ION GEOPHYSICAL CORP
Form 10-Q
May 01, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2013
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	22-2286646
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2105 CityWest Blvd. Suite 400 Houston, Texas	77042-2839
(Address of principal executive offices)	(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: ý 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 ý 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	ý	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: ¨ No: ý
At April 23, 2013, there were 156,851,390 shares of common stock, par value $0.01 per share, outstanding.

1

Table of Contents

ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
TABLE OF CONTENTS FOR FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2013

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	March 31, 2013	December 31, 2012
	(In thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 66,575	$ 60,971
Accounts receivable, net	91,034	127,136
Unbilled receivables	77,846	89,784
Inventories	68,083	70,675
Prepaid expenses and other current assets	23,527	25,605
Total current assets	327,065	374,171
Deferred income tax asset	34,503	28,414
Property, plant, equipment and seismic rental equipment, net	34,153	33,772
Multi-client data library, net	224,993	230,315
Equity method investments	76,518	73,925
Goodwill	53,753	55,349
Intangible assets, net	13,817	14,841
Other assets	17,602	9,796
Total assets	$ 782,404	$ 820,583
LIABILITIES AND EQUITY		
Current liabilities:		
Current maturities of long-term debt	$ 3,402	$ 3,496
Accounts payable	33,499	28,688
Accrued expenses	92,252	124,095
Accrued multi-client data library royalties	22,223	26,300
Deferred revenue	19,631	26,899
Total current liabilities	171,007	209,478
Long-term debt, net of current maturities	101,057	101,832
Other long-term liabilities	8,813	8,131
Total liabilities	280,877	319,441
Redeemable noncontrolling interest	2,151	2,123
Equity:		
Cumulative convertible preferred stock	27,000	27,000
Common stock, $0.01 par value; authorized 200,000,000 shares; outstanding 156,665,553 and 156,356,949 shares at March 31, 2013 and December 31, 2012, respectively, net of treasury stock	1,567	1,564
Additional paid-in capital	850,832	848,669
Accumulated deficit	(358,422)	(360,297)
Accumulated other comprehensive loss	(15,542)	(11,886)
Treasury stock, at cost, 849,539 shares at both March 31, 2013 and December 31, 2012	(6,565)	(6,565)
Total stockholders’ equity	498,870	498,485
Noncontrolling interests	506	534
Total equity	499,376	499,019

Total liabilities and equity	$ 782,404	$ 820,583

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

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

	Three Months Ended March 31,	
	2013	2012
	(In thousands, except per share data)	
Service revenues	$89,949	$66,634
Product revenues	39,788	45,076
Total net revenues	129,737	111,710
Cost of services	69,273	47,406
Cost of products	25,507	23,148
Gross profit	34,957	41,156
Operating expenses:		
Research, development and engineering	9,290	7,726
Marketing and sales	7,980	7,417
General, administrative and other operating expenses	15,764	14,370
Total operating expenses	33,034	29,513
Income from operations	1,923	11,643
Interest expense, net	(1,066)	(1,518)
Equity in earnings of investments	1,116	2,468
Other income (expense)	1,027	(686)
Income before income taxes	3,000	11,907
Income tax expense	1,201	3,445
Net income	1,799	8,462
Net income attributable to noncontrolling interest	76	113
Net income attributable to ION	1,875	8,575
Preferred stock dividends	338	338
Net income applicable to common shares	$1,537	$8,237
Net income per share:		
Basic	$0.01	$0.05
Diluted	$0.01	$0.05
Weighted average number of common shares outstanding:		
Basic	156,465	155,543
Diluted	157,315	156,547

Table of Contents

ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(UNAUDITED)

	Three Months Ended March 31,	
	2013	2012
	(In thousands)	
Net income	$1,799	$8,462
Other comprehensive income (loss), net of taxes, as appropriate:		
Foreign currency translation adjustments	(3,641)	1,767
Equity interest in investees' other comprehensive income (loss)	(23)	348
Unrealized income (loss) on available-for-sale securities	(68)	962
Other changes in other comprehensive income	76	7
Total other comprehensive income (loss), net of taxes	(3,656)	3,084
Comprehensive net income (loss)	(1,857)	11,546
Comprehensive income attributable to noncontrolling interest	76	113
Comprehensive net income (loss) attributable to ION	$(1,781)	$11,659

