GULF ISLAND FABRICATION INC
Form 10-Q
August 04, 2015

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, 2015

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 001-34279

GULF ISLAND FABRICATION, INC.
(Exact name of registrant as specified in its charter)

LOUISIANA (State or other jurisdiction of incorporation or organization)	72-1147390 (I.R.S. Employer Identification No.)
16225 PARK TEN PLACE, SUITE 280 HOUSTON, TEXAS (Address of principal executive offices)	77084 (Zip Code)

(713) 714-6100
(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 x 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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-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 x

The number of shares of the registrant's common stock, no par value per share, outstanding as of August 4, 2015 was 14,542,971.

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GULF ISLAND FABRICATION, INC.
I N D E X

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements.
GULF ISLAND FABRICATION, INC.
CONSOLIDATED BALANCE SHEETS

	June 30, 2015 (Unaudited) (in thousands)	December 31, 2014 (Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$53,384	$36,085
Contracts receivable, net	37,402	80,448
Costs and estimated earnings in excess of billings on uncompleted contracts	25,358	26,989
Prepaid expenses and other	3,563	4,510
Inventory	9,895	10,140
Deferred tax assets	1,155	2,646
Income tax receivable	—	1,350
Assets held for sale	10,327	10,327
Total current assets	141,084	172,495
Property, plant and equipment, net	215,790	224,777
Other assets	672	671
Total assets	$357,546	$397,943
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$15,779	$40,272
Billings in excess of costs and estimated earnings on uncompleted contracts	9,228	18,766
Accrued contract losses	213	817
Accrued employee costs	7,217	7,723
Income tax payable	100	—
Accrued expenses and other liabilities	2,384	5,187
Total current liabilities	34,921	72,765
Deferred tax liabilities	37,174	39,380
Total liabilities	72,095	112,145
Shareholders' equity:		
Preferred stock, no par value, 5,000,000 shares authorized, no shares issued and outstanding	—	—
Common stock, no par value, 20,000,000 shares authorized, 14,541,268 issued and outstanding at June 30, 2015 and 14,539,104 at December 31, 2014, respectively	10,204	10,090
Additional paid-in capital	94,857	93,828
Retained earnings	180,390	181,880
Total shareholders' equity	285,451	285,798
Total liabilities and shareholders' equity	$357,546	$397,943

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

GULF ISLAND FABRICATION, INC.
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenue	$84,338	$129,169	$183,571	$263,859
Cost of revenue	78,533	118,847	173,318	244,764
Gross profit	5,805	10,322	10,253	19,095
General and administrative expenses	3,726	3,873	8,019	7,246
Operating income	2,079	6,449	2,234	11,849
Other income (expense):				
Interest expense	(50)	(25)	(87)	(49)
Interest income	7	2	13	5
Other income (expense)	17	8	20	(96)
	(26)	(15)	(54)	(140)
Income before income taxes	2,053	6,434	2,180	11,709
Income taxes	696	2,124	740	3,864
Net income	$1,357	$4,310	$1,440	$7,845
Per share data:				
Basic earnings per share - common shareholders	$0.09	$0.30	$0.10	$0.54
Diluted earnings per share - common shareholders	$0.09	$0.30	$0.10	$0.54
Cash dividend declared per common share	$0.10	$0.10	$0.20	$0.20

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

GULF ISLAND FABRICATION, INC.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

	Common Stock		Additional Paid-In	Retained Earnings	Total Shareholders'
	Shares	Amount	Capital		Equity
	(in thousands, except share data)				
Balance at January 1, 2015	14,539,104	$10,090	$93,828	$181,880	$285,798
Net income	—	—	—	1,440	1,440
Vesting of restricted stock	2,164	(1)	(9)	—	(10)
Compensation expense restricted stock	—	115	1,038	—	1,153
Dividends on common stock	—	—	—	(2,930)	(2,930)
Balance at June 30, 2015	14,541,268	$10,204	$94,857	$180,390	$285,451

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

GULF ISLAND FABRICATION, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended June 30,	
	2015	2014
	(in thousands)	
Cash flows from operating activities:		
Net income	$1,440	$7,845
Adjustments to reconcile net income to net cash provided by operating activities:		
Bad debt expense	400	—
Depreciation	13,140	12,958
(Gain) loss on sale of asset	(10)	85
Deferred income taxes	(715)	4,046
Compensation expense - restricted stock	1,153	652
Changes in operating assets and liabilities:		
Contracts receivable and retainage	41,446	34,097
Costs and estimated earnings in excess of billings on uncompleted contracts	1,631	7,163
Prepaid expenses and other assets	946	746
Inventory	245	542
Accounts payable	(24,493)	(33,431)
Billings in excess of costs and estimated earnings on uncompleted contracts	(9,538)	(15,445)
Accrued employee costs	(516)	(334)
Accrued expenses	(2,803)	(592)
Accrued contract losses	(604)	—
Current income taxes	1,450	(194)
Net cash provided by operating activities	23,172	18,138
Cash flows from investing activities:		
Capital expenditures	(2,953)	(21,334)
Proceeds on the sale of equipment	10	925
Net cash used in investing activities	(2,943)	(20,409)
Cash flows from financing activities:		
Borrowings against line of credit	—	22,000
Payments on line of credit	—	(22,000)
Payments of dividends on common stock	(2,930)	(2,931)
Net cash used in financing activities	(2,930)	(2,931)
Net change in cash and cash equivalents	17,299	(5,202)
Cash and cash equivalents at beginning of period	36,085	36,569
Cash and cash equivalents at end of period	$53,384	$31,367

