ION GEOPHYSICAL CORP
Form 10-K/A
July 09, 2010

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
Form 10-K/A
(Amendment No. 1)

(Mark One)

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

For the Fiscal Year Ended December 31, 2009

or

o **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, Including Zip Code)
(281) 933-3339
(Registrant s Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, $0.01 par value	New York Stock Exchange
Rights to Purchase Series A Junior Participating Preferred Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act Yes o No þ

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 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 o No o

* The registrant has not yet been phased into the interactive data requirements.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. 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 o Accelerated filer þ 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 Act). Yes o No þ

As of June 30, 2009 (the last business day of the registrant s second quarter of fiscal 2009), the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was $279.4 million based on the closing sale price on such date as reported on the New York Stock Exchange.

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date: common stock, $.01 par value, 118,695,952 shares outstanding as of February 22, 2010.

DOCUMENTS INCORPORATED BY REFERENCE

Document	**Parts Into Which Incorporated**
Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held May 26, 2010	Part III

TABLE OF CONTENTS

PART II
- Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations
- Item 9A. Controls and Procedures

PART III
- Item 11. Executive Compensation

PART IV
- Item 15. Exhibits and Financial Statement Schedules

SIGNATURES
EX-23.1
EX-31.1
EX-31.2
EX-32.1
EX-32.2

Table of Contents

EXPLANATORY NOTE

This Form 10-K/A is being filed to revise certain sections of Part II, Item 7 and Part II, Item 9A, of ION Geophysical Corporation s Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Securities and Exchange Commission on March 1, 2010. In addition, this Form 10-K/A includes disclosures pursuant to Part III, Item 11 of Form 10-K. These revisions are made in response to recent comments from the staff of the Division of Corporation Finance of the Securities and Exchange Commission.

This amendment revises Part II, Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations* as follows:

- Amends the section entitled *Key Financial Metrics* by adding gross profit and gross margin data to the table;

- Amends the subsections entitled *Results of Operations Year Ended December 31, 2009 Compared to Year Ended December 31, 2008* and *Results of Operations Year Ended December 31, 2008 Compared to Year Ended December 31, 2007,* by providing under *Net Revenues, Gross Profits and Gross Margins* of each subsection, additional disclosures regarding the profitability of our business segments;

- Amends the first paragraph under *Liquidity and Capital Resources Sources of Capital* to provide additional disclosures regarding our working capital requirements; and

- Amends the subsection entitled *Meeting our Liquidity Requirements Cash Flow from Operations* to provide additional disclosures regarding our cash flows from operations and causes of changes in certain working capital line items in 2009 and 2008.

This amendment also revises Part II, Item 9A. *Controls and Procedures* by deleting the last two sentences from the first paragraph under sub-section (a), *Evaluation of Disclosure Controls and Procedures*.

In addition, this amendment revises certain information contained in ION Geophysical s Definitive Proxy Statement for its Annual Meeting of Stockholders held on May 26, 2010, which was filed with the SEC on Schedule 14A on April 21, 2010. These revisions appear in Part III, Item 11. *Executive Compensation* of this Form 10-K/A:

- Amends the subsection entitled *Compensation Discussion and Analysis Objectives of Our Executive Compensation Programs General Compensation Philosophy and Policy* by providing additional information regarding our company s determination not to proceed with our stock option replenishment program during 2009;

- Amends the subsection entitled *Compensation Discussion and Analysis Annual Incentive Compensation 2009 Incentive Plan* by providing additional information regarding the Compensation Committee s evaluation of executive performance and personal criteria success factors; and

- Amends the subsection entitled *Summary Compensation Table Potential Payments Upon Termination or Change of Control* by providing information regarding the definition of change of control under certain employment agreements and equity compensation plans and information regarding certain potential payments upon termination or a change of control for James R. Hollis, a former executive officer.

As required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended (the Exchange Act), new certifications by our company s principal executive officer and principal financial officer are being filed as exhibits to this Form 10-K/ A under Item 15 of Part IV.

For purposes of this Form 10-K/A, and in accordance with Rule 12b-15 under the Exchange Act, each item of our Annual Report on Form 10-K for the year ended December 31, 2009, as originally filed on March 1, 2010, that was affected by this Form 10-K/A, has been amended and restated in its entirety. No attempt has been made in this Form 10-K/A to modify or update other disclosures as presented in the original Form 10-K, except as required to reflect such amendments.

This Form 10-K/A contains forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements should be read in conjunction with the cautionary

statements and other

Table of Contents

important factors included in the Form 10-K. See Item 1A. Risk Factors of the Form 10-K for a description of important factors which could cause actual results to differ materially from those contained in the forward-looking statements.

In this Form 10-K/A, ION Geophysical, ION, company, we, our, ours and us refer to ION Geophysical Corporation and its consolidated subsidiaries, except where the context otherwise requires or as otherwise indicated. Certain trademarks, service marks and registered marks of ION referred to in this Form 10-K /A are defined in Item 1. *Business Intellectual Property* in the Form 10-K.

Table of Contents

PART II

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Note: The following should be read in conjunction with our Consolidated Financial Statements and related notes that appear elsewhere in the Annual Report on Form 10-K filed with the SEC on March 1, 2010.

Executive Summary

Our Business. We are a technology-focused seismic solutions company that provides advanced seismic data acquisition equipment, seismic software and seismic planning, processing and interpretation services to the global energy industry. Our products, technologies and services are used by oil and gas exploration and production (E&P) companies and seismic contractors to generate high-resolution images of the Earth s subsurface for exploration, exploitation and production operations.

We operate our company through four business segments. Three of our business segments Land Imaging Systems, Marine Imaging Systems and Data Management Solutions make up our ION Systems division. Our fourth business segment is our ION Solutions division.

- *Land Imaging Systems* cable-based, cableless and radio-controlled seismic data acquisition systems, digital geophone sensors, vibroseis vehicles (i.e., vibrator trucks) and source controllers for detonator and vibrator energy sources and also consisting of analog geophone sensors. After we complete our land equipment joint venture with BGP, all of these business lines, with the exception of analog geophone sensors, will become part of the joint venture. See *Proposed Land Joint Venture with BGP*.

- *Marine Imaging Systems* towed streamer and redeployable ocean bottom cable seismic data acquisition systems and shipboard recorders, streamer positioning and control systems and energy sources (such as air guns and air gun controllers).

- *Data Management Solutions* software systems and related services for navigation and data management involving towed marine streamer and seabed operations.