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

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

	Three Months Ended March 31, 2013	2012
	(In thousands)	
Cash flows from operating activities:		
Net income	$1,799	$8,462
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization (other than multi-client data library)	4,200	3,090
Amortization of multi-client data library	18,592	22,620
Stock-based compensation expense	2,011	1,484
Equity in earnings of investments	(1,116)	(2,468)
Deferred income taxes	(6,150)	(1,063)
Change in operating assets and liabilities:		
Accounts receivable	35,307	61,018
Unbilled receivables	11,938	(23,016)
Inventories	1,381	965
Accounts payable, accrued expenses and accrued royalties	(28,686)	(13,025)
Deferred revenue	(7,153)	(4,736)
Other assets and liabilities	2,155	(1,491)
Net cash provided by operating activities	34,278	51,840
Cash flows from investing activities:		
Investment in multi-client data library	(13,270)	(24,527)
Purchase of property, plant and equipment	(3,969)	(1,768)
Investment in and advances to GeoRXT	(9,500)	—
Maturity of short-term investments	—	20,000
Investment in convertible notes	(1,000)	—
Other investing activities	76	—
Net cash used in investing activities	(27,663)	(6,295)
Cash flows from financing activities:		
Payments on long-term debt	(848)	(1,431)
Payment of preferred dividends	(338)	(338)
Proceeds from exercise of stock options	716	249
Other financing activities	350	453
Net cash used in financing activities	(120)	(1,067)
Effect of change in foreign currency exchange rates on cash and cash equivalents	(891)	216
Net increase in cash and cash equivalents	5,604	44,694
Cash and cash equivalents at beginning of period	60,971	42,402
Cash and cash equivalents at end of period	$66,575	$87,096

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

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, 2012 has been derived from the Company’s audited consolidated financial statements at that date. The condensed consolidated balance sheet at March 31, 2013, and the condensed consolidated statements of operations, comprehensive income (loss) and cash flows for the three months ended March 31, 2013 and 2012, 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 months ended March 31, 2013 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, 2012 and Amendment No. 1 thereto on Form 10-K/A, which was filed on April 17, 2013 and contains the separate consolidated financial statements of INOVA Geophysical Equipment Limited (“INOVA Geophysical”) for the fiscal year ended December 31, 2012.

(2) Segment Information

The Company operates through three business segments – Solutions, Systems and Software – as well as through the Company’s INOVA Geophysical joint venture. The Company measures segment operating results based on income from operations. See Note 3 “Equity Method Investments” for the summarized financial information for INOVA Geophysical.

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

	Three Months Ended March 31, 2013	2012
Net revenues:		
Solutions:		
New Venture	$48,436	$28,994
Data Library	9,448	10,268
Total multi-client revenues	57,884	39,262
Data Processing	31,286	26,865
Total	$89,170	$66,127
Systems:		
Towed Streamer	$13,549	$15,804
Ocean Bottom	6,765	3,519
Other	11,533	17,383
Total	$31,847	$36,706
Software:		
Software Systems	$7,941	$8,370
Services	779	507
Total	$8,720	$8,877
Total	$129,737	$111,710

Gross profit:		
Solutions	$20,197	$18,985
Systems	8,380	15,812
Software	6,380	6,359
Total	$34,957	$41,156
Gross margin:		
Solutions	23 %	29 %
Systems	26 %	43 %
Software	73 %	72 %
Total	27 %	37 %
Income from operations:		
Solutions	$7,357	$9,606
Systems	934	8,740
Software	5,161	5,482
Corporate and other	(11,529)	(12,185)
Income from operations	1,923	11,643
Interest expense, net	(1,066)	(1,518)
Equity in earnings of investments	1,116	2,468
Other income (expense)	1,027	(686)
Income before income taxes	$3,000	$11,907

(3) Equity Method Investments

The following table reflects the change in our equity method investments during the three months ended March 31, 2013 (in thousands):

	INOVA Geophysical	GeoRXT	Total
Investment at December 31, 2012	$73,925	$—	$73,925
Investment in equity	—	1,500	1,500
Equity in earnings (losses) of investments	1,851	(735)	1,116
Equity interest in investees' other comprehensive income (loss)	(23)	—	(23)
Investments at March 31, 2013	$75,753	$765	$76,518

