

HORNBECK OFFSHORE SERVICES INC /LA

Form 10-Q

November 09, 2009

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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 September 30, 2009

OR

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

For the transition period from _____ to _____

Commission file number 001-32108

Hornbeck Offshore Services, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

72-1375844
(I.R.S. Employer

Identification Number)

103 NORTHPARK BOULEVARD, SUITE 300

COVINGTON, LA 70433

(Address of Principal Executive Offices) (Zip Code)

(985) 727-2000

(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 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

Non-accelerated filer

Accelerated filer

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

The total number of shares of common stock, par value \$.01 per share, outstanding as of September 30, 2009 was 26,116,144.

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2009

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Table of Contents**PART 1 FINANCIAL INFORMATION****Item 1 Financial Statements****HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(In thousands, except per share data)

	September 30, 2009	December 31, 2008
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 61,891	\$ 20,216
Accounts receivable, net of allowance for doubtful accounts of \$1,303 and \$2,135, respectively	63,197	87,942
Other receivables, net	9,038	13,865
Other current assets	13,509	12,203
Total current assets	147,635	134,226
Property, plant and equipment, net	1,563,202	1,405,340
Deferred charges, net	39,050	37,972
Other assets	16,245	18,205
Total assets	\$ 1,766,132	\$ 1,595,743
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 9,051	\$ 16,693
Accrued interest	10,202	2,110
Accrued payroll and benefits	7,594	10,078
Deferred revenue	6,374	21,720
Current taxes payable	1,242	13,990
Other accrued liabilities	6,717	3,566
Total current liabilities	41,180	68,157
Revolving credit facility		125,000
Long-term debt, net of original issue discount of \$56,087 and \$56,481, respectively	743,913	493,519
Deferred tax liabilities, net	194,120	169,987
Other liabilities	2,285	2,180
Total liabilities	981,498	858,843
Stockholders equity:		
Preferred stock: \$0.01 par value; 5,000 shares authorized; no shares issued and outstanding		
Common stock: \$0.01 par value; 100,000 shares authorized; 26,116 and 25,920 shares issued and outstanding, respectively	261	259
Additional paid-in-capital	404,242	397,593

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Retained earnings	379,892	338,818
Accumulated other comprehensive income	239	230
Total stockholders' equity	784,634	736,900
Total liabilities and stockholders' equity	\$ 1,766,132	\$ 1,595,743

The accompanying notes are an integral part of these consolidated statements.

Table of Contents**HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share data)

	Three Months Ended September 30, 2009		Nine Months Ended September 30, 2008	
	(Unaudited)		(Unaudited)	
Revenues	\$ 90,086	\$ 109,060	\$ 297,642	\$ 311,053
Costs and expenses:				
Operating expenses	39,741	41,270	121,191	124,363
Depreciation	11,091	8,463	57,410	24,215
Amortization	5,423	4,379	18,564	13,825
General and administrative expenses	6,864	8,726	23,302	26,718
	63,119	62,838	220,467	189,121
Gain on sale of assets	105	6,401	346	8,402
Operating income	27,072	52,623	77,521	130,334
Other income (expense):				
Interest income	179	142	365	1,370
Interest expense	(5,586)	(1,393)	(12,584)	(5,466)
Other income (expense), net	(14)	67	(263)	141
	(5,421)	(1,184)	(12,482)	(3,955)
Income before income taxes	21,651	51,439	65,039	126,379
Income tax expense	(7,877)	(18,157)	(23,965)	(45,222)
Net income	\$ 13,774	\$ 33,282	\$ 41,074	\$ 81,157
Basic earnings per common share	\$ 0.53	\$ 1.29	\$ 1.58	\$ 3.14
Diluted earnings per common share	\$ 0.51	\$ 1.23	\$ 1.52	\$ 3.00
Weighted average basic shares outstanding	26,100	25,867	26,013	25,825
Weighted average diluted shares outstanding	27,036	27,089	26,955	27,062

The accompanying notes are an integral part of these consolidated statements.

Table of Contents**HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

	Nine Months Ended September 30,	
	2009	2008
	(Unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 41,074	\$ 81,157
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	57,410	24,215
Amortization	18,564	13,825
Stock-based compensation expense	6,584	8,433
Provision for bad debts	(832)	149
Deferred tax expense	17,883	31,204
Amortization of deferred financing costs	9,256	8,611
Gain on sale of assets	(346)	(8,402)
Equity in (income) loss from investment	267	(168)
Changes in operating assets and liabilities:		
Accounts receivable	24,340	(14,538)
Other receivables and current assets	4,349	2,014
Deferred drydocking charges	(15,039)	(14,821)
Accounts payable	(9,809)	2,453
Accrued liabilities and other liabilities	(19,180)	10,816
Accrued interest	8,092	5,683
Net cash provided by operating activities	142,613	150,631
CASH FLOWS FROM INVESTING ACTIVITIES:		
Costs incurred for MPSV program	(96,498)	(241,866)
Costs incurred for OSV newbuild program #4	(117,398)	(138,147)
Costs incurred for TTB newbuild program #2		(9,261)
Acquisition of shore-base port facility		(11,541)
Net proceeds from sale of assets	7,047	17,812
Vessel capital expenditures	(4,444)	(19,622)
Non-vessel capital expenditures	(3,509)	(11,878)
Net cash used in investing activities	(214,802)	(414,503)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings under revolving credit facility	75,000	110,000
Repayment of borrowings under revolving credit facility	(200,000)	
Net proceeds from issuance of senior notes	242,808	
Deferred financing costs	(5,537)	
Net cash proceeds from other shares issued	1,585	1,638
Net cash provided by financing activities	113,856	111,638
Effects of exchange rate changes on cash	8	17
Net increase (decrease) in cash and cash equivalents	41,675	(152,217)

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Cash and cash equivalents at beginning of period	20,216	173,552
Cash and cash equivalents at end of period	\$ 61,891	\$ 21,335
SUPPLEMENTAL DISCLOSURES OF CASH FLOW ACTIVITIES:		
Cash paid for interest	\$ 12,914	\$ 12,424
Cash paid for income taxes	\$ 15,520	\$ 4,096

The accompanying notes are an integral part of these consolidated statements.

