APOLLO INVESTMENT CORP
Form 10-Q
August 04, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number: 814-00646
APOLLO INVESTMENT CORPORATION
(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| Maryland | 52-2439556 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 9 West 57th Street<br>37th Floor<br>New York, New York | 10019 |
| (Address of principal executive offices) | (Zip Code) |

(212) 515-3450
(Registrant's telephone number, including area code)
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 x No ¨
Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨
Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class of Common Stock | Outstanding at August 3, 2017 |
|---|---|
| $0.001 par value | 219,694,654 |

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PART I. FINANCIAL INFORMATION

In this report, the terms the "Company," "Apollo Investment," "AIC," "we," "us," and "our" refer to Apollo Investment Corporation unless the context specifically states otherwise.

Item 1. Financial Statements

APOLLO INVESTMENT CORPORATION

STATEMENTS OF ASSETS AND LIABILITIES

(In thousands, except share and per share data)

| | June 30, 2017 (Unaudited) | March 31, 2017 |
|---|---|---|
| Assets | | |
| Investments at fair value: | | |
| Non-controlled/non-affiliated investments (cost — $1,493,015 and $1,510,980, respectively) | $1,475,682 | $1,402,409 |
| Non-controlled/affiliated investments (cost — $242,840 and $417,471, respectively) | 220,149 | 239,050 |
| Controlled investments (cost — $729,539 and $676,972, respectively) | 720,748 | 675,249 |
| Total investments at fair value (cost — $2,465,394 and $2,605,423, respectively) | 2,416,579 | 2,316,708 |
| Cash and cash equivalents | 29,853 | 9,783 |
| Foreign currencies (cost — $2,801 and $1,494, respectively) | 2,837 | 1,497 |
| Receivable for investments sold | 4,812 | 40,226 |
| Interest receivable | 18,709 | 17,072 |
| Dividends receivable | 3,163 | 6,489 |
| Deferred financing costs | 16,633 | 17,632 |
| Prepaid expenses and other assets | 857 | 713 |
| Total Assets | $2,493,443 | $2,410,120 |
| | | |
| Liabilities | | |
| Debt | $920,674 | $848,449 |
| Payable for investments purchased | 26,109 | 13,970 |
| Distributions payable | 32,954 | 32,954 |
| Management and performance-based incentive fees payable | 17,345 | 16,306 |
| Interest payable | 11,612 | 7,319 |
| Accrued administrative services expense | 1,166 | 2,250 |
| Other liabilities and accrued expenses | 5,959 | 7,075 |
| Total Liabilities | $1,015,819 | $928,323 |
| Commitments and contingencies (Note 8) | | |
| Net Assets | $1,477,624 | $1,481,797 |
| | | |
| Net Assets | | |
| Common stock, $0.001 par value (400,000,000 shares authorized; 219,694,654 and 219,694,654 shares issued and outstanding, respectively) | $220 | $220 |
| Paid-in capital in excess of par | 2,924,775 | 2,924,775 |
| Accumulated underdistributed net investment income | 88,500 | 88,134 |
| Accumulated net realized loss | (1,511,380) | (1,277,625) |
| Net unrealized loss | (24,491) | (253,707) |
| Net Assets | $1,477,624 | $1,481,797 |
| | | |
| Net Asset Value Per Share | $6.73 | $6.74 |

See notes to financial statements.

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APOLLO INVESTMENT CORPORATION
STATEMENTS OF OPERATIONS (Unaudited)
(In thousands, except per share data)

| | Three Months Ended June 30, | |
|---|---|---|
| | 2017 | 2016 |
| Investment Income | | |
| Non-controlled/non-affiliated investments: | | |
| Interest income | $41,008 | $48,343 |
| Dividend income | — | 1,104 |
| Other income | 1,129 | 1,699 |
| Non-controlled/affiliated investments: | | |
| Interest income | 2,551 | 262 |
| Dividend income | 1,087 | 3,046 |
| Other income | (306 ) | 70 |
| Controlled investments: | | |
| Interest income | 16,392 | 17,245 |
| Dividend income | 4,850 | 4,700 |
| Other income | — | — |
| Total Investment Income | $66,711 | $76,469 |
| Expenses | | |
| Management fees | $12,125 | $14,398 |
| Performance-based incentive fees | 7,912 | |

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 allows companies the option to report certain financial assets and liabilities at fair value, establishes presentation and disclosure requirements and requires additional disclosure surrounding the valuation of the financial assets and liabilities presented at fair value on the balance sheet. The provisions of SFAS 159 are effective for fiscal years beginning after November 15, 2007. The Company did not elect the fair value option for any of its financial assets or liabilities, and therefore, the adoption of SFAS 159 had no impact on the Company s consolidated financial position, results of operations or cash flows.