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

GULF ISLAND FABRICATION, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Gulf Island Fabrication, Inc., together with its subsidiaries (the "Company", "we" or "our"), is a leading fabricator of offshore drilling and production platforms and other specialized structures. The Company's principal corporate office is located in Houston, Texas and its fabrication facilities are located in Houma, Louisiana and San Patricio County, Texas. The Company's principal markets are concentrated in the offshore regions and along the coast of the Gulf of Mexico. The consolidated financial statements include the accounts of Gulf Island Fabrication, Inc. and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Gulf Island Fabrication, Inc. serves as a holding company and conducts all of its operations through its subsidiaries, which include Gulf Island, L.L.C. and Gulf Marine Fabricators, L.P., both of which perform fabrication of offshore drilling and production platforms and other specialized structures used in the development and production of oil and gas reserves, Gulf Island Marine Fabricators, L.L.C., which performs marine fabrication and construction services, Dolphin Services, L.L.C., which performs offshore and onshore fabrication and construction services, Dolphin Steel Sales, L.L.C., which sells steel plate and other steel products and Gulf Island Resources, L.L.C., which hires laborers with similar rates and terms as those provided by contract labor service companies.

Structures and equipment fabricated by us include: jackets and deck sections of fixed production platforms; hull, tendon, and/or deck sections of floating production platforms (such as "TLPs", "SPARs", "FPSOs" and "MinDOCs"); piles; wellhead protectors; subsea templates; various production, compressor and utility modules; offshore living quarters; towboats; offshore support vessels; dry docks; liftboats; tanks and barges. The Company also provides offshore interconnect pipe hook-up, inshore marine construction, manufacture and repair of pressure vessels, heavy lifts such as ship integration and TLP module integration, loading and offloading of jack-up drilling rigs, semi-submersible drilling rigs, TLPs, SPARs or other similar cargo, onshore and offshore scaffolding, piping insulation services, and steel warehousing and sales. For definitions of certain technical terms contained in this Form 10-Q, see the Glossary of Certain Technical Terms contained in our Annual Report on Form 10-K for the year ended December 31, 2014.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information, the instructions to Form 10-Q, and Article 10 of Regulation S-X. Accordingly, the consolidated financial statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three-month and six-month periods ended June 30, 2015 are not necessarily indicative of the results that may be expected for the year ended December 31, 2015.

The balance sheet at December 31, 2014 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

For further information, refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

NOTE 2 – CONTRACTS RECEIVABLE AND RETAINAGE

The principal customers of the Company include major and large independent oil and gas companies, marine companies, and their contractors. Of our contracts receivable balance at June 30, 2015, $23.4 million, or 62.6%, is with five customers. The significant projects for these five customers consist of:

- a large deepwater jacket, piles and topside;
- two separate projects with fabrication and installation of offshore skids;
- shallow water jackets, piles, and topsides;
- three inland river towing vessels; and
- an upgrade to an oil unloading and handling facility.

At June 30, 2015, there was no allowance for bad debt included in the Company's contract receivable balance.

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In connection with work associated with a completed hull and topside project for a large deepwater customer in the first quarter 2014, we had a remaining receivable balance of $10.0 million at December 31, 2014. In the first quarter 2015, we entered into a settlement agreement with this customer that included payment of $8.4 million in cash and title to certain skidway equipment used for project load-outs. The cash settlement was received during the first quarter 2015. The equipment, valued at $1.2 million, was included in property, plant and equipment at June 30, 2015 with an assigned useful life of 15 years and represents a non-cash change in contracts receivable and property, plant and equipment in the accompanying unaudited statement of cash flows for the six months ended June 30, 2015. The remaining $0.4 million balance was charged to bad debt expense and was included in general and administrative expenses for the six-months ended June 30, 2015.