- *ION Solutions* advanced seismic data processing services for marine and land environments, seismic data libraries, and Integrated Seismic Solutions (ISS) services.

Our current business strategy is predicated on successfully executing seven key imperatives:

- Increasing our market share and profitability in land acquisition systems and furthering the commercialization of FireFly, our cableless full-wave land data acquisition system, and our other land equipment technologies through our participation in the proposed land equipment joint venture with BGP;

- Continuing to manage our cost structure to reflect current market and economic conditions while keeping key strategic technology programs progressing with an overall goal of enabling E&P companies to solve their complex reservoir problems most efficiently and effectively;

- Expanding our ION Solutions business in new regions with new customers and new land and marine service offerings, including proprietary services for owners and operators of oil and gas properties;

- Globalizing our ION Solutions data processing business by opening advanced imaging centers in new strategic locations, and expanding our presence in the land seismic processing segment, with emphasis on serving the national oil companies;

- Developing and introducing our next generation of marine towed streamer products, with a goal of developing markets beyond the new vessel market;

- Expanding our seabed imaging solutions business using our VectorSeis Ocean (VSO) acquisition system platform and derivative products to obtain technical and market leadership in what we continue to believe is a

very important and expanding market; and

Leveraging our proposed land equipment joint venture with BGP to design and deliver lower cost, more reliable land imaging systems to our worldwide customer base of land acquisition contractors, while concurrently tapping into a broader set of global geophysical opportunities associated with the exploration, asset development, and production operations of BGP s parent, CNPC.

Our Current Debt Levels. In connection with our acquisition in September 2008 of ARAM, we increased our total indebtedness significantly. As of December 31, 2009, we had outstanding total indebtedness of approximately $277.4 million, net of a $8.7 million non-cash debt discount associated with $40.0 million in Convertible Notes, and including capital lease obligations. Total indebtedness on that date included $101.6 million of outstanding five-year term indebtedness and $118.0 million, excluding the non-cash debt discount, in outstanding revolving credit debt, in each case incurred under our amended commercial banking credit facility (the Amended Credit Facility). Total indebtedness on that date also included $19.1 million in borrowings under our secured equipment financing transaction with ICON (described below) and $35.0 million of subordinated indebtedness outstanding under an amended and restated subordinated promissory note (the Amended and Restated Subordinated Note) that we had issued to one of ARAM s selling shareholders as part of the purchase price consideration for the ARAM acquisition.

On June 4, 2009, we completed a private placement transaction under which we issued and sold 18,500,000 shares of our common stock in privately-negotiated transactions, for aggregate gross proceeds of approximately $40.7 million. The $38.2 million of net proceeds from the offering, along with $2.6 million of cash on hand, were applied to repay in full the outstanding indebtedness under a 2008 bridge loan agreement with Jefferies Finance LLC. The indebtedness under the bridge loan agreement had been scheduled to mature on January 31, 2010 and had an effective interest rate at the time of repayment of 25.3%. We also entered into an additional amendment to the Amended Credit Facility (the Fifth Amendment), which among other things, modified certain of the financial and other covenants contained in the Amended Credit Facility. See further discussion below at *Liquidity and Capital Resources Sources of Capital* and at Note 12 *Notes Payable, Long-term Debt and Lease Obligations*.

On June 29, 2009, we entered into a $20.0 million secured equipment financing with ICON ION, LLC, an affiliate of ICON Capital Inc. (ICON), receiving $12.5 million in funding on that date and $7.5 million in July 2009. All borrowed indebtedness under the master loan agreements governing this equipment financing arrangement is scheduled to mature on July 31, 2014. We used the proceeds of the secured term loans for working capital and general corporate purposes. See further discussion below at *Liquidity and Capital Resources Sources of Capital* and at Note 12 *Notes Payable, Long-term Debt and Lease Obligations.*

Proposed Joint Venture with BGP. On October 23, 2009, we entered into a binding term sheet (the Term Sheet) with BGP Inc., China National Petroleum Corporation, a company organized under the laws of the people s Republic of China (BGP), which sets forth, among other things, the principal terms for a proposed land equipment joint venture between BGP and us. In connection with the execution of the Term Sheet, we entered into an amendment to the Amended Credit Facility (the Sixth Amendment) that, among other things, (i) increased the aggregate revolving commitment amount under the Amended Credit Facility from $100.0 million to $140.0 million, (ii) permitted Bank of China, New York Branch (Bank of China), to join the Amended Credit Facility as a lender, and (iii) modified, or provided limited waivers of, certain of the financial and other covenants contained in the Amended Credit Facility.
Our bridge financing arrangement consisted of the following:

Two promissory notes (the Convertible Notes) issued to the Bank of China under the Amended Credit Facility for an aggregate principal amount of $40.0 million, both convertible into shares of our common stock; and

A Warrant Issuance Agreement with BGP, under which we granted to BGP a warrant (the Warrant) to purchase shares of our common stock that may be exercised in lieu of conversion of the Convertible Notes.

See further discussion below at *Proposed Joint Venture and Related Transactions with BGP.*

Waivers under Amended Credit Facility. As a result of our October 2009 bridge financing arrangements with Bank of China, we believe that our liquidity will be sufficient to fund our operations until such time as the transactions with BGP are completed or alternative financing could be obtained. Additionally, as a result of our entering into the Sixth Amendment, we believe that the waivers of the financial covenants contained in the Amended Credit Facility for the fiscal quarters ending September 30, 2009, December 31, 2009, March 31, 2010 and June 30, 2010 should enable us

to conduct our operations without defaulting under our Amended Credit Facility until the transactions under the Term Sheet are completed. We currently expect these transactions will be completed in March 2010. Without these waivers, we would not have been in compliance with certain of our financial covenants at September 30, 2009 or December 31, 2009.

If the proposed transactions under the Term Sheet are not completed by March 31, 2010, then the current waivers, upon notice from the lenders after a designated period of time, would cease to be effective and we at that time would likely not be in compliance with certain of the financial covenants contained in the Amended Credit Facility, which could then result in an event of default. As the current waivers cover a period of less than twelve months from December 31, 2009, we have classified our long-term indebtedness under our revolving line of credit and term loan facility under the Amended Credit Facility as current at December 31, 2009. As a result of the cross-default provisions in our secured equipment financing and our amended and restated subordinated seller note, we have also classified these long-term obligations as current at December 31, 2009.

