ION GEOPHYSICAL CORP
Form 10-Q
May 07, 2008

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2008

OR

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

COMMISSION FILE NUMBER: 1-12691

ION GEOPHYSICAL CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	22-2286646
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2105 CityWest Blvd. Suite 400 Houston, Texas	77042-2839
(Address of principal executive offices)	(Zip Code)

REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE: (281) 933-3339

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: þ No: o

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. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes: o No: þ

At April 30, 2008, there were 94,065,602 shares of common stock, par value $0.01 per share, outstanding.

ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
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FOR THE QUARTER ENDED MARCH 31, 2008

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PART I. FINANCIAL INFORMATION

Item 1. *Unaudited Financial Statements*

ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	March 31, 2008	December 31, 2007
	(In thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 36,022	$ 36,409
Restricted cash	6,815	7,052
Accounts receivable, net	160,060	188,029
Current portion of notes receivable, net	4,761	5,454
Unbilled receivables	43,975	22,388
Inventories	163,978	128,961
Prepaid expenses and other current assets	12,852	12,717
Total current assets	428,463	401,010
Non-current deferred income tax asset	2,964	2,872
Property, plant and equipment, net	36,784	36,951
Multi-client data library, net	76,456	59,689
Investments at cost	4,954	4,954
Goodwill	152,529	153,145
Intangible and other assets, net	48,198	50,528
Total assets	$ 750,348	$ 709,149
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable and current maturities of long-term debt	$ 14,505	$ 14,871
Accounts payable	54,607	44,674
Accrued expenses	61,157	66,911
Accrued multi-client data library royalties	27,570	29,962
Deferred revenue	17,274	21,278
Deferred income tax liability	2,792	2,792
Total current liabilities	177,905	180,488
Long-term debt, net of current maturities	8,274	9,842
Non-current deferred income tax liability	3,034	3,384
Other long-term liabilities	4,135	4,195
Fair value of preferred stock redemption features	9,378	

Total liabilities	202,726	197,909
Cumulative convertible preferred stock	60,444	35,000
Stockholders equity:		
Common stock, $0.01 par value; authorized 200,000,000 shares; outstanding 94,037,306 and 93,847,608 shares at March 31, 2008 and December 31, 2007, respectively, net of treasury stock	950	948
Additional paid-in capital	562,911	559,255
Accumulated deficit	(75,211)	(82,839)
Accumulated other comprehensive income	5,126	5,460
Treasury stock, at cost, 854,383 and 853,402 shares at March 31, 2008 and December 31, 2007, respectively	(6,598)	(6,584)
Total stockholders equity	487,178	476,240
Total liabilities and stockholders equity	$ 750,348	$ 709,149

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended March 31,	
	2008	2007
	(In thousands, except per share data)	
Product revenues	$ 93,034	$ 123,480
Service revenues	47,125	41,565
Total net revenues	140,159	165,045
Cost of products	59,617	91,704
Cost of services	32,148	34,176
Gross profit	48,394	39,165
Operating expenses:		
Research, development and engineering	12,159	11,304
Marketing and sales	11,156	10,637
General and administrative	14,784	11,280
Total operating expenses	38,099	33,221
Income from operations	10,295	5,944
Interest expense	(487)	(1,453)
Interest income	537	615
Other income (expense)	74	(227)
Fair value adjustment of preferred stock redemption features	178	
Income before income taxes	10,597	4,879
Income tax expense	2,059	1,204
Net income	8,538	3,675
Preferred stock dividends and accretion	910	602
Net income applicable to common shares	$ 7,628	$ 3,073
Net income per share:		
Basic and Diluted	$ 0.08	$ 0.04
Weighted average number of common shares outstanding:		