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited consolidated financial statements do not include certain information and footnote disclosures required by United States generally accepted accounting principles, or GAAP. The interim financial statements and notes are presented as permitted by instructions to the Quarterly Report on Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments necessary for a fair presentation of the interim financial statements have been included and consist only of normal recurring items. The unaudited quarterly financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Annual Report on Form 10-K of Hornbeck Offshore Services, Inc. (together with its subsidiaries, the Company) for the year ended December 31, 2008, as supplemented by the Company's Current Report on Form 8-K filed August 11, 2009 to reflect certain retrospective adjustments relating to the adoption of new rules impacting the accounting for the Company's convertible senior notes. The results of operations for the three and nine month periods ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. Certain amounts reported in prior periods have been reclassified or adjusted to conform to the 2009 presentation as further discussed below in Recent Accounting Pronouncements. We have evaluated all subsequent events through November 9, 2009, the date the financial statements were issued and have considered any such events for disclosure.

The consolidated balance sheet at December 31, 2008 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements.

Recent Accounting Pronouncements

Convertible Debt. Effective January 1, 2009, the Company retroactively applied new accounting rules set forth by the Financial Accounting Standards Board regarding the Company's 1.625% convertible senior notes due 2026, or convertible senior notes. The new requirements state that the liability and equity components of a convertible debt instrument that may be settled in cash upon conversion be accounted for separately so that an entity's accounting reflects additional non-cash original issue discount, or OID, interest expense to match the non-convertible debt borrowing rate when interest cost is recognized in subsequent periods. The Company applied a non-convertible debt borrowing rate of 7.125% upon adoption of these new rules based on quoted market prices for its 6.125% senior notes due 2014 on the date the convertible senior notes were issued. The impact of this requirement has resulted in a material increase to the Company's non-cash OID interest expense for financial statements covering the periods ended December 31, 2006 through December 31, 2013. The additional interest costs are being amortized over the period ending November 15, 2013, which is the date that the convertible senior notes are first puttable by the convertible note holders.

For the quarter ended September 30, 2009, the impact of incremental non-cash OID interest expense related to this new accounting treatment on the Company's income before taxes, net income and diluted earnings per share was \$1.2 million, \$0.8 million and \$0.03, respectively. For

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the nine months ended September 30, 2009, the impact of incremental non-cash OID interest expense related to this requirement on the Company's income before taxes, net income and diluted earnings per share was \$3.0 million, \$1.9 million and \$0.07, respectively. The table below reflects the impact of the Company's retrospective application of the new accounting rules to the financial captions on the Company's balance sheet as of December 31, 2008 and consolidated income statement and statement of cash flows for the three and nine month periods ended September 30, 2008. (in thousands, except per share data):

	December 31, 2008 As Reported	Adjustment	December 31, 2008 As Adjusted
Balance Sheet:			
Assets:			
Property, plant and equipment, net	\$ 1,394,643	\$ 10,697	\$ 1,405,340
Total assets	1,585,046	10,697	1,595,743
Liabilities:			
Long-term debt	\$ 549,602	\$ (56,083)	\$ 493,519
Deferred tax liabilities	145,729	24,258	169,987
Total liabilities	890,668	(31,825)	858,843
Equity:			
Additional paid-in-capital	\$ 349,427	\$ 48,166	\$ 397,593
Retained earnings	344,462	(5,644)	338,818
Total equity	694,378	42,522	736,900
	Three Months Ended September 30, 2008 As Reported	Adjustment	Three Months Ended September 30, 2008 As Adjusted
Income Statement:			
Interest expense, net (1)	\$ 1,062	\$ 331	\$ 1,393
Income before income tax	51,770	(331)	51,439
Income tax expense	18,275	(118)	18,157
Net Income	33,495	(213)	33,282
Diluted earnings per share	1.24	(0.01)	1.23
	Nine Months Ended September 30, 2008 As Reported	Adjustment	Nine Months Ended September 30, 2008 As Adjusted
Income Statement:			
Interest expense, net (1)	\$ 4,105	\$ 1,361	\$ 5,466
Income before income tax	127,740	(1,361)	126,379
Income tax expense	45,708	(486)	45,222
Net Income	82,032	(875)	81,157
Diluted earnings per share	3.03	(0.03)	3.00

Statement of Cash Flows:

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Net cash provided by operating activities	\$ 145,014	\$ 5,617	\$ 150,631
Net cash used in investing activities	(408,886)	(5,617)	(414,503)

(1) Interest expense, net excludes interest that was capitalized as part of ongoing newbuild construction or conversion programs.

