HORNBECK OFFSHORE SERVICES INC /LA
Form 10-Q
August 09, 2013
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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 June 30, 2013

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	**72-1375844**
(State or other jurisdiction of incorporation or organization)	**(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 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	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 x

The total number of shares of common stock, par value $.01 per share, outstanding as of July 31, 2013 was 36,025,027.

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2013

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PART 1 FINANCIAL INFORMATION

Item 1 Financial Statements

HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	June 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 636,174	$ 576,678
Accounts receivable, net of allowance for doubtful accounts of $2,881 and $3,028, respectively	109,316	103,265
Deferred tax assets, net	43,880	28,720
Other current assets	20,763	22,846
Total current assets	810,133	731,509
Property, plant and equipment, net	2,018,432	1,812,110
Deferred charges, net	79,128	74,835
Other assets	12,813	13,277
Total assets	$ 2,920,506	$ 2,631,731
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 43,259	$ 48,286
Accrued interest	13,706	14,790
Accrued payroll and benefits	15,660	13,748
Deferred revenue	21,419	19,425
Current portion of long-term debt, net of original issue discount of $4,517 and $11,093, respectively	245,483	238,907
Other accrued liabilities	13,416	8,349
Total current liabilities	352,943	343,505
Long-term debt, net of original issue discount of $65,403 and $74,470, respectively	1,059,597	850,530
Deferred tax liabilities, net	297,550	270,478
Other liabilities	2,820	1,373
Total liabilities	1,712,910	1,465,886
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; 36,016 and 35,479 shares issued and outstanding, respectively	360	355
Additional paid-in-capital	717,738	705,658
Retained earnings	490,079	460,090
Accumulated other comprehensive loss	(581)	(258)
Total stockholders equity	1,207,596	1,165,845

Total liabilities and stockholders equity	$ 2,920,506	$ 2,631,731

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

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
	(Unaudited)		(Unaudited)	
Revenues	$ 154,323	$ 131,645	$ 301,839	$ 251,618
Costs and expenses:				
Operating expenses	65,899	63,456	129,264	122,665
Depreciation	15,413	15,171	30,723	30,253
Amortization	8,628	7,107	16,184	13,024
General and administrative expenses	13,819	12,081	27,698	23,207
	103,759	97,815	203,869	189,149
Gain (loss) on sale of assets	1,599	(11)	1,599	(3)
Operating income	52,163	33,819	99,569	62,466
Other income (expense):				
Loss on early extinguishment of debt	(1,457)	(855)	(25,776)	(6,048)
Interest income	668	461	1,245	1,014
Interest expense	(13,242)	(14,342)	(26,964)	(28,274)
Other income (expense), net	93	224	(14)	329
	(13,938)	(14,512)	(51,509)	(32,979)
Income before income taxes	38,225	19,307	48,060	29,487
Income tax expense	14,395	7,293	18,071	11,166
Net income	$ 23,830	$ 12,014	$ 29,989	$ 18,321
Basic earnings per common share	$ 0.66	$ 0.34	$ 0.84	$ 0.52
Diluted earnings per common share	$ 0.65	$ 0.33	$ 0.82	$ 0.51
Weighted average basic shares outstanding	35,864	35,308	35,742	35,222
Weighted average diluted shares outstanding	36,499	36,050	36,425	36,029

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

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(Unaudited)		(Unaudited)	
Net income	$ 23,830	$ 12,014	$ 29,989	$ 18,321
Other comprehensive income, net of tax:				
Foreign currency translation loss	(435)	(477)	(323)	(97)
Total comprehensive income	$ 23,395	$ 11,537	$ 29,666	$ 18,224

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

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HORNBECK OFFSHORE SERVICES, INC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
	(Unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 29,989	$ 18,321
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	30,723	30,253
Amortization	16,184	13,024
Stock-based compensation expense	6,444	4,435
Loss on early extinguishment of debt	25,776	6,048
Provision for bad debts	(147)	430
Deferred tax expense	11,559	10,723
Amortization of deferred financing costs	9,735	7,608
(Gain) loss on sale of assets	(1,599)	3
Changes in operating assets and liabilities:		
Accounts receivable	(5,653)	(21,128)
Other receivables and current assets	4,289	(2,241)
Deferred drydocking charges	(18,726)	(19,745)
Accounts payable	(156)	4,749
Accrued liabilities and other liabilities	2,140	1,585
Accrued interest	(1,083)	5,023
Net cash provided by operating activities	109,475	59,088
CASH FLOWS FROM INVESTING ACTIVITIES:		
Costs incurred for OSV newbuild program #5	(222,591)	(80,793)
Net proceeds from sale of assets	17,536	1,332
Vessel capital expenditures	(28,384)	(9,728)
Non-vessel capital expenditures	(2,938)	(994)
Net cash used in investing activities	(236,377)	(90,183)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Tax benefit from share-based payments	4,757	
Repayment of senior notes	(250,000)	(300,000)
Proceeds from the issuance of senior notes	450,000	375,000
Premium on the retirement of debt	(17,658)	(3,692)
Payments for public offering of common stock		(180)
Deferred financing costs	(7,673)	(7,531)
Net cash proceeds from other shares issued	7,295	2,336
Net cash provided by financing activities	186,721	65,933
Effects of exchange rate changes on cash	(323)	(97)
Net increase in cash and cash equivalents	59,496	34,741
Cash and cash equivalents at beginning of period	576,678	356,849
Cash and cash equivalents at end of period	$ 636,174	$ 391,590

SUPPLEMENTAL DISCLOSURES OF CASH FLOW ACTIVITIES:		
Cash paid for interest	$ 27,932	$ 18,377
Cash paid for income taxes	$ 1,925	$ 729

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, 2012. The results of operations for the six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. Certain reclassifications have been made to prior period results to conform to current year presentation.

The consolidated balance sheet at December 31, 2012 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.

2. Earnings Per Share

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. 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 June 30,		Six Months Ended June 30,	
	2013	**2012**	**2013**	**2012**
Net income (1)	$ 23,830	$ 12,014	$ 29,989	$ 18,321
Weighted average number of shares of common stock outstanding	35,864	35,308	35,742	35,222
Add: Net effect of dilutive stock options and unvested restricted stock (2)(3)(4)	635	742	683	807
Weighted average number of dilutive shares of common stock outstanding	36,499	36,050	36,425	36,029
Earnings per common share:				
Basic	$ 0.66	$ 0.34	$ 0.84	$ 0.52
Diluted	$ 0.65	$ 0.33	$ 0.82	$ 0.51

(1) Net income for the three and six months ended June 30, 2013 includes loss on early extinguishment of debt of $1.5 million and $25.8 million, respectively. Net income for the three and six months ended June 30, 2012 includes loss on early extinguishment of debt of $0.9 million and $6.0 million, respectively. See Note 3 for further information regarding the Company s debt.

HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(2) For the three and six months ended June 30, 2013 and 2012, the Company had no anti-dilutive stock options. Stock options are anti-dilutive when the exercise price of the options is greater than the average market price of the common stock for the period or when the results from operations are a net loss.
(3) As of June 30, 2013, the 2019 convertible senior notes and 2026 convertible senior notes were not dilutive, and as of June 30, 2012, the 2026 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.
(4) Dilutive unvested restricted stock units are expected to fluctuate from quarter to quarter depending on the Company s performance compared to a predetermined set of performance criteria. See Note 4 to these financial statements for further information regarding certain of the Company s restricted stock.

3. Long-Term Debt

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

	June 30, 2013	December 31, 2012
8.000% senior notes due 2017, net of original issue discount of $4,771	$	$ 245,229
5.875% senior notes due 2020	375,000	375,000
5.000% senior notes due 2021	450,000	
1.500% convertible senior notes due 2019, net of original issue discount of $65,403 and $69,699	234,597	230,301
1.625% convertible senior notes due 2026, net of original issue discount of $4,517 and $11,093 (1)	245,483	238,907
Revolving credit facility due 2016		
	1,305,080	1,089,437
Less current maturities	(245,483)	(238,907)
	$ 1,059,597	$ 850,530

(1) The notes initially bear interest at a fixed rate of 1.625% per year, declining to 1.375% beginning on November 15, 2013. A portion of the proceeds from the Company s 2019 convertible senior notes offering in August 2012 are expected to be used to retire the 2026 convertible senior notes in November 2013.

The Company s 8.000% senior notes due 2017, or 2017 senior notes, had semi-annual cash interest payments of $10.0 million due and payable each March 1 and September 1, prior to the repurchase and redemption of such notes in March and May 2013, respectively, as discussed below. The Company s 5.875% senior notes due 2020, or 2020 senior notes, have semi-annual cash interest payments of $11.0 million due and payable each April 1 and October 1. The Company s 1.500% convertible senior notes due 2019, or 2019 convertible senior notes, have semi-annual cash interest payments of $2.3 million due and payable each March 1 and September 1. The Company s 1.625% convertible senior notes due 2026, or 2026 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. Subject to certain conversion and redemption features of the 2026 convertible senior notes, holders of such notes may require the Company to purchase all or a portion of their notes on each of November 15, 2013, November 15, 2016 and November 15, 2021. The Company intends to redeem all of the 2026 convertible senior notes at par on or after November 15, 2013.

On March 14, 2013, the Company commenced a cash tender offer for all of the outstanding $250.0 million aggregate principal amount of its 2017 senior notes. Senior notes

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

totaling approximately $234.7 million, or approximately 94% of the 2017 senior notes outstanding, were validly tendered during the designated tender period and were repurchased at 107.12% of par on March 28, 2013. The remaining $15.3 million of 2017 senior notes were redeemed at 106.20% of par on May 13, 2013. A loss on early extinguishment of debt for the 2017 senior notes of approximately $24.3 million was recorded during the first quarter of 2013 and includes the tender offer costs, an allocable portion of the write-off of unamortized financing costs and original issue discount, and a bond redemption premium. A loss on early extinguishment of debt of approximately $1.5 million was recorded during the second quarter of 2013 for those costs allocable to the 2017 senior notes redeemed on May 13, 2013.

On March 14, 2013, the Company issued $450.0 million in aggregate principal amount of 5.000% senior notes due 2021, or 2021 senior notes. The net proceeds to the Company from the offering were approximately $442.4 million, net of estimated transaction costs. The Company used $252.7 million of such proceeds to repurchase approximately 94% of the outstanding 2017 senior notes pursuant to its tender offer noted above. The Company used approximately $16.3 million of proceeds on May 13, 2013 to redeem the remaining 6% of the outstanding 2017 senior notes pursuant to the redemption noted above. The remaining proceeds are available for general corporate purposes, which may include funding for the acquisition, construction or retrofit of vessels. The 2021 senior notes mature on March 1, 2021 and require semi-annual interest payments of $11.3 million due and payable each March 1 and September 1 of each year until maturity, commencing September 1, 2013. The effective interest rate on the new senior notes is 5.21%. No principal payments are due until maturity. Holders of the 2021 senior notes are entitled to certain registration rights as set forth in an exchange and registration rights agreement dated as of March 28, 2013. The 2021 senior notes are senior unsecured obligations and rank equally in right of payment with other existing and future senior indebtedness and senior in right of payment to any subordinated indebtedness that may be incurred by the Company in the future. The 2021 senior notes are guaranteed by certain of the Company s subsidiaries. The guarantees are full and unconditional, joint and several, and all of the Company s non-guarantor subsidiaries are minor as defined in the Securities and Exchange Commission regulations. Hornbeck Offshore Services, Inc., as the parent company issuer of the 2021 senior notes, has no independent assets or operations other than its ownership interest in its subsidiaries and affiliates. 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 the Company s two principal subsidiaries. The Company may, at its option, redeem all or part of the 2021 senior notes from time to time at specified redemption prices and subject to certain conditions required by the indenture governing the 2021 senior notes. 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 Company has an undrawn senior secured revolving credit facility, with a borrowing base of $300.0 million and an accordion feature that allows for the potential expansion of the facility up to an aggregate of $500.0 million. The facility matures in November 2016.

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Under the Company s revolving credit facility, it 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 $^1/_2$ 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 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 ranging from 37.5 basis points to 50.0 basis points as determined by a pricing grid.

As of June 30, 2013, there were no amounts drawn under the Company s $300.0 million revolving credit facility and $0.9 million posted as letters of credit. As of June 30, 2013, the Company was in compliance with all financial covenants required by its revolving credit facility and the full amount of the undrawn borrowing base under the facility was available to the Company for all permissible uses of proceeds, including working capital, if necessary.

The Company estimates the fair value of its 2020 senior notes, 2021 senior notes, 2019 convertible senior notes and 2026 convertible senior notes by primarily 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 $1,375.0 million, $1,305.1 million and $1,453.7 million, respectively, as of June 30, 2013. Given the observability of the inputs to these estimates, the fair values presented for long-term debt have been assigned a Level 2, of the three-level valuation hierarchy.

Capitalized Interest

During the three and six months ended June 30, 2013, the Company capitalized approximately $7.4 million and $13.4 million respectively, of interest costs related to the construction of vessels. During the three and six months ended June 30, 2012, the Company capitalized approximately $2.0 million and $3.5 million respectively, of interest costs related to the construction of vessels.