In late February 2013, the Company purchased from Reservoir Exploration Technology ASA its 30% interest in a joint venture entity, GeoRXT B.V. (“GeoRXT”), for $1.5 million. GeoRXT is headquartered in Rio de Janeiro, Brazil, and specializes in seismic acquisition operations using ocean-bottom cables deployed from vessels leased by GeoRXT. The Company has an option, exercisable at any time on or prior to May 15, 2013, to increase its ownership percentage to 50% by making additional capital contributions to GeoRXT of $40.0 million. Additionally, the Company provided GeoRXT with an $8.0 million working capital loan, the repayment of which is guaranteed by GeoRXT’s majority joint venture partner, Georadar Levantamentos Geofisicos S/A (“Georadar”). GeoRXT is obligated to repay this loan to the Company on or before May 25, 2013. However, the Company currently expects to exercise its option to increase its ownership interest in GeoRXT to 50%, of which part of the required capital contribution will be funded through the conversion of this loan into additional equity. Therefore, this loan has been classified within long-term other assets. The Company accounts for its interest in GeoRXT on a current basis; its share of losses in GeoRXT for March 2013 was $(0.7) million.

The Company accounts for its 49% interest in INOVA Geophysical as an equity method investment and records its share of earnings and losses of INOVA Geophysical on a one fiscal quarter lag basis. The following table reflects the summarized financial information for INOVA Geophysical for the three-month periods ended December 31, 2012 and 2011 (in thousands):

Table of Contents

	Three Months Ended December 31,	
	2012	2011
Net revenues	$59,611	$58,998
Gross profit	$12,327	$13,964
Income (loss) from operations	$(250)	$6,509
Net income	$3,742	$5,717

(4) Inventories

A summary of inventories is as follows (in thousands):	March 31, 2013	December 31, 2012
Raw materials and subassemblies	$47,709	$49,421
Work-in-process	7,976	8,613
Finished goods	26,672	26,880
Reserve for excess and obsolete inventories	(14,274)	(14,239)
Total	$68,083	$70,675

(5) Net Income per Share

Basic net income per common share is computed by dividing net income applicable to common shares by the weighted average number of common shares outstanding during the period. Diluted net income per common share is determined based on the assumption that dilutive restricted stock and restricted stock unit awards have vested and outstanding dilutive stock options have been exercised and the aggregate proceeds were used to reacquire common stock using the average price of such common stock for the period. The total number of shares issued or reserved for future issuance under outstanding stock options at March 31, 2013 and 2012 was 7,717,937 and 6,832,575, respectively, and the total number of shares of restricted stock and shares reserved for restricted stock units outstanding at March 31, 2013 and 2012 was 1,034,280 and 1,168,001, respectively.

As of March 31, 2013, there are 27,000 outstanding shares of the Company's Series D Cumulative Convertible Preferred Stock ("Series D Preferred Stock"), which may currently be converted, at the holder's election, into up to 6,065,075 shares of the Company's common stock. The outstanding shares of Series D Preferred Stock were anti-dilutive for all periods presented.

The following table summarizes the computation of basic and diluted net income per common share (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2013	2012
Net income applicable to common shares	$1,537	$8,237
Weighted average number of common shares outstanding	156,465	155,543
Effect of dilutive stock awards	850	1,004
Weighted average number of diluted common shares outstanding	157,315	156,547
Basic net income per share	$0.01	$0.05
Diluted net income per share	$0.01	$0.05

(6) Long-term Debt

Obligations (in thousands)	March 31, 2013	December 31, 2012
Revolving line of credit	$97,250	$97,250
Facility lease obligation	2,139	2,334
Equipment capital leases	5,070	5,744
Total	104,459	105,328
Current portion of long-term debt and lease obligations	(3,402)	(3,496)
Non-current portion of long-term debt and lease obligations	$101,057	$101,832

Table of Contents

Revolving Line of Credit

On May 29, 2012, the Company amended the terms of its senior secured credit facility (the “Credit Facility”) with China Merchants Bank Co., Ltd., New York Branch, as administrative agent and lender (“CMB”). The First Amendment to the Credit Agreement and Loan Documents (the “First Amendment”) modified certain provisions of the Company’s senior credit agreement with CMB that it had entered into on March 25, 2010. The maturity date of any outstanding debt under the Credit Facility remains March 24, 2015.