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Basic earnings per common share was calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per common share was calculated by dividing net income by the weighted average number of common shares outstanding during the year plus the effect of dilutive stock options and restricted stock unit awards, or restricted stock. Weighted average number of common shares outstanding was calculated by using the sum of the shares determined on a daily basis divided by the number of days in the period. The table below reconciles the Company's earnings per share (in thousands, except for per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net income	\$ 13,774	\$ 33,282	\$ 41,074	\$ 81,157
Weighted average number of shares of common stock outstanding	26,100	25,867	26,013	25,825
Add: Net effect of dilutive stock options and unvested restricted stock (1)(2)(3)	936	1,222	942	1,237
Adjusted weighted average number of shares of common stock outstanding	27,036	27,089	26,955	27,062
Earnings per common share:				
Basic	\$ 0.53	\$ 1.29	\$ 1.58	\$ 3.14
Diluted	\$ 0.51	\$ 1.23	\$ 1.52	\$ 3.00

- (1) Stock options representing rights to acquire 199 shares of common stock for the three months ended September 30, 2009 and 419 shares of common stock for the nine months ended September 30, 2009, were excluded from the calculation of diluted earnings per share, because the effect was anti-dilutive after considering the exercise price of the options in comparison to the average market price, proceeds from exercise, taxes, and related unamortized compensation.
- (2) As of September 30, 2009 and 2008, the 1.625% convertible senior notes were not dilutive, as the average price of the Company's stock was less than the effective conversion price of such notes.
- (3) Dilutive restricted stock is expected to fluctuate from quarter to quarter depending on the Company's performance compared to a predetermined set of performance criteria. See Note 4 for further information regarding certain of the Company's restricted stock awards.

3. Long-Term Debt

As of the dates indicated, the Company had the following outstanding long-term debt (in thousands):

	September 30, 2009	December 31, 2008
Revolving credit facility due 2011	\$	\$ 125,000
6.125% senior notes due 2014, net of original issue discount of \$356 and \$398	299,644	299,602
8.000% senior notes due 2017, net of original issue discount of \$7,140	242,860	
1.625% convertible senior notes due 2026, net of original issue discount of \$48,591 and \$56,083 (1)	201,409	193,917
	743,913	618,519
Less current maturities		

\$ 743,913 \$ 618,519

- (1) The notes initially bear interest at a fixed rate of 1.625% per year, declining to 1.375% beginning on November 15, 2013.

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On August 17, 2009, the Company closed on a private placement of \$250.0 million of 8.000% senior notes, or new senior notes. The net proceeds to the Company from the offering were approximately \$237.3 million, net of original issue discount and estimated transaction costs. The Company used \$200.0 million of proceeds to repay debt under its revolving credit facility, which may be reborrowed. The remaining proceeds are available for general corporate purposes, which may include partial funding of the construction of new offshore supply vessels, or OSVs, and multi-purpose supply vessels, or MPSVs, under existing newbuild programs.

The 6.125% senior notes due 2014 have semi-annual cash interest payments of \$9.2 million due and payable each June 1 and December 1. The convertible senior notes have semi-annual cash interest payments of \$2.0 million due May 15 and November 15, declining to 1.375%, or \$1.7 million semi-annually, beginning on November 15, 2013. The new senior notes mature on September 1, 2017 and require semi-annual interest payments at an annual rate of 8.000%, or \$10.0 million semi-annually, on March 1 and September 1 of each year until maturity, beginning on March 1, 2010. The effective interest rate on the new senior notes is 8.63% and no principal payments are due until maturity.

The new senior notes are unsecured senior obligations and rank equally in right of payment with other existing and future senior indebtedness, including the Company's 6.125% senior notes due 2014, convertible senior notes and future borrowings under its revolving credit facility, and senior in right of payment to any subordinated indebtedness incurred by the Company in the future. The Company's new senior notes are guaranteed by certain of its subsidiaries. The guarantees are full and unconditional, joint and several and any subsidiaries that are not guarantors are minor as defined in the Securities and Exchange Commission regulations. The Company may, at its option, redeem all or part of the new senior notes from time to time at specified redemption prices and subject to certain conditions required by the indenture. The Company is permitted under the terms of the indenture to incur additional indebtedness in the future, provided that certain financial conditions set forth in the indenture are satisfied by the Company. The new senior notes will be exchanged for new senior notes with substantially similar terms, except that the issuance of the new senior notes issued in the exchange offer will be registered under the Securities Act of 1933, or Securities Act. Both series of new senior notes are issued under and are entitled to the benefits of the same indenture.

As of September 30, 2009, the Company had the option under its revolving credit facility of borrowing at a variable rate of interest equal to either (i) the London Interbank Offered Rate, or LIBOR, plus an applicable margin, or (ii) the greater of the prime rate announced by Wells Fargo Bank, N.A. in San Francisco, or the Prime Rate, or the Federal Funds Effective Rate plus $\frac{1}{2}$ of 1%, plus in each case an applicable margin. The applicable margin for each base rate was determined by a pricing grid, which was based on the Company's leverage ratio, as defined in the credit agreement governing its revolving credit facility. Unused commitment fees were payable quarterly at the annual rate of 17.5 to 30.0 basis points of the unused portion of the \$250.0 million borrowing base of the revolving credit facility, based on the defined leverage ratio. As of September 30, 2009, there were no amounts drawn under

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the Company's revolving credit facility and \$0.9 million posted in letters of credit, which resulted in \$249.1 million of credit immediately available under such facility. Subsequent to September 30, 2009, the Company has not made any additional drawings under the revolving credit facility. As of September 30, 2009, we are in compliance with all financial covenants required by our revolving credit facility.