4. Incentive Compensation

Stock-Based Incentive Compensation Plan

The Company s stock-based incentive compensation plan covers a maximum of 4.2 million shares of common stock that allows the Company to grant restricted stock awards, restricted stock unit awards, or collectively restricted stock, stock options and stock appreciation rights to employees and directors.

During the six months ended June 30, 2013, the Company granted cash-settled phantom restricted stock units, time-based restricted stock units and performance-based restricted stock units. Time-based restricted stock units were granted to executive officers and directors of the Company. Cash-settled phantom restricted stock units were granted to certain shoreside employees of the Company.

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Performance-based restricted stock units were granted to executive officers of the Company. The shares to be received under the performance-based restricted stock units are calculated based on the Company s performance compared to three pre-determined criteria, as defined by the restricted stock agreements governing such awards. The actual number of shares that could be received by the award recipients can range from 0% to 100% of the Company s awards depending on the Company s performance. During the six months ended June 30, 2013, the Company granted 197,623 time-based restricted stock units and performance-based restricted stock units and 21,490 cash-settled phantom restricted stock units.

Compensation expense related to 2013 restricted stock unit grants is recognized over the three-year service period. The fair value of the Company s performance-based restricted stock units, which is the stock price on the date of grant, is applied to the total shares that are expected to fully vest and is amortized over the vesting period, which is generally three years, based on the Company s internal performance measured against the pre-determined criteria, as applicable. The compensation expense related to time-based restricted stock units and cash-settled phantom restricted stock units are amortized over a vesting period of up to three years, as applicable, and 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. The cash-settled phantom restricted stock units are re-measured quarterly and classified as a liability, due to the settlement of these awards in cash. In addition to the restricted stock units granted in 2013, the Company granted performance-based and time-based restricted stock units in 2010, 2011 and 2012. During the six months ended June 30, 2013, the Company issued 536,594 shares, in the aggregate, of stock due to: 1) employees exercising previously vested stock options, 2) vestings pursuant to share-based compensation grants from such prior periods and 3) employee purchases under the Company s Employee Stock Purchase Plan.

The 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 June 30,		Six Months Ended June 30,	
	2013	**2012**	**2013**	**2012**
Income before taxes	$ 3,122	$ 2,185	$ 6,444	$ 4,435
Net income	$ 1,945	$ 1,359	$ 4,021	$ 2,754
Earnings per common share:				
Basic	$ 0.05	$ 0.04	$ 0.11	$ 0.08
Diluted	$ 0.05	$ 0.04	$ 0.11	$ 0.08

HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

5. Commitments and Contingencies

Vessel Construction

In November 2011, the Company announced, and has since expanded, its fifth OSV newbuild program. This program consists of vessel construction contracts with three domestic shipyards to build four 300 class OSVs, six 310 class OSVs, ten 320 class OSVs and four 310 class MPSVs. In June 2013, the Company placed in-service the first 300 class OSV under this program, the *HOS Red Dawn*. The 23 remaining vessels under this 24-vessel domestic newbuild program are expected to be placed in service as follows: four in 2013, 13 in 2014, four in 2015 and two in 2016. Based on current contracts and internal estimates, the aggregate total cost of this program, before construction period interest, is expected to be approximately $1,240.0 million. As of June 30, 2013, the Company had incurred construction costs of approximately $487.5 million, or 39.3%, since the inception of its fifth OSV newbuild program.

200 Class OSV Retrofit Program

In September 2012, the Company awarded a contract for the upgrading and stretching of six of the Company s Super 200 class DP-1 OSVs, converting them into 240 class DP-2 OSVs. The project costs for these discretionary vessel modifications are expected to be approximately $50.0 million, in the aggregate ($8.3 million each), and the Company expects to incur approximately 799 vessel-days of aggregate commercial downtime for the six vessels (roughly 133 vessel-days each). The first two vessels were re-delivered to the Company in May 2013 and the current schedule projects re-deliveries of two vessels each in September and December of 2013, respectively. As of June 30, 2013, the Company had incurred construction costs of approximately $24.0 million, or 48%, since the inception of its 200 class OSV retrofit program.

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, results of operations, or cash flows. 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 2013 and 2012, the terms of entry for our Downstream segment contained an annual aggregate deductible, or 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,

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

assumptions and consultation with outside counsel. As additional information becomes available, the Company will assess the potential liability related to its pending claims and revise its estimates. Although revisions to such estimates historically have not been material, changes in estimates of the potential liability could materially impact the Company s results of operations, financial position or cash flows. As of June 30, 2013, the Company s claims incurred under its P&I Club policies have not exceeded the AAD for the 2013 policy year.

During 2010 and 2011, the Company mobilized 12 vessels, in the aggregate, to Brazil to operate under long-term contracts for Petrobras. These vessels required a significant amount of modifications to comply with requirements of the contracts. The Company has been assessed penalties by Petrobras for late deliveries. In addition, these vessel charters with Petrobras include limitations regarding fuel consumption. Petrobras has asserted claims against the Company relating to excess fuel consumption. The Company s exposure for these assessments, net of amounts accrued, is in the range of approximately $0.5 million to $8.0 million. The Company disagrees with a majority of these assessments. In addition, the Company also has claims against Petrobras for their contributory actions related to the vessels late deliveries. Such claims exceed the maximum exposure noted above. The Company is not able to predict the ultimate outcome of these claims and counterclaims with Petrobras as of June 30, 2013. While the Company cannot currently estimate the amounts or timing of the resolution of these matters, the Company believes that the outcome will not have a material impact on its liquidity or financial position, but the ultimate resolution could have a material impact on its interim or annual results of operations.

During 2012, an Upstream customer, ATP Oil and Gas, Inc., initiated a reorganization proceeding under Chapter 11 of the United States Bankruptcy Code. Pre-petition receivables from ATP were $4.8 million, of which the Company has recorded $0.9 million in reserves. While the Company believes that the net receivables are collectible, it will continue to monitor the proceedings, which may result in actual collections that may differ from the current estimate.

6. 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, other U.S. coastlines, Latin America and the Middle East and operates a shore-base facility in Port Fourchon, Louisiana through its Upstream segment. The OSVs, MPSVs and the shore-base facility principally support complex exploration and production projects by transporting cargo to offshore drilling rigs and production facilities and providing support for oilfield and non-oilfield specialty services, including military applications. The Downstream segment operates ocean-going tugs and tank barges primarily in the northeastern United States, the GoM, the Great Lakes and Puerto Rico. The ocean-going tugs and tank barges provide 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.