**Item 2.** ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

**Executive Summary**

We are a technology-focused seismic solutions company, providing the global oil and natural gas industry with a variety of seismic products and services, including land and marine seismic data acquisition equipment, survey design planning services, software products, seismic data libraries, and seismic data processing services. In recent years, we have transformed our business from being solely a seismic equipment manufacturer to being a provider of a full range of seismic imaging products and services including designing and planning a seismic survey, overseeing the acquisition of seismic data by seismic contractors, and processing the acquired seismic data using advanced algorithms and mode workflows.

We operate our company through four business segments: three of these segments Land Imaging Systems, Marine Imaging Systems and Data Management Solutions make up our ION Systems Division, and the fourth segment is our ION Solutions Division. Our current growth strategy is predicated on successfully executing six key imperatives:

- Expanding our ION Solutions business in new regions with new customers and with new 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 locations, and expanding our presence in the land seismic processing segment;

- Successfully developing and introducing our next generation of marine towed streamer products;

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Expanding our seabed imaging solutions business using our VectorSeis Ocean® (VSO) acquisition system platform and derivative products;

Increasing our market share in cable-based land acquisition systems through the latest version of our Scorpion® acquisition system; and

Ongoing development and further commercialization of FireFly®, our cableless full-wave land acquisition system.

During the three months ended March 31, 2008, our ION Solutions and Data Management Solutions segments experienced strong percentage increases in revenues compared to their revenues for the comparable three months in 2007. Our Land Imaging Systems and Marine Imaging Systems segments revenues for 2008 s first quarter declined compared to their revenues in 2007 s first quarter. This decline was principally due to the fact that shipments of our VectorSeis® Ocean (VSO) data acquisition systems and a FireFly system sale were recorded in the first quarter of 2007. These large sales were not duplicated in the first quarter of 2008, further demonstrating the unevenness of our period-to-period sales. Our total net revenues of $140.2 million for the three months ended March 31, 2008 decreased $24.9 million, or 15.1%, compared to fiscal 2007 total net revenues. However, despite the decrease in revenues, overall gross margin percentages were 34.5%, an increase of 10.8% in our consolidated gross margin percentages compared to the first quarter of 2007. Additionally, overall income from operations for the three months ended March 31, 2008 grew by over 70% compared to income from operations for the comparable period in 2007.

During the three months ended March 31, 2008, we continued to see interest in our new technologies. For example:

In March 2008, we completed acquisition of our latest basin-scale seismic survey library. The program provides a new regional 2D seismic framework of the Eastern Java Sea and the Makassar Straits, two highly prospective areas offshore Indonesia and Malaysia. Data for nearly 10,000 kilometers were acquired during the acquisition phase of this project.

We completed sales of three of our DigiFIN advanced streamer command and control systems for $5.5 million as market demand continues to be strong for our new product.

The following table provides an overview of key financial metrics for our company as a whole and our four business segments during the three months ended March 31, 2008 compared to those periods one year ago (in thousands, except per share amounts):

| | **Three Months Ended March 31,** | | |
|---|---|---|---|
| | **2008** | **2007** | **Year-over-year Increase (decrease)** |
| Net revenues: | | | |
| Land Imaging Systems | $ 49,888 | $ 73,486 | (32.1%) |
| Marine Imaging Systems | 34,488 | 44,149 | (21.9%) |
| Data Management Solutions | 9,166 | 6,560 | 39.7% |
| Total ION Systems | 93,542 | 124,195 | (24.7%) |
| ION Solutions | 46,617 | 40,850 | 14.1% |
| Total | $ 140,159 | $ 165,045 | (15.1%) |
| Income from operations: | | | |
| Land Imaging Systems | $ 3,295 | $ 4,365 | (24.5%) |
| Marine Imaging Systems | 10,001 | 11,990 | (16.6%) |

| | | | |
|---|---|---|---|
| Data Management Solutions | 5,208 | 1,781 | 192.4% |
| Total ION Systems | 18,504 | 18,136 | 2.0% |
| ION Solutions | 6,227 | (416) | 1,569.9% |
| Corporate | (14,436) | (11,776) | (22.6%) |
| Total | $ 10,295 | $ 5,944 | 73.2% |

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

There are a number of factors that could impact our future operating results and financial condition, and may, if realized, cause our expectations set forth in this Form 10-Q and elsewhere to vary materially from what we anticipate. See Part II, Item 1A. *Risk Factors* below.