As amended by the First Amendment, the Credit Facility provides that the Company may make revolving credit borrowings in U.S. Dollars, Euros, British Pounds Sterling or Canadian Dollars up to an amount not to exceed the U.S. Dollar equivalent of $175.0 million. The Company also agreed that no additional borrowings may be made at any time at which the outstanding indebtedness under the revolving line of credit (principal, accrued interest and fees) exceeds the U.S. Dollar equivalent of $175.0 million. In addition, all then-outstanding term loan indebtedness under the Credit Facility was converted to revolving credit indebtedness, such that as of May 29, 2012, there was $98.3 million in total revolving credit indebtedness outstanding under the Credit Facility. The First Amendment eliminated sub-facility limits under the Credit Facility.

The Company’s obligations under the Credit Facility continue to be guaranteed by certain of its material U.S. subsidiaries that remain as parties to the Credit Facility. In addition, INOVA Geophysical continues to provide a bank stand-by letter of credit as credit support for the Company’s obligations under the Credit Facility. The Company also entered into a credit support agreement with INOVA Geophysical whereby the Company has agreed to indemnify INOVA Geophysical for any and all losses sustained by INOVA Geophysical that arise out of or are a result of the enforcement of INOVA Geophysical’s guarantee.

As amended by the First Amendment, the interest rates per annum on borrowings under the Credit Facility are, at the Company’s option:

- an alternate base rate equal to the sum of (i) the greatest of (a) the prime rate of CMB, (b) a federal funds effective rate plus 0.50%, or (c) an adjusted LIBOR-based rate plus 1.0%, and (ii) an applicable interest margin of 1.4% (reduced from 2.5%); or
- for eurodollar borrowings and borrowings in Euros, Pounds Sterling or Canadian Dollars, the sum of (i) an adjusted LIBOR-based rate, and (ii) an applicable interest margin of 2.4% (reduced from 3.5%).

As of March 31, 2013, there was $97.3 million of outstanding revolving credit indebtedness under the Credit Facility that accrued interest at a rate of 2.71% per annum.

The Credit Facility contains covenants that restrict the Company, subject to certain exceptions, from:

- incurring additional indebtedness (including certain capital lease obligations), granting or incurring additional liens on the Company's properties, pledging shares of the Company's subsidiaries, entering into certain merger or other change-in-control transactions, entering into certain transactions with the Company's affiliates, making certain sales or other dispositions of assets, making certain investments, acquiring other businesses and entering into sale-leaseback transactions with respect to the Company's properties;
- paying cash dividends on the Company's common stock; and
- repurchasing and acquiring the Company's capital stock, unless there is no event of default under the Credit Facility and the amount of such repurchases does not exceed an amount equal to (i) 25% of the Company's consolidated net income for the prior fiscal year, less (ii) the amount of any cash dividends paid on the Company's common stock.

The Credit Facility requires compliance with certain financial covenants, including the following:

- maintain a minimum fixed charge coverage ratio, as defined, in an amount equal to at least 1.125 to 1;
- not exceed a maximum leverage ratio, as defined, of 3.25 to 1; and
- maintain a minimum tangible net worth of at least 60% of ION’s tangible net worth as of March 31, 2010, as defined.

The fixed charge coverage ratio is defined as the ratio of (i) the Company's consolidated EBITDA, as defined in the Credit Facility, less cash income tax expense, non-financed capital expenditures and capitalized research and development costs to (ii) the sum of scheduled payments of lease payments and payments of principal indebtedness, interest expense actually paid and cash dividends, in each case for the four consecutive fiscal quarters most recently ended. The leverage ratio is defined as the ratio of (x) total funded consolidated debt, capital lease obligations and issued letters of credit (net of cash collateral) to (y) the Company's consolidated EBITDA for the four consecutive fiscal quarters most recently ended.

The Credit Facility contains customary event of default provisions, including a “change of control” event, the occurrence of which could lead to an acceleration of the Company's obligations under the Credit Facility. The Credit Facility also pr

10

Table of Contents

ovides that certain acts of bankruptcy, insolvency or liquidation of INOVA Geophysical or BGP, Inc., China National Petroleum Corporation ("BGP") would constitute additional events of default under the Credit Facility.

