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Q1 2019 ION Geophysical Corp Earnings Call

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## CORPORATE PARTICIPANTS

**R. Brian Hanson** *ION Geophysical Corporation - President & CEO*  
**Rachel White** *ION Geophysical Corporation - VP of Corporate Communications*  
**Steven A. Bate** *ION Geophysical Corporation - Executive VP & CFO*

## CONFERENCE CALL PARTICIPANTS

**Andrew McLellan**

## PRESENTATION

### Operator

Greetings and welcome to the ION Geophysical First 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, Vice President of Corporate Communications.

Thank you, Miss White, you may begin.

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

Thank you, operator. Good morning and welcome to ION's first quarter 2019 earnings conference call. We appreciate your joining us today. As indicated on Slide 2, our hosts today are Brian Hanson, President and Chief Executive officer; and Steve Bate, 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, they are accessible via a link on the Investor Relations page of our website, iongeo.com. There you will also find a replay of today's call.

Moving on to Slide 3. Information reported on this call speaks only as of today, May 2, 2019, and therefore you are advised that time-sensitive information may no longer be accurate at the time of any replay.

Before we begin, let me remind you that certain statements made during this call may constitute forward-looking statements, which are based on our current expectations and include known and unknown risks, uncertainties and other factors, many of which we are unable to predict or control that may cause our actual results or performance to differ materially from any future results or performance expressed or implied by those statements.

These risks and uncertainties include the risk factors disclosed by ION from time to time in our filings with the SEC, including in our annual report on Form 10-K and in our quarterly reports on Form 10-Q. Furthermore, as we start this call, please refer to the disclosure regarding forward-looking statements incorporated in our press release issued yesterday, and please note that the contents of our conference call this morning are covered by these statements.

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

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### **R. Brian Hanson** *ION Geophysical Corporation - President & CEO*

Thanks, Rachel, and good morning, everyone. We're off to a positive start given the uncertain outlook many of our E&P clients had in December due to oil price volatility. Our revenues were up 10% across both of our business segments. Net cash flows from operations were \$15 million compared to \$1 million in the first quarter of 2018. Including investing and financing activities, we generated \$5 million of cash during the quarter, increasing our total liquidity to \$78 million.

In our E&P Technology & Services segment, most clients are indicating their budgets will be flat or up slightly in line with analysts' expectations that E&P spending will be up single digits this year. However, global exploration spending remains very focused as E&P companies continue to prioritize cash conservation over reserve replacement. It remains unclear how robust exploration activity and funding will be in 2019. We expect the majority of multi-client data sales to be tied to license rounds closing this year.



Our new venture program activity continues to improve and we plan to increase the number of new sanctioned programs this year. We are cautiously optimistic, given the uptick in new venture interest and activity we're seeing. We have already sanctioned five new multi-client programs this year compared to seven for all of last year. I'll speak to the three that we've announced so far.

We are continuing to expand our large Picanha 3D reimagining program offshore Brazil with a fourth phase further north. The Picanha program seamlessly integrates over 50 surveys to provide a regionally calibrated and consistently imaged 3D dataset across the Campos and Santos basins.

We also sanctioned a new 2D multi-client reimagining program offshore Brazil called Farofa, which covers deepwater acreage in the Campos basin that will be available for licensing this October in Brazil's upcoming Round 16. These two programs expand our data library offshore Brazil to 75,000 square kilometers of 3D data and 85,000 kilometers of 2D data.

Maya is a new 2D multi-client reimagining program off the Pacific coast of Central America. A broad range of E&P companies are looking to add new low-cost reserves to their portfolios and are interested in exploring some new frontiers. The 9,000-kilometer program covers unexplored, open acreage that has not had E&P activity in 40 years, but previous exploration wells suggests the presence of an active petroleum system.

Backlog is also up \$7 million sequentially to \$29 million. Imaging Services backlog is the highest it's been in 3.5 years, driven primarily by continued awards of higher value, technology-driven ocean bottom nodal projects.