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The information contained in this Quarterly Report on Form 10-Q contains references to our trademarks, service marks and registered marks, as indicated. Except where stated otherwise or unless the context otherwise requires, the terms VectorSeis, GATOR, Scorpion, Orca, and FireFly refer to our VectorSeis®, GATOR®, Scorpion®, Orca® and FireFly® registered marks, and the terms DigiFIN and DigiSTREAMER refers to our DigiFIN and DigiSTREAMER trademarks and service marks.

**Results of Operations**

**Three Months Ended March 31, 2008 Compared to Three Months Ended March 31, 2007**

*Net Revenues*. Net revenues of $140.2 million for the three months ended March 31, 2008 decreased $24.9 million, or 15.1%, compared to the corresponding period last year. Land Imaging Systems net revenues decreased by $23.6 million, to $49.9 million compared to $73.5 million in the corresponding period of last year. This decrease related mainly to the FireFly system sale of $20.8 million in the first quarter of 2007 that was not duplicated in the first quarter of 2008. Marine Imaging Systems net revenues for the three months ended March 31, 2008 decreased by $9.7 million to $34.5 million compared to $44.1 million in the corresponding period of last year, principally due to the timing of our VectorSeis Ocean (VSO) system sales. This decrease was offset by increased sales of our DigiFIN advanced streamer command and control system. Our Data Management Solutions segment (Concept Systems) contributed $9.2 million to our net revenues for the first quarter, compared to $6.6 million in the corresponding period of last year. This increase primarily reflects increased energy industry demand for marine seismic work and sales from our GATOR® and newly launched Orca® towed streamer navigation and data management applications product line.

Our ION Solutions division s net revenues increased by $5.8 million, to $46.6 million for the three months ended March 31, 2008, compared to $40.9 million in the corresponding period of last year. The results for the first quarter of 2008 included increases in our new venture programs, especially off the coasts of South America and Indonesia. Supplementing this increase was larger multi-client seismic data library sales related to our ultra-deep seismic data program and geologic study off the east and west coasts of India and in the Arctic region. These sales accounted for the majority of our data library sales during the first quarter of 2008.

*Gross Profit and Gross Profit Percentage*. Gross profit of $48.4 million for the three months ended March 31, 2008 increased $9.2 million, compared to the corresponding period last year. Gross profit percentages for the three months ended March 31, 2008 and 2007 were 34.5% and 23.7%, respectively. The increase in overall margins were seen across all business segments but most significantly by our ION Solutions division s robust multi-client data library related to our recently completed programs in the Arctic region combined with strong pre-funded multi-client BasinSpan surveys off the coast of South America. We experienced stronger margins in our Marine Imaging Systems segment due to increased sales of our marine positioning products, and, in our Land Imaging Systems segment, we saw notable margin improvement in our Scorpion cable systems and vibroseis vehicle sales in 2008 compared to 2007. We also had an increase in higher margin sales at Concept Systems. Additionally, the first quarter of 2007 included the recognition of the sale of our first FireFly system, which, as a newly-developed system, had relatively high built-in costs of sale and lower than average margins.

*Research, Development and Engineering*. Research, development and engineering expense was $12.2 million, or 8.7% of net revenues, for the three months ended March 31, 2008, an increase of $0.9 million compared to $11.3 million, or 6.8% of net revenues, for the corresponding period last year. The increase is due primarily to increased personnel costs related to additional hirings, professional fees and increased costs related to the development of our FireFly version 2.0 system and to the development of our current and next generation VSO product line. We expect to continue to incur significant research and development expenses as we continue to invest heavily in the next generation of our seismic acquisition products and services, such as our next generation of marine products.

*Marketing and Sales*. Marketing and sales expense of $11.2 million, or 8.0% of net revenues, for the three months ended March 31, 2008 increased $0.6 million compared to $10.6 million, or 6.4% of net revenues, for the corresponding period last year. The increase in our sales and marketing expenditures reflects the hiring of additional sales personnel. We intend to continue investing significant sums in our marketing efforts as we further penetrate markets with our new products.

