrates the pro forma effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS 123R to the three-month period ended March 31, 2005 (in thousands, except per share amounts):

Net Income:		
As reported	$	10,592
Employee stock-based compensation included in net income, net of income tax benefit		1,045
Pro forma compensation expense determined under fair value methods for all awards, net of income tax benefit		(2,025)
Pro forma	$	9,612
Reported earnings per common share:		
Basic	$	0.41
Diluted	$	0.40
Pro forma earnings per common share:		
Basic	$	0.37
Diluted	$	0.36

For purposes of these pro forma disclosures, we estimated the fair value of each option grant as of the date of grant using a Black-Scholes option pricing model. The estimated fair value of the options was amortized to pro forma expense over the expected average lives of the options. We believe the pro forma expense for the three-month period ended March 31, 2005 provides a reasonable approximation of the stock-based compensation expense that would have been recorded in our consolidated statements of income under SFAS 123R.

2. Investments in Unconsolidated Affiliates

Our investments in unconsolidated affiliates consisted of the following:

	March 31, 2006	Dec. 31, 2005
	(in thousands)	
Medusa Spar LLC	$ 59,741	$ 57,440
Smit-Oceaneering Cable Systems LLC	2,719	2,811
Other	1,347	1,347
Total	$ 63,807	$ 61,598

We own a 50% equity interest in Medusa Spar LLC. Medusa Spar LLC owns a 75% interest in a production spar platform, which is currently located at the site of the Medusa field 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 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 current carrying value of $59.7 million. Medusa Spar LLC is a variable interest entity. As we are not the primary

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beneficiary under FASB Interpretation Number 46, *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 operations of Medusa Spar LLC.

	For the Three Months Ended March 31,	
	2006	2005
	(in thousands)	
Medusa Spar LLC		
Condensed Statements of Operations		
Revenue	$ 11,033	$ 11,133
Depreciation	(2,369)	(2,369)
General and administrative	(16)	(16)
Interest	(491)	(652)
Net Income	$ 8,157	$ 8,096
Equity earnings reflected in our financial statements	$ 4,034	$ 4,009

3. Inventory and Other Current Assets

Our inventory and other current assets consisted of the following:

	March 31, 2006	Dec. 31, 2005
	(in thousands)	
Inventory of spare parts for remotely operated vehicles	$ 43,355	$ 38,981
Other inventory, primarily raw materials	53,498	39,924
Deferred taxes	11,486	9,091
Other	10,767	10,432
Total	$ 119,106	$ 98,428

Inventory is stated 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:

	March 31, 2006	Dec. 31, 2005
	(in thousands)	
6.72% Senior Notes	$ 100,000	$ 100,000
Revolving credit facility	80,000	74,000
Total	$ 180,000	$ 174,000

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Scheduled maturities of our long-term debt as of March 31, 2006 were as follows:

	6.72% Notes	Revolving Credit	Total
		(in thousands)	
Remainder of 2006	$ 20,000	$	$ 20,000
2007	20,000		20,000
2008	20,000	80,000	100,000
2009	20,000		20,000
2010	20,000		20,000
Thereafter			
Total	$ 100,000	$ 80,000	$ 180,000

Maturities through March 31, 2007 are not classified as current as of March 31, 2006, since we can extend the maturity by reborrowing under the revolving credit facility with a maturity date after one year. We capitalized interest charges of $47,000 in the three-month period ended March 31, 2006, as part of construction-in-progress.

5. Shareholders Equity and Comprehensive Income

Our shareholders equity consisted of the following:

	March 31, 2006	Dec. 31, 2005
	(in thousands)	
Common Stock, par value $0.25; 90,000,000 shares authorized; 26,859,869 and 26,779,444 shares issued	$ 6,715	$ 6,695
Additional paid-in capital	182,472	179,132
Retained earnings	373,532	348,031
Other comprehensive income	5,776	2,260
Total	$ 568,495	$ 536,118

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 March 31,	
	2006	2005
	(in thousands)	
Net Income per Consolidated Statements of Income	$ 25,502	$ 10,592
Foreign Currency Translation Gains (Losses)	2,904	(4,123)
Change in Minimum Pension Liability Adjustment, net of tax	566	627
Change in Fair Value of Hedge, net of tax	46	531
Total	$ 29,018	$ 7,627

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

	March 31, 2006	Dec. 31, 2005
	(in thousands)	
Accumulated Net Foreign Currency Translation Adjustments	$ 7,195	$ 4,291
Minimum Pension Liability Adjustment	(1,983)	(2,549)
Fair Value of Hedge	564	518
Total	$ 5,776	$ 2,260

6. Income Taxes

During interim periods, we provide for income taxes at our estimated annual effective tax rate, currently 35.6% for 2006, 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.

We paid cash taxes of $4.7 million and $6.2 million for the three-month periods ended March 31, 2006 and 2005, respectively.

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; Mobile Offshore Production Systems; and Inspection. Our Advanced Technologies business is a separate segment that provides project management, engineering services 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, 2005. The following summarizes certain financial data by business segment:

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	For the Three Months Ended		
	March 31, 2006	March 31, 2005	Dec. 31, 2005
		(in thousands)	
Revenue			
Oil and Gas			
ROVs	$ 88,947	$ 67,616	$ 86,206
Subsea Products	84,518	40,678	83,893
Subsea Projects	41,120	24,478	43,663
Mobile Offshore Production Systems	13,332	11,363	13,083
Inspection	33,423	36,932	34,490
Total Oil and Gas	261,340	181,067	261,335
Advanced Technologies	28,169	29,670	27,390
Total	$ 289,509	$ 210,737	$ 288,725
Gross Margins			
Oil and Gas			
ROVs	$ 26,584	$ 16,715	$ 18,715
Subsea Products	18,790	2,559	18,245
Subsea Projects	13,330	4,950	13,612
Mobile Offshore Production Systems	4,202	4,348	5,100
Inspection	5,361	4,436	4,077
Total Oil and Gas	68,267	33,008	59,749
Advanced Technologies	3,539	5,914	3,727
Unallocated Expenses	(11,489)	(5,719)	(7,300)
Total	$ 60,317	$ 33,203	$ 56,176
Income from Operations			
Oil and Gas			
ROVs	$ 22,205	$ 13,081	$ 14,319
Subsea Products	12,561	(2,143)	11,636
Subsea Projects			