Basic	93,969	80,216
Diluted	98,961	83,247

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 8,538	$ 3,675
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization (other than multi-client library)	6,226	6,395
Amortization of multi-client library	10,168	8,865
Stock-based compensation expense related to stock options, nonvested stock and employee stock purchases	2,056	1,598
Fair value adjustment of preferred stock redemption features	(178)	
Deferred income tax	145	(226)
Bad debt expense	153	113
(Gain) loss on sale of fixed assets	(31)	87
Change in operating assets and liabilities:		
Accounts and notes receivable	28,679	9,778
Unbilled receivables	(21,587)	3,196
Inventories	(34,334)	(19,247)
Accounts payable, accrued expenses and accrued royalties	2,165	671
Deferred revenue	(4,001)	(16,246)
Other assets and liabilities	(1,628)	(4,894)
Net cash used in operating activities	(3,629)	(6,235)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(3,841)	(1,773)
Investment in multi-client data library	(26,935)	(10,687)
Proceeds from the sale of fixed assets	88	190
Net cash used in investing activities	(30,688)	(12,270)
Cash flows from financing activities:		
Borrowings under revolving line of credit		10,000
Payments on notes payable and long-term debt	(1,934)	(2,011)
Issuance of preferred stock	35,000	
Payment of preferred dividends	(910)	(589)
Proceeds from employee stock purchases and exercise of stock options	1,656	1,403
Restricted stock cancelled for employee minimum income taxes	(53)	
Purchases of treasury stock	(14)	(65)
Net cash provided by financing activities	33,745	8,738

Effect of change in foreign currency exchange rates on cash and cash equivalents	185	(378)
Net decrease in cash and cash equivalents	(387)	(10,145)
Cash and cash equivalents at beginning of period	36,409	17,056
Cash and cash equivalents at end of period	$ 36,022	$ 6,911

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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ION GEOPHYSICAL CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The consolidated balance sheet of ION Geophysical Corporation and its subsidiaries (collectively referred to as the Company or ION, unless the context otherwise requires) at December 31, 2007 has been derived from the Company s audited consolidated financial statements at that date. The consolidated balance sheet at March 31, 2008, the consolidated statements of operations for the three months ended March 31, 2008 and 2007, and the consolidated statements of cash flows for the three months ended March 31, 2008 and 2007 have been prepared by the Company without audit. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the three months ended March 31, 2008 are not necessarily indicative of the operating results for a full year or of future operations.

These consolidated financial statements have been prepared using accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q and applicable rules of Regulation S-X of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements presented in accordance with accounting principles generally accepted in the United States have been omitted. The accompanying consolidated financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2007.

During the first quarter of 2008, the Company determined that its engineering expenses relating to product enhancements are more appropriately reflected as combined with the engineering expenses associated with its research and development activities. These engineering expenses related to product enhancements had been previously classified within cost of products. The Company s previously reported cost of products and research, development and engineering expenses for the three months ended March 31, 2007 have been reclassified to conform to the current year s presentation. This reclassification (a total of $1.2 million for the three months ended March 31, 2007) had no impact on income from operations or net income.

(2) Summary of Significant Accounting Policies and Estimates

Refer to the Company s Annual Report on Form 10-K for the year ended December 31, 2007, for a complete discussion of the Company s significant accounting policies and estimates.

(3) Segment and Product Information

The Company evaluates and reviews results based on four segments: three of these segments Land Imaging Systems, Marine Imaging Systems and Data Management Solutions make up the ION Systems Division, and the fourth segment is the ION Solutions Division to allow for increased visibility and accountability of costs and more focused customer service and product development. The Company s land sensors business unit, which specializes in the design and manufacture of geophones, and its land imaging systems business unit are aggregated to form the Land Imaging Systems segment. The Company measures segment operating results based on income from operations.

A summary of segment information for the three ended March 31, 2008 and 2007, is as follows (in thousands):

	Three Months Ended March 31,	
	2008	**2007**
Net revenues:		
Land Imaging Systems	$ 49,888	$ 73,486
Marine Imaging Systems	34,488	44,149
Data Management Solutions	9,166	6,560
Total ION Systems	93,542	124,195
ION Solutions	46,617	40,850
Total	$ 140,159	$ 165,045

Income from operations:		
Land Imaging Systems	$ 3,295	$ 4,365
Marine Imaging Systems	10,001	11,990
Data Management Solutions	5,208	1,781
Total ION Systems	18,504	18,136

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	Three Months Ended March 31,	
	2008	2007
ION Solutions	6,227	(416)
Corporate	(14,436)	(11,776)
Total	$ 10,295	$ 5,944

(4) Inventories

A summary of inventories is as follows (in thousands):

	March 31, 2008	December 31, 2007
Raw materials and subassemblies	$ 88,577	$ 70,870
Work-in-process	24,648	13,681
Finished goods	63,214	55,945
Reserve for excess and obsolete inventories	(12,461)	(11,535)
Inventories, net	$ 163,978	$ 128,961