*General and Administrative*. General and administrative expenses of $14.8 million for the three months ended March 31, 2008 increased $3.5 million compared to $11.3 million for the first quarter of 2007. General and administrative expenses as a percentage of net revenues for the three months ended March 31, 2008 and 2007 were 10.5% and 6.8%, respectively. The increase in general and administrative expense reflects our increased personnel headcount and continued international expansion of our operations in the Middle East, including higher payroll costs and an increase in professional costs and travel associated with our international expansion

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and new headquarters in the United Arab Emirates. As we continue into 2008 and continue to grow our earnings and revenues, we expect to more fully leverage costs, similar to last year.

*Interest Expense.* Interest expense of $0.5 million for the three months ended March 31, 2008 decreased $1.0 million compared to $1.5 million for the first quarter of 2007. The decrease is due to the conversion of $52.8 million of our convertible senior notes in the fourth quarter of 2007. The remaining $7.2 million outstanding principal amount of these notes matures on December 15, 2008.

*Income Tax Expense*. Income tax expense for the three months ended March 31, 2008 was $2.1 million compared to $1.2 million for the three months ended March 31, 2007. Income tax expense consists mainly of non-U.S. taxes and U.S. deferred taxes related to the utilization of acquired net operating losses. We continue to maintain a valuation allowance for substantially all of our U.S. federal net deferred tax assets. Our effective tax rate for the three months ended March 31, 2008 and 2007 was 19.4% and 24.7%, respectively. The decrease in our effective tax rate relates primarily to greater significance of our U.S. operations when compared to our international activities.

*Preferred Stock Dividends*. The preferred dividend relates to our Series D-1 Preferred Stock, our Series D-2 Preferred Stock and our Series D-3 Preferred Stock (Series D Preferred Stock) we issued in February 2005, December 2007 and February 2008, respectively. Quarterly dividends may be paid, at our option, either in cash or by the issuance of our common stock. Dividends are paid at a rate equal to the greater of (i) five percent per annum or (ii) the three month LIBOR rate on the last day of the immediately preceding calendar quarter plus two and one-half percent 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 7.2% at March 31, 2008.

**Liquidity and Capital Resources**

***Sources of Capital***

*Revolving Line of Credit*. In March 2007, we obtained a $75.0 million revolving line of credit (the Facility ) having a maturity date of March 2011. The Facility replaced our $25.0 million revolving line of credit facility that was scheduled to mature in May 2008. Except for $1.0 million with respect to outstanding letters of credit, there was no indebtedness outstanding for borrowings under the Facility at March 31, 2008. The Facility is available for our working capital needs and general corporate purposes, subject to a borrowing base. In addition, the Facility includes a $25.0 million sub-limit for the issuance of documentary and standby letters of credit. The Facility includes an accordion feature under which the total commitments under the Facility may be increased to $100.0 million, subject to the satisfaction of certain conditions.

The Facility borrowing base is calculated based on the sum of (i) 85% of our total eligible accounts receivable, eligible foreign accounts receivable and insured foreign accounts receivable, plus (ii) the lesser of (x) thirty percent (30%) of eligible inventory or (y) $20.0 million. For purposes of this calculation, eligible foreign accounts receivable cannot exceed $23.5 million. As of March 31, 2008, the borrowing base calculation permitted total borrowings of $75.0 million, of which $74.0 million remained available.

The interest rate on borrowings under the Facility will be, at our option, (i) an alternate base rate (as defined in the credit agreement) or (ii) for Eurodollar borrowings, a LIBOR rate plus an applicable margin. The amount of the margin will be based on our then-current leverage ratio as defined in the Facility credit agreement. The applicable margin will be increased by 0.50% with respect to any borrowings that are applied to repay the convertible senior notes debt.

We are obligated to pay a commitment fee of 0.25% per annum on the unused portion of the Facility. A significant portion of our assets are pledged as collateral for outstanding borrowings under the Facility. The Facility credit agreement restricts our ability to pay dividends on our common stock, incur additional debt, sell significant assets, acquire other businesses, merge with other entities and take certain other actions without the consent of the lenders.

