

DAWSON GEOPHYSICAL CO

Form 10-Q

May 10, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the Quarterly Period Ended March 31, 2006**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_**  
**Commission File No. 0-10144**  
**DAWSON GEOPHYSICAL COMPANY**

**Texas**  
**(State or other jurisdiction of incorporation or organization)**

**75-0970548**  
**(I.R.S. Employer Identification No.)**

**508 West Wall, Suite 800, Midland, Texas 79701**

**(Principal Executive Office)**

**Telephone Number: 432-684-3000**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

**Title of Each Class**  
**Common Stock, \$.33 1/3 par value**

**Outstanding at April 23,2006**  
**7,527,744 shares**

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**PART I. FINANCIAL INFORMATION**  
**ITEM 1. FINANCIAL STATEMENTS**  
**DAWSON GEOPHYSICAL COMPANY**  
**STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

	Three Months Ended March 31,		Six Months Ended March 31,	
	2006	2005	2006	2005
Operating revenues	\$ 40,042,000	\$ 26,515,000	\$ 75,535,000	\$ 48,074,000
Operating costs:				
Operating expenses	29,109,000	21,378,000	57,247,000	38,222,000
General and administrative	1,314,000	989,000	2,441,000	1,783,000
Depreciation	3,188,000	1,662,000	6,164,000	3,132,000
	33,611,000	24,029,000	65,852,000	43,137,000
Income from operations	6,431,000	2,486,000	9,683,000	4,937,000
Other income:				
Interest income	167,000	99,000	328,000	123,000
Interest expense		(65,000)		(65,000)
Gain on disposal of assets	142,000		136,000	
Loss on sale of marketable securities	(6,000)		(17,000)	
Other	(23,000)	233,000	17,000	239,000
Income before income tax	6,711,000	2,753,000	10,147,000	5,234,000
Income tax (expense) benefit:				
Current	(1,307,000)	(733,000)	(1,842,000)	(733,000)
Deferred	(1,053,000)	307,000	(1,654,000)	(574,000)
	(2,360,000)	(426,000)	(3,496,000)	(1,307,000)
Net income	\$ 4,351,000	\$ 2,327,000	\$ 6,651,000	\$ 3,927,000
Net income per common share	\$ 0.58	\$ 0.37	\$ 0.89	\$ 0.66
Net income per common share-assuming dilution	\$ 0.57	\$ 0.37	\$ 0.88	\$ 0.65
Weighted average equivalent common shares outstanding	7,504,811	6,262,794	7,495,499	5,947,148
Weighted average equivalent common shares outstanding-assuming dilution	7,593,193	6,360,345	7,583,611	6,051,413

*See accompanying notes to the financial statements.*

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**DAWSON GEOPHYSICAL COMPANY  
BALANCE SHEETS**

	March 31, 2006 (Unaudited)	September 30, 2005
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 505,000	\$ 2,803,000
Short-term investments	13,840,000	20,326,000
Accounts receivable, net of allowance for doubtful accounts of \$51,000 in March 2006 and \$331,000 in September 2005	34,572,000	28,696,000
Prepaid expenses and other assets	644,000	1,127,000
Current deferred tax asset	18,000	1,229,000
Total current assets	49,579,000	54,181,000
<b>Property, plant and equipment</b>	143,388,000	124,478,000
Less accumulated depreciation	(70,045,000)	(64,532,000)
Net property, plant and equipment	73,343,000	59,946,000
	\$ 122,922,000	\$ 114,127,000
 <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 6,230,000	\$ 6,601,000
Accrued liabilities:		
Payroll costs and other taxes	1,300,000	1,198,000
Other	3,288,000	2,182,000
Deferred revenue	245,000	190,000
Total current liabilities	11,063,000	10,171,000
<b>Deferred tax liability</b>	2,495,000	2,052,000
<b>Stockholders equity:</b>		
Preferred stock-par value \$1.00 per share; 5,000,000 shares authorized, none outstanding		
Common stock-par value \$.33 1/3 per share; 50,000,000 and 10,000,000 shares authorized in each period; 7,493,544 and 7,484,044 shares issued and outstanding in each period	2,508,000	2,495,000
Additional paid-in capital	81,786,000	80,987,000

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Other comprehensive income, net of tax	(80,000)	(77,000)
Retained earnings	25,150,000	18,499,000
Total stockholders' equity	109,364,000	101,904,000
	\$ 122,922,000	\$ 114,127,000

*See accompanying notes to the financial statements.*

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**DAWSON GEOPHYSICAL COMPANY**  
**STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

