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Q4 2019 ION Geophysical Corp Earnings Call

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CORPORATE PARTICIPANTS

Christopher T. Usher *ION Geophysical Corporation - President & CEO*
Michael L. Morrison *ION Geophysical Corporation - Executive VP & CFO*
Rachel White *ION Geophysical Corporation - VP of Corporate Communications*

CONFERENCE CALL PARTICIPANTS

Joseph Mark Beninati *Oppenheimer & Co. Inc., Research Division - Associate*

PRESENTATION

Operator

Greetings, and welcome to the ION Geophysical Fourth Quarter Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Rachel White, VP of Corporate Communications. Thank you, Rachel. You may begin.

Rachel White ***ION Geophysical Corporation - VP of Corporate Communications***

Thank you, operator. Good morning, and welcome to ION's Fourth Quarter 2019 Earnings Conference Call. We appreciate your joining us today. As indicated on Slide 2, our hosts today are Chris Usher, President and Chief Executive Officer; and Mike Morrison, Executive Vice President and Chief Financial Officer.

Before I turn the call over to them, I have a few items to cover. We will be using slides to accompany today's call, which are accessible via link on our website, iongeo.com. There you will also find a replay of today's call.

Before we begin, let me remind you that certain statements made during this call may constitute forward-looking statements. These statements are subject to various risks and uncertainties, including those detailed in our latest 10-K and other SEC filings, which may cause our results or performance to differ materially from those projected in these statements.

Our remarks today may also include non-GAAP financial measures. Additional details regarding these non-GAAP financial measures, including reconciliations to the most directly comparable GAAP financial measures, can be found in our earnings release issued yesterday.

I'll now turn the call over to Chris, who will begin on Slide 4.

Christopher T. Usher ***ION Geophysical Corporation - President & CEO***

Thank you, Rachel. Good morning, everyone, and thanks again for joining us today. Our fourth quarter financial results were quite disappointing, primarily because we were not able to launch multiple new acquisition multi-client programs and close several data library deals in our pipeline. As a result, our full year results were down slightly rather than the upward trajectory we have been building towards for 2019, with timing on fourth quarter multi-client deals countering the annual improvements in all our other businesses.

We secured rights to acquire new multi-client programs in new geographies, but did not get the programs launched due to host government delays. In addition, tighter E&P budgetary controls and longer procurement processes have been impacting the data library business in recent years, but the fourth quarter phenomenon observed across our peer group appears to have different drivers. Despite significant deal volume during the quarter, several material data library deals on the order of tens of millions of dollars ultimately did not close by year-end. Several of our large data library customers have now reported deteriorated fourth quarter earnings due to the lower oil price, and given their strong focus on value generation, discretionary exploration data purchases were pushed out.

Just to give you a sense of the sales disruption in multi-client, 7 of our top 15 customers had more than a 3-fold change in 2019 ION spend versus an average of the prior 2 years. While we recognize the data library business has always been lumpy, we expect this more extreme activity to be temporary as market indicators are improving in the sectors we are targeting, and as I just mentioned, all our other business lines are up year-on-year.

As a result, we are focused on fundamentals and working areas we directly control: our strategy, organizational structure, costs and investments. We revamped our organizational structure in 2 key ways to improve our execution and accountability. We restructured our E&P Technology & Services segment to reflect our shift in multi-client strategy to include new 3D acquisition and implemented a significant cost-reduction program to lower our operating expenses. We reorganized our new venture sales organization to accelerate our entry into the 3D multi-client new acquisition market, bringing our projects closer to the reservoir, where capital investment tends to be more consistent and programs have larger scale revenue and earnings potential. This is our top operational objective for 2020.

We have been laying the groundwork for a more meaningful shift in focus for some time. We have rapidly grown our 3D data library from almost nothing to 350,000 square kilometers of seamlessly integrated, beautifully re-imaged data over the last few years, which has given us credibility and experience in the 3D space and led to a pipeline of opportunities for new 3D towed streamer and/or seabed programs we have not seen before. We completed development of enabling technologies like our Enhanced Frequency Source and 4Sea ocean bottom system to further increase the likelihood of our participation success in new 3D multi-client programs.

We also successfully released -- we also successfully increased Marlin adoption in our core market and gained traction in new markets. Therefore, we redistributed resources on the Software side to significantly increase the business development outreach to accelerate Marlin adoption by ports and harbors, which is our Company's second major operational objective.