Even though we believe the joint venture with BGP will be completed as planned, there are certain events outside of the our control (such as us experiencing a material adverse event or condition that results in a material adverse effect on our business, our prospects or results of operations) that could cause the closing of the joint venture to be delayed, terminated or abandoned. In such event, we would need to seek to amend, or seek additional covenant waivers under, the Amended Credit Facility. Even though the lenders under the Amended Credit Facility have demonstrated their willingness to work with us in amending or providing sufficient waivers to its facility, there can be no assurance that we would be able to obtain any such waivers or amendments in the future. If we were to be unable to obtain such waivers or amendments from the lenders, we would likely seek to replace or pay off the Amended Credit Facility with new secured debt, unsecured debt or equity financing.

As part of the formation of the joint venture, we have been in discussions with various financial institutions (both domestic and international) on the refinancing of our debt. As a result of these discussions and with the recent improvements within the financial markets, we believe that in the unlikely event the joint venture is not completed as planned, we would be able to obtain additional debt or equity financings prior to defaulting on our current debt obligations. However, there also can be no assurance that such debt or equity financing would be available on terms acceptable to us or at all.

Economic Conditions and Cost Containments. Demand for our products and services is cyclical and substantially dependent upon activity levels in the oil and gas industry, particularly our customers willingness and ability to expend their capital for oil and natural gas exploration and development projects. This demand is highly sensitive to current and expected future oil and natural gas prices. The volatility of oil and natural gas prices in recent years has resulted in sharply curtailed demand for oil and gas exploration activities in North America and other regions. The uncertainty surrounding future economic activity levels and the tightening of credit availability resulted in decreased sales levels for several of our businesses in 2009. Our land seismic equipment businesses in North America and Russia have been particularly adversely affected.

Our seismic contractor customers and the E&P companies that are users of our products, services and technology have generally reduced their capital spending levels since 2008. We also expect that exploration and production expenditures will remain at restrained levels to the extent E&P companies and seismic contractors are limited in their access to the credit markets as a result of further disruptions in, or continued conservative lending practices in, the credit markets. There continues to be significant uncertainty about future activity levels and the impact on our businesses. In particular, our North America and Russia land systems business and our vibroseis truck business experienced steep sales declines in 2009, and uncertain prospects for 2010.

In response to the global economic downturn, we took measures to reduce operating costs in our businesses during 2008 and 2009. In addition, we slowed our capital spending, including our investments in our multi-client data libraries in 2009. For the year ended December 31, 2009, total capital expenditures were $92.6 million, compared to $127.9 million for the year ended December 31, 2008. We are projecting capital expenditures for 2010 to be between $100 million to $110 million. Of that total, we expect to spend approximately $90 million to $100 million on investments in our multi-client data library, and we anticipate that a majority of this investment will be underwritten by our customers. To the extent that our customers commitments do not reach an acceptable level of pre-funding, the amount of our anticipated investment could in likely respect decline. The remaining sums are expected to be funded from internally generated cash.

We are continuing to explore ways to reduce our cost structure. We have taken a deliberate approach to analyzing product and service demands in our business and are taking a more conservative approach in offering extended

financing terms to our customers. Our most significant cost reduction to date has related to reduced headcount. Beginning in the fourth quarter of 2008 and continuing through 2009, we reduced our headcount by 384 positions, or approximately 26% of our employee headcount, in order to adjust to the lower levels of activity. Including all contractors and employees, we reduced our headcount by 489 positions, or 27%. In April 2009, we also initiated a salary reduction program that reduced employee salaries. The salary reductions reduced affected employees annual base salaries by 12% for our chief executive officer, chief operating officer and chief financial officer, 10% for all other executives and senior management, and 5% for most other employees. Our Board also elected to implement a 15% reduction in director fees. In addition to the salary reduction program, we suspended our matching contributions to employee 401(k) plan contributions.

We reinstated all employees salaries and director fees at their previous levels following the October 23, 2009 announcement of our company and BGP entering into a binding Term Sheet providing for, among other things, the formation of a joint venture between our company and BGP involving our land-based seismic data acquisition equipment business (see *Proposed Joint Venture and Related Transactions with BGP* below).

We will continue to fund strategic programs to position us for the expected recovery in economic activity. Overall, we will give priority to generating cash flows and reducing our cost structure, while maintaining our long-term commitment to continued technology development. Our business is mainly technology-based. We are not in the field crew business, and therefore do not have large amounts of capital and other resources invested in vessels or other assets necessary to support contracted seismic data acquisition services, nor do we have large manufacturing facilities. This cost structure gives us the flexibility to adjust our expense base when downward economic cycles affect our industry.

While the current global recession and the decline in oil and gas prices have slowed demand for our products and services in the near term, we believe that our industry s long-term prospects remain favorable because of the declining rates in oil and gas production and the relatively small number of new discoveries of oil and gas reserves. We believe that technology that adds a competitive advantage through cost reductions or improvements in productivity will continue to be valued in our marketplace, even in the current difficult market. For example, we believe that our new technologies, such as FireFly, DigiFIN and Orca, will continue to attract interest from our customers because those technologies are designed to deliver improvements in image quality within more productive delivery systems. We have adjusted much of our sales efforts for our ARIES land seismic systems from North America to international sales channels (other than Russia).

International oil companies (IOCs) continue to have difficulty accessing new sources of supply for their exploration activities, partially as a result of the growth of national oil companies. This situation is also affected by increasing environmental concerns, particularly in North America, where companies may be denied access to some of the most promising onshore and offshore exploration opportunities. It is estimated that approximately 85%-90% of the world s reserves are controlled by national oil companies, which increasingly prefer to develop resources on their own or by working directly with the oil field services and equipment providers. These dynamics often prevent capital, technology and project management capabilities from being optimally deployed on the best exploration and production opportunities, which results in global supply capacity being less than it otherwise might be. As a consequence, the pace of new supply additions may be insufficient to keep up with demand once the global recession ends.

2009 Developments. Our overall total net revenues of $419.8 million for the year ended December 31, 2009 decreased $259.7 million, or 38.2%, compared to total net revenues for the year ended December 31, 2008. At the same time, our overall gross profit percentage improved for the year ended 2009 to 31.5% compared to 30.6% for the year ended 2008. For the year ended December 31, 2009, we recorded a loss from operations of ($58.2) million (which includes the effect of an impairment of intangible assets charge of $38.0 million taken in the first quarter of 2009), compared to ($212.8) million (which includes the effect of impairments of goodwill and intangible asset charges of $252.3 million taken in the fourth quarter of 2008) for the year ended December 31, 2008.