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table shows reportable segment information for the three and six months ended June 30, 2013 and 2012, reconciled to consolidated totals and prepared on the same basis as the Company s consolidated financial statements (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Operating revenues:				
Upstream				
Domestic	$ 107,308	$ 84,315	$ 200,965	$ 141,043
Foreign (1)	30,503	37,383	69,372	88,548
	137,811	121,698	270,337	229,591
Downstream				
Domestic	14,819	7,584	27,706	17,428
Foreign (1)(2)	1,693	2,363	3,796	4,599
	16,512	9,947	31,502	22,027
Total	$ 154,323	$ 131,645	$ 301,839	$ 251,618
Operating expenses:				
Upstream	$ 58,701	$ 56,201	$ 114,995	$ 108,328
Downstream	7,198	7,255	14,269	14,337
Total	$ 65,899	$ 63,456	$ 129,264	$ 122,665
Depreciation:				
Upstream	$ 13,448	$ 13,045	$ 26,644	$ 26,005
Downstream	1,965	2,126	4,079	4,248
Total	$ 15,413	$ 15,171	$ 30,723	$ 30,253
Amortization:				
Upstream	$ 7,460	$ 5,761	$ 13,683	$ 9,998
Downstream	1,168	1,346	2,501	3,026
Total	$ 8,628	$ 7,107	$ 16,184	$ 13,024
General and administrative expenses:				
Upstream	$ 12,822	$ 11,177	$ 25,756	$ 21,435
Downstream	997	904	1,942	1,772
Total	$ 13,819	$ 12,081	$ 27,698	$ 23,207
Gain (loss) on sale of assets:				
Upstream	$ 1,569	$ (11)	$ 1,569	$ (3)
Downstream	30		30	

Total	$ 1,599	$ (11)	$ 1,599	$ (3)
Operating income (loss):				
Upstream	$ 46,949	$ 35,503	$ 90,828	$ 63,822
Downstream	5,214	(1,684)	8,741	(1,356)
Total	$ 52,163	$ 33,819	$ 99,569	$ 62,466
Loss on early extinguishment of debt:				
Upstream	$ 1,457	$ 681	$ 25,776	$ 4,037
Downstream		174		2,011
Total	$ 1,457	$ 855	$ 25,776	$ 6,048
Capital expenditures:				
Upstream	$ 157,299	$ 45,458	$ 250,941	$ 89,683
Downstream	310	974	598	1,004
Corporate	2,002	521	2,374	828
Total	$ 159,611	$ 46,953	$ 253,913	$ 91,515

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HORNBECK OFFSHORE SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

	As of June 30, 2013	As of December 31, 2012
Identifiable Assets:		
Upstream	$ 2,678,225	$ 2,397,155
Downstream	204,984	203,128
Corporate	37,297	31,448
Total	$ 2,920,506	$ 2,631,731
Long-Lived Assets:		
Upstream		
Domestic (3)	$ 1,590,567	$ 1,244,509
Foreign (1)	256,821	393,318
	1,847,388	1,637,827
Downstream		
Domestic	153,980	140,460
Foreign (1)(2)	9,682	28,028
	163,662	168,488
Corporate	7,382	5,795
Total	$ 2,018,432	$ 1,812,110

(1) The Company s vessels conduct operations in international areas from time to time. Vessels will routinely move to and from domestic and international 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 June 30, 2013 and December 31, 2012, 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.

(3) Included in the Company s Upstream Domestic assets is $479.7 million and $299.6 million of vessel construction-in-progress as of June 30, 2013 and December 31, 2012, respectively.

7. *Subsequent Event*

On July 22, 2013, the Company entered into a definitive agreement with an affiliate of Genesis Energy, L.P. (NYSE: GEL) to sell its active Downstream fleet and related business for cash consideration of $230 million. Simultaneously with the execution of the definitive agreement, Genesis posted a $23 million deposit. The transaction is subject to customary closing conditions and regulatory clearances, including the expiration or termination of the waiting period under the Hart-Scott-Rodino Act, and is anticipated to close by the end of the third quarter of 2013. The Company and Genesis also plan to enter into transition service agreements at closing in order to provide for a smooth transition of operations and services for both employees and customers.

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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 as of and for the year ended December 31, 2012. 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. Please refer to Item 5 Other Information for a glossary of terms used throughout this Quarterly Report on Form 10-Q.

In this Quarterly Report on Form 10-Q, we rely on and refer to information regarding our industry from the BOEM, EIA and IHS-Petrodata, Inc. These organizations are not affiliated with us and are not aware of and have not consented to being named in this Quarterly Report on Form 10-Q. We believe this information is reliable. In addition, in many cases we have made statements in this Quarterly Report on Form 10-Q regarding our industry and our position in the industry based on our experience in the industry and our own evaluation of market conditions.

General

Our Upstream Segment

The OSV market is expanding globally. Generally, offshore exploration and production activities are increasingly focused on deep wells (as defined by total well depth rather than water depth), whether on the Outer Continental Shelf or in the deepwater or ultra-deepwater. These types of wells require high-specification equipment and have resulted in an on-going newbuild cycle for drilling rigs and for high-spec OSVs. As a result of the projected deepwater drilling activity levels worldwide, there were 99 floating rigs under construction or on order on August 1, 2013 and, as of that date, there were options outstanding to build 36 additional floating rigs. In addition, on that date, there were 114 high-spec jack-up rigs under construction or on order worldwide, and there were options outstanding to build 37 additional high-spec jack-up rigs. Each drilling rig working on deep-well projects typically requires more than one OSV to service it, and the number of OSVs required per rig is dependent on many factors, including the type of activity being undertaken and the location of the rig. For example, based on the historical data for the number of floating rigs and OSVs working, we believe that two to four OSVs per rig are required in the GoM and even more OSVs are necessary per rig in Brazil where greater logistical challenges result in longer vessel turnaround times to service drill sites. Typically, during the initial drilling stage, more OSVs are required to supply drilling mud, drill pipe and other materials than at later stages of the drilling cycle. In addition, generally, more OSVs are required the farther a drilling rig is located from shore. Under normal weather conditions, the transit time to deepwater drilling rigs in the GoM and Brazil can typically range from six to 24 hours for a new generation vessel. In Brazil, transit time for a new generation vessel to some of the newer, more logistically remote deepwater drilling rig locations are more

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appropriately measured in days, not hours. In addition to drilling rig support, deepwater and ultra-deepwater exploration and production activities will result in the expansion of other specialty-service offerings for our vessels. These markets include subsea construction support, installation, IRM work, and life-of-field services, which include well-stimulation, workovers and decommissioning.

Presently, our oilfield service operations are conducted in three primary geographic regions comprised of the GoM, Brazil and Mexico. Descriptions of these three regions are included below.