On the cost side of the equation, we recognize the need to reduce our corporate cost structure. After monitoring the business and market for my first half year as CEO and taking into account the time it takes to adjust strategy, I felt we were due to undertake these restructuring actions. Our disappointing fourth quarter performance certainly cemented that decision, but it was something we needed to address in the market recovery that has been slower and more subdued than past cycles.

In January, we executed a program that will limit active priorities to improve focus and execution on strategic initiatives while delivering annualized cost savings of over $20 million. Mike will provide more detail on the savings impact this program will achieve shortly.

With that work behind us, I can say I'm still as excited about the business as when I took the CEO role. We are aligned around select initiatives that can uniquely position ION in the new industry landscape, which should lead to better financial results. Offshore is picking up, and we see material activity among our customer base to rebalance portfolios and maximize value, which drives related data sales opportunities that fill customer knowledge gaps.

We have reengaged around several large data library deals that slipped out in the fourth quarter, including a notable one that would have reshaped our 2019 results and could close as early as this quarter. There is a lot of positive momentum around 3D new acquisition multi-client opportunities and our growing operations optimization business, which I'll speak to next.

In our E&P Technology & Services segment, revenues decreased 51% this quarter compared to the fourth quarter 2018 due to a decrease in our multi-client revenues. While the quarterly decline is more pronounced in new venture activity, we had planned to finish the year strong with data library sales, per my earlier commentary. It is important to note that a significant phase of our largest 3D multi-client program, Picanha, offshore Brazil, recently went on the shelf, which attributes to some of the shift to data library in the fourth quarter.

For the year, E&P Technology Services revenues were down 8% while multi-client revenues were down 12%. About a third of our full year multi-client revenues were from our growing Picanha program offshore Brazil.

We expanded our data library portfolio significantly during 2019, increasing 2D by 16%, and more importantly, 3D by 56%. We sanctioned 12 new multi-client programs, ahead of our goal of 8 and compared to 7 for all of 2018. While the quantity improved, the scale and timing of new multi-client programs didn't materialize as we envisioned, especially the two higher-dollar investment programs that were delayed due to governmental access. Of the two large programs we anticipated launching in the second half, we were successful in gaining an award on one, but it has not yet started. And the second one, the tendering process and permitting have been delayed since the summer. Also, 4 of the 12 programs were sanctioned in December, so most of the revenue for those programs will start flowing in 2020.

During the quarter, we sanctioned 5 new multi-client programs. We spoke about the 3D reimaging program in Argentina's unconventional Neuquén Basin last call and have since sanctioned 3 new 3D reimaging programs offshore Brazil totaling 65,000 square kilometers, building on our substantial offering there. We also sanctioned a 27,000-kilometer 2D reimaging program offshore Colombia.

In addition to reprocessing existing data, Colombia's National Hydrocarbon Agency, the ANH, also recently granted us rights to acquire new 2D and 3D multi-client programs offshore.

Early in the first quarter, we sanctioned a new 3D reimaging program offshore Uruguay. Leveraging our existing regional UruguaySPAN data and subsurface knowledge, we are reimaging 22,000 square kilometers of data over the country's deep water blocks to create a holistic exploration perspective of the continental margin.

Looking forward to 2020, we worked hard to diversify our portfolio mix to target all aspects of E&P spending, a large part of which was moving closer to the reservoir. We can now support clients' strategic decision-making around infrastructure-led exploration near existing production, emerging basins, lower breakeven opportunities and targeted frontier basins. Spending is shifting back offshore as customers seek to rebalance portfolios, whether that's diversifying out of shale or filling knowledge gaps in attractive acreage opportunities. We are strategically leveraging our global BasinSPAN library to identify opportunities to expand our multi-client offerings to 3D, through either reimaging or new acquisition as the opportunities dictate.

Last quarter, we spoke about our ability to differentiate in the rapidly evolving ocean bottom ecosystem with our enhanced frequency source. As a reminder, this novel energy source significantly extends low frequencies in the acquired data for improved velocity model estimation while limiting higher frequencies to a more environmentally-friendly range.

Developed in collaboration with an E&P operator and validated during multiple field trials over the last 24 months, we have established significant industry support for this solution to be a key ingredient, increasing the final image quality of both seabed as well as towed streamer datasets. We are actively engaged with customers and launch partners around our 2020 commercialization roadmap.