In our Operations Optimization segment, our Software group's revenue was up due to record engineering services revenues, primarily driven by the high volume of Marlin deployments. 20% of our Software revenue was attributable to Marlin this quarter. Marlin deployments continue to grow across both service providers and E&P customers with sustainable growth now arising from long-term customer commitments. In adjacent markets, we are working closely with a U.K. customer to configure our Marlin ports and harbors offering, to be branded SmartPorts, for a late second quarter deployment as part of their digital transformation initiative.

Partnerships are key to our Marlin adoption strategy. We continue to improve Marlin's ease of adoption, working closely with the leading cloud services provider and in the quarter also established partnerships with a drilling logistics software firm and a weather data content provider to further extend Marlin's footprint.

In the Devices group of our Operations Optimization segment, revenues were up 16% year-on-year, due to an increase in our towed streamer equipment repair business, monetization of a seabed monitoring solution, modest growth of our sensor offerings for seabed nodal providers and the release of our new lower frequency 5 Hertz sensor.

The ocean bottom market is projected to continue growing due to its value in optimizing production. As a reminder, we are offering 4Sea components more broadly to the growing number of OBS service providers under recurring revenue commercial strategies that enable us to share in the value our technology delivers. The remaining elements of our next-generation ocean bottom nodal system, 4Sea, are on track to be commercialized in 2019.

After another successful proof-of-concept demonstration, we were able to achieve deployment and retrieval speeds of 5 knots. We finalized the design of a proprietary back deck system, which has the potential to dramatically improved the economics of today's very expensive nodal surveys to automation and unique attachment.

We also held two successful SailWing field trials with 2 different clients this quarter, who are potential launch partners. SailWing is an innovative foil-based alternative to conventional bulky marine diverters and has the potential to be \$3 million to \$5 million a year of high-margin recurring niche revenue as we gain traction improving source vessel performance in the growing ocean bottom market place.

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



**Steven A. Bate ION Geophysical Corporation - Executive VP & CFO**

Thanks, Brian. Good morning, everyone. Our total first quarter revenues were up 10% compared to the first quarter of 2018. Revenues in our E&P Technology & Services segment and Operations Optimization segment both increased by 10%.

As we mentioned in our last earnings call in February, we have discontinued reporting our Ocean Bottom Integrated Technologies as a separate segment. Going forward, all revenues and costs from our 4Sea technologies will be recorded in the relevant other two segments with the majority of the 4Sea technology cost residing in Operations Optimization in 2019.

Within our E&P Technology & Services segment, our multi-client revenues were \$23 million, an increase of 19% over the first quarter of 2018, with data library revenues increasing by 67% and new venture revenues essentially flat to the first quarter of 2018.

The increase in our data library revenues was primarily due to sales of our recently completed Brazil 3D reimagining programs and existing Brazil 2D data library. Our Imaging Services revenues were \$4 million, a decrease of 25%. While Imaging Services experienced a decline in revenues, a significant number of new projects closed during the quarter, increasing Imaging Services backlog to its highest level since 2015. This increase in Imaging Services backlog should lead to an increase in revenue during the remainder of 2019.

In our Operations Optimization segment, our Optimization Software & Services revenues were \$5 million, a 5% increase from the first quarter of 2018. This was due to an increase in engineering services revenues, primarily driven by the continued increase in market adoption and deployment of our Marlin offshore operations optimization software. Devices revenues were \$5 million, a 16% increase, driven by an increase in repairs.

While we experienced an increase in our consolidated revenues, our overall operating margin declined compared to the first quarter of 2018, due in part to an increase in our compensation expenses as we recorded \$5 million of SARs expenses compared to \$1 million in the first quarter of 2018.

Overall, we reported a net loss for the first quarter of \$21 million or \$1.52 per share compared to a net loss of \$18 million or \$1.44 per share in the first quarter of 2018.

Our adjusted EBITDA for the first quarter was a negative \$5 million, compared to a negative \$1 million, 1 year ago. The decline in our adjusted EBITDA was related to the increase in compensation expense I described a moment ago.

Our liquidity remains strong at \$78 million, an increase of \$4 million from 1 year ago.

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

**R. Brian Hanson ION Geophysical Corporation - President & CEO**

Thanks, Steve. We continue to believe market fundamentals will gradually improve as it becomes increasingly critical to meet production demand in the next decade. While we do not provide guidance, we currently anticipate 2019 will be a significant improvement on 2018, subject to E&P budget levels increasing as expected.