Developments during 2009 and early 2010 include the following:

In January 2009, we announced our first delivery of a multi-thousand station version 2.0 FireFly system equipped with digital, full-wave VectorSeis sensors to the world s largest land contractor. The deployment in the second quarter of 2009 (we recognized the revenue from this sale in the fourth quarter of 2009) of this FireFly system occurred in a producing hydrocarbon basin containing reservoirs that have proven difficult to image with conventional seismic techniques.

In March 2009, we announced that we had signed an agreement with The Polarcus Group of Companies for the provision of seismic data processing services. Under the agreement, we will provide hardware, software and geophysicists in order to support a seismic project s entire imaging lifecycle, from the vessel to an onshore data processing center.

In April 2009, we announced that a 6,100 station FireFly system will be utilized by a major oil company to undertake two high channel count, multicomponent (full-wave) seismic acquisition programs in northeast Texas, and, in July 2009, we announced that our client had sanctioned the second phase of the program.

In April 2009, we announced the first commercial sale of our cable-based ARIES II seismic recording platform to one of the world s largest geophysical services providers. The sale includes two 5,000 channel ARIES II recording systems that the customer plans to deploy on upcoming, high-channel count seismic surveys.

In May 2009, we announced that an 8,000 station FireFly system will be utilized by Compania Mexicana de Exploraciones (Comesa), an oilfield services company majority-owned by PEMEX, the national oil company of Mexico, on three projects in Mexico.

In May 2009, we announced that we had successfully acquired an additional 6,200 kilometers of regional seismic data offshore India s western coast as part of our ongoing IndiaSPAN program. Another 3,800 kilometers has since been acquired off the east coast of India.

In July 2009, we announced that we had successfully completed the data processing and interpretation for ArgentineSPAN , a basin-scale seismic program offshore Argentina. ArgentineSPAN contains approximately 11,800 kilometers of new, regional data.

In July 2009, we announced that we had successfully acquired 5,000 kilometers of regional seismic data covering the Bight Basin and Ceduna Sub-basin offshore southern Australia. Known as BightSPAN , this latest addition to our global BasinSPAN seismic data library offers the first regional geologic study of Australia s deepwater southern coast.

In October 2009, we announced our proposed joint venture with BGP and the related bridge financing transactions. See *Proposed Joint Venture and Related Transactions with BGP.*

In January 2010, we announced that we had extended our BrasilSPAN program, which makes it one of the largest 2-D seismic datasets in our multi-client data library. The program currently contains 42,000 km of data off the coast of South America.

Proposed Joint Venture and Related Transactions with BGP

On October 23, 2009, we entered into a binding Term Sheet with BGP, which provides for, among other things, the formation of a joint venture between our company and BGP involving our land-based seismic data acquisition equipment business.

The Term Sheet contemplates that we will enter into a purchase agreement with BGP to form the joint venture. We expect to form the joint venture entity as a wholly-owned subsidiary of ION Geophysical Corporation and will contribute to the joint venture certain assets and related liabilities that relate to the proposed joint venture business. Then, BGP will acquire from us a 51% equity interest in the joint venture for an aggregate purchase price of $108.5 million cash and will contribute to the joint venture certain of its assets and related liabilities that relate to the joint venture s business. The assets of each party to be contributed to the joint venture will include seismic recording systems, inventory, certain intellectual property rights and contract rights, all as may be necessary to or principally used in the conduct or operation of the businesses to be contributed to the joint venture as presently conducted or operated by each party.

The scope of the joint venture s business is defined in the Term Sheet as being the business of designing, development, engineering, manufacturing, research and development, distribution, sales and marketing and field support of land-based equipment used in seismic data acquisition for the petroleum industry. Excluded from the scope of the joint venture s business will be (x) the analog sensor businesses of our company and BGP and (y) the businesses of certain companies in which BGP or we are currently a minority owner. In addition to these excluded businesses, all of our other businesses including our Marine Imaging Systems, Data Management Solutions and ION Solutions, which includes GXT s Imaging Solutions, Integrated Seismic Solutions (ISS) and BasinSPAN and seismic data libraries will remain owned and operated by us and will not comprise a part of the joint venture.

Under the Term Sheet, the parties have agreed to use their best efforts to cause the closing of the joint venture and related transactions to occur as soon as practicable following the execution of the definitive transaction documents, and on or before the later to occur of the following dates: (i) December 31, 2009 or (ii) 10 business days following the date on which all necessary regulatory approvals (including receiving clearance from the Committee on Foreign Investment in the United States (CFIUS) to complete the transactions) have been obtained, but in any event, no later than March 31, 2010. The parties obligations under the Term Sheet may be terminated (a) by written agreement of the parties, (b) by either party in the even that such party s conditions have not been satisfied on or before March 31, 2010 (subject to a 15-day cure period) or (c) by either party in the event that certain mutual conditions have not been satisfied on or before March 31, 2010. In addition, BGP and we have each agreed to pay the other a break-up fee of $5.0

Table of Contents

million if either party determines to terminate its obligations under the Term Sheet because the other party has failed to satisfy certain conditions, including conditions precedent to closing that (x) the other party has not experienced a material adverse event or condition that has resulted in a material adverse effect on its business, prospects and results of operations change, (y) the other party has not breached any of its representations and warranties contained in the Term sheet and such representations and warranties continue to be true and correct and (z) with respect to BGP s obligations under the Term Sheet, we have not suffered any material default or accelerations of any of our liabilities.

On October 27, 2009, we borrowed an aggregate of $40.0 million in the form of revolving credit bridge loan financing from Bank of China, which was evidenced by the Convertible Notes. This borrowing was pursuant to and permitted by the terms of the Sixth Amendment to the Credit Facility, which increased the aggregate revolving commitment amount under the accordion feature provisions of the Amended Credit Facility from $100.0 million to $140.0 million and permitted the Bank of China to join the Amended Credit Facility as a lender.

The Convertible Notes provide that at the stated initial conversion price of $2.80 per share, the full $40.0 million principal amount under the Convertible Notes would be convertible into 14,285,714 shares of Common Stock. The Convertible Notes provide that the conversion price and the number of shares into which the notes may be converted are subject to adjustment under certain terms and conditions similar to those contained in the Warrant.