On November 4, 2009, the Company amended and extended its revolving credit facility, which will maintain its \$250.0 million borrowing base but now includes an accordion feature that allows for the expansion of the facility up to an aggregate of \$350.0 million. The amended facility, among other changes, also extends the maturity from September 2011 to March 2013. With the amended facility, the Company has the option of borrowing at a variable rate of interest equal to either (i) LIBOR, plus an applicable margin, or (ii) the greatest of the Prime Rate, the Federal Funds Effective Rate plus $\frac{1}{2}$ of 1% and the one-month LIBOR plus 1%, plus in each case an applicable margin. The applicable margin for each base rate is determined by a new pricing grid, which is based on the Company's leverage ratio, as defined in the credit agreement governing the amended revolving credit facility. Unused commitment fees are payable quarterly at the annual rate of 50.0 basis points of the unused portion of the borrowing base of the amended facility. The Company also swapped the vessels pledged as collateral under the amended revolving credit facility so as to reduce the total number of such vessels to 19 new generation OSVs. None of the Company's Downstream vessels are now pledged under the facility.

The Company estimates the fair value of its 6.125% senior notes due 2014, its 8.000% senior notes due 2017 and its 1.625% convertible senior notes due 2026 by using quoted market prices. The fair value of the Company's revolving credit facility, when there are outstanding balances, approximates its carrying value. The face value, carrying value and fair value of the Company's total debt was \$800.0 million, \$743.9 million and \$746.1 million, respectively, as of September 30, 2009.

Hornbeck Offshore Services, Inc., as the parent company issuer of the 6.125% senior notes due 2014 and the 8.000% senior notes due 2017, has no independent assets or operations. There are no significant restrictions on the Company's ability or the ability of any guarantor to obtain funds from its subsidiaries by such means as a dividend or loan, except for certain restrictions contained in the Company's revolving credit facility restricting the payment of dividends by two subsidiaries to the parent.

Capitalized Interest

Interest expense excludes capitalized interest related to the construction or conversion of vessels in the approximate amounts of \$6.2 million for the third quarter of 2009, \$8.1 million for the third quarter of 2008, \$17.7 million for the first nine months of 2009 and \$21.3 million for the first nine months of 2008.

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The Company has a stock-based incentive compensation plan covering a maximum of 3.5 million shares of common stock that allows the Company to grant stock options, restricted stock awards, restricted stock unit awards and stock appreciation rights to employees and directors. These elements of stock-based compensation, whether individually or collectively, are referred to herein as restricted stock.

During the nine months ended September 30, 2009, the Company granted time-based and performance-based restricted stock. Time-based restricted stock was granted to directors and a combination of time-based and performance-based restricted stock was granted to executive officers and certain shore-side employees of the Company. The shares to be received under the performance-based restricted stock are calculated based on the Company's achievement of any one of four pre-determined performance criteria over a three-year period as defined by the restricted stock agreement governing such awards. The actual number of shares that could be received by these award recipients can range from 0% to 100% of the Company's base share awards depending on the performance goals attained by the Company.

Compensation expense related to restricted stock is recognized over the period the restrictions lapse, from one to four years. The fair value of the Company's performance-based restricted stock, which is determined using a Monte Carlo simulation, is applied to the total shares that are expected to fully vest and is amortized over the vesting period based on the Company's internal performance measured against pre-determined criteria or relative performance compared to peers, as applicable. The compensation expense related to time-based restricted stock, which is amortized over a vesting period from one to four years, is determined based on the market price of the Company's stock on the date of grant applied to the total shares that are expected to fully vest.

In addition to the restricted stock granted in 2009, the Company granted performance-based and time-based restricted stock in 2006, 2007 and 2008. The performance-based restricted stock grants issued in 2006 were eligible for vesting in February 2009, but the Company did not meet the vesting criteria and such restricted stock was cancelled. The related stock-based compensation expense charges from previously issued equity grants and the financial impact such grants have on the Company's operating results are reflected in the table below (in thousands, except for per share data):

	Three Months Ended September 30, 2009		September 30, 2008	
	2009	2008	2009	2008
Income before taxes	\$ 1,908	\$ 2,828	\$ 6,584	\$ 8,433
Net income	\$ 1,214	\$ 1,830	\$ 4,158	\$ 5,415
Earnings per common share:				
Basic	\$ 0.05	\$ 0.07	\$ 0.16	\$ 0.21
Diluted	\$ 0.04	\$ 0.07	\$ 0.15	\$ 0.20

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In addition, the Company capitalized stock-based compensation expense as part of its ongoing newbuild construction programs and general corporate projects in the approximate amounts of \$0.2 million and \$0.4 million for the three months ended September 30, 2009 and 2008, respectively, and \$0.7 million and \$1.1 million for the nine months ended September 30, 2009 and 2008, respectively.

5. Contingencies

In the normal course of its business, the Company becomes involved in various claims and legal proceedings in which monetary damages are sought. It is management's opinion that the Company's liability, if any, under such claims or proceedings would not materially affect its financial position or results of operations.

The Company insures against losses relating to its vessels, pollution and third party liabilities, including claims by employees under Section 33 of the Merchant Marine Act of 1920, or the Jones Act. Third party liabilities and pollution claims that relate to vessel operations are covered by the Company's entry in a mutual protection and indemnity association, or P&I Club, as well as by marine liability policies in excess of the P&I Club's coverage. In February 2009, the terms of entry with the P&I Club for both of the Company's segments contained an annual aggregate deductible (AAD) for which the Company remains responsible. The P&I Club is responsible for covered amounts that exceed the AAD, after payment by the Company of an additional individual claim deductible. The Company provides reserves for those portions of the AAD and any individual claim deductibles for which the Company remains responsible by using an estimation process that considers Company-specific and industry data, as well as management's experience, assumptions and consultation with outside counsel. As additional information becomes available, the Company will assess the potential liability related to its pending litigation and revise its estimates. Such revisions in estimates of the potential liability could materially impact the Company's results of operations, financial position or cash flows.