(5) Net Income per Common Share

Basic net income per common share is computed by dividing net income applicable to common shares by the weighted average number of common shares outstanding during the period. Diluted net income per common share is determined based on the assumption that dilutive restricted stock and restricted stock unit awards have vested and outstanding dilutive stock options have been exercised and the aggregate proceeds were used to reacquire common stock using the average price of such common stock for the period. The total number of shares issued or committed for issuance under outstanding stock options at March 31, 2008 and 2007 were 6,588,791 and 6,658,120, respectively, and the total number of shares of restricted stock and restricted stock units at March 31, 2008 and 2007 were 1,094,791 and 1,182,251, respectively. The number of shares issued under stock option exercises during the three months ended March 31, 2008 and 2007 were 124,250 and 136,378 shares, respectively.

The Company has outstanding $7.2 million of convertible senior notes, under which 1,675,926 shares of common stock may currently be acquired upon full conversion. In addition, there are 30,000, 5,000 and 35,000 outstanding shares, respectively, of Series D-1, Series D-2, and Series D-3 Cumulative Convertible Preferred Stock (Series D Preferred Stock), which may currently be converted, at the holder s election, into up to 3,812,428 shares, 311,664 shares and 2,365,168 shares, respectively, of common stock. As shown in the table below, the convertible senior notes are dilutive for the three months ended March 31, 2008 and anti-dilutive for the three months ended March 31, 2007. The Series D-3 Preferred Stock (purchased in February 2008) was dilutive for the three months ended March 31, 2008; however, the Series D-1 Preferred Stock and the Series D-2 Preferred Stock were anti-dilutive for all periods presented and outstanding.

The following table summarizes the computation of basic and diluted net income per common share (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2008	2007
Net income applicable to common shares	$ 7,628	$ 3,073
Income impact of assumed convertible debt conversion	120	

Impact of assumed Series D-3 Preferred Stock conversion:		
Series D-3 Preferred Stock dividends	280	
Fair value adjustment of Series D-3 Preferred Stock redemption feature	(371)	
Net income after impact of assumed convertible debt and Series D-3 Preferred Stock conversions	$ 7,657	$ 3,073
Weighted average number of common shares outstanding	93,969	80,216
Effect of dilutive stock awards	2,302	3,031
Effect of assumed convertible debt conversion	1,676	
Effect of assumed Series D-3 Preferred Stock conversion	1,014	
Weighted average number of diluted common shares outstanding	98,961	83,247
Basic and diluted net income per common share	$ 0.08	$ 0.04

(6) Notes Payable, Long-term Debt and Lease Obligations

Obligations	March 31, 2008	December 31, 2007
$75.0 million revolving line of credit	$	$
Convertible senior notes	7,240	7,240
Facility lease obligation	4,891	4,975
Equipment capital leases and other notes payable	10,648	12,498
Total	$ 22,779	$ 24,713

Revolving Line of Credit. In March 2007, the Company obtained a $75.0 million revolving line of credit (the Facility) with a scheduled maturity in March 2011. There was no indebtedness for borrowings outstanding under the Facility at March 31, 2008. The Facility is available for revolving credit borrowings to be used for the Company s 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, of which $1.0 million had been issued at March 31, 2008. 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 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 the Company s option, (i) an alternate base rate (as defined in the Facility credit agreement) or (ii) for Eurodollar borrowings, a LIBOR rate plus an applicable margin. The amount of the applicable margin will be based on the Company s then-current leverage ratio as defined in the 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.

The Company is obligated to pay a commitment fee of 0.25% per annum on the unused portion of the Facility. A significant portion of the Company s assets are pledged as collateral for outstanding borrowings under the Facility. The Facility credit agreement restricts the Company s ability to pay dividends on its 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 compliance with certain financial and non-financial covenants, including requirements related to (i) maintaining a minimum fixed charge coverage ratio of 1.25 to 1.0, and (ii) not exceeding a maximum leverage ratio of 2.75 to 1.0 (provided that, upon the Company s repaying the outstanding indebtedness under the convertible senior notes, the maximum leverage ratio shall fall to 2.50 to 1.0 for 12 months and then 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 the Company and its domestic subsidiaries by certain of the Company s foreign subsidiaries and provided for certain additional financial covenants with respect to the Company s domestic operations and subsidiaries. Specifically, these additional financial covenants obligate the Company to (x) not exceed a minimum domestic fixed charge coverage 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, permitted investments, inventory and equipment of the Company and its domestic subsidiaries, to the total commitments of the lenders under the Facility, to be less than 1.75 to 1.0. At March 31, 2008, the Company was in compliance with all of the covenants under the credit agreement.