We are maturing our pipeline of 3D new acquisition opportunities and have secured a number of 3D multi-client permits around the world. We believe our technology portfolio, including our enhanced frequency source, will be a key ingredient in successfully executing this significant addition to ION's data library portfolio and are hoping to announce a 3D new acquisition multi-client program in the second quarter.

Our Imaging Services revenues were up 14% this quarter and for the full year. We continue to strategically reserve the majority of our imaging capacity to distinguish our multi-client offerings and deploy the remaining resources on challenging proprietary projects that keep ION's tier 1 imaging brand at the forefront of our customers' minds. This is important when those customers become potential underwriters for new multi-client programs.

Our Imaging Services team focuses on key basins and clients that enable us to continually advance our proprietary technology suite, and 80% of our 2019 business met this criteria. We have had strong repeat business under this strategy and attracted new clients who have benefited from our approach to problem solving and customer service. Imaging Services backlog remains healthy.

Our Operations Optimization revenues were up 13% this year, largely due to new technology sales and increased marine equipment replacement and repairs. Our Software group's revenue was up 10% annually, reaching the highest level since the downturn, due to continued strong performance of our command and control solutions, combined with robust Marlin-related revenues and deployments. We renewed two long-term command and control contracts during the quarter, one for towed streamer and one for seabed. We don't consider these long-term contracts as backlog per se in the Operations Optimization side of our business, but this recurring revenue lease model provides great stability for our software business.

I'm very pleased that about 20% of our Software revenues this year were from recent technology investments and commercialization. Our Marlin software continues to drive improved operational performance and efficiency offshore and has become a recognized enabler for maritime digital transformation in our market segment. We doubled the number of companies committed to the use of Marlin, moving from 3 to 6 long-term contracts.

Moving to adjacent markets, our Marlin SmartPort pilot in the U.K. is progressing nicely. Our latest release is successfully deployed with this anchor customer and is already surpassing expectations around the digitalization of port workflows. Given our progress, we ramped up our Marlin SmartPort business development capacity during the quarter and just secured another U.K. port and ferry customer. Despite cuts we made in other parts of ION's business, we will add sales resources this quarter to address ports in other geographies, given the appeal of the solution. We are working with industry experts to refine our Marlin SmartPort roadmap and continue to engage closely with AWS to assure efficient provision of the Software as a Service solution and develop other Ports and Harbor offerings. I'm pleased with the progress we've made executing key initiatives in our Software business that position the company for future success in both core and adjacent markets.

In the Devices group of our Operations Optimization segment, revenues were up 16% year-on-year, driven by an increase in towed streamer equipment replacement and repairs. Our towed streamer clients are seeing higher crew utilization and improved pricing for proprietary surveys and, correspondingly, we have the highest level of contracted business since the downturn.

SailWing deployments in the seabed segment continued to go well, and the solution clearly provides both efficiency and positioning accuracy to our clients' projects.

During the fourth quarter, we reviewed the adjacent market initiatives underway in our Devices business. With a purposeful intent across ION to do fewer things better, we identified Devices activities exhibiting broader synergies with our Software business versus some technical successes that perhaps lack future materiality, and shelved the latter.

We mentioned our successful Port Security demo at the U.S. Navy's Advanced Naval Technology Exercise (ANTX) in a prior call, which featured Marlin as the technology integration center piece. That success has led to our recent invitation back by the Navy for their ANTX 2020 event to demo our next generation of this solution. We believe the Harbor Security market is closely aligned to our activities in the broader Ports and Harbors digital transformation arena, and synergies here can drive our diversification efforts much more rapidly across our Operations Optimization segment.

With that, I'll turn it over to Mike to walk us through the financials, and then I'll wrap up before taking questions.

Michael L. Morrison ***ION Geophysical Corporation - Executive VP & CFO***

Thanks, Chris. Good morning, everyone. I'd like to take a moment to introduce myself in my first call as CFO, before reviewing our financial results. I have over 25 years of finance and accounting experience, the last 17 I've spent at ION. The first decade of my career was primarily focused on accounting and auditing. The second decade centered on the controllership at ION. During this time frame, ION started strategically pivoting to a solutions company, and I helped acquire and integrate some of the company's most successful acquisitions.