6. Other Receivables

As of September 30, 2009, Other Receivables is comprised primarily of amounts billed to Superior Offshore International, Inc., or Superior Offshore, for the *HOS Achiever* time charter, a conventional OSV time charter and shore-base services at HOS Port. These receivable balances are net of \$8.0 million in proceeds collected under a letter of credit from Superior Offshore. See discussion in Legal Proceedings for additional information concerning on-going litigation with Superior Offshore.

7. Asset and Goodwill Impairment Assessment

The continued low demand in the Company's Downstream segment resulted in a reported operating loss during the quarter ended June 30, 2009. With no material change in Downstream contract coverage since March 31, 2009 and none that was expected in the near term, the Company determined that an impairment assessment for the Downstream segment was necessary as of June 30, 2009. The impairment assessment compared the net book values of the Company's Downstream marine assets, as well as Downstream segment

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

goodwill that was booked upon the Company's formation in June 1997, to their respective fair values. Based on its analysis during the second quarter of 2009, which included recent vessel sales, quoted market prices and past third-party appraisals, the Company recorded a non-cash asset impairment charge of \$25.8 million, or \$0.60 per diluted share, related to ten single-hulled tank barges and six ocean-going tugs. This impairment charge is reflected in depreciation expense for the nine-month period ended September 30, 2009. The Company's amortization expense for such periods includes a \$0.9 million, or \$0.02 per diluted share, non-cash charge for the write-off of remaining goodwill associated with its Downstream segment.

Based on recent comparable vessel sales in the second half of 2009 and third party appraisals obtained in connection with the Company's amended and extended revolving credit facility in November 2009, the Company believes that no further impairment for its stacked vessels was required as of September 30, 2009.

8. Segment Information

The Company provides marine transportation and logistics services through two business segments. The Company primarily operates new generation OSVs and MPSVs in the U.S. Gulf of Mexico, or GoM, and other select domestic and international markets and operates a shore-base facility in Port Fourchon, Louisiana through its Upstream segment. The Upstream segment principally supports complex exploration and production projects by transporting cargo to offshore drilling rigs and production facilities and provides support for oilfield and non-oilfield specialty services, including military applications. The Downstream segment primarily operates ocean-going tugs and tank barges in the northeastern United States and GoM. The Downstream segment provides coastwise transportation of refined and bunker grade petroleum products as well as non-traditional downstream services, such as support of deepwater well testing and other specialty applications for the Company's upstream customers.

Table of Contents**HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table shows reportable segment information for the three and nine months ended September 30, 2009 and 2008, reconciled to consolidated totals and prepared on the same basis as the Company's consolidated financial statements (in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Operating revenues:				
Upstream				
Domestic	\$ 62,191	\$ 68,313	\$ 206,251	\$ 180,454
Foreign (1)	11,519	19,702	41,734	53,987
	73,710	88,015	247,985	234,441
Downstream				
Domestic	15,917	17,734	48,416	68,234
Foreign (1)(2)	459	3,311	1,241	8,378
	16,376	21,045	49,657	76,612
Total	\$ 90,086	\$ 109,060	\$ 297,642	\$ 311,053
Operating expenses:				
Upstream	\$ 31,133	\$ 28,579	\$ 90,850	\$ 82,752
Downstream	8,608	12,691	30,341	41,611
Total	\$ 39,741	\$ 41,270	\$ 121,191	\$ 124,363
Depreciation:				
Upstream	\$ 8,955	\$ 5,466	\$ 24,987	\$ 15,527
Downstream	2,136	2,997	32,423	8,688
Total	\$ 11,091	\$ 8,463	\$ 57,410	\$ 24,215
Amortization:				
Upstream	\$ 4,183	\$ 2,629	\$ 11,588	\$ 8,018
Downstream	1,240	1,750	6,976	5,807
Total	\$ 5,423	\$ 4,379	\$ 18,564	\$ 13,825
General and administrative expenses:				
Upstream	\$ 5,710	\$ 6,403	\$ 19,299	\$ 17,412
Downstream	1,154	2,323	4,003	9,306
Total	\$ 6,864	\$ 8,726	\$ 23,302	\$ 26,718
Gain (loss) on sale of assets:				

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Upstream	\$ 111	\$ 6,401	\$ 111	\$ 8,402
Downstream	(6)		235	
Total	\$ 105	\$ 6,401	\$ 346	\$ 8,402
Operating income (loss):				
Upstream	\$ 23,840	\$ 51,339	\$ 101,372	\$ 119,134
Downstream	3,232	1,284	(23,851)	11,200
Total	\$ 27,072	\$ 52,623	\$ 77,521	\$ 130,334
Capital expenditures:				
Upstream	\$ 65,884	\$ 131,633	\$ 220,190	\$ 419,665
Downstream	84	1,667	533	10,700
Corporate	479	312	1,126	1,950
Total	\$ 66,447	\$ 133,612	\$ 221,849	\$ 432,315

Table of Contents**HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	As of September 30, 2009	As of December 31, 2008
Identifiable assets:		
Upstream	\$ 1,527,369	\$ 1,319,392
Downstream	212,526	254,574
Corporate	26,237	21,777
Total	\$ 1,766,132	\$ 1,595,743
Long-lived assets:		
Upstream		
Domestic	\$ 1,257,380	\$ 1,042,540
Foreign (1)	102,732	126,709
	1,360,112	1,169,249
Downstream		
Domestic	\$ 195,417	223,669
Foreign (1)(2)		4,431
	195,417	228,100
Corporate	7,673	7,991
Total	\$ 1,563,202	\$ 1,405,340

(1) The Company's vessels conduct operations in international areas. Vessels will routinely move to and from international and domestic operating areas. As these assets are highly mobile, the long-lived assets reflected above represent the assets that were present in international areas as of September 30, 2009 and December 31, 2008, respectively.