The credit agreement requires us to comply with certain financial and non-financial covenants. These covenants include requirements on us to (i) maintain a minimum fixed charge coverage ratio of 1.25 to 1.0, and (ii) not exceed a maximum leverage ratio of 2.75 to 1.0 (upon retirement of our convertible senior notes debt, the maximum leverage ratio will be reduced to 2.50 to 1.0 for 12 months, and then to 2.0 to 1.0 thereafter).

In February 2008, the Facility was amended, modifying the indebtedness covenant to permit certain intercompany indebtedness of up to $150.0 million during 2008, and $135.0 million thereafter owing to ourselves and our domestic

subsidiaries by certain of our foreign subsidiaries and provided for certain additional financial covenants with respect to our domestic operations and subsidiaries. Specifically, these additional financial covenants obligate us to (x) not exceed a minimum domestic fixed charge ratio of 1.5 to 1.0; (y) not exceed a maximum domestic leverage ratio of 1.5 to 1.0; and (z) not permit the ratio of the book value of total receivables, cash,

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permitted investments, inventory and equipment of ourselves and our domestic subsidiaries, to the total commitments of the lenders under the Facility, to be less than 1.75 to 1.0. As of March 31, 2008, we were in compliance with all of the covenants under the credit agreement.

*Convertible Senior Notes*. As of March 31, 2008, $7.2 million of our original $60.0 million principal amount of our 5.5% convertible senior notes were outstanding. These notes mature on December 15, 2008. The notes are not redeemable prior to their maturity, and are convertible into our common stock at an initial conversion rate of 231.4815 shares per $1,000 principal amount of notes (a conversion price of $4.32 per share for a total conversion into 1,675,926 shares).

In November 2007, a holder of $52.8 million principal amount of our $60.0 million outstanding convertible senior notes approached us and made an offer to convert its notes into common stock. The conversion occurred on November 27, 2007, and we issued to the holder 12,212,964 shares upon conversion, in accordance with the terms of the notes.

*Cumulative Convertible Preferred Stock*. In February 2005, we issued 30,000 shares of Series D-1 Cumulative Convertible Preferred Stock (Series D-1 Preferred Stock) in a privately-negotiated transaction, and received $29.8 million in net proceeds. Under our agreement with the Series D-1 Preferred Stock purchaser, we also granted to the purchaser an option to purchase up to an additional 40,000 shares of Series D Preferred Stock, having a conversion price equal to 122% of an average daily volume-weighted market price of our common stock over a trailing period of days, as of the time of issuance.

In December 2007, the holder exercised this option and purchased 5,000 shares of Series D-2 Cumulative Convertible Preferred Stock (Series D-2 Preferred Stock) for $5.0 million. In addition, on February 21, 2008, the holder exercised the option and purchased the remaining 35,000 shares of Series D-3 Cumulative Convertible Preferred Stock (Series D-3 Preferred Stock) for $35.0 million. The shares of Series D Preferred Stock have substantially similar terms, except for their conversion prices per share:

The conversion price for the Series D-1 Preferred Stock is $7.869 per share;

The conversion price for the Series D-2 Preferred Stock is $16.0429 per share; and

The conversion price for the Series D-3 Preferred Stock is $14.7981 per share.

The proceeds from the sales of the Series D-2 Preferred Stock and the Series D-3 Preferred Stock have been applied to current working capital needs. All rights held by the holder to purchase any shares of our preferred stock have been exercised.

The Series D-1, the Series D-2 and the Series D-3 Preferred Stock may be converted at the holder s election into 3,812,428 shares, 311,664 shares and 2,365,168 shares, respectively, of our common stock subject to adjustment. The holder has the right to redeem, at any time, all or part of the Series D Preferred Stock. We may satisfy its redemption obligations either in cash or by the issuance of our common stock, adjusted based upon changes in our 40-day average prevailing market price but not less than $4.45 per share (the Minimum Price) of our common stock at the time of redemption. Also, if we fall out of registration, we will pay an additional dividend equal to 1/15% multiplied by the number of days (equates to 2% per month) an effective registration is not available. However, if the 20-day average price of our common stock is less than the Minimum Price during that time, we may satisfy our redemption obligation by resetting the conversion price to the Minimum Price, and thereafter, all dividends must be paid in cash. In the event we cannot deliver registered shares upon redemption for stock, and to the extent we do not deliver cash, the dividend rate will increase to 15%.

