ATWOOD OCEANICS INC
Form 10-Q
February 01, 2013

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 QUARTERLY PERIOD ENDED December 31, 2012
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
COMMISSION FILE NUMBER 1-13167

ATWOOD OCEANICS, INC.
(Exact name of registrant as specified in its charter)

TEXAS	74-1611874
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
15835 Park Ten Place Drive Houston, Texas	77084
(Address of principal executive offices)	(Zip Code)

281-749-7800
(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, and (2) has been subject to such filings 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	x	Accelerated filer	¨
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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of January 30, 2013:
65,641,866 shares of common stock, $1.00 par value

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FORM 10-Q
For the Quarter Ended December 31, 2012
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PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

Atwood Oceanics, Inc. and Subsidiaries
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended December 31,	
(In thousands, except per share amounts)	2012	2011
REVENUES:		
Contract drilling	$245,093	$184,672
COSTS AND EXPENSES:		
Contract drilling	111,916	78,344
Depreciation	27,578	15,363
General and administrative	17,221	14,094
Other, net	7	—
	156,722	107,801
OPERATING INCOME	88,371	76,871
OTHER INCOME (EXPENSE):		
Interest expense, net of capitalized interest	(4,408)	(603)
Interest income	124	86
Other	—	1,577
	(4,284)	1,060
INCOME BEFORE INCOME TAXES	84,087	77,931
PROVISION FOR INCOME TAXES	11,256	12,463
NET INCOME	$72,831	$65,468
EARNINGS PER COMMON SHARE (NOTE 2):		
Basic	1.11	1.01
Diluted	1.10	1.00
AVERAGE COMMON SHARES OUTSTANDING (NOTE 2):		
Basic	65,528	65,024
Diluted	66,092	65,541

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

Atwood Oceanics, Inc. and Subsidiaries
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended December 31,	
(In thousands)	2012	2011
Net income	$72,831	$65,468
Other comprehensive income (loss)		
Interest rate swaps	372	(208)
Other comprehensive income (loss)	372	(208)
Total comprehensive income	$73,203	$65,260

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

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Atwood Oceanics, Inc. and Subsidiaries
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)	December 31, 2012	September 30, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$108,341	$77,871
Accounts receivable, net of allowance for doubtful accounts of $1,871 and $0 at December 31, 2012 and September 30, 2012, respectively	142,934	167,186
Income tax receivable	5,609	5,750
Inventories of materials and supplies	80,367	80,290
Prepaid expenses and deferred costs	31,117	39,437
Total current assets	368,368	370,534
Property and equipment, net	2,854,515	2,537,340
Other receivables	11,868	11,875
Deferred costs and other assets	24,195	24,013
Total assets	$3,258,946	$2,943,762
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$78,420	$83,592
Accrued liabilities	29,261	24,478
Notes payable	—	5,148
Income tax payable	13,314	9,711
Deferred credits	15,095	13,738
Total current liabilities	136,090	136,667
Long-term debt	1,070,000	830,000
Deferred income taxes	8,571	8,791
Deferred credits	7,659	8,928
Other	20,300	19,954
Total long-term liabilities	1,106,530	867,673
Commitments and contingencies (Note 10)		
Shareholders’ equity:		
Preferred stock, no par value, 1,000 shares authorized, none outstanding	—	—
Common stock, $1.00 par value, 90,000 shares authorized with 65,632 and 65,452 issued and outstanding at December 31, 2012 and September 30, 2012, respectively	65,632	65,452
Paid-in capital	164,061	160,540
Retained earnings	1,789,272	1,716,441
Accumulated other comprehensive loss	(2,639)	(3,011)
Total shareholders' equity	2,016,326	1,939,422
Total liabilities and shareholders' equity	$3,258,946	$2,943,762

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

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Atwood Oceanics, Inc. and Subsidiaries
UNAUDITED CONDENSED CONSOLIDATED
STATEMENTS OF CASH FLOWS