(2) Included are amounts applicable to the Puerto Rico downstream operations, even though Puerto Rico is considered a possession of the United States and the Jones Act applies to vessels operating in Puerto Rican waters.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read together with our unaudited consolidated financial statements and notes to unaudited consolidated financial statements in this Quarterly Report on Form 10-Q and our audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008, as supplemented by the Company's Current Report on Form 8-K filed August 11, 2009 to reflect certain retrospective adjustments relating to the adoption of new rules impacting the accounting for our convertible senior notes. This discussion contains forward-looking statements that reflect our current views with respect to future events and financial performance. Our actual results may differ materially from those anticipated in these forward-looking statements. See *Forward Looking Statements* for additional discussion regarding risks associated with forward-looking statements. In this Quarterly Report on Form 10-Q, company, we, us, our or like terms refer to Hornbeck Offshore Services, Inc. and its subsidiaries, except as otherwise indicated.

References in this Quarterly Report on Form 10-Q to OSVs mean offshore supply vessels; to TTB mean ocean-going tugs and tank barges; to MPSVs mean multi-purpose support vessels; to AHTS mean anchor-handling towing supply; to ROVs mean remotely operated vehicles; to DP-1, DP-2 and DP-3 mean various classifications of dynamic positioning systems on new generation vessels to automatically maintain a vessel's position and heading; to flotel mean accommodations services, such as lodging, meals and office space; to deepwater mean offshore areas, generally 1,000 to 5,000 in depth; to ultra-deepwater mean offshore areas, generally more than 5,000 in depth; to deep well mean a well drilled to a true vertical depth of 15,000 or greater; to new generation, when referring to OSVs, mean modern, deepwater-capable vessels subject to the regulations promulgated under the International Convention on Tonnage Measurement of Ships, 1969, which was adopted by the United States and made effective for all U.S.-flagged vessels in 1992 and foreign-flagged equivalent vessels; and to conventional, when referring to OSVs, mean vessels that are at least 20 years old, are generally less than 200 in length or carry less than 1,500 dead weight tons of cargo when originally built and primarily operate on the Continental Shelf.

General

Outlook

The continued weakness in the overall economy and depressed commodity prices, especially natural gas prices, has resulted in less exploration, development and production spending by our customers. Consequently, we are experiencing weakened demand for our services, which is having a corresponding negative impact on our dayrates and utilization. The ultimate extent of such weakened demand and how long it may last is not known. In addition, a lack of liquidity in the general credit markets may also impact the viability of projects contemplated by our customers. Finally, the construction of deepwater drilling rigs, which are a demand driver for our Upstream segment, may be cancelled or delayed in the current climate. The weakness in demand for our services has manifested itself at a time when we are completing the construction of new OSVs and MPSVs. While, as is discussed

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below, several of our OSVs have been or will be delivered to customers under existing contracts, that is not the case for our MPSVs, which have been or will be delivered into the spot market. While we believe that the long-term market for these vessels will likely strengthen, we anticipate short-term weakness affecting our MPSVs, which may last for several quarters.

Upstream Segment

Our average new generation OSV dayrates for the third quarter of 2009 were approximately \$21,000 and our average OSV utilization was in the low-70% range. The significant drop in the price of oil and natural gas since its peak in 2008 has increasingly affected our new generation OSV effective dayrates during the first nine months of 2009. OSV market conditions in the U.S. Gulf of Mexico, or GoM, have continued to deteriorate, particularly for our 200 class vessels. This vessel class has experienced a quarterly average dayrate decrease of over \$3,400 from the first quarter of 2009 and spot dayrate decreases of \$10,000, or roughly half of the spot dayrates experienced in late 2008. The extended soft OSV market conditions in the GoM have now begun to affect demand for our larger 240 class and 265 class OSVs. Average dayrates for these larger OSV classes have decreased sequentially by roughly \$2,000 and dropped approximately \$4,000 compared to the first quarter of 2009. Effective, or utilization-adjusted, dayrates for our 240 and 265 class vessels were down approximately \$1,700 sequentially and down roughly \$6,700 from the first quarter of 2009. The OSV demand outlook in the GoM is not expected to change in the near term based on various market indicators such as rig counts and oil and gas industry capital spending budgets for the remainder of 2009. In recognition of the current and forecasted soft demand for such vessels, we elected to stack eight 200 class new generation OSVs on various dates since May 2009. During the third quarter of 2009, we sold three of our conventional OSVs. Our three remaining conventional OSVs are still stacked. These older vessels were acquired in August 2007 and are considered non-core assets.