Under the agreement, the Series D Preferred Stock has a minimum annual dividend rate of 5.0% and a maximum annual dividend rate of LIBOR plus 2.5%. So long as any shares of Series D Preferred Stock are outstanding, we may not pay any dividends in cash or property to holders of our common stock, and may not purchase or redeem for cash or property any common stock, unless there are no arrearages in dividends paid on the Series D Preferred Stock and sufficient cash has been set aside to pay dividends on the Series D Preferred Stock for the next four quarterly dividend periods. Dividends are payable quarterly in cash or common shares at our option. To date, all dividends on the shares of Series D Preferred Stock have been paid in cash, and we intend for the foreseeable future to continue to pay cash

dividends on those shares. The dividend rate for the Series D Preferred Stock was 7.2% at March 31, 2008.

The conversion prices per share of common stock under the Series D-1 Preferred Stock and the 5.5% convertible senior notes are substantially below the currently prevailing market prices for our common stock. Converting all of the Series D-1 Preferred Stock and the remaining 5.5% convertible senior notes at one time would result in significant dilution to our stockholders that could limit our ability to raise additional capital.

Based on our forecasts and our liquidity requirements for the near term future, we believe that the combination of our projected internally generated cash, the borrowing availability under our revolving line of credit and our working capital (including our cash and cash equivalents on hand) will be sufficient to fund our operational needs and liquidity requirements for at least the next twelve months.

***Cash Flow from Operations***

We have historically financed operations from internally generated cash and funds from equity and debt financings. Cash and cash equivalents were $36.0 million at March 31, 2008, a decrease of $0.4 million from December 31, 2007. Net cash used in operating activities was approximately $3.6 million and $6.2 million for the three months ended March 31, 2008 and 2007, respectively. The net cash used in our operating activities in 2008 was primarily related to increased investment in our inventories and an increase in our unbilled receivables associated with our ION Solutions division s sales. We expect a significant portion of the 2008 balance in our unbilled receivables to be invoiced during the second quarter of 2008. These increases were partially offset by a reduction in our accounts receivable due to timing of our sales.

***Cash Flow from Investing Activities***

Net cash flow used in investing activities was $30.7 million for the three months ended March 31, 2008, compared to $12.3 million for the three months ended March 31, 2007. The principal uses of cash in our investing activities during the three months ended March 31, 2008 were $26.9 million for investments in our multi-client data library and $3.8 million for equipment purchases. We expect to spend an additional $45 million to $55 million for investments in our multi-client data library and on equipment purchases during the remainder of 2008. The range of expenditures for the remainder of the year could vary depending on the level of multi-client seismic data acquisition projects that are initiated during the remainder of 2008. In general, a majority or all of direct expenses associated with completing a multi-client survey are typically pre-funded by our customers.

***Cash Flow from Financing Activities***

Net cash flow provided by financing activities was $33.8 million for the three months ended March 31, 2008, compared to $8.7 million for the three months ended March 31, 2007. The net cash flow provided by financing activities during the three months ended March 31, 2008 was primarily related to the $35.0 million issuance and sale of our Series D-3 Preferred Stock and $1.7 million in proceeds related to the exercise of stock options and stock purchases by our employees. This cash inflow was partially offset by scheduled principal payments of $1.9 million on our notes payable and capital lease obligations and $0.9 million in cash dividends paid on our outstanding Series D-1, Series D-2 and Series D-3 Preferred Stock.

**Inflation and Seasonality**

Inflation in recent years has not had a material effect on our costs of goods or labor or the prices for our products or services. Traditionally, our business has been seasonal, with strongest demand in the fourth quarter of our fiscal year.

**Critical Accounting Policies and Estimates**

*General.* Please refer to our Annual Report on Form 10-K for the year ended December 31, 2007, for a complete discussion of our other significant accounting policies and estimates. There have been no material changes in the current period regarding our critical accounting policies and estimates, except for the following significant accounting policy:

*Fair Value of Preferred Stock Redemption Features.* The redemption features of our outstanding Series D-2 Preferred Stock and Series D-3 Preferred Stock are embedded derivatives that are required to be bifurcated and accounted for separately at their fair value. Changes in the fair value of these derivatives are recognized below income from operations in the period of change. The fair value of the redemption features was determined using a lattice convertible bond option model that calculated thousands of scenarios based upon certain key inputs. The key inputs for the lattice option model include the current market price of our common stock, the yield on the preferred stock dividend payments, interest rates calculated according to companies in our similar financial and credit position and our stock s historical and implied volatility. The most significant input is the current market price of our common stock. Holding all other inputs constant, a 10% increase or decrease in our common stock would result in a decrease or increase in the fair value of the redemption features of $1.4 million and ($1.6 million), respectively.