Gulf of Mexico

The GoM continues to be considered a world-class basin by exploration and production companies. In its Annual Energy Outlook 2013, the EIA estimated that the GoM contains 45 billion barrels of recoverable oil equivalent. According to IHS-Petrodata as of August 1, 2013, the number of floating rigs available in the GoM region is currently 43, which has increased from the pre-Macondo level of 34, because the 10 floaters that left the region and the four floaters that have been stacked or are currently being rebuilt have since been replaced by 23 vessels arriving in the region. Of the 43 rigs available in the GoM, 35 were actively drilling as of August 1, 2013. We expect at least four additional deepwater drilling units to arrive in the GoM during 2013 and 14 additional units to begin work in 2014. During 2012, the rate of deepwater drilling permit approvals improved significantly over 2011, however, the pace of permitting was still inconsistent compared to pre-Macondo levels. While the period of time required for BSEE to review, approve and issue drilling permits is generally longer than historical norms, our customers have indicated that the permitting process has become more repeatable and predictable.

Improvements in dayrates and utilization for our high-spec Upstream vessels continued through the first half of 2013. Leading-edge spot market OSV dayrates in the GoM for our 240 and 265 class DP-2 equipment were in the $38,000 to $45,000 range. Whether these rates can be sustained will depend on, among other things, the future rig-count and the pace of permitting in the GoM. Market conditions for high-spec DP-2 vessels may also be impacted during 2013 by the anticipated delivery of 21 additional Jones Act-qualified DP-2 vessels from U.S. shipyards, including four being constructed by the Company. This impact is expected to be mitigated with the announced mobilization of new drilling rigs to the GoM in the second half of 2013 and into 2014. Fleetwide effective, or utilization-adjusted, dayrates for our new generation OSVs increased $2,470, or roughly 12%, from $20,558 for the year-ago quarter to $23,028 for the second quarter of 2013. As of June 30, 2013, we had reactivated all of our previously stacked new generation OSVs. We expect that our DP-1 vessels will experience continued volatility as our deepwater customers continue their bias towards using only DP-2 vessels in deepwater operations. Six DP-1 vessels are being converted to 240 class DP-2 vessels under our 200 class OSV retrofit program during 2013, including two vessels that have already returned to service under their new configuration. The Company is considering whether to convert additional DP-1 vessels to DP-2.

The GoM could be adversely affected by an increasing shortage of, and competition for, qualified mariners. This shortage is being exacerbated by customer and regulatory driven requirements that increase the manning levels on many vessels, including drilling units that operate in the GoM. Mariner shortages have driven up labor costs, which comprise the greatest portion of our operating costs. In the past, intense competition for licensed mariners has required the Company to unexpectedly increase our Upstream crew wages in response to across-the-board raises instituted by competitors. Such an increase usually results in a permanent increase in our annual operating costs. The most recent such increase occurred in April 2012, resulting in a quarterly operating expense increase of $5.0 million based upon the size of our mariner workforce at that time. We will also have incremental expenses due to roughly 100 mariners-in-training that are riding in the fleet and additional shoreside support staff in anticipation of the vessels that will be delivered under our fifth OSV newbuild program.

Brazil

Brazil is experiencing an increase in activity related to its large deepwater and pre-salt oilfield basins. This increase in activity is driven primarily by the state-owned oil company, Petroleo Brasileiro S.A., or Petrobras, and other producers, including BP p.l.c., Chevron Corporation, Exxon Mobil Corporation, OGX Petroleo e Gas Participacoes and Royal Dutch Shell plc. Petrobras has publicly announced plans to spend approximately $148 billion on exploration and production activities from 2013 through 2017 and has stated that its offshore supply vessel needs could increase from approximately 290 in 2010 to nearly 480 in 2015. Brazilian operators do not plan to add any new floating rigs by the end of 2013.

Since 2011, we have decreased our presence in Brazil from as many as 14 vessels to five vessels currently working under long-term contracts for Petrobras. We have remobilized to the GoM nine of our OSVs at the conclusion of their contracts. Current high operating costs as well as regulatory complexity and bureaucratic inefficiency are impacting our ability to generate operating margins in Brazil that are commensurate with those we are and have historically generated in the GoM. Moreover, Petrobras is the single largest consumer of our services in Brazil. As is typical with large state-owned national oil companies, contracts with Petrobras are onerous and contain multiple provisions that allow Petrobras to impose penalties and deduct payments for performance issues even if we disagree with the basis of those penalties or deductions. Petrobras has exercised these kinds of measures in our contracts and we expect that we will continue to confront similar issues with Petrobras going forward. In addition to regulatory complexity and the inherent difficulties associated with the Petrobras contracting regime, there is an acute shortage of mariners in Brazil, which we are required by law to employ on our vessels. This shortage is a significant contributor to escalating costs in Brazil and could present a barrier to our near-term growth in that market. We declined the opportunity to renew, with Petrobras, one of our remaining five 240 class vessels whose charter expires during the summer of 2013. Our long-term view in Brazil is that its preeminence as a deep water drilling region will offer us significant opportunities, particularly as our newbuild vessels are delivered. Those vessels will have the large capacities necessary for remote and ultra-deep water drilling regions, such as the pre-salt Brazilian market. We see Petrobras making significant investments intended to stem the logistical bottlenecks that have hampered its ability to take full advantage of its offshore fleet. As those chokepoints get worked out over the next few years, we believe that the 6,000 DWT vessels in our fifth OSV newbuild program will have a competitive advantage over 3,000 DWT vessels, which dominate Pebrobras fleet today.

Mexico

The primary customer in the Mexican market is the state-owned oil company, PEMEX. Production from the Cantarell field, which according to the EIA is PEMEX s largest offshore oilfield, has declined to 500,000 barrels per day from approximately 2.1 million barrels per day at its peak. In 2011, 75% of Mexico s total crude oil production came from offshore fields located in the Bay of Campeche, including the Cantarell field and the Ku-Maloob-Zaap field. In its *July 2011 Outlook*, PEMEX highlighted that 49% of its prospective resources, or 26.6 billion barrels of oil equivalent, are in the deepwater Gulf of Mexico. However, in order to develop this resource, PEMEX will likely need to tap the expertise of non-Mexican international oil companies. Under Article 27 of the Mexican constitution, private persons or companies (other than the state-owned PEMEX) are not allowed to explore for petroleum, and solid, liquid, or gaseous hydrocarbons. As a result, while we believe that Mexico could develop into a large market for deepwater activity, we do not expect this to occur until the Mexican government has found a solution to their constitutional constraints. We believe that this situation may be improved by the election of President Peña Nieto in July 2012, who campaigned on constitutional reform to reinvigorate the Mexican oil industry. Currently, there are five floating rigs and 35 jack-up rigs drilling offshore Mexico. PEMEX has announced plans to add seven more high-spec jack-up rigs during the remainder of 2013. We began working in Mexico in 2002 and currently have seven vessels working there under long-term contracts. We will continue to actively bid additional vessels into Mexico as tenders are issued by PEMEX.