As part of BGP arranging for the Bank of China to join our Amended Credit Facility, we granted to BGP the Warrant. The Warrant will be exercisable, in whole or in part, at any time and from time to time, subject to the conditions described below. The Warrant will initially entitle the holder thereof to purchase a number of shares of common stock equal to $40.0 million divided by the exercise price of $2.80 per share, subject to adjustment as described below. At the initial exercise price of $2.80 per share, at such time as the Warrant becomes exercisable, it would initially be fully exercisable for 14,285,714 shares of common stock.

The Warrant will only become exercisable and the Convertible Notes will only become convertible upon receipt of certain governmental approvals. Any conversions of the Convertible Notes and prior exercises of the Warrant will reduce the dollar amount under the Warrant into which the exercise price may be divided to determine the number of shares that may be acquired upon exercise.

Additionally, the Term Sheet provides that when the joint venture transactions are closed:

- BGP will have purchased approximately 23.8 million shares of our common stock for $66.6 million and thereby own, before giving effect to the issuance of those shares, approximately 19.99% of our outstanding common stock.

- To the extent that shares are not purchased by BGP under the Warrant prior to closing, the new revolving credit loans from Bank of China, evidenced by the Convertible Notes will convert into approximately 14.3 million shares of ION common stock and will be credited against the approximately 23.8 million shares of ION stock to be purchased by BGP at the transaction closing.

- ION will appoint a designee of BGP to its Board of Directors to serve with the current nine members of ION s Board of Directors.

- BGP will arrange for our then-outstanding long-term debt under the Amended Credit Facility (currently $101.6 million outstanding at February 22, 2010) to be refinanced at the joint venture closing.

- We will use a portion of the proceeds from the transactions to pay off and retire our outstanding indebtedness under our current revolving credit facility (after giving effect to the $40.0 million in additional revolving credit borrowings under our existing Amended Credit Facility, approximately $118.0 million is currently outstanding at February 22, 2010) and $35.0 million in seller subordinated indebtedness incurred in connection with our acquisition of ARAM in September 2008.

- We will receive a new $100 million revolving credit facility at the joint venture closing.

The $19.1 million (as of December 31, 2009) secured equipment financing transaction with ICON will be assigned to and become indebtedness of the joint venture.

The proposed joint venture is intended to provide a number of benefits and opportunities, including the following:

Table of Contents

Preferred access to BGP, currently the world s largest land seismic contractor;

Anticipated improved economies of scope and scale in our land data acquisition system manufacturing and sales operations, enabling us to deliver products in a more timely manner at an overall lower cost to its customers;

Combining our strengths in land equipment technologies with BGP s emerging geophysical product portfolio and expertise in operating land seismic acquisition crews, which should permit new joint venture products to be designed and field-tested for reliability, quality and productivity to the benefit of all customers; and

Aligning the joint venture engineering teams to develop innovative, market-leading land recording systems, 3C (full-wave) sensor and vibroseis products.

We believe that the joint venture will enable us to continue developing land systems and sensor technologies with lessened primary capital requirements through our partnership with BGP.

Key Financial Metrics

The following table provides an overview of key financial metrics for our company as a whole and our four business segments during the twelve months ended December 31, 2009, compared to those for fiscal 2008 and 2007 (in thousands, except per share amounts):

	Years Ended December 31,		
	2009	**2008**	**2007**
Net revenues:			
ION Systems Division:			
Land Imaging Systems	$ 103,038	$ 200,493	$ 325,037
Marine Imaging Systems	103,024	182,710	177,685
Data Management Solutions	33,733	37,240	37,660
Total ION Systems Division	239,795	420,443	540,382
ION Solutions Division	179,986	259,080	172,729
Total	$ 419,781	$ 679,523	$ 713,111
Gross profits:			
ION Systems Division:			
Land Imaging Systems	$ 1,931	$ 30,279	$ 59,786
Marine Imaging Systems	48,365	74,567	69,904
Data Management Solutions	21,998	24,656	22,292
Total ION Systems Division	72,294	129,502	151,982
ION Solutions Division	59,844	78,246	54,601
Total	$ 132,138	$ 207,748	$ 206,583
Gross margins:			
ION Systems Division:			
Land Imaging Systems	1.9%	15.1%	18.4%
Marine Imaging Systems	46.9%	40.8%	39.3%

Data Management Solutions	65.2%	66.2%	59.2%
Total ION Systems Division	30.1%	30.8%	28.1%
ION Solutions Division	33.2%	30.2%	31.6%
Total	31.5%	30.6%	29.0%
Income (loss) from operations:			
ION Systems Division:			
Land Imaging Systems	$ (39,126)	$ (13,662)	$ 28,681
Marine Imaging Systems	29,632	52,624	44,727
Data Management Solutions	19,970	22,298	17,290
Total ION Systems Division	10,476	61,260	90,698
ION Solutions Division	27,747	40,534	21,646
Corporate	(58,395)	(62,334)	(48,450)
Impairment of goodwill and intangible assets	(38,044)	(252,283)	
Total	$ (58,216)	$ (212,823)	$ 63,894
Net income (loss) applicable to common shares	$ (113,559)	$ (293,713)	$ 40,256
Basic net income (loss) per common share	$ (1.03)	$ (3.06)	$ 0.49
Diluted net income per (loss) common share	$ (1.03)	$ (3.06)	$ 0.45

We intend that the discussion of our financial condition and results of operations that follows will provide information that will assist in understanding our consolidated financial statements, the changes in certain key items in those financial statements from year to year, and the primary factors that accounted for those changes.

We anticipate that we will account for our 49% interest in the proposed joint venture with BGP under the equity method of accounting under U.S. generally accepted accounting principles. As a result, after the joint venture is formed, we will no longer include in our results of operations all of the net revenues and costs and expenses attributable to the contributed businesses on a going forward basis. In our results of operations, our proportional share of the joint venture s net income (loss) will be reported as a single line item, and our investment in the joint venture will be increased by our proportional share of joint venture net income and decreased by our proportional payment of dividends made. Additionally, our equity investment in the joint venture will be reported as a single line item on our balance sheet, and the assets and liabilities of the contributed business currently consolidated in our balance sheet as of December 31, 2009 will be removed. See *Proposed Joint Venture and Related Transactions with BGP* below.

For a discussion of factors that could impact our future operating results and financial condition, see Item 1A. *Risk Factors* above.