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**Recent Accounting Pronouncements**

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities,* (SFAS 161). SFAS 161 provides more guidance on disclosure criteria and requires more enhanced disclosures about a company s derivative and hedging activities. The provisions for SFAS 161 are effective for fiscal years beginning after November 15, 2008 with earlier adoption allowed. We will adopt SFAS 161 upon its effective date. We do not anticipate the adoption of SFAS 161 will have a material impact on our financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 allows companies the option to report certain financial assets and liabilities at fair value, establishes presentation and disclosure requirements and requires additional disclosure surrounding the valuation of the financial assets and liabilities presented at fair value on the balance sheet. The provisions of SFAS 159 are effective for fiscal years beginning after November 15, 2007. We did not elect the fair value option for any of its financial assets or liabilities, and therefore, the adoption of FAS 159 had no impact on our consolidated financial position, results of operations or cash flows.

**Credit and Foreign Sales Risks**

For the three months ended March 31, 2008, we recognized $36.8 million of sales to customers in Europe, $22.6 million of sales to customers in Asia Pacific, $7.3 million of sales to customers in the Middle East, $6.7 million of sales to customers in Latin American countries, $6.7 million of sales to customers in the Commonwealth of Independent States, or former Soviet Union (CIS) and $0.8 million of sales to customers in Africa. The majority of our foreign sales are denominated in U.S. dollars. For the three months ended March 31, 2008 and 2007, international sales comprised 58% and 54%, respectively of total net revenues. Certain of these countries have experienced economic problems and uncertainties from time to time. To the extent that world events or economic conditions negatively affect our future sales to customers in these and other regions of the world or the collectibility of our existing receivables, our future results of operations, liquidity and financial condition may be adversely affected. We currently require customers in these higher risk countries to provide their own financing and in some cases have assisted the customer in organizing international financing and Export-Import credit guarantees provided by the United States government. We do not currently extend long-term credit through notes to companies in countries we consider to be inappropriate for credit risk purposes.

**Item 3. *Quantitative and Qualitative Disclosures about Market Risk***

Please refer to Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2007, for a discussion regarding the Company s quantitative and qualitative disclosures about market risk. There have been no material changes to those disclosures during the three months ended March 31, 2008, except as described below.

**Fair Value of Preferred Stock Redemption Features**

Our Series D-2 Preferred Stock and Series D-3 Preferred Stock contain embedded redemption features that are required to be bifurcated and accounted for separately at their fair values. The value of the redemption features was determined using a lattice convertible bond option model. The key inputs for the lattice option model include the current market price of our common stock, the yield on the preferred stock dividend payments, interest rates calculated according to companies in our similar financial and credit position and our stock s historical and implied volatility. Holding all other inputs constant, a 10% increase or decrease in our common stock would result in a decrease or increase in the fair value of the redemption features of $1.4 million and ($1.6 million), respectively.

**Item 4. *Controls and Procedures***

*Disclosure Controls and Procedures*. Under the supervision and with the participation of management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a 15(e) and 15d 15(e) under the Exchange Act as of March 31, 2008. Based on this evaluation, our principal executive officer and principal financial officer concluded that as of March 31, 2008, our disclosure controls and procedures were effective such that the information relating to our company, including our consolidated subsidiaries, required to be disclosed in our SEC reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and (ii) is accumulated and communicated to our management, including our principal executive officer and principal

financial officer, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control over Financial Reporting.* There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(f) under the Exchange Act that was conducted during the prior

fiscal quarter, which have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II OTHER INFORMATION

**Item 1.** ***Legal Proceedings.***

We have been named in various lawsuits or threatened actions that are incidental to our ordinary business. Such lawsuits and actions could increase in number as our business expands and we grow larger. Litigation is inherently unpredictable. Any claims against us, whether meritorious or not, could be time consuming, cause us to incur costs and expenses, require significant amounts of management time and result in the diversion of significant operational resources. The results of these lawsuits and actions cannot be predicted with certainty. We currently believe that the ultimate resolution of these matters will not have a material adverse impact on our financial condition, results of operations or liquidity.