Market conditions. As of August 1, 2013, we had 66% of our new generation OSV vessel-days contracted for the remainder of 2013. Our forward OSV contract coverage for the fiscal year ending December 31, 2014 currently stands at 27%. Included within our new generation contract coverage are five vessels on long-term charters with the United States government in defense capacities. With the $85 billion sequestration that went into effect March 1, 2013, it is possible that these contracts could be impacted. Our MPSV contract coverage has also increased as a result of the improving market conditions in the GoM. On the strength of long-term contracts awarded to two of our MPSVs during 2011 and recent spot market activity, MPSV contract coverage for 2013 and 2014 is currently 65% and 31%, respectively.

A sustained market recovery will depend upon several factors outside of our control including 1) the ability of operators and drilling contractors to comply with the new regulatory requirements; 2) the pace at which regulators approve plans and permit applications required by operators to drill; 3) the content of additional as yet unpromulgated rules that are expected to be issued; 4) the outcome of pending litigation brought by environmental groups challenging recent exploration plans approved by the DOI and 5) general economic conditions. In addition, there are currently 57 high-spec, Jones Act-qualified vessels under construction in U.S. shipyards that will deliver through 2016. Twenty-three of such vessels are being constructed by the Company.

All of our current Upstream vessels are qualified under the Jones Act to engage in U.S. coastwise trade, except for five foreign-flagged new generation OSVs, two foreign-flagged well stimulation vessels and two foreign-flagged MPSVs. As of June 30, 2013, our 50 active new generation OSVs and four MPSVs were operating in domestic and international areas as noted in the following table:

Operating Areas	
Domestic	
GoM	34
Other U.S. coastlines (1)	5
	39
Foreign	
Brazil	5
Mexico	8
Middle East	2
	15
Total Upstream Vessels (2)	54

(1) Includes five vessels that are currently supporting the military.

(2) Excluded from this table is one conventional OSV that was stacked as of June 30, 2013. During the second quarter of 2013, we took delivery of a 300 class OSV, the *HOS Red Dawn*, we sold two of our six 220 class DP-1 new generation OSVs and activated the remaining stacked 220 class DP-1 new generation OSV.

Our Downstream Segment

As of June 30, 2013, our Downstream fleet was comprised of nine double-hulled tank barges and 12 ocean-going tugs, three of which are older, lower-horsepower tugs that are stacked. Although Downstream results have improved from the prior year, recent dayrates are still below the Downstream dayrates that existed from 2006 to 2008. Downstream vessel demand has increased as a result of transportation needs related to the Eagle Ford and Bakken shale trends and we believe these developments, along with the overall improvement of the U.S. economy, will continue to have a positive impact on our Downstream vessels operating in the GoM and in the Northeast. With the ongoing expansion of our Upstream fleet, we expect our Downstream segment to continue to represent a much smaller portion of our consolidated operating results compared to historical trends. On July 22, 2013 we entered into a definitive agreement to sell our active Downstream vessels.

Critical Accounting Estimates

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. GAAP. In other circumstances, we are required to make estimates, judgments and assumptions that we believe are reasonable based on available information. We base our estimates and judgments on historical experience and various other factors that we believe are reasonable based upon the information available. 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, 2012.

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Results of Operations

The tables below set forth, by segment, the average dayrates, utilization rates and effective dayrates for our vessels and the average number and size of vessels owned during the periods indicated. These new generation OSVs and tank barges generate a substantial portion of our revenues and operating profit. Excluded from the OSV information below are the results of operations for our MPSVs, conventional vessels, our shore-base facility, and vessel management services. The Company does not provide average or effective dayrates for its MPSVs. MPSV dayrates are impacted by highly variable customer-required cost-of-sales associated with ancillary equipment and services, such as ROVs, living quarters and cranes, which are typically recovered through higher dayrates charged to the customer. Due to the fact that each of our MPSVs have a workload capacity and significantly higher income generating potential than each of the Company s new generation OSVs, the utilization and dayrate levels of our MPSVs could have a very large impact on our results of operations. For this reason, our consolidated operating results, on a period-to-period basis, are disproportionately impacted by the level of dayrates and utilization achieved by our four MPSVs.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Upstream:				
New Generation Offshore Supply Vessels:				
Average number of new generation OSVs (1)	50.0	51.0	50.5	51.0
Average number of active new generation OSVs (2)	49.4	48.0	49.7	47.4
Average new generation OSV fleet capacity (DWT)	126,870	128,190	127,530	128,190
Average new generation vessel capacity (DWT)	2,538	2,514	2,526	2,514
Average new generation OSV utilization rate (3)	88.3%	88.1%	87.5%	84.6%
Average new generation OSV dayrate (4)	$ 26,079	$ 23,335	$ 25,611	$ 22,896
Effective dayrate (5)	$ 23,028	$ 20,558	$ 22,410	$ 19,370
Downstream:				
Double-hulled tank barges:				
Average number of tank barges (6)	9.0	9.0	9.0	9.0
Average fleet capacity (barrels)	884,621	884,621	884,621	884,621
Average barge capacity (barrels)	98,291	98,291	98,291	98,291
Average utilization rate (3)	100.0%	74.6%	97.8%	80.0%
Average dayrate (7)	$ 20,169	$ 16,284	$ 19,765	$ 16,811
Effective dayrate (5)	$ 20,169	$ 12,148	$ 19,330	$ 13,449

(1) We owned 50 new generation OSVs as of June 30, 2013. For the three and six months ended June 30, 2013, our average number of new generation OSVs above includes the *HOS Red Dawn,* which is our first newly constructed OSV that was placed in service under our fifth OSV newbuild program in June 2013. Excluded from this data is one stacked conventional OSV that we consider to be a non-core asset. Also excluded from this data are four MPSVs owned and operated by the Company.
(2) In response to weak market conditions, we elected to stack certain of our new generation OSVs on various dates in 2010 and 2011. Based on improved market conditions, we had re-activated all of our stacked new generation OSVs as of June 30, 2013. Active new generation OSVs represent vessels that are immediately available for service during each respective period.
(3) Utilization rates are average rates based on a 365-day year. Vessels are considered utilized when they are generating revenues.
(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) Other operating data for tugs and tank barges reflects our active Downstream fleet of nine double-hulled barges and nine ocean-going tugs. We also own three older, lower-horsepower tugs, which we consider to be non-core assets and are marketed for sale. On July 22, 2013, we entered into a definitive agreement to sell our active Downstream vessels.
(7) 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.