Primary drivers in improvement include an increase of new venture programs as compared to 2018, any benefit of the 2018 program sales pushed into 2019, a software business that is experiencing solid growth and the commercialization of several offerings we developed over the last few years. The combination of recently closed deals, general momentum and backlog, we expect to recognize during the second quarter suggests we have already exceeded the second quarter 2018's revenue and EBITDA with 2 months left to go.

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

**Operator**

(Operator Instructions) Our first question comes from the line of Andrew McLellan with Wasserstein Company.

**Andrew McLellan**

I just had a question around the SARs that you mentioned. If you add back some of the noncash stock expense during the quarter, what adjusted EBITDA will look like?

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**Steven A. Bate ION Geophysical Corporation - Executive VP & CFO**

Thanks, Andrew. This is Steve. It would be roughly flat quarter-over-quarter.

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**Andrew McLellan**

And is that the right way as we think about just the SARs impact going forward? Could you just elaborate on how we should kind of model that out?

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**Steven A. Bate ION Geophysical Corporation - Executive VP & CFO**

Yes, it's a complicated topic. I won't get into all the details, but the 2016 SARs are now fully vested and so they get -- they're going to get mark-to-market every quarter and so it's going to move with the stock price.

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**Andrew McLellan**

Okay. Any updates on Panama? And what we...

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**R. Brian Hanson ION Geophysical Corporation - President & CEO**

Yes. No real update other than -- yes, no real update, Andrew, other than -- it's the same as last quarter. We're waiting for the elections in May, and then we'll evaluate on the other side of the elections.

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**Andrew McLellan**

Got it. And then the other comment that you made, Brian, at the end of the prepared comments with regards to the second quarter trajectory 2 months ago and EBITDA being kind of at similar levels to last year's second quarter. What's the driver so far that you're seeing that's providing kind of the improvement at least so far in April?

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**R. Brian Hanson ION Geophysical Corporation - President & CEO**

I would say the drivers are -- if you look across every segment of our business, every segment of our business this year is healthy and performing. Where if you went back to the second quarter of 2018, every segment of our business but the multi-client segment performed in that quarter. So I'd expect the second quarter of this year to be significantly better than last year.

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**Andrew McLellan**

Got it. And in terms of the new programs, you said five already this year versus seven all of last year. What do you expect that number to be in terms of guideposts for the year?

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**R. Brian Hanson ION Geophysical Corporation - President & CEO**

A little early to give you that kind of direction. We're seeing improved or increased interest in our multi-client programs. So we're going to need a little bit more time to really flesh that out. It's still early stages with our customers.

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**Andrew McLellan**

Directionally, can you give us kind of a guidepost though on -- is it north of 10? Is it north of 15? Or too early to tell?

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**R. Brian Hanson ION Geophysical Corporation - President & CEO**

Yes, it's too early to tell. And also, all programs are not created equal, right? Some are small, some are large. And so the absolute numbers, probably as not as meaningful as just. Probably we'll have to give you a lot more color on the next call.

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**Andrew McLellan**

And in terms of the backlog improvement that's up \$7 million, I think you mentioned. Where would we see that in the business as we go through the year? What part of the business would that benefit the most?

**R. Brian Hanson *ION Geophysical Corporation - President & CEO***

Well, the largest increase in backlog in the last quarter was attributed to the Imaging Services side of the business.

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**Andrew McLellan**

Got it. And sorry one last question. I think in the 10-K, you provided just kind of guideposts around multi-client investments for the year. Is that, has that stayed consistent with what was provided previously, in terms of what you expect to spend this year?

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**Steven A. Bate *ION Geophysical Corporation - Executive VP & CFO***

Yes, Andrew this is Steve, that guidance hasn't -- we're still standing by that.

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**Operator**

There are no further questions in the queue. I'd like to hand the call back to management for closing comments.

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**R. Brian Hanson *ION Geophysical Corporation - President & CEO***

Well, thank you for taking the time to attend our conference call. We look forward to speaking to you on the second quarter call.

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**Operator**

Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time, and have a wonderful day.

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