As of March 31, 2013, the Company was in compliance with these financial covenants and the Company expects to remain in compliance with these financial covenants for at least the next 12 months.

(7) Income Taxes

The Company maintains a valuation allowance for a portion of its deferred tax assets that relate to U.S. capital losses or basis differences that will create capital losses as well as non-U.S net operating losses. The valuation allowance is calculated in accordance with the provisions of Accounting Series Codification ("ASC") 740 "Income Taxes," which requires that a valuation allowance be established or maintained when it is "more likely than not" that all or a portion of deferred tax assets will not be realized. In the event the Company's expectations of future operating results change, the valuation allowance may need to be adjusted upward or downward. As of March 31, 2013, the Company's unreserved U.S. deferred tax assets totaled $13.8 million. These existing unreserved deferred tax assets are currently considered to be "more likely than not" to be realized.

The Company's effective tax rates for the three months ended March 31, 2013 and 2012 were 40.0% and 28.9%, respectively. The change in the Company's effective tax rate for the three months ended March 31, 2013 was primarily due to a $1.2 million adjustment that related to prior periods, which was partially offset by discrete tax benefits totaling $(0.9) million. The adjustment primarily relates to differences in prior periods between the Company's financial statements and its tax returns, which had not been appropriately reflected in those periods. Because this adjustment was not material to either of the prior periods nor to the expected results or trend of earnings for 2013, it was recorded in the current period. The discrete tax benefits recorded in the three months ended March 31, 2013 were mainly comprised of U.S. tax benefits and credits that were extended in the American Taxpayer Relief Act of 2012, signed into law in January 2013. Excluding these amounts, the Company's effective tax rate for the three months ended March 31, 2013 would have been 28.9%.

The total amount of unrecognized tax benefits as of March 31, 2013 was $1.8 million. The Company accrues interest and penalties, if any, related to unrecognized tax benefits as a component of the Company's provision for income taxes.

The Company's U.S. federal tax returns for 2007 and subsequent years remain subject to examination by tax authorities. The Company is no longer subject to IRS examination for periods prior to 2007, although carryforward attributes that were generated prior to 2007 may still be adjusted upon examination by the IRS if they either have been or will be used in an open year. In the Company's foreign tax jurisdictions, tax returns for 2008 and subsequent years generally remain open to examination.

(8) Fair Value of Financial Instruments

The Company's financial instruments include cash and cash equivalents, accounts and unbilled receivables, notes receivable, accounts payable, accrued multi-client data library royalties, investment in two convertible notes from a privately-owned U.S.-based technology company and long-term debt. The carrying amounts of cash and cash equivalents, accounts and unbilled receivables, notes receivable, accounts payable and accrued multi-client data library royalties approximate fair value due to the highly liquid nature of these instruments.

The carrying amount of the Company's long-term debt as of March 31, 2013 and December 31, 2012 was $104.5 million and $105.3 million, respectively, compared to fair value of $104.6 million and $105.3 million as of March 31, 2013 and December 31, 2012, respectively. The fair value of the long-term debt was calculated using a market approach based upon Level 3 inputs, including an estimated interest rate reflecting current market conditions.

The following table provides additional information related to assets measured at fair value on a recurring basis at March 31, 2013 and December 31, 2012. The reference to level within the table relates to the level of inputs used to determine fair value, which the key inputs are then described below. The table is as follows (amounts in thousands):

	Level 1	Level 2	Level 3
As of March 31, 2013:			
Investment in convertible notes	$—	$—	$9,127
As of December 31, 2012:			
Investment in convertible note	—	—	8,195

Investment in Convertible Notes. In May 2011, the Company purchased a convertible note from a privately-owned U.S.-based technology company. The original principal amount of the note is $6.5 million, and it bears interest at a rate of 4% per annum. In March 2012, the Company and the investee entered into an agreement for the Company to make available to the investee a credit facility in an amount of up to $4.0 million. This credit facility originally had a term of one year with an option to extend its term by one year, which was exercised by the investee. The credit facility allows for conversion of the outstanding

Table of Contents

balance of the promissory note under the credit facility into common shares of the investee. As of March 31, 2013, the investee had drawn $3.0 million under this credit arrangement.