Results of Operations

Year Ended December 31, 2009 Compared to Year Ended December 31, 2008

*Net Revenues, Gross Profits and Gross Margins***.**

Land Imaging Systems. Net revenues in 2009 decreased by $97.5 million, to $103.0 million, compared to $200.5 million for the twelve months ended December 31, 2008. Despite the inclusion of ARAM s full-year operating results, net revenues decreased across all of the land imaging segment s product lines due to the continued market decline, which greatly impacted our business in North America and Russia. Gross profit decreased by $28.3 million to $1.9 million, representing a 1.9% gross margin, compared to $30.3 million, representing a 15.1% gross margin, during the twelve months ended December 31, 2008. The decrease in gross margins in our Land Imaging Systems was due to the full-year impact of ARAM s intangible asset amortization and our land segment s rental pool depreciation, combined with lower sales volumes. Additionally, sales of our land acquisition systems, which normally have higher margins than our other land products (such as vibrator trucks), also decreased in 2009 compared to 2008, and contributed to the decreased gross margins in this segment.

Marine Imaging Systems. Net revenues in 2009 decreased by $79.7 million to $103.0 million, compared to $182.7 million for the year ended December 31, 2008. This decrease was seen across most of our marine imaging product lines, most notably in our marine streamer positioning products and our VectorSeis Ocean (VSO) system product line. The decline in our marine streamer positioning products was due to the delays in the scheduled completion and commissioning of new marine vessels to be introduced into the market, which would otherwise have been outfitted with our marine products and would have contributed to our revenues. The decrease in our VSO revenues was due to deliveries in 2008 of VSO System 4 and System 5, which were not duplicated in 2009. This decrease was partially offset by increased sales of our DigiFIN streamer control systems, compared to 2008 levels. Gross profit decreased by $26.2 million to $48.4 million, representing a 46.9% gross margin, compared to $74.6 million, representing a 40.8% gross margin, during the twelve months ended December 31, 2008. The increase in gross margins in our Marine Imaging Systems segment was mainly due to changes in the product mix, principally attributable to a decrease of $38.7 million in VSO revenues in 2009 compared to 2008. Sales of our VSO systems have generally experienced lower margins compared to our other marine products.

Data Management Solutions. Our Data Management Solutions net revenues decreased by $3.5 million to $33.7 million, compared to $37.2 million in 2008. The decrease was due entirely to the effect of foreign currency exchange rate fluctuations. Expressed in Great Britain Pounds Sterling (the local currency), net revenues actually increased by £1.2 million, which was

principally due to increased sales of our Orca software product. Gross profit decreased by $2.7 million to $22.0 million, representing a 65.2% gross margin, compared to $24.7 million, representing a 66.2% gross margin, during the twelve months ended December 31, 2008. The slight decrease in gross margins in our Data Management Systems was due to changes in product mix, with slightly more equipment sales, which have lower margins than the software sales, in 2009 compared to 2008.

ION Solutions. Net revenues decreased by $79.1 million, to $180.0 million, compared to $259.1 million in 2008. The results for 2009 reflected decreases in sales from our seismic data library from our completed multi-client seismic surveys, most notably in the Africa and India regions, and decreased revenues from new multi-client seismic surveys. These decreases were due to decreased spending by our customers as a result of reduced demand caused by the economic recession. With the overall market decline, the market focus shifted from the acquisition of new seismic data to utilizing and reprocessing previously acquired seismic data. This shift was evidenced by the decreases in our multi-client seismic data library sales and revenues from new multi-client seismic surveys; however, these decreases were partially offset by increases in data processing revenues. Gross profit decreased by $18.4 million to $59.8 million, representing a 33.2% gross margin, compared to $78.2 million, representing a 30.2% gross margin, during the twelve months ended December 31, 2008. The increase in gross margins for our ION Solutions division was mainly driven by the increased revenues from our data processing services compared to revenues from these services for the prior year. This increase was partially offset by lower gross margins in our multi-client data library sales, which were due to the impact of the straight-line multi-client data library amortization rates, combined with lower revenues from sales from that data library. See *Critical Accounting Policies and Estimates Revenue Recognition and Product Warranty*.

Research, Development and Engineering. Research, development and engineering expense was $44.9 million, or 10.7% of net revenues, for the year ended December 31, 2009, a decrease of $4.6 million compared to $49.5 million, or 7.3% of net revenues, for the corresponding period last year. The decrease was due primarily to decreased salary and payroll expenses related to our reduced headcount, partially offset by increased professional fees relating to current projects.

Marketing and Sales. Marketing and sales expense of $34.9 million, or 8.3% of net revenues, for the year ended December 31, 2009 decreased $13.0 million compared to $47.9 million, or 7.0% of net revenues, for the corresponding period last year. The decrease in our sales and marketing expenditures reflects decreased salary and payroll expenses related to reduced headcount, a decrease in travel expenses as part of our cost reduction measures, and a decrease in conventions, exhibits, advertising and office expenses related to cost reduction measures and the timing of the expenses throughout the year. Based upon the recently completed restructuring programs, we expect to continue to incur lower costs related to our marketing and sales efforts than in prior periods as mentioned in *Executive Summary* above.

General and Administrative. General and administrative expense of $72.5 million for the year ended December 31, 2009 increased $1.6 million compared to $70.9 million in the prior year. General and administrative expenses as a percentage of net revenues for the years ended December 31, 2009 and 2008 were 17.3% and 10.4%, respectively. The increase in general and administrative expense was mainly due to additional stock-based compensation expense related to adjustments between estimated and actual award forfeitures of $4.5 million, of which $3.3 million is an out-of-period adjustment. Additionally, general and administrative expenses also reflect the inclusion of ARAM s expenses in 2009 and severance charges related to reductions in headcount. This increase is partially offset by decreased professional legal fees, travel expenses and general office expenses related to cost reduction measures. Based upon the recently completed restructuring programs, we expect to incur lower costs related to our general and administrative activities than in prior periods as mentioned in *Executive Summary* above.

Impairment of Intangible Assets. At March 31, 2009, we further evaluated our intangible assets for potential impairment. Based upon our evaluation and given the current market conditions, we determined that approximately $38.0 million of proprietary technology and customer relationships (written off entirely) related to ARAM acquired intangibles were impaired. In the fourth quarter of 2008, we recorded an impairment charge of $10.1 million related to ARAM s customer relationships, trade name and non-compete agreements. Our net book value associated with ARAM s acquired intangibles is $34.8 million at December 31, 2009 and has a remaining weighted average life of 6.2

years.