NOTE 3 – ASSETS HELD FOR SALE

Assets held for sale consist of a partially constructed topside, related valves, piping and equipment that we acquired from a customer following its default under a contract for a deepwater project in 2012. Assets held for sale are required to be measured at the lower of their carrying amount or fair value less cost to sell. Management determines fair value of these assets with the assistance of third party valuation specialists, assuming the sale of the underlying assets individually or in the aggregate to a willing market participant, including normal ownership risks assumed by the purchaser, and the sale of certain components at scrap value. We estimate fair value relying primarily on the cost approach and applied the market approach where comparable sales transaction information was readily available. The cost approach is based on current replacement or reproduction costs of the subject assets less depreciation attributable to physical, functional, and economic factors. The market approach involves gathering data on sales and offerings of similar assets in order to value the subject assets. This approach also includes an assumption for the measurement of the loss in value from physical, functional, and economic factors. The fair value of assets held for sale represent Level 3 fair value measurements (as defined by GAAP), based primarily on the limited availability of market pricing information for either identical or similar items. As of June 30, 2015, management estimates that the fair value of these assets held for sale was $10.3 million.

During the first quarter of 2014, we entered into an agreement with the manufacturer of certain equipment included in our assets held for sale, representing approximately 50% of the total fair value of assets held for sale, whereby the manufacturer agreed to assist with restoration and marketing efforts, in return for a percentage of the sale proceeds. The agreement is subject to six-month renewal periods; the next option to renew occurs in October 2015.

To date, we have not sold, licensed, or leased any of this equipment; however, we continue to actively market the equipment, and believe that the fair value of the assets is recoverable through the eventual sale of this equipment and the other project deliverables. We continue to engage engineering consultants to assist with marketing efforts for the assets held for sale. However, the ultimate amount we are able to recover for these assets is dependent upon market interest in the project deliverables and equipment, which may change in the future. The timing of any sales we are able to consummate and the price we are able to obtain may result in a revision to the recorded fair value amount of any remaining assets held for sale.

NOTE 4 – LINE OF CREDIT

The Company has an $80 million revolving credit facility with Whitney Bank and JPMorgan Chase Bank, N.A. maturing December 31, 2015. The credit facility is used to manage working capital needs and for the issuance of letters of credit in the ordinary course of business. Under the credit facility we may utilize up to the full amount of the available borrowing base for borrowings and letters of credit. At June 30, 2015, no amounts were outstanding under the credit facility, and we had outstanding letters of credit totaling $17.6 million, reducing the unused portion of our credit facility to $62.4 million.

The credit facility is secured by substantially all of our assets other than real property located in the state of Louisiana. Amounts borrowed under the credit facility bear interest, at our option, at either the prime lending rate established by JPMorgan Chase Bank, N.A. or LIBOR plus 1.5 percent. We pay a fee on a quarterly basis of one-fourth of one percent per annum on the weighted-average unused portion of the credit facility. We are required to maintain certain financial covenants, including:

- a minimum current ratio of 1.25 to 1;
- a net worth minimum requirement of $254.8 million;

- debt to net worth ratio of 0.5 to 1; and
- an earnings before interest, taxes, depreciation and amortization (EBITDA) to interest expense ratio of 4.0 to 1.

As of June 30, 2015, we were in compliance with all covenants.
We intend to renew our credit facility through December 31, 2016 before the maturity date.

NOTE 5 – CONTRACT COSTS

The Company uses the percentage-of-completion accounting method for fabrication contracts. Revenue from fixed-price or unit rate contracts is recognized on the percentage-of-completion method, computed by the efforts-expended method which measures the percentage of labor hours incurred to date as compared to estimated total labor hours to complete each contract. This progress percentage is applied to our estimate of total anticipated gross profit for each contract to determine gross profit earned to date. Revenue recognized in a period for a contract is the amount of gross profit recognized for that period plus labor costs and pass-through costs incurred on the contract during the period. We define pass-through costs as material, freight, equipment rental, and sub-contractor services included in the direct costs of revenue associated with projects. Consequently, pass-through costs are included in revenue but have no impact on the gross profit realized for that particular period.

Pass-through costs as a percentage of revenue were 39.5% and 50.9% for the three-month periods ended June 30, 2015 and 2014, respectively. Pass-through costs as a percentage of revenue were 39.5% and 50.1% for the six-month periods ended June 30, 2015 and 2014, respectively.

Costs and estimated earnings in excess of billings on uncompleted contracts at June 30, 2015 include unbilled costs of $17.1 million relating to two major customers. Billings in excess of costs and estimated earnings at June 30, 2015 include advances of $5.5 million from two major customers.

At June 30, 2015, we included in our estimates to complete, $22.3 million for change orders on three projects which have been approved as to scope but not price. These projects were 86%, 96% and 69% complete, respectively, at June 30, 2015. We expect to resolve these change orders before the end of the third quarter of 2015. At June 30, 2014, we included in our estimates to complete $5.2 million for change orders on three projects which were approved as to scope but not price. All unapproved change orders as of June 30, 2014 were subsequently approved in the normal course of business.

NOTE 6 – EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	June 30, 2015	June 30, 2014	June 30, 2015	June 30, 2014
Basic:				
Numerator:				
Net Income	$1,357	$4,310		