The Company performed a fair value analysis with respect to its investment in the convertible notes using a market approach based upon Level 3 inputs, including the terms and likelihood of an investment event and the time to conversion or repayment. As of March 31, 2013, the fair value of these investments was approximately $9.1 million, with $0.4 million of unrealized losses recorded through accumulated other comprehensive income within equity.

(9) Litigation

WesternGeco

In June 2009, WesternGeco L.L.C. (“WesternGeco”) filed a lawsuit against the Company in the United States District Court for the Southern District of Texas, Houston Division. In the lawsuit, styled WesternGeco L.L.C. v. ION Geophysical Corporation, WesternGeco alleges that the Company had infringed several method and apparatus claims contained in four of its United States patents regarding marine seismic streamer steering devices. WesternGeco sought unspecified monetary damages and an injunction prohibiting the Company from making, using, selling, offering for sale or supplying any infringing products in the United States.

In June 2009, the Company filed an answer and counterclaims against WesternGeco, in which the Company denied that it had infringed WesternGeco’s patents and asserted that the WesternGeco patents were invalid or unenforceable. The Company also asserted that WesternGeco’s Q-Marine system, components and technology infringed upon a United States patent related to marine seismic streamer steering devices. In addition, the Company claimed that the lawsuit by WesternGeco was an illegal attempt by WesternGeco to control and restrict competition in the market for marine seismic surveys performed using laterally steerable streamers. In its counterclaims, the Company requested various remedies and relief, including a declaration that the WesternGeco patents were invalid or unenforceable, an injunction prohibiting WesternGeco from making, using, selling, offering for sale or supplying any infringing products in the United States, a declaration that the WesternGeco patents should be co-owned by the Company, and an award of unspecified monetary damages.

In June 2010, WesternGeco filed a lawsuit against various subsidiaries and affiliates of Fugro N.V. (“Fugro”), one of the Company’s seismic contractor customers, accusing Fugro of infringing the same United States patents regarding marine seismic streamer steering devices by planning to use certain equipment purchased from the Company on a survey located outside of U.S. territorial waters. The court approved the consolidation of the Fugro case with the case against the Company. Fugro filed a motion to dismiss the lawsuit, and in March 2011 the presiding judge granted Fugro’s motion to dismiss in part, on the basis that the alleged activities of Fugro would occur more than 12 miles from the U.S. coast and therefore are not actionable under U.S. patent infringement law. In February 2012, the Court granted WesternGeco’s motions for summary judgment, dismissing the Company’s claims as plaintiff against WesternGeco for infringement, inventorship and inequitable conduct. In response to a Motion for Summary Judgment filed jointly by the Company and Fugro, the Court ruled in April 2012 that the Company did not directly infringe WesternGeco’s method patent claims. In a pre-trial ruling on June 29, 2012, the Court ruled that, if a particular patent claim of WesternGeco was held to be valid and enforceable at the upcoming trial, the Company’s supplying of its DigiFIN® lateral streamer control system from the United States to its customers overseas with an intention for the customers to combine DigiFIN with other required components of the patent claim, would infringe one claim in one of WesternGeco’s asserted patents, U.S. Patent No. 7,293,520.

Trial began on July 23, 2012. During the trial, Fugro settled all claims asserted against it by WesternGeco and obtained a global license from WesternGeco. A verdict was returned by the jury on August 16, 2012, finding that the Company willfully infringed the claims contained in the four patents by supplying DigiFIN from the United States and awarded WesternGeco the sum of $105.9 million in damages, consisting of $12.5 million in reasonable royalty and $93.4 million in lost profits. The Company believes that the verdict is not consistent with applicable law or the facts or evidence in the case and, in September 2012, filed motions with the trial court to overturn all or portions of the verdict.

The ultimate outcome of the case in the trial court, and the content of the final judgment as a whole, presently rests with the presiding trial court judge. The next step in the case is for the trial court judge to decide post-verdict motions filed by the parties and enter a final judgment. The final judgment will determine the result of the trial prior to appeal.

When he enters a final judgment in the case, the judge can choose to follow the jury verdict or to take other actions, such as changing to a different result or ordering an entirely new trial. As of the filing date of this Quarterly Report on Form 10-Q, the Court had not yet entered a final judgment in the case.