Interest Expense, including Amortization of a Non-Cash Debt Discount. Interest expense of $35.7 million for the year ended December 31, 2009 increased $23.0 million compared to $12.7 million for the corresponding period last year. The increase is due to the higher levels of outstanding indebtedness and the secured equipment financing transaction that occurred during the second and third quarters of 2009 combined with increased revolver borrowings of $118.0 million and higher prevailing average interest rates in 2009 compared to 2008. Also, during the year ended December 31, 2009, we amortized to interest expense $6.7 million of a non-cash debt discount associated with the Convertible Notes. The remaining unamortized non-cash debt discount was $8.7 million at December 31, 2009 and will be recognized over the expected term of the Convertible Notes (March 31, 2010). See further discussion

of the Convertible Notes and other bridge financing arrangements related to BGP and the Bank of China at *Proposed Joint Venture and Related Transactions with BGP* and *Liquidity and Capital Resources Sources of Capital.* Because of these increased levels of borrowed indebtedness, our interest expense will continue to be significantly higher in 2010 than we experienced in prior years; however, with the closing of the proposed joint venture with BGP and the subsequent re-financing of the Amended Credit Facility, the Company believes that its interest expense will decrease compared to 2009.

Fair Value Adjustment of the Warrant. We are required to account for separately and adjust to fair value the Warrant. We recorded a non-cash fair value adjustment of $29.4 million, reflecting a total non-cash liability associated with the Warrant of $44.8 million at December 31, 2009. We will continue to adjust the Warrant to fair value until such time as it is exercised or converted into our equity at the closing of the joint venture, which is expected to occur in March 2010. Also, associated with the Warrant, we recorded a $15.4 million non-cash discount on the Convertible Notes, which is being amortized to interest expense (see discussion above) over the expected term of the notes (March 31, 2010).

Impairment of Cost Method Investment. At December 31, 2009, we evaluated our cost method investments for potential impairments. Based upon our evaluation and given the current market conditions related to our investment in Colibrys, Ltd., we determined that the investment was fully impaired and recorded an impairment charge of $4.5 million.

Other Income (Expense). Other expense for the year ended December 31, 2009 was ($4.0) million compared to other income of $4.2 million for 2008. The other expense for 2009 mainly relates to higher foreign currency exchange losses that primarily resulted from our operations in the United Kingdom and Canada.

Income Tax (Benefit) Expense. Income tax benefit for the year ended December 31, 2009 was ($20.0) million compared to $1.1 million of tax expense for the year ended December 31, 2008. The increase in tax benefits during 2009 primarily relates to reduced consolidated income from operations. We continue to maintain a valuation allowance for a significant portion of our U.S. net deferred tax assets. Our effective tax rate for the year ended December 31, 2009 was 15.4% as compared to (0.5%) for the similar period during 2008. The increase in our effective tax rate relates primarily to the 2008 impairment of goodwill, which has no tax benefit.

Preferred Stock Dividends. The preferred stock dividend relates to our Series D-1, Series D-2 and Series D-3 Cumulative Convertible Preferred Stock (collectively referred to as the Series D Preferred Stock) that we issued in February 2005, December 2007 and February 2008, respectively. Quarterly dividends must be paid in cash. Dividends are paid at a rate equal to the greater of (i) 5% per annum or (ii) the three month LIBOR rate on the last day of the immediately preceding calendar quarter plus $2^1/2$% per annum. All dividends paid to date on the Series D Preferred Stock have been paid in cash. The Series D Preferred Stock dividend rate was 5.0% at December 31, 2009.

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

*Net Revenues, Gross Profits and Gross Margins***.**

Land Imaging Systems. Net revenues decreased by $124.5 million, to $200.5 million compared to $325.0 million during the twelve months ended December 31, 2007. Despite the inclusion of ARAM s operating results for the last three and a half months of 2008, the segment was strongly impacted by the market decline, which resulted in reduced sales of both land systems and vibroseis trucks. This decrease was made more pronounced by the inclusion of several large 2007 sales of our land acquisition systems that were not duplicated in 2008, including the sale of 14 land acquisition systems to ONGC, the sale of our initial version of FireFly and significantly increased vibrator truck sales in 2007. Gross profit decreased by $29.5 million to $30.3 million, representing a 15.1% gross margin, compared to $59.8 million, representing a 18.4% gross margin, during the twelve months ended December 31, 2007. The decrease in gross margins in our Land Imaging Systems was principally due to inventory write downs of our mature analog products of approximately $10.1 million directly related to the integration activities of ARAM into our current operating segment and the addition of ARAM s intangible asset amortization combined with lower sales volumes. Additionally, sales of our legacy land acquisition systems, which normally have higher margins, also decreased compared to 2007 and contributed to the decreased gross margins.

Marine Imaging Systems. Net revenues increased by $5.0 million to $182.7 million, compared to $177.7 million during the year ended December 31, 2007, principally due to stronger sales of our marine positioning products,

including sales related to the full commercialization of our DigiFIN advanced streamer command and control system, the first two commercial sales of our DigiSTREAMER system and stronger sales of our marine seismic data acquisition products. We delivered to RXT the fifth VSO

system in 2008; however, VSO system sales decreased compared to 2007, mainly due to the timing of the sales. Gross profit increased by $4.7 million to $74.6 million, representing a 40.8% gross margin, compared to $69.9 million, representing a 39.3% gross margin, during the twelve months ended December 31, 2007. The increase in gross margins in our Marine Imaging Systems segment is mainly due to product mix with a decrease in our VSO revenues in 2008 compared to 2007. Our VSO product lines normally have lower margins when compared to our other products.

Data Management Solutions. Net revenues decreased slightly by $0.5 million to $37.2 million compared to $37.7 million. This decrease was due entirely to the effect of foreign currency exchange rate fluctuations in 2008. Removing the impact of these exchange rate fluctuations, net revenues increased by £1.4 million, principally due to increased sales of Orca. Gross profit increased by $2.4 million to $24.7 million, representing a 66.2% gross margin, compared to $22.3 million, representing a 59.2% gross margin, during the twelve months ended December 31, 2007. This increase in gross margins was due to changes in product mix, with more sales in 2008 of software products (especially Orca), which traditionally have higher margins than equipment sales, than we experienced in 2007.