	Three Months Ended December 31,	
(In thousands)	2012	2011
Cash flows from operating activities:		
Net income	$72,831	$65,468
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	27,578	15,363
Amortization of debt issuance costs	1,036	681
Amortization of deferred items	(32)	393
Provision for doubtful accounts	1,871	—
Provision for inventory obsolescence	181	255
Deferred income tax benefit	(220)	(186)
Share-based compensation expense	3,048	1,790
Other, net	7	—
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable	22,388	(32,511)
Decrease in income tax receivable	141	1,640
(Increase) decrease in inventory	(257)	6,106
Decrease in prepaid expenses	5,470	1,378
Increase in deferred costs and other assets	(4,039)	(1,040)
Increase (decrease) in accounts payable	(27,978)	3,463
Increase (decrease) in accrued liabilities	4,937	(9,143)
Increase in income tax payable	3,603	3,249
Increase in deferred credits and other liabilities	6,354	843
	44,088	(7,719)
Net cash provided by operating activities	116,919	57,749
Cash flows from investing activities:		
Capital expenditures	(321,995)	(257,446)
Proceeds from sale of assets	41	—
Net cash used by investing activities	(321,954)	(257,446)
Cash flows from financing activities:		
Proceeds from bank credit facilities	240,000	—
Principal payments on notes payable	(5,148)	(5,461)
Proceeds from exercise of stock options	653	79
Net cash provided (used) by financing activities	235,505	(5,382)
Net increase (decrease) in cash and cash equivalents	$30,470	$(205,079)
Cash and cash equivalents, at beginning of period	$77,871	$295,002
Cash and cash equivalents, at end of period	$108,341	$89,923
Non-cash activities		
Increase (decrease) in accounts payable and accrued liabilities related to capital expenditures	$22,806	$(83,190)

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

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Atwood Oceanics, Inc. and Subsidiaries
UNAUDITED CONDENSED CONSOLIDATED
STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	Common Stock		Paid-in	Retained	Accumulated Other Comprehensive	Total Stockholders'
(In thousands)	Shares	Amount	Capital	Earnings	Loss	Equity
September 30, 2012	65,452	$65,452	$160,540	$1,716,441	$ (3,011)	$1,939,422
Net income	—	—	—	72,831	—	72,831
Other comprehensive gain	—	—	—	—	372	372
Restricted stock awards	142	142	(142)	—	—	—
Exercise of employee stock options	38	38	615	—	—	653
Stock option and restricted stock award compensation expense		—	3,048	—	—	3,048
December 31, 2012	65,632	$65,632	$164,061	$1,789,272	$ (2,639)	$2,016,326

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

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Atwood Oceanics, Inc. and Subsidiaries
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1—UNAUDITED INTERIM INFORMATION

The unaudited interim condensed consolidated financial statements of Atwood Oceanics, Inc. and its subsidiaries as of December 31, 2012, and for the three months ended December 31, 2012 and 2011, included herein, have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Unless otherwise indicated, references to "we", "us", "our" and the "Company" refer collectively to Atwood Oceanics, Inc. and subsidiaries. The year-end condensed consolidated balance sheet data was derived from the audited financial statements as of September 30, 2012. Although these financial statements and related information have been prepared without audit, and certain information and note disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted, we believe that the note disclosures are adequate to make the information not misleading. The interim financial results may not be indicative of results that could be expected for a full fiscal year. It is suggested that these unaudited condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended September 30, 2012. In our opinion, the unaudited interim financial statements reflect all adjustments considered necessary for a fair statement of our financial position, results of operations and cash flows for the periods presented.

NOTE 2—EARNINGS PER COMMON SHARE

The computation of basic and diluted earnings per share for the three months ended December 31, 2012 and 2011 is as follows (in thousands, except per share amounts):

	Three Months Ended		
	Net Income	Shares	Per Share Amount
December 31, 2012			
Basic earnings per share	$72,831	65,528	$1.11
Effect of dilutive securities:			
Stock options	—	409	$(0.01)
Restricted stock	—	155	$—
Diluted earnings per share	$72,831	66,092	$1.10
December 31, 2011			
Basic earnings per share	$65,468	65,024	$1.01
Effect of dilutive securities:			
Stock options	—	348	$(0.01)
Restricted stock	—	169	$—
Diluted earnings per share	$65,468	65,541	$1.00

The calculation of diluted earnings per share for the three months ended December 31, 2012 and 2011 excludes shares of common stock related to approximately 296,000 and 977,000 outstanding stock options, respectively, because such options were anti-dilutive. These options could potentially dilute basic earnings per share in the future.

NOTE 3—SHARE-BASED COMPENSATION

Share-based compensation cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the requisite service period, which is generally the vesting period of the equity award. As of December 31, 2012, unrecognized compensation cost, net of estimated forfeitures, related to stock options and restricted stock awards was approximately $5.6 million and $24.3 million, respectively, which we expect to recognize over a weighted average period of approximately 2.4 years.

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Stock Options

Under our stock incentive plans, the exercise price of each stock option must be equal to or greater than the fair market value of one share of our common stock on the date of grant, with all outstanding options having a maximum term of 10 years. Options vest ratably over a period ranging from the end of the first to the fourth year from the date of grant for stock options. Each option is for the purchase of one share of our common stock.

A summary of stock option activity during the three months ended December 31, 2012 is as follows:

	Number of Options (000s)	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Life (Years)	Aggregate Intrinsic Value (000s)
Outstanding at October 1, 2012	1,450	$29.74	6.1	$22,663
Granted	0	$—		
Exercised	(38)	$16.25		$1,181
Forfeited	(16)	$38.96		
Outstanding at December 31, 2012	1,396	$29.98	5.9	$22,058
Exercisable at December 31, 2012	1,023	$26.44	5.0	$19,785

Restricted Stock

We have awarded restricted stock under the Atwood Oceanics, Inc. 2007 Long-Term Incentive Plan (as amended, the "2007 Plan") to certain employees and to our non-employee directors. All current awards of restricted stock to employees are subject to a vesting and restriction period ranging from three to four years, subject to early termination as provided in the 2007 Plan. In addition, certain awards of restricted stock to employees are subject to market-based performance conditions. The number of shares that vest based on market-based performance conditions will depend on the degree of achievement of specified corporate performance criteria which are strictly market-based. All awards of restricted stock to non-employee directors are subject to a vesting and restriction period of a minimum of 13 months, subject to early termination as provided in the 2007 Plan. We value restricted stock awards based on the fair market value of our common stock on the date of grant and also adjust fair market value for any awards subject to market-based performance conditions, where applicable.

A summary of restricted stock activity for the three months ended December 31, 2012 is as follows:

	Number of Shares (000s)	Wtd. Avg. Fair Value
Unvested at October 1, 2012	701	$38.54
Granted	323	$46.46
Vested	(142)	$34.77
Forfeited	(9)	$39.62
Unvested at December 31, 2012	873	$42.06

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NOTE 4—PROPERTY AND EQUIPMENT

A summary of property and equipment by classification is as follows (in thousands):

(In thousands)	December 31, 2012	September 30, 2012
Drilling vessels and equipment	$2,727,429	$2,523,895
Construction work in progress	575,820	438,081
Drill pipe	20,658	20,576
Office equipment and other	22,099	19,610
Cost	3,346,006	3,002,162
Less: Accumulated depreciation	(491,491)	(464,822)
Drilling and other property and equipment, net	$2,854,515	$2,537,340

Property and equipment are recorded at cost. Interest incurred related to property under construction is capitalized as a component of construction costs. Interest capitalized during the three months ended December 31, 2012 and 2011 was approximately $9.0 million and $4.8 million, respectively.

Construction Projects

As of December 31, 2012, we had expended approximately $564 million towards our four drilling units under construction. Total remaining firm commitments for our four drilling units currently under construction were approximately $1.2 billion at December 31, 2012.

NOTE 5—LONG-TERM DEBT

A summary of long-term debt is as follows (in thousands):

	December 31, 2012	September 30, 2012
Senior Notes, bearing fixed interest at 6.5% per annum	$450,000	$450,000
Credit Facility, bearing interest at approximately 3.0%(1) per annum at December 31, 2012 and 3.2%(1) per annum at September 30, 2012	620,000	380,000
(1) After the impact of our interest rate swaps.	$1,070,000	$830,000

Revolving Credit Facility

As of December 31, 2012, we had $620 million of outstanding borrowings under our five-year $750 million senior secured revolving credit facility. The credit facility was entered into in May 2011 and matures in May 2016. Our wholly-owned subsidiary, Atwood Offshore Worldwide Limited ("AOWL"), is the borrower under the credit facility, and we and certain of our other subsidiaries are guarantors under the facility. Borrowings under the credit facility bear interest at the Eurodollar rate plus a margin of 2.5%. Certain borrowings effectively bear interest at a fixed rate due to our interest rate swaps (See Note 6).

We were in compliance with all financial covenants under the credit facility at December 31, 2012.

NOTE 6—INTEREST RATE SWAPS

Our credit facility exposes us to short-term changes in market interest rates as our interest obligations on these instruments are periodically re-determined based on the prevailing Eurodollar rate. We enter into interest rate swaps to limit our exposure to fluctuations and volatility in interest rates. We do not engage in derivative transactions for speculative or trading purposes and we are not a party to leveraged derivatives.

At December 31, 2012, we had five $50 million notional interest rate swaps in effect. These interest rate swaps fix the interest rate on $250 million of borrowings under the credit facility at a weighted average interest rate of 3.4% through September 2014.

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Fair Value of Derivatives

The following table presents the carrying amount of our cash flow hedge derivative contracts included in the Consolidated Balance Sheets as of December 31, 2012 and September 30, 2012 (in thousands):

Type of Contract	Balance Sheet Classification	December 31, 2012	September 30, 2012
Short term interest rate swaps	Accrued liabilities	$1,751	$1,705
Long term interest rate swaps	Other long-term liabilities	1,002	1,414
Total derivative contracts, net		$2,753	$3,119

We record the interest rate derivative contracts at fair value on our consolidated balance sheets (See Note 8). Hedging effectiveness is evaluated each quarter end using the “Dollar Off-Set Method”. Each quarter, changes in the fair values will adjust the balance sheet asset or liability, with an offset to Other Comprehensive Income (“OCI”) for the effective portion of the hedge.

For the three months ended December 31, 2012, we recognized a gain of approximately $0.4 million in OCI as a result of realized losses associated with effective portion of the hedge and classified as interest expense, net of capitalized interest on our Consolidated Statement of Operations.

For interest rate swaps, we compare all material terms between the swap and the underlying debt obligation to evaluate effectiveness. Any change in fair value resulting from ineffectiveness is recognized immediately in earnings. No loss was recognized during the quarters ended December 31, 2012 and 2011 due to hedge ineffectiveness.

NOTE 7—INCOME TAXES

Our consolidated effective income tax rate for the three months ended December 31, 2012 was approximately 13%. We record estimated accrued interest and penalties related to uncertain tax positions as income tax expense. At December 31, 2012, we had approximately $8.3 million of reserves for uncertain tax positions, including estimated accrued interest and penalties of $2.6 million, which are included in Other Long Term Liabilities in the Consolidated Balance Sheet. None of our reserves for uncertain tax positions relate to timing differences. All $8.3 million of the net uncertain tax liabilities would affect the effective tax rate if recognized.

Our United States tax returns for fiscal year 2009 and subsequent years remain subject to examination by tax authorities. As we conduct business globally, we have various tax years that remain open to examination in certain international tax jurisdictions. Although we cannot predict the outcome of ongoing or future tax examinations, we do not anticipate that the ultimate resolution of these examinations will have a material impact on our consolidated financial position, results of operations or cash flows.

NOTE 8—FAIR VALUE

We have certain assets and liabilities that are required to be measured and disclosed at fair value in accordance with generally accepted accounting principles (“GAAP”). Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The established GAAP fair value hierarchy prioritizes inputs to valuation techniques used to measure fair value into three levels. Priority is given to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Assets and liabilities measured at fair value are classified based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment, which may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels. The determination of the fair values, stated below, takes into account the market for our financial assets and liabilities, the associated credit risk and other considerations.

We have classified and disclosed fair value measurements using the following levels of the fair value hierarchy:

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Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability.
Level 3: Measurement based on prices or valuation models that require inputs that are both significant to the fair value measurement and less observable for objective sources (i.e., supported by little or no market activity).

Fair value of Certain Assets and Liabilities

The fair value of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of their short term maturities.

Fair Value of Financial Instruments
The fair value of financial instruments is determined by using quoted market prices when available. When quoted prices are not available, independent third party services may be used to determine the fair value with reference to observable inputs used.

The following table sets forth the estimated fair value of certain financial instruments at December 31, 2012 and September 30, 2012, which are measured and recorded at fair value on a recurring basis:

		December 31, 2012 Fair Value Measurements				
		Carrying Amount	Level 1	Level 2	Level 3	Estimated Fair Value
Type of Contract	Balance Sheet Classification					
Short term interest rate swaps	Accrued liabilities	$1,751	$—	$1,751	$—	$1,751
Long term interest rate swaps	Other long-term liabilities	1,002	—	1,002	—	1,002
Total derivative contracts, net		$2,753	$—	$2,753	$—	$2,753

		September 30, 2012 Fair Value Measurements				
		Carrying Amount	Level 1	Level 2	Level 3	Estimated Fair Value
Type of Contract	Balance Sheet Classification					
Short term interest rate swaps	Accrued liabilities	$1,705	$—	$1,705	$—	$1,705
Long term interest rate swaps	Other long-term liabilities	1,414	—	1,414	—	1,414
Total derivative contracts, net		$3,119	$—	$3,119	$—	$3,119

Interest rate swaps - The fair values of our interest rate swaps are based upon valuations calculated by an independent third party. The derivatives were valued according to the "Market approach" where possible, and the "Income approach" otherwise. A third party independently valued each instrument using forward price data supplied by dealers and the Chicago Mercantile Exchange (the exchange on which similar derivatives trade) indexed to one month USD LIBOR as of December 31, 2012, and broker quotes for credit default swaps or related credit instruments. It was determined that the contribution of the credit valuation adjustment to total fair value is less than 5.0% for all derivatives and is therefore not significant. Based on valuation inputs for fair value measurement and independent review performed by third party consultants, we have classified our derivative contracts as Level 2.

Long-term Debt – Our long-term debt consists of both our 6.5% Senior Notes due 2020 (the “Notes”) and our credit facility.

Credit Facility – The carrying amounts of our variable-rate debt approximates fair value because such debt bears short-term, market-based interest rates. We have classified this instrument as Level 2 as valuation inputs for purposes of determining our fair value disclosure are read