Most recently, my focus was on finance, FP&A, capital market transactions and increasingly operational finance, leading to my most recent role as VP of Finance and Treasurer, where I served as Steve Bate's right-hand man for the last 5 years. Steve will remain with ION until the end of June to help facilitate a smooth transition.

With that introduction, I will now walk through the financials. Our full year revenues were $175 million, down 3% compared to 2018, the result of the decline in fourth quarter multi-client revenues. Excluding multi-client revenues, all other businesses were up year-over-year. Our full year Adjusted EBITDA was $32 million compared to $42 million last year.

Moving to the fourth quarter, our revenues were $43 million, down 43% compared to the fourth quarter of 2018. Revenues in our E&P Technology & Services segment were down 51% and our Operations Optimization segment revenues were down 8%. The decrease in revenues within E&P Technology & Services was driven by our multi-client revenues, which declined by 57% compared to the fourth quarter of 2018. As Chris mentioned, this was largely related to our new venture programs and reduced year-end data library spending.

A bright spot was in our Imaging Services group, which had revenues of $6 million, a 14% increase this quarter. Our Imaging Services business remains healthy as we enter 2020 with backlog more than double that of one year ago.

In our Operations Optimization segment, Optimization Software & Services revenues were $5 million, a 9% decline from the fourth quarter of 2018 and our Devices revenues were $8 million, an 8% decline. Both groups were modestly down during the quarter due to the normal ebbs and flows of those businesses.

For the full year, Optimization Software & Services revenues were up 10%, the result of increased Marlin deployments. And Devices revenues were [up] (added by company after the call) 16%, driven by increase in towed streamer equipment replacement and repairs.

Overall, we reported a net loss for the fourth quarter of $14 million or a loss of $1.02 per share compared to a net loss of $19 million or a loss of $1.38 per share in the fourth quarter of 2018. Excluding special items in both periods, our adjusted net loss was $6 million or a loss of $0.40 per share compared to an adjusted net income of $15 million or $1.07 per diluted share in the fourth quarter of 2018. The special item impacting our fourth quarter 2019 primarily related to a non-cash charge of $9 million associated with the impairment of certain older vintages of our 2D data library. You can find a detailed reconciliation of the special items in our financial results in the tables of our press release issued yesterday.

As Chris mentioned, we implemented a cost savings program in January. This program focused on reducing our use of contractors and eliminating certain discretionary spending, reducing our facilities and reducing our workforce by around 11%. Overall, this program will save over $20 million on an annualized basis. We will start to benefit immediately from these reductions, realizing the full effect of these savings starting in the fourth quarter of this year.

To help illustrate the meaningful impact of these cost savings, on a pro forma basis, our full year 2019 Adjusted EBITDA would have been over $50 million or greater than 30% of our 2019 revenues. Our cash balance was $33 million, and there were no outstanding amounts under our credit facility at the end of the year.

Our total liquidity, defined as the combination of our cash balance and the available borrowing capacity under our revolving credit facility, was $72 million, up $7 million from one quarter ago and down $3 million from the end of last year. Despite the decline in fourth quarter revenues, our liquidity remains healthy as we head into 2020.

With that, I'll turn it back to Chris.

Christopher T. Usher ***ION Geophysical Corporation - President & CEO***

Thanks, Mike. So we have digested our disappointing fourth quarter, and made some required course adjustments to set the stage for more consistent and improved performance. While 2020 outlooks are still crystalizing as our clients finalize budgets, we expect E&P and seismic spending to be up single digits year-on-year with more investments flowing offshore. We anticipate stronger double-digit growth in the key areas we play, such as multi-client. We also believe there is an emerging trend among our E&P client base for more disciplined budgeting processes that will lead to more regular spending throughout the year, with perhaps less discretionary funds left over in the fourth quarter for data purchases. Part of our reorganization is aimed at adjusting our customer engagement and account planning to address this possibility.

So given an E&P recovery that's still developing, we will not solely rely on market growth to improve our business. We are focused on controlling costs and entering new market segments where we believe we're competitive. In a seismic landscape that is largely bifurcated into asset-light players and asset-only providers, we believe we are different; Our customers have said we "punch above our weight" in terms of innovation.