While we have had some measure of success with our newly delivered MPSVs, these vessels have also been impacted by the trough market conditions in the GoM. Fleetwide MPSV effective dayrates have trended about 25% lower than what we originally projected for 2009. The *HOS Centerline*, which was delivered in early 2009, recently received final regulatory approvals to operate under subchapters L, I, D, and O. We have taken advantage of general softness in the market to make some final modifications needed to comply with the subchapter D and O requirements. In connection with these requirements, the *HOS Centerline* experienced about 10 days of out-of-service time during the third quarter and we expect an additional 40 days out of service during the fourth quarter to complete final documentation activities. We believe that this vessel is now, not only the largest supply vessel in the world, but also the only vessel to be authorized to work under each of these four subchapters. We expect that the *HOS Strongline*, the sister vessel to the *HOS Centerline*, will also receive these four regulatory notations. As of September 30, 2009, our 37 active new generation OSVs and two MPSVs were operating in domestic and international areas as noted in the following table:

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Upstream Operating Areas	
<i>Domestic</i>	
GoM (1)	26
Other U.S. coastlines	5
	31
<i>Foreign</i>	
Latin America	6
Middle East	2
	8
<i>Total Upstream Vessels</i>	39

(1) The Company is expected to mobilize four OSVs from the GoM to Latin America under long-term contracts, as follows: two vessels during the fourth quarter of 2009 and two vessels during the first half of 2010. One of these four OSVs is currently stacked and not included in the active Upstream fleet noted above.

Downstream Segment

As of September 30, 2009, our Downstream fleet was comprised of a mix of nine double-hulled tank barges, ten single-hulled tank barges and 16 ocean-going tugs. In recognition of the soft market conditions for our single-hulled equipment that began early in the second quarter of 2008, we stacked all of our single-hulled tank barges and six lower horsepower tugs on various dates since the first quarter of 2008. Five of our stacked single-hulled barges have subsequently been sold during October 2009. The unfavorable revenue impact of stacking barges and tugs was partially offset by the reduced operating expenses associated with the lower cost of maintaining stacked equipment. Weak demand for Downstream equipment during the first nine months of 2009 has also impacted double-hulled tank barge utilization, particularly for our black-oil equipment. We anticipate these weak market conditions will continue throughout 2010.

Critical Accounting Policies

This Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our unaudited consolidated financial statements included in this Quarterly Report on Form 10-Q. In many cases, the accounting treatment of a particular transaction is specifically dictated by U.S. generally accepted accounting principles, or GAAP. In other circumstances, we are required to make estimates, judgments and assumptions based upon available information. We base our estimates and judgments on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions and conditions. Our significant accounting policies are discussed in Note 2 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2008, as supplemented by the Company's Current Report on Form 8-K filed August 11, 2009 to reflect certain retrospective adjustments relating to the adoption of new rules impacting the accounting for our convertible senior notes and Note 1 to our unaudited consolidated financial statements included in this Form 10-Q.

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The tables below set forth, by segment, the average dayrates, utilization rates, effective utilization and effective dayrates for our vessels and the average number and size of vessels owned during the periods indicated. These new generation OSVs and double-hulled tank barges generate the vast majority of our revenues and operating profit. Excluded from the information below are the results of operations for our MPSVs, conventional OSVs, stacked and retired tank barges, our shore-base facility, and vessel management services.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Offshore Supply Vessels:				
Average number of new generation OSVs (1)	44.0	36.8	42.2	35.8
Average new generation OSV fleet capacity (deadweight)	108,640	85,885	102,890	83,157
Average new generation vessel capacity (deadweight)	2,469	2,333	2,436	2,321
Average new generation OSV utilization rate (2)	71.9%	96.1%	82.5%	95.0%
Effective new generation OSV utilization rate (3)	83.2%	96.1%	87.6%	95.0%
Average new generation OSV dayrate (4)	\$ 20,915	\$ 23,884	\$ 21,829	\$ 22,411
Effective dayrate (5)	\$ 15,038	\$ 22,953	\$ 18,009	\$ 21,290
Tugs and Tank Barges:				
<i>Double-hulled tank barges (6):</i>				
Average number of tank barges (7)	9.0	9.0	9.0	8.8
Average fleet capacity (barrels) (7)	884,621	884,621	884,621	868,255
Average barge capacity (barrels)	98,291	98,291	98,291	99,002
Average utilization rate (2)	67.6%	80.2%	71.5%	88.2%
Average dayrate (8)	\$ 28,503	\$ 22,642	\$ 22,797	\$ 22,294
Effective dayrate (5)	\$ 19,268	\$ 18,159	\$ 16,300	\$ 19,663

- (1) We operated 44 new generation OSVs as of September 30, 2009. For the nine months ended September 30, 2009, the average number of new generation OSVs above includes five newly constructed OSVs that were placed in service under our fourth OSV newbuild program in January 2009, February 2009, March 2009, June 2009 and June 2009, respectively. At September 30, 2009, seven new generation OSVs were stacked and an eighth vessel was stacked in October 2009.
- (2) Utilization rates are average rates based on a 365-day year. Vessels are considered utilized when they are generating revenues.
- (3) Effective utilization rate is based on a denominator comprised only of vessel-days available for service by the active fleet, which excludes the impact of stacked vessel days.
- (4) Average dayrates represent average revenue per day, which includes charter hire, crewing services and net brokerage revenues, based on the number of days during the period that the OSVs generated revenue.
- (5) Effective dayrate represents the average dayrate multiplied by the average utilization rate.
- (6) The operating data presented above reflects only the results from our double-hulled tank barges. Our single-hulled tank barges, all of which have been stacked, have been excluded from our Downstream dayrate and utilization rate information. Our active Downstream fleet is comprised of nine double-hulled barges and ten ocean-going tugs.
- (7) We owned nine double-hulled tank barges as of September 30, 2009. For the nine months ended September 30, 2008, the average number of double-hulled tank barges includes the *Energy 6508* that was placed in service under our second TTB newbuild program in March 2008.
- (8) Average dayrates represent average revenue per day, including time charters, brokerage revenue, revenues generated on a per-barrel-transported basis, demurrage, shipdocking and fuel surcharge revenue, based on the number of days during the period that the tank barges generated revenue. For purposes of brokerage arrangements, this calculation excludes that portion of revenue that is equal to the cost paid by customers of in-chartering third-party equipment.