**Item 1A.** ***Risk Factors.***

This report (as well as certain oral statements made from time to time by authorized representatives on behalf of our company) contain statements concerning our future results and performance and other matters that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These statements involve known and unknown risks, uncertainties, and other factors that may cause our or our industry s results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, will, should, intend, expect, plan, anti believe, estimate, predict, potential or continue or the negative of such terms or other comparable terminology. Examples of other forward-looking statements contained in this report (or in such oral statements) include statements regarding:

- expected net revenues, income from operations and net income;
- expected gross margins for our products and services;
- future benefits to our customers to be derived from new products and services, such as Scorpion and FireFly;
- future growth rates for certain of our products and services;
- future sales to our significant customers;
- expectations of oil and natural gas E&P companies and contractor end-users purchasing our more expensive, more technologically advanced products and services;
- the degree and rate of future market acceptance of our new products and services;
- expectations regarding future mix of business and future asset recoveries;
- the timing of anticipated sales;
- anticipated timing and success of commercialization and capabilities of products and services under development and start- up costs associated with their development;
- expected improved operational efficiencies from our full-wave digital products and services;
- potential future acquisitions;

future levels of capital expenditures;

future cash needs and future sources of cash, including availability under our revolving line of credit facility;

the outcome of pending or threatened disputes and other contingencies;

future demand for seismic equipment and services;

future seismic industry fundamentals;

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- the adequacy of our future liquidity and capital resources;
- future oil and gas commodity prices;
- future opportunities for new products and projected research and development expenses;
- future worldwide economic conditions;
- success in integrating our acquired businesses;
- expectations regarding realization of deferred tax assets; and
- anticipated results regarding accounting estimates we make.

These forward-looking statements reflect our best judgment about future events and trends based on the information currently available to us. Our results of operations can be affected by inaccurate assumptions we make or by risks and uncertainties known or unknown to us. Therefore, we cannot guarantee the accuracy of the forward-looking statements. Actual events and results of operations may vary materially from our current expectations and assumptions.

Information regarding factors that may cause actual results to vary from our expectations, called risk factors, appears in our Annual Report on Form 10-K for the year ended December 31, 2007 in Part II, Item 1A. Risk Factors. There have been no material changes from the risk factors previously disclosed in that Form 10-K.

**Item 2**. ***Unregistered Sales of Equity Securities and Use of Proceeds.***

(c) During the three months ended March 31, 2008, the Company withheld and subsequently cancelled shares of our common stock to satisfy the minimum statutory income tax withholding obligation on the vesting of restricted stock for related employees. The date of cancellation, number of shares and average effective acquisition price per share, were as follows:

| Period | (a) Total Number of Shares Acquired | | (b) Average Price Paid Per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Program | (d) Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Plans or Program |
|---|---|---|---|---|---|
| January 1, 2008 to January 31, 2008 | 1,354 | $ | 13.59 | Not applicable | Not applicable |
| February 1, 2008 to February 29, 2008 | | $ | | Not applicable | Not applicable |
| March 1, 2008 to March 31, 2008 | 3,630 | $ | 13.25 | Not applicable | Not applicable |

| | | | |
|---|---|---|---|
| Total | 4,984 | $ | 13.34 |

**Item 6.** ***Exhibits***

31.1 Certification of President and Chief Executive Officer Pursuant to Rule 13a-14(a).

31.2 Certification of Executive Vice President and Chief Financial Officer Pursuant to Rule 13a-14(a).

32.1 Certification of President and Chief Executive Officer Pursuant to 18 U.S.C. §1350.

32.2 Certification of Executive Vice President and Chief Financial Officer Pursuant to 18 U.S.C. §1350.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ION GEOPHYSICAL CORPORATION

By /s/ R. Brian Hanson
R. Brian Hanson
*Executive Vice President and Chief Financial Officer*

Date: May 7, 2008

## EXHIBIT INDEX

| Exhibit No. | Description |
|---|---|
| 31.1 | Certification of President and Chief Executive Officer Pursuant to Rule 13a-14(a). |
| 31.2 | Certification of Executive Vice President and Chief Financial Officer Pursuant to Rule 13a-14(a). |
| 32.1 | Certification of President and Chief Executive Officer Pursuant to 18 U.S.C. §1350. |
| 32.2 | Certification of Executive Vice President and Chief Financial Officer Pursuant to 18 U.S.C. §1350. |