ION Solutions. Net revenues increased by $86.4 million, to $259.1 million, compared to $172.7 million in 2008. The results for 2008 reflected increases in our new venture program revenues, mainly off the coasts of Alaska and South America, increases in our multi-client data library sales, most notably in the Africa region, and in our data processing revenues. These increases were due to the continued increased spending throughout a majority of 2008; however, the economic recession impacted our new venture programs and our multi-client data library businesses beginning in late 2008. Gross profit increased by $23.6 million to $78.2 million, representing a gross margin of 30.2%, compared to $54.6 million, representing a gross margin of 31.6%, during the twelve months ended December 31, 2007. The decrease in gross margins in this segment was mainly driven by the change in the sales mix between our new venture program sales and multi-client data library sales, partially offset by the higher levels of data processing revenues.

Research, Development and Engineering. Research, development and engineering expense was $49.5 million, or 7.3% of net revenues, for the year ended December 31, 2008, a decrease of $0.5 million compared to $50.0 million, or 7.0% of net revenues, for the corresponding period last year. We expect to continue to incur research, development and engineering expenses in 2009 at a more conservative rate than in prior years, as we continue to invest in our next generation of seismic acquisition products and services.

Marketing and Sales. Marketing and sales expense of $47.9 million, or 7.0% of net revenues, for the year ended December 31, 2008 increased $4.0 million compared to $43.9 million, or 6.2% of net revenues, for the corresponding period last year. The increase in our sales and marketing expenditures reflects the hiring of additional sales personnel, increased exhibit and convention costs and increased travel associated with our global marketing efforts. This increase was partially offset by a decrease in our corporate branding expenses in 2008, due to the higher expenses in 2007 associated with our name change that year.

General and Administrative. General and administrative expense of $70.8 million for the year ended December 31, 2008 increased $21.7 million compared to $49.1 million in the prior year. General and administrative expenses as a percentage of net revenues for the years ended December 31, 2008 and 2007 were 10.4% and 6.9%, respectively. The increase in expenditures was primarily due to increases in our bad debt reserves of $4.6 million, in our professional fees relating to our financing efforts of $5.7 million, in salaries and related expenses of $8.7 million due to the hiring of additional personnel and an increase in general office expenses related to our acquisition of ARAM. This increase was partially offset by a decrease in bonus expense due to the lower operating performance compared to 2007 s operating performance.

Impairment of Goodwill and Intangible Assets. At December 31, 2008, we evaluated our reporting units for potential impairment. Based upon our evaluation and given the current market conditions, we determined that approximately $252.3 million of goodwill and intangible assets related to our Land Imaging Systems, ARAM Systems and ION Solutions reporting units were impaired. We recorded the expense as of December 31, 2008 and reduced the carrying amount of our goodwill and intangible assets.

Income Tax Expense. Income tax expense for the year ended December 31, 2008 was $1.1 million compared to income tax expense of $12.8 million for the twelve months ended December 31, 2007. The decrease in tax expense

during 2008 primarily relates to reduced consolidated income from operations and changes to the valuation allowance on U.S. deferred tax assets. This decrease was partially offset by deferred taxes on the utilization of acquired net operating losses. We continue to maintain a valuation allowance for a significant portion of our U.S. net deferred tax assets. Our effective tax rate for the year ended December 31, 2008 was (0.5%) as compared to 23.1% for the similar period during 2007. The decreased effective tax rate for 2008 relates primarily to the impairment of goodwill, which has no tax benefit, and a reduction in the valuation allowance on U.S. deferred tax assets offset by deferred tax expense related to the utilization of acquired net operating losses of $3.5 million. The 2007 and 2008 effective tax rates

were lower than the statutory rate due to the goodwill impairment in 2008 and to the utilization of previously reserved U.S. deferred tax assets in both 2007 and 2008.

Preferred Stock Dividends and Accretion. The preferred stock dividend relates to our Series D Preferred Stock that we issued in February 2005, December 2007 and February 2008. Quarterly dividends must be paid in cash. Dividends are paid at a rate equal to the greater of (i) 5% per annum or (ii) the three month LIBOR rate on the last day of the immediately preceding calendar quarter plus $2^1/2$% per annum. All dividends paid to date on the Series D Preferred Stock have been paid in cash. The Series D Preferred Stock dividend rate was 6.55% at December 31, 2008.

Adjustments from Preferred Stock Redemption and Conversion Features. Our results of operations for 2008 reflected additional credits to and charges against our earnings resulting from our outstanding Series D-1 Cumulative Convertible Preferred Stock (the Series D-1 Preferred Stock), Series D-2 Cumulative Convertible Preferred Stock (the Series D-2 Preferred Stock) and Series D-3 Cumulative Convertible Preferred Stock (the Series D-3 Preferred Stock and together with the Series D-1 Preferred Stock and the Series D-2 Preferred Stock, the Series D Preferred Stock).

On November 28, 2008, we delivered a notice (the Reset Notice) to Fletcher International, Ltd. (Fletcher) of our election to reset the conversion prices on our outstanding shares of Series D Preferred Stock. See *Liquidity and Capital Resources Sources of Capital Cumulative Convertible Preferred Stock.* Fletcher is the holder of all of the outstanding shares of our Series D Preferred Stock. By delivering the Reset Notice to Fletcher, we reset the conversion prices on all of our Series D Preferred Stock to $4.4517 per share, in accordance with the terms of our agreement with Fletcher dated as of February 15, 2005 (as amended, the Fletcher Agreement). Under the Fletcher Agreement, if a 20-day volume-weighted average trading price per share of our common stock fell below $4.4517 (the Minimum Price), we would be required to (i) thereafter pay all dividends on shares of Series D Preferred Stock only in cash and (ii) elect to either (a) satisfy future redemption obligations by distributing only cash (or a combination of cash and common stock), or (b) reset the conversion prices of all of outstanding shares of Series D Preferred Stock to the Minimum Price, in which event the Series D Preferred Stock holder would have no further rights to call for the redemption of those shares.

We had originally classified the preferred stock outside of stockholders equity on the balance sheet below total liabilities. However, with the termination of the redemption rights, there are no other provisions that require cash redemption. Therefore, in the fourth quarter of 2008, we reclassified the preferred stock to stockholders equity.

The redemption features of our outstanding Series D-2 Preferred Stock and Series D-3 Preferred Stock had been considered embedded derivatives that were required to be bifurcated and accounted for separately at their fair value during 2008. These features had been bifurcated as a separate line item in the liabilities section of our consolidated balance sheet. For each quarter during 2008, these redemption features had been re-measured at qua