Non-GAAP Financial Measures

We disclose and discuss EBITDA as a non-GAAP financial measure in our public releases, including quarterly earnings releases, investor conference calls and other filings with the Commission. We define EBITDA as earnings (net income) before interest, income taxes, depreciation and amortization. Our measure of EBITDA may not be comparable to similarly titled measures presented by other companies. Other companies may calculate EBITDA differently than we do, which may limit its usefulness as comparative measure.

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We view EBITDA primarily as a liquidity measure and, as such, we believe that the GAAP financial measure most directly comparable to this measure is cash flows provided by operating activities. Because EBITDA is not a measure of financial performance calculated in accordance with GAAP, it should not be considered in isolation or as a substitute for operating income, net income or loss, cash flows provided by operating, investing and financing activities, or other income or cash flow statement data prepared in accordance with GAAP.

EBITDA is widely used by investors and other users of our financial statements as a supplemental financial measure that, when viewed with our GAAP results and the accompanying reconciliation, we believe provides additional information that is useful to gain an understanding of the factors and trends affecting our ability to service debt, pay deferred taxes and fund drydocking charges and other maintenance capital expenditures. We also believe the disclosure of EBITDA helps investors meaningfully evaluate and compare our cash flow generating capacity from quarter to quarter and year to year.

EBITDA is also a financial metric used by management (i) as a supplemental internal measure for planning and forecasting overall expectations and for evaluating actual results against such expectations; (ii) as a significant criteria for annual incentive cash compensation paid to our executive officers and bonuses paid to other shore-based employees; (iii) to compare to the EBITDA of other companies when evaluating potential acquisitions; and (iv) to assess our ability to service existing fixed charges and incur additional indebtedness.

The following table provides the detailed components of EBITDA as we define that term for the three and nine months ended September 30, 2009 and 2008, respectively (in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Components of EBITDA:				
Net income	\$ 13,774	\$ 33,282	\$ 41,074	\$ 81,157
Interest expense, net				
Debt obligations	5,586	1,393	12,584	5,466
Interest income	(179)	(142)	(365)	(1,370)
Total interest, net	5,407	1,251	12,219	4,096
Income tax expense	7,877	18,157	23,965	45,222
Depreciation	11,091	8,463	57,410	24,215
Amortization	5,423	4,379	18,564	13,825
EBITDA	\$ 43,572	\$ 65,532	\$ 153,232	\$ 168,515

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The following table reconciles EBITDA to cash flows provided by operating activities for the three and nine months ended September 30, 2009 and 2008, respectively (in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
EBITDA Reconciliation to GAAP:				
EBITDA	\$ 43,572	\$ 65,532	\$ 153,232	\$ 168,515
Cash paid for deferred drydocking charges	(2,406)	(5,411)	(15,039)	(14,821)
Cash paid for interest	(463)	(917)	(12,914)	(12,424)
Cash paid for taxes	(1,779)	(659)	(15,520)	(4,096)
Changes in working capital	7,256	(3,022)	27,179	13,445
Stock-based compensation expense	1,908	2,828	6,584	8,433
Changes in other, net	(222)	(6,879)	(909)	(8,421)
Net cash flows provided by operating activities	\$ 47,866	\$ 51,472	\$ 142,613	\$ 150,631

In addition, we also make certain adjustments to EBITDA, such as loss on early extinguishment of debt, stock-based compensation expense and interest income, as applicable, to compute ratios used in certain financial covenants of our revolving credit facility with various lenders. We believe that these ratios are a material component of such credit agreements and failure to comply with the financial covenants could result in the acceleration of indebtedness or the imposition of restrictions on our financial flexibility.

The following table provides certain detailed adjustments to EBITDA, as defined in our revolving credit facility, for the three and nine months ended September 30, 2009 and 2008, respectively (in thousands).

Adjustments to EBITDA for Computation of Financial Ratios Used in Debt Covenants

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Stock-based compensation expense	\$ 1,908	\$ 2,828	\$ 6,584	\$ 8,433
Interest income	179	142	365	1,370

Set forth below are the material limitations associated with using EBITDA as a non-GAAP financial measure compared to cash flows provided by operating activities.

EBITDA does not reflect the future capital expenditure requirements that may be necessary to replace our existing vessels as a result of normal wear and tear,

EBITDA does not reflect the interest, future principal payments and other financing-related charges necessary to service the debt that we have incurred in acquiring and constructing our vessels,

EBITDA does not reflect the deferred income taxes that we will eventually have to pay, and

EBITDA does not reflect changes in our net working capital position.

Management compensates for the above-described limitations in using EBITDA as a non-GAAP financial measure by only using EBITDA to supplement our GAAP results.

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Summarized financial information concerning our reportable segments for the three months ended September 30, 2009 and 2008, respectively, is shown below in the following table (in thousands, except percentage changes):

	Three Months Ended September 30,	Increase (Decrease)
--	---	--------------------------------