	Six Months Ended March 31,	
	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 6,651,000	\$ 3,927,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	6,164,000	3,132,000
Gain on disposal of assets	(136,000)	
Realized loss on sale of marketable securities	17,000	
Deferred income tax expense	1,654,000	574,000
Non-cash compensation	536,000	45,000
Excess tax benefit from share based payment arrangement	(46,000)	
Other	(30,000)	27,000
Change in current assets and liabilities:		
Decrease (increase) in accounts receivable	(5,876,000)	1,755,000
Decrease (increase) in prepaid expenses	483,000	(130,000)
Increase (decrease) in accounts payable	(371,000)	255,000
Increase in deferred revenue	55,000	367,000
Increase (decrease) in accrued liabilities	1,208,000	(217,000)
Net cash provided by operating activities	10,309,000	9,735,000
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(19,713,000)	(21,408,000)
Proceeds from maturity of short-term investments	6,510,000	
Proceeds from disposal of assets	320,000	
Acquisition of short-term investments		(21,309,000)
Net cash used in investing activities	(12,883,000)	(42,717,000)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from exercise of stock options	230,000	35,000
Proceeds from line of credit		10,000,000
Repayment on line of credit		(10,000,000)
Proceeds from stock offering		41,004,000
Excess tax benefit from share based payment arrangement	46,000	
Net cash provided by financing activities	276,000	41,039,000



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Net increase (decrease) in cash and cash equivalents	(2,298,000)	8,057,000
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	2,803,000	3,587,000
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	\$ 505,000	\$ 11,644,000
<b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>		
Cash paid during the period for income taxes	\$ 604,000	\$ 376,000
<b>NON CASH INVESTING ACTIVITIES:</b>		
Unrealized gain (loss) on investments	\$ (29,000)	\$ (144,000)

*See accompanying notes to the financial statements.*

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**DAWSON GEOPHYSICAL COMPANY  
NOTES TO FINANCIAL STATEMENTS**

**1. ORGANIZATION AND NATURE OF OPERATIONS**

Dawson Geophysical Company (the Company) is the leading provider of onshore seismic data acquisition services in the United States as measured by the number of active data acquisition crews. Founded in 1952, the Company acquires and processes 2-D, 3-D and multi-component seismic data for its clients, ranging from major oil and gas companies to independent oil and gas operators as well as providers of multi-client data libraries.

**2. OPINION OF MANAGEMENT**

Although the information furnished is unaudited, in the opinion of management of the Company, the accompanying financial statements reflect all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of the financial condition and results of operations necessary for the periods presented. The results of operations for the three months and the six months ended March 31, 2006, are not necessarily indicative of the results to be expected for the fiscal year.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted in this Form 10-Q report pursuant to certain rules and regulations of the Securities and Exchange Commission. These financial statements should be read with the financial statements and notes included in the Company's 2005 Form 10-K.

**Critical Accounting Policies**

The preparation of the Company's financial statements in conformity with generally accepted accounting principles requires that certain assumptions and estimates be made that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Because of the use of assumptions and estimates inherent in the reporting process, actual results could differ from those estimates.

*Revenue Recognition.* Contracts for services are provided under cancelable service contracts. These contracts are either turnkey or term agreements. The Company recognizes revenues when services are performed under both types of agreements. Services are defined as the commencement of data acquisition or processing operations. Under turnkey agreements, revenue is recognized on a per unit of data acquired rate, as services are performed. Under term agreements, revenue is recognized on a per unit of time worked rate, as services are performed. In the case of a cancelled service contract, revenue is recognized and the customer is billed for services performed up to the date of cancellation. The Company receives reimbursements for certain out-of-pocket expenses under the terms of our service contracts. Amounts billed to clients are recorded in revenue at the gross amount including out-of-pocket expenses that are reimbursed by the client.

In some instances, clients are billed in advance of the services performed. In those cases, the Company recognizes the liability as deferred revenue.

*Allowance for Doubtful Accounts.* Management prepares its allowance for doubtful accounts receivable based on its past experience of historical write-offs, its current customer base and review of past due accounts. The inherent volatility of the energy industry's business cycle can cause swift and unpredictable changes in the financial stability of the Company's customers.

*Impairment of Long-lived Assets.* Long-lived assets are reviewed for impairment when triggering events occur suggesting deterioration in the assets' recoverability or fair value. Recognition of an impairment charge is required if future expected net cash flows are insufficient to recover the carrying value of the asset. Management's forecast of future cash flow used to perform impairment analysis includes estimates of future revenues and future gross margins. If the Company is unable to achieve these cash flows an impairment charge would be recorded.

*Depreciable Lives of Property, Plant and Equipment.* Property, plant and equipment is capitalized at historical cost and depreciated over the useful life of the asset. Management's estimation of useful lives is based on circumstances that exist in the seismic industry and information available at the time of the purchase of the asset. The technology of the equipment used to gather data in the seismic industry has historically evolved such that obsolescence does not occur quickly. As circumstances change and new information becomes available, these estimates could change. Depreciation is computed using the straight-line method.



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*Tax Accounting.* The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes, which requires the recognition of amounts of taxes payable or refundable for the current year and an asset and liability approach in recognizing the amount of deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Management determines deferred taxes by identifying the types and amounts of existing temporary differences, measuring the total deferred tax asset or liability using the applicable tax rate and reducing the deferred tax asset by a valuation allowance if, based on available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Management's methodology for recording income taxes requires judgment regarding assumptions and the use of estimates, including determining the annual effective tax rate and the valuation of deferred tax assets, which can create variance between actual results and estimates. The process involves making forecasts of current and future years' taxable income and unforeseen events may significantly affect these estimates. Those factors, among others, could have a material impact on the Company's provision or benefit for income taxes.