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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 Securities and Exchange 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.

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 six months ended June 30, 2013 and 2012, respectively (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Components of EBITDA:				
Net income	$ 23,830	$ 12,014	$ 29,989	$ 18,321
Interest expense, net				
Debt obligations	13,242	14,342	26,964	28,274
Interest income	(668)	(461)	(1,245)	(1,014)
Total interest, net	12,574	13,881	25,719	27,260
Income tax expense	14,395	7,293	18,071	11,166
Depreciation	15,413	15,171	30,723	30,253
Amortization	8,628	7,107	16,184	13,024
EBITDA	$ 74,840	$ 55,466	$ 120,686	$ 100,024

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The following table reconciles EBITDA to cash flows provided by operating activities for the three and six months ended June 30, 2013 and 2012, respectively (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
EBITDA Reconciliation to GAAP:				
EBITDA	$ 74,840	$ 55,466	$ 120,686	$ 100,024
Cash paid for deferred drydocking charges	(11,292)	(11,586)	(18,726)	(19,745)
Cash paid for interest	(13,667)	(3,621)	(27,932)	(18,377)
Cash paid for taxes	(1,372)	(197)	(1,925)	(729)
Changes in working capital	19,453	(10,542)	6,898	(13,001)
Stock-based compensation expense	3,122	2,185	6,444	4,435
Loss on early extinguishment of debt	1,457	855	25,776	6,048
Changes in other, net	(1,605)	427	(1,746)	433
Net cash flows provided by operating activities	$ 70,936	$ 32,987	$ 109,475	$ 59,088

In addition, we also make certain adjustments to EBITDA for loss on early extinguishment of debt, stock-based compensation expense and interest income 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 certain financial covenants in 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 six months ended June 30, 2013 and 2012, respectively (in thousands).

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Loss on early extinguishment of debt	$ 1,457	$ 855	$ 25,776	$ 6,048
Stock-based compensation expense	3,122	2,185	6,444	4,435
Interest income	668	461	1,245	1,014

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 once we are no longer in an overall tax net operating loss carryforward position, as applicable, and

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

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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.

Summarized financial information concerning our reportable segments for the three months ended June 30, 2013 and 2012, respectively, is shown below in the following table (in thousands, except percentage changes):

	Three Months Ended June 30		Increase (Decrease)	
	2013	2012	$ Change	% Change
Revenues:				
Upstream				
Domestic	$ 107,308	$ 84,315	$ 22,993	27.3%
Foreign	30,503	37,383	(6,880)	(18.4)
	137,811	121,698	16,113	13.2
Downstream				
Domestic	14,819	7,584	7,235	95.4
Foreign (1)	1,693	2,363	(670)	(28.4)
	16,512	9,947	6,565	66.0
	$ 154,323	$ 131,645	$ 22,678	17.2%
Operating expenses:				
Upstream	$ 58,701	$ 56,201	$ 2,500	4.4%
Downstream	7,198	7,255	(57)	(0.8)
	$ 65,899	$ 63,456	$ 2,443	3.8%
Depreciation and amortization:				
Upstream	$ 20,908	$ 18,806	$ 2,102	11.2%
Downstream	3,133	3,472	(339)	(9.8)
	$ 24,041	$ 22,278	$ 1,763	7.9%
General and administrative expenses:				
Upstream	$ 12,822	$ 11,177	$ 1,645	14.7%
Downstream	997	904	93	10.3
	$ 13,819	$ 12,081	$ 1,738	14.4%
Gain (loss) on sale of assets:				
Upstream	$ 1,569	$ (11)	$ 1,580	>100.0%
Downstream	30		30	100.0
	$ 1,599	$ (11)	$ 1,610	>100.0%
Operating income (loss):				
Upstream	$ 46,949	$ 35,503	$ 11,446	32.2%
Downstream	5,214	(1,684)	6,898	>100.0

	$ 52,163	$ 33,819	$ 18,344	54.2%
Loss on early extinguishment of debt	$ 1,457	$ 855	$ 602	70.4%
Interest expense	$ 13,242	$ 14,342	$ (1,100)	(7.7)%
Interest income	$ 668	$ 461	$ 207	44.9%
Income tax expense	$ 14,395	$ 7,293	$ 7,102	97.4%
Net income	$ 23,830	$ 12,014	$ 11,816	98.4%

(1) Included are the amounts applicable to our 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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Three Months Ended June 30, 2013 Compared to Three Months Ended June 30, 2012

Revenues. Revenues for the three months ended June 30, 2013 increased by $22.7 million, or 17.2%, to $154.3 million compared to the same period in 2012, primarily due to improved Upstream and Downstream market conditions. Our weighted-average active operating fleet for the three months ended June 30, 2013 was 71 vessels compared to 70 during the same period in 2012.

Revenues from our Upstream segment increased by $16.1 million, or 13.2%, to $137.8 million for the three months ended June 30, 2013 compared to $121.7 million for the same period in 2012. Our higher Upstream revenues primarily resulted from improved market conditions for our high-spec OSVs and MPSVs in the GoM. Revenue from our four-vessel MPSV fleet increased by $7.1 million, or 28.4%, compared to the same period in 2012. Our new generation OSV average dayrates were $26,079 for the second quarter of 2013 compared to $23,335 for the same period in 2012, an increase of $2,744, or 11.8%. Our new generation OSV utilization was 88.3% for the second quarter of 2013, which was in-line with the same period in 2012. Domestic revenues for our Upstream segment increased $23.0 million from the year-ago quarter due to improved spot market activity in the GoM. Foreign revenues for our Upstream segment decreased $6.9 million, or 18.4%, primarily due to an average of four fewer vessels deployed to foreign regions during the three months ended June 30, 2013 compared to the year-ago quarter. Foreign revenues, for the second quarter of 2013, comprised 22.1% of our total Upstream revenues compared to 30.7% for the year-ago quarter.

Revenues from our Downstream segment increased by $6.6 million, or 66.0%, to $16.5 million for the three months ended June 30, 2013 compared to the year-ago quarter. This revenue increase was due to improved market conditions in the GoM and in the Northeast and, to a lesser extent, 164 fewer days out-of-service related to the installation of vapor recovery systems on three barges and the regulatory drydocking of a fourth barge that occurred during the three months ended June 30, 2012. Our double-hulled tank barge average dayrates were $20,169 for the three months ended June 30, 2013, an increase of $3,885, or 23.9%, from $16,284 for the same period in 2012. Our double-hulled tank barge utilization was 100.0% for the second quarter of 2013 compared to 74.6% for the second quarter of 2012. Effective, or utilization-adjusted, dayates for our double-hulled tank barges were $20,169 for the three months ended June 30, 2013, which was $8,021, or 66.0%, higher than the prior-year quarter effective dayrates.