Convertible Senior Notes. In November 2007, a holder of $52.8 million principal amount of the $60.0 million outstanding convertible senior notes approached the Company and made an offer to convert its portion of the debt into common stock. This conversion occurred on November 27, 2007. The remaining $7.2 million balance of the convertible senior notes remains outstanding as of March 31, 2008. The notes bear interest at an annual rate of 5.5%, payable semi-annually. The notes, which are not redeemable prior to their maturity, are convertible into the Company s 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), which represents 1,675,926 total common shares.

(7) Cumulative Convertible Preferred Stock

Cumulative Convertible Preferred Stock. On February 21, 2008, the holder of the Company s outstanding Series D-1 and Series D-2 Cumulative Convertible Preferred Stock (Series D-1 Preferred Stock and Series D-2 Preferred Stock, respectively), exercised its

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-3 Preferred Stock have similar terms as the Series D-1 Preferred Stock and the Series D-2 Preferred Stock, except the Series D-3 Preferred Stock is initially convertible into 2,365,168 shares of the Company s common stock at an initial conversion price of $14.7981 per share, subject to adjustments in certain events. On February 20, 2008, the closing sales price per share of ION common stock on the New York Stock Exchange was $13.26.

The proceeds from the sale of the Series D-3 Preferred Stock were applied to current working capital needs. All rights held by the holder to purchase any shares of the Company s preferred stock have been exercised. The proceeds received from the sale of the Series D-3 Preferred Stock, less its initial fair value associated with the redemption feature (see further discussion below), have been classified outside of stockholders equity on the balance sheet below total liabilities. Prior to conversion, common shares issuable will be assessed for inclusion in the weighted average shares outstanding for the Company s diluted earnings per share using the if-converted method.

The outstanding shares of the Series D-2 Preferred Stock and the Series D-3 Preferred Stock are subject to the accounting guidance contained in EITF Topic D-109: *Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share under FASB Statement No. 133* (Topic D-109). Topic D-109 became effective on a prospective basis on July 1, 2007, and the additional guidance and clarification of Topic D-109 applies to transactions occurring after July 1, 2007, including the issuances of the Series D-2 Preferred Stock and the Series D-3 Preferred Stock. Under Topic D-109, the redemption features of the Series D-2 Preferred Stock and the Series D-3 Preferred Stock are embedded derivatives that are required to be bifurcated and accounted for separately at their fair value. The fair value of the redemption features has been classified as a liability on the balance sheet of the Company and, on a quarterly basis, changes in the fair value of these redemption features will be reflected in the income statement below income from operations. For the period ending March 31, 2008, the fair value adjustment associated with the embedded derivatives resulted in a decrease (income) in their fair values of $0.2 million.

Fair Value. On January 1, 2008, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements,* (SFAS 157), for financial assets and liabilities. SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 does not require new fair value measurements. The standard establishes a fair value hierarchy based on whether the inputs to valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company s own assumptions about the assumptions market participants would use. The fair value hierarchy includes three levels of inputs that may be used to measure fair value. Level 3 inputs include assets and liabilities whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques reflecting the Company s own assumptions about the assumptions market participants would use as well as those requiring significant management judgment.

The embedded redemption features related to the Series D-2 Preferred Stock and the Series D-3 Preferred Stock are the only material transactions requiring recurring fair value calculations. The fair value of the redemption features are estimated using a lattice option model, which includes a variety of inputs. The key inputs for the lattice option model include the current market price of the Company s common stock, the yield on the preferred stock dividend payments, interest rates calculated according to companies in similar financial and credit positions and the Company s stock historical and implied volatility. For the three months ended, March 31, 2008, the redemption features for the Series D-2 Preferred Stock and the Series D-3 Preferred Stock had a combined value of $9.4 million, which was comprised entirely of Level 3 inputs. During the three months ended March 31, 2008, the Series D-2 Preferred Stock redemption feature increased in value from $1.1 million to $1.3 million, or an unrealized loss of $0.2 million. On February 21, 2008, the Series D-3 Preferred Stock was purchased, and its redemption feature was valued at $8.5 million, which decreased to $8.1 million at March 31, 2008, or an unrealized gain of $0.4 million.