If the Court enters a final judgment that is adverse to the Company, the Company intends to appeal the judgment to the United States Court of Appeals for the Federal Circuit. WesternGeco would also have the right to elect to appeal any final judgment.

In rendering its verdict, the jury determined that the Company's infringement was willful. Because the jury verdict indicated willfulness, the trial court judge will determine whether, in his independent judgment, the Company willfully infringed and he should declare this case to be “exceptional.” In order for the judge to find willful infringement and whether this case is exceptional, WesternGeco must prove, by clear and convincing evidence, that the Company acted with objective recklessness and in bad faith, fraudulently or engaged in similar misconduct related to the case. If the judge finds willful infringement and declares this case to be exceptional, the judge has the discretion, but not the obligation, to enhance the damages amount, not to exceed a trebling of the final judgment damages award plus reasonable attorneys’ fees.

The Company believes that, given its understanding and judgment of applicable law and the relevant facts and evidence in this case, and after considering the advice of counsel, it is unlikely that the Company will incur any additional loss as a result of the jury’s finding of willfulness.

Based on the Company’s understanding and judgment of relevant law and the facts and merits of this case, including appellate defenses, and after considering the advice of counsel, the Company has determined it is probable that, after exhaustion of all appeals, this lawsuit will result in a loss contingency to the Company in the amount of approximately $10 million, consisting of reasonable royalty damages, interest and court costs. The Company has reserved for this loss contingency.

It is reasonably possible that the Company may not ultimately prevail in the litigation and appeals process and that the Company’s loss related to the lawsuit could exceed the amount currently accrued, up to the amount of the damages in the jury verdict plus interest and court costs, or even higher if the Court decides to enhance the damages as described above. However, the Company does not believe that a loss of this magnitude is probable. The Company’s assessment of its potential loss contingency may change in the future due to developments at the trial court or appellate court and other events, such as changes in applicable law, and such reassessment could lead to the determination that no loss contingency is probable or that a greater loss contingency is probable, which could have a material effect on the Company’s financial condition or results of operations.

As stated above, the Company intends to appeal the judgment to the United States Court of Appeals for the Federal Circuit if the trial court enters a judgment adverse to the Company. In order to appeal the judgment, the Company may be required to post an appeal bond for the full amount of damages entered in the judgment. To be prepared for a possible adverse judgment in this case, the Company has arranged with sureties to post an appeal bond on its behalf if necessary. The terms of the bond enable each surety to require the Company to post collateral with the surety at any time the bond is outstanding, for up to the full amount of the bond. Depending on the size of the bond and the level of required collateral, in order to collateralize the bond the Company might need to utilize a combination of cash on hand, undrawn balances available under the revolving line of credit and possibly incur additional debt and/or equity financing, and the collateralization of a large appeal bond could have a possible adverse effect on the Company’s liquidity. If the Company is unable to post the appeal bond, the Company may be unable to stay enforcement of the judgment or appeal the case. At this time, the Company is unable to determine whether an appeal bond would be required, the amount of such an appeal bond, or whether and to what extent the sureties may require the appeal bond to be collateralized in the future. Similarly, the Company is unable to predict the timing of the final judgment being entered by the trial court or the timing of posting any required appeal bond.