In 2020, we will do fewer things better, and we will continue to build a culture around execution. We are reorganized and focused on materially entering the 3D new acquisition multi-client market and building out the Marlin SmartPort business. We believe the combination of our streamlined strategy, reorganization, and cost reductions will enable us to deliver the first full year of profitability in recent memory.

With that, we'll turn it back to the operator for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Colin Rusch of Oppenheimer & Company.

Joseph Mark Beninati ***Oppenheimer & Co. Inc., Research Division - Associate***

This is Joe on for Colin. Can you give a little update on the pace of the sales cycle for your Imaging Services business? I see that the backlog has grown, but are you seeing clients make purchasing decisions on shorter time lines?

Christopher T. Usher ***ION Geophysical Corporation - President & CEO***

Joe, yes, this is Chris, thank you so much for joining us this morning. Well, first thing on the Imaging Services, we're certainly seeing more tender activity than we've seen. So it's kind of a bellwether for things gradually picking up. In terms of making decisions, it depends because you have some surveys that are very large that people put out there and you're also in the proprietary market waiting for also acquisition to be awarded, which can be the driver on delays or timing. So for some of those, you see that takes a long time to get the awards. But for the reprocessing, that stuff -- the data already exists. The clients have access to those tapes. So those tend to go pretty quickly. So -- and we are seeing a trend towards a larger deal size, which is a good thing. People are -- have obviously an appetite and budget for reprocessing or processing larger surveys.

So I don't -- I certainly don't see a trend where the timing to close deals is pushing out. It's variable depending on the size of the surveys and whether they're new acquisition or reprocessing. But I don't -- I think we're in good shape there.

Joseph Mark Beninati ***Oppenheimer & Co. Inc., Research Division - Associate***

Got it. Kind of switching gears. How many customers do you all have currently testing the Marlin offering? And then, I guess, talking about how much that's grown in the last year.

Christopher T. Usher ***ION Geophysical Corporation - President & CEO***

Sure. So on the Marlin side, you got -- obviously, we've got our core market seismic where we've made good progress, which I reflected on year-on-year. So we often have people using it on a temporary basis, on a project basis. It's clearly useful in very congested areas, complicated operational environment. So over the last 18 months, we've had no trouble getting people to just deploy it on a project basis. And obviously, our long-term objective is getting long-term subscribers for the software, just like our core command and control business. And we've been successful there. As I noted, we went from 3 long-term installations to 6, and we got -- we basically -- and that's been with oil companies and also with the contractor base. The contractor base has been the most resistant to signing up for long-term contracts. They clearly wanted to just try it out where they needed it. But we've been successful this year and actually getting 3 of our contractor customers over the line, and they've tagged on Marlin into their long-term multi-year software lease agreements, kind of tagged on to our command and control leases. So that's been very good. So it's completely commercial that's out there. It's just a question of getting people to decide to adopt it for the long term.

The area where it's being tested more is in the adjacent markets, where people have not been familiar with the track record with Marlin that we've had in the seismic business over the last couple of years. So we're entering brand-new markets, and that's where it's been very satisfying as well. We've had Ports and Harbors customers who we really only started focusing on last year in 2019, once we identified that was an interesting market and digital transformation was starting to take hold and initial discussions with some ports were very interesting. So we've been able to put Marlin in front of those guys on a test basis and very quickly convert them to take it onboard and then help us define the roadmap for customizing the software for those installations. But they've actually made a purchasing decision based on the existing product with very little testing and just kind of saying, next year, we'd like to add this feature. The year after, we'd like to see this, connecting the back office invoicing systems, et cetera. So we've had 2 of those just in the fourth quarter. We had 2 customers go live with Marlin in the port space.

Does that answer your question?

Joseph Mark Beninati ***Oppenheimer & Co. Inc., Research Division - Associate***

Yes.

Operator

(Operator Instructions) Mr. Usher, there are no further questions at this time. The floor is yours for any closing comments.

Christopher T. Usher ***ION Geophysical Corporation - President & CEO***

Thank you very much. Well, I appreciate everyone coming on the call today and listening to our full year and fourth quarter results in 2019 as well as the outlook we have for 2020. Thank you for taking the time to attend the call, and we look forward to speaking to you on the first quarter, and hopefully, have some interesting updates for you at that time.

Operator

Ladies and gentlemen, thank you for your participation. This does conclude today's teleconference. You may disconnect your lines, and have a wonderful day.