(8) Income Taxes

In 2002, the Company established a valuation allowance for substantially all of its deferred tax assets. Since that time, the Company has continued to record a valuation allowance. The valuation allowance was calculated in accordance with the provisions of SFAS 109, *Accounting for Income Taxes,* which require that a valuation

allowance be established or maintained when it is more likely than not that all or a portion of deferred tax assets will not be realized. The Company will continue to reserve for substantially all net deferred tax assets until there is sufficient evidence to warrant reversal. The Company s effective tax rates for the three months ended March 31, 2008 and 2007 were 19.4% and 24.7%, respectively, and are primarily related to the Company s earnings in its foreign jurisdictions as well as U.S. deferred taxes related to the utilization of acquired net operating losses.

The Company has no unrecognized tax benefits and does not expect to recognize significant increases in unrecognized tax benefits during the next twelve month period.

Interest and penalties, if any, related to unrecognized tax benefits are recorded in income tax expense.

The Company s U.S. federal tax returns for 2004 and subsequent years remain subject to examination by tax authorities. The Company is no longer subject to IRS examination for periods prior to 2004, although carryforward attributes that were generated prior to 2004 may still be adjusted upon examination by the IRS if they either have been or will be used in a future period. In the Company s foreign tax jurisdictions, tax returns for 2000 and subsequent years generally remain open to examination.

(9) Comprehensive Net Income

The components of comprehensive net income are as follows (in thousands):

	Three Months Ended March 31,	
	2008	**2007**
Net income applicable to common shares	$ 7,628	$ 3,073
Foreign currency translation adjustment	(334)	(75)
Comprehensive net income	$ 7,294	$ 2,998

(10) Stock-Based Compensation Valuation Assumptions

The Company calculated the fair value of each option award on the date of grant using the Black-Scholes option pricing model. The following assumptions were used for each respective period:

	Three Months Ended March 31,	
	2008	**2007**
Risk-free interest rates	2.5%	4.5%
Expected lives (in years)	5.0	4.5
Expected dividend yield	0%	0%
Expected volatility	48.5%	48.8%

The computation of expected volatility during the three months ended March 31, 2008 and 2007 was based on an equally weighted combination of historical volatility and market-based implied volatility. Historical volatility was calculated from historical data for a period of time approximately equal to the expected term of the option award, starting from the date of grant. Market-based implied volatility was derived from traded options on the Company s common stock having a term of six months. The risk-free interest rate assumption is based upon the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option.

(11) Commitments and Contingencies

Legal Matters: The Company has been named in various lawsuits or threatened actions that are incidental to its ordinary business. Such lawsuits and actions could increase in number as the Company s business expands and the Company grows larger. Litigation is inherently unpredictable. Any claims against the Company, whether meritorious or not, could be time consuming, cause the Company 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. Management currently believes that the ultimate resolution of these matters will not have a material adverse impact on the financial condition, results of operations or liquidity of the Company.

Warranties: The Company generally warrants that all of its manufactured equipment will be free from defects in workmanship, materials and parts. Warranty periods generally range from 30 days to three years from the date of original purchase, depending on the product. The Company provides for estimated warranty as a charge to cost of sales at time of sale, which is when estimated future expenditures associated with such contingencies become probable and reasonably estimated. However, new information may become available, or circumstances (such as applicable

laws and regulations) may change, thereby resulting in an increase or decrease in the amount required to be accrued for such matters (and therefore a decrease or increase in reported net income in the period of such change). A summary of warranty activity is as follows (in thousands):

	Three Months Ended March 31,	
	2008	2007
Balance at beginning of period	$ 13,439	$ 6,255
Accruals for warranties issued during the period	1,389	2,597
Settlements made (in cash or in kind) during the period	(1,643)	(1,552)
Balance at end of period	$ 13,185	$ 7,300

(12) Concentration of Credit and Foreign Sales Risks

For the three months ended March 31, 2008, the Company recognized $36.8 million of sales to customers in Europe, $22.6 million of sales to customers in the Asia-Pacific region, $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 the Company s 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 the Company s future sales to customers in these and other regions of the world or the collectibility of the Company s existing receivables, the Company s future results of operations, liquidity and financial condition may be adversely affected.

(13) Recent Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board (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. The Company will adopt SFAS 161 upon its effective date. The Company does not anticipate the adoption of SFAS 161 will have a material impact on the Company s financial position, results of operations or cash flows.