Fletcher

In November 2009, Fletcher International Ltd. (“Fletcher”), the holder of the shares of the Company’s outstanding Series D Preferred Stock until June 2012, filed a lawsuit against the Company and certain of its directors in the Delaware Court of Chancery. In the lawsuit, styled Fletcher International, Ltd. v. ION Geophysical Corporation, et al, Fletcher alleged, among other things, that the Company violated Fletcher’s consent rights contained in the Series D Preferred Stock Certificates of Designation, by (a) the execution and delivery of a convertible promissory note to the Bank of China, New York Branch by one of our subsidiaries (incorporated in Luxembourg), in connection with a bridge loan funded in October 2009 by Bank of China, and (b) a Canadian subsidiary of the Company executing and delivering several promissory notes in 2008 in connection with the Company’s acquisition of ARAM Systems Ltd., Fletcher also alleged that the Company’s directors violated their fiduciary duties by allowing the subsidiaries to deliver the notes without Fletcher’s consent. In a Memorandum Opinion issued in May 2010 in response to a motion for partial summary judgment, the judge dismissed all of Fletcher’s claims against the named Company directors but also concluded that, because the bridge loan note executed by the Company’s Luxembourg subsidiary in 2009 was convertible into the Company’s common stock, Fletcher had the right to consent to the issuance of the note and that the Company had violated Fletcher’s consent rights by that subsidiary’s issuing the note without Fletcher’s consent. In March 2011, the judge dismissed certain additional claims asserted by Fletcher. In May 2012, the judge ruled that Fletcher did not have the right to consent with respect to two promissory notes executed and delivered by the Canadian subsidiary in September 2008 in connection with the Company’s purchase of ARAM Systems Ltd., but that Fletcher did have the right to consent to the execution and delivery in December 2008 of a replacement promissory note in the principal amount of $35 million, and that the Company had violated Fletcher’s consent rights by the subsidiary’s executing and delivering the replacement promissory note without Fletcher’s consent. Fletcher has since declared to the Court that it will not pursue damages related to the issuance of the replacement $35 million promissory note.

Table of Contents

In June 2012, Fletcher filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York. Fletcher's shares of Series D Preferred Stock, which had been pledged by Fletcher to secure certain indebtedness, were sold by the pledgee to the affiliate of D.E. Shaw & Co., Inc. in June 2012. The Company does not believe that the acquisition of the shares by an affiliate of D. E. Shaw & Co., Inc. or the bankruptcy filing by Fletcher will have a material impact on Fletcher's lawsuit against the Company. The Company believes that the monetary damages suffered by Fletcher as a result of the Company's subsidiary executing and delivering the convertible note without Fletcher's consent are nonexistent or nominal, and that the ultimate outcome of the lawsuit will not result in a material adverse effect on the Company's financial condition or results of operations.

Other

The Company has been named in various other lawsuits or threatened actions that are incidental to its ordinary business. Litigation is inherently unpredictable. Any claims against the Company, whether meritorious or not, could be time-consuming, cause the Company to incur costs and expenses, require significant amounts of management time and result in the diversion of significant operational resources. The results of these lawsuits and actions cannot be predicted with certainty. Management currently believes that the ultimate resolution of these matters will not have a material adverse impact on the financial condition, results of operations or liquidity of the Company.

(10) Related Party Transactions

BGP owned approximately 15.2% of the Company's outstanding common stock as of March 31, 2013. For the three months ended March 31, 2013 and 2012, the Company recorded revenues from BGP of $0.9 million and $6.1 million, respectively. Total receivables due from BGP were $1.7 million at March 31, 2013. During the three months ended March 31, 2013, the Company paid to BGP $18.4 million for seismic acquisition services provided on a large 3D marine project; the Company owed BGP $5.9 million for those same services at March 31, 2013.

For the three months ended March 31, 2013, the Company sold equipment to GeoRXT for $6.4 million, which is due to be paid in May 2013. The purchase of this equipment has been guaranteed by GeoRXT's majority joint venture partner Georadar. The Company deferred 30% (ION's ownership percentage in GeoRXT) of its profit on this sale.

(11) Restructuring Activities

At December 31, 2012, the Company had a liability (classified as other long-term liability) of $5.1 million related to its permanently ceasing to use certain leased building facilities. During the three months ended March 31, 2013, the Company made cash payments of $0.3 million and accrued $0.1 million related to accretion expense, resulting in a remaining liability of $4.9 million as of March 31, 2013.

Table of Contents

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations
Executive Summary
Our Business
We are a global, technology-focused seismic solutions company. Our services and products include data processing and reservoir imaging services; planning services for survey design and optimization; navigation, command and control, and data management software products; and marine and land seismic data acquisition equipment. In addition, we maintain a multi-client data library with seismic data acquired and processed from surveys of offshore and onshore regions around the world. We serve customers in all major energy producing regions of the world from strategically located offices in 20 cities on five continents.
For over 45 years we have been engaged in providing industry leading seismic data acquisition technology, such as full-wave imaging capability with VectorSeis® products, the ability to record seismic data from basins that underlie ice fields in polar regions and cableless seismic techniques. The advanced technologies we currently offer include DigiSTREAMER™, Orca