*Stock Based Compensation.* On December 16, 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)). SFAS 123(R) requires companies to measure all employee stock-based compensation awards using a fair value method and recognize compensation cost in its financial statements. SFAS 123(R) is effective beginning as of the first annual reporting period beginning after June 15, 2005. The Company adopted on a prospective basis SFAS 123(R) beginning October 1, 2005 for stock-based compensation awards granted after that date and for unvested awards outstanding at that date using the modified prospective application method. The Company recognizes the fair value of stock-based compensation awards as wages in the Statements of Operations on a straight-line basis over the vesting period.

Prior to October 1, 2005, the Company accounted for stock-based compensation utilizing the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees (APB 25) and related interpretations. Under APB 25, no compensation expense was recognized for stock-based compensation. The following pro forma information, as required by Statement of Financial Accounting Standards No. 123 Accounting for Stock-Based Compensation (SFAS 123), as amended by Statement of Financial Accounting Standards No. 148 (SFAS 148), presents net income and earnings per share information as if the stock options issued since February 2, 1999 were accounted for using the fair value method. The fair value of stock options issued for each year was estimated at the date of grant using the Black-Scholes option pricing model.

The SFAS 123 pro forma information for the three months and the six months ended March 31, 2005 is as follows:

	Three Months Ended March 31, 2005	Six Months Ended March 31, 2005
Net income, as reported	\$ 2,327,000	\$ 3,927,000
Add: Stock-based employee compensation expense included in net income, net of tax		45,000
Deduct: Stock-based employee compensation expense determined under fair value based method (SFAS 123), net of tax	(106,000)	(251,000)
Net income, pro forma	\$ 2,221,000	\$ 3,721,000
Basic:		
Net income per common share, as reported	\$ 0.37	\$ 0.66
Net income per common share, pro forma	\$ 0.35	\$ 0.63

Diluted:

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Net income per common share, as reported	\$	0.37	\$	0.65
Net income per common share, pro forma	\$	0.35	\$	0.61

The adoption of SFAS 123(R) in the first quarter of fiscal year 2006 resulted in prospective changes in our accounting for stock-based compensation awards including recording stock-based compensation expense related to stock options that became vested during the quarter on a prospective basis. Because the Company's plans are incentive stock option plans, no tax deduction is recorded when options are granted. If an exercise and sale of vested options results in a disqualifying disposition, a tax deduction for the Company occurs. The excess tax benefit from the disqualifying disposition is reflected in the cash flow statement.

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The adoption of SFAS 123(R) resulted in the recognition of compensation expense of \$91,000, or \$0.01 per share, and \$182,000, or \$0.02 per share in wages in the Statement of Operations for the three months and the six months ended March 31, 2006. In accordance with the modified prospective application method of SFAS 123(R), prior period amounts have not been restated to reflect the recognition of stock-based compensation costs. The total cost related to non-vested awards not yet recognized at March 31, 2006 totals approximately \$373,000 which is expected to be recognized over a weighted average of 1.87 years.

In periods ending prior to October 1, 2005, the income tax benefits from the exercise of stock options were classified as net cash provided by operating activities pursuant to Emerging Issues Task Force Issue No. 00-15. However, for periods ending after December 31, 2005, pursuant to SFAS 123(R), the excess tax benefits are required to be reported in net cash provided by financing activities. For the six months ended March 31, 2006, excess tax benefits from disqualifying dispositions of options of \$46,000 were reflected as an outflow in cash flows from operating activities and an inflow in cash flows from financing activities in the Statements of Cash Flows. In the prior year period, income tax benefits resulting from the disqualifying disposition of options of \$19,000 were reflected in net cash provided by operating activities.

The Company adopted the 2000 Incentive Stock Plan during fiscal 1999, which provides options to purchase 500,000 shares of authorized but unissued common stock of the Company. The option price is the market value of the Company's common stock at date of grant. Options are exercisable 25% annually from the date of the grant and the options expire five years from the date of grant. The 2000 Plan provides that 50,000 of the 500,000 shares of authorized but unissued common stock may be awarded to officers, directors and employees of the Company for the purpose of additional compensation.

In fiscal 2004, the Company adopted the 2004 Incentive Stock Plan which provides 375,000 shares of authorized but unissued common stock of the Company. The 2004 Incentive Stock Plan operates like the 2000 Incentive Stock Plan except that of the 375,000 shares, up to 125,000 shares may be awarded to officers, directors, and employees of the Company for the purpose of additional compensation and up to 125,000 shares may be awarded with restrictions.

Options for 80,500, 55,500 and 204,750 shares were exercisable with weighted average exercise prices of \$7.02, \$7.42 and \$6.94 as of September 30, 2005, 2004 and 2003, respectively.

Outstanding options at March 31, 2006 expire between April, 2006 and November, 2009 and have exercise prices ranging from \$5.21 to \$17.91.

The fair value of each stock option is estimated on the date of grant using the Black-Scholes valuation model. The expected volatility is based