Operating expenses. Operating expenses for the three months ended June 30, 2013 increased by $2.4 million, or 3.8%, to $65.9 million. This increase was primarily associated with higher crew wages and the growth of our weighted-average active operating fleet by 1.4 vessels compared to the year-ago quarter.

Operating expenses for our Upstream segment were $58.7 million, an increase of $2.5 million, or 4.4%, for the three months ended June 30, 2013 compared to $56.2 million for the same period in 2012. Operating expenses for our Upstream segment were driven higher by the April 2012 mariner wage increases and by an increase in the number of active vessels in our fleet during the three months ended June 30, 2013. This increase was partially offset by lower operating costs for four vessels that were mobilized to the GoM from Latin America during the second half of 2012. Aggregate cash operating expenses for our Upstream segment are projected to be in the range of $241.0 million to $246.0 million for the year ending December 31, 2013. Our cash operating expense estimate is exclusive of any additional repositioning expenses we may incur that are not recoverable through charter hire in connection with the potential relocation of more of our vessels to or from international markets; or any customer-required cost-of-sales related to future contract fixtures that are typically recovered through higher dayrates.

Operating expenses for our Downstream segment were $7.2 million for the three months ended June 30, 2013, which was in-line with the same period in 2012.

Depreciation and Amortization. Depreciation and amortization was $1.8 million higher for the three months ended June 30, 2013 compared to the same period in 2012. This increase is primarily due to higher shipyard costs for vessel regulatory drydockings for our Upstream vessels. Depreciation and amortization expense is expected to increase from current levels as the vessels under our current newbuild and conversion programs are placed in-service and when any newly constructed vessels undergo their initial 30-month and 60-month recertifications.

General and Administrative Expense. General and administrative, or G&A, expenses of $13.8 million, or 9.0% of revenues, increased by $1.7 million during the three months ended June 30, 2013 compared to same period in 2012. This increase in G&A expenses was primarily attributable to higher shoreside incentive compensation expense. Our general and administrative expenses are expected to be in the approximate annual range of $54 million to $56 million for the year ending December 31, 2013, commensurate with our pending fleet growth. However, we still expect our G&A expenses as a percentage of revenues, or G&A margin, to remain within the historical range of our domestic public company OSV peer group.

Gain on Sale of Assets. During the second quarter of 2013, we sold certain non-core assets that resulted in an aggregate gain of approximately $1.6 million ($1.0 million after-tax or $0.03 per diluted share). No vessels were sold during the second quarter of 2012.

Operating Income. Operating income increased by $18.3 million, or 54.2%, to $52.2 million during the three months ended June 30, 2013 compared to the same period in 2012 for the reasons discussed above. Operating income as a percentage of revenues for our Upstream segment was 34.1% for the three months ended June 30, 2013 compared to 29.2% for the same period in 2012. Operating income as a percentage of revenues for our Downstream segment was 31.6% for the three months ended June 30, 2013 compared to an operating loss of 16.9% for the same period in 2012.

Loss on Early Extinguishment of Debt. On May 13, 2013, the remaining $15.3 million of our 8.000% senior notes were redeemed. During the second quarter of 2013, we recorded a loss on early extinguishment of debt of approximately $1.5 million ($0.9 million after-tax or $0.02 per diluted share), which was comprised of the tender offer costs, the write-off of any remaining unamortized financing costs and original issue discount, and a bond redemption premium. During the second quarter of 2012, we recorded a loss on early extinguishment of debt of approximately $0.9 million ($0.6 million after-tax or $0.02 per diluted share) related to the tender offer for our 6.125% senior unsecured notes due 2014, or 2014 senior notes.

Interest Expense. Interest expense decreased $1.1 million during the three months ended June 30, 2013 compared to the same period in 2012. Higher capitalized interest

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associated with vessels under construction was the primary reason that our interest expense decreased from the prior-year quarter. During the second quarter of 2013, we capitalized interest of $7.4 million, or roughly 36% of our total interest costs compared to capitalized interest of $2.0 million, or roughly 12% of our total interest costs for the year-ago quarter. This net decrease in interest expense, due to capitalized interest, was primarily offset by the incurrence of an incremental $5.4 million of interest expense (including $2.2 million of incremental original issue discount) related to the issuances of additional convertible senior notes in August 2012 and senior notes in March 2013.

Interest Income. Interest income was $0.7 million during the three months ended June 30, 2013, which was in-line with the same period in 2012. Our average cash balance increased to $678.5 million for the three months ended June 30, 2013 compared to $413.6 million for the same period in 2012. The average interest rate earned on our invested cash balances was 0.4% and 0.5% during the three months ended June 30, 2013 and 2012, respectively. The increase in average cash balance was primarily due to our August 2012 convertible senior note offering, which resulted in net cash proceeds of $266.0 million in the aggregate, and our March 2013 bond refinancing, which resulted in incremental net cash proceeds of $190.5 million in the aggregate, net of the costs of the tender offer and redemption of the 2017 senior notes.

Income Tax Expense. Our effective tax rate was 37.7% and 37.8% for the three months ended June 30, 2013 and 2012, respectively. During the second quarter of 2013, our income tax expense primarily consisted of deferred taxes. Our income tax rate differs from the federal statutory rate primarily due to expected state tax liabilities and items not deductible for federal income tax purposes.

Net Income. Operating performance increased by $11.8 million for reported net income of $23.8 million for the three months ended June 30, 2013. The higher net income for the second quarter of 2013 was primarily due to the increase in operating income based on improved market conditions discussed above and a $1.3 million pre-tax decrease in net interest expense .

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Summarized financial information concerning our reportable segments for the six months ended June 30, 2013 and 2012, respectively, is shown below in the following table (in thousands, except percentage changes):

	Six Months Ended June 30		Increase (Decrease)	
	2013	2012	$ Change	% Change
Revenues:				
Upstream				
Domestic	$ 200,965	$ 141,043	$ 59,922	42.5%
Foreign	69,372	88,548	(19,176)	(21.7)
	270,337	229,591	40,746	17.7
Downstream				
Domestic	27,706	17,428	10,278	59.0
Foreign (1)	3,796	4,599	(803)	(17.5)
	31,502	22,027	9,475	43.0
	$ 301,839	$ 251,618	$ 50,221	20.0%
Operating expenses:				
Upstream	$ 114,995	$ 108,328	$ 6,667	6.2%
Downstream	14,269	14,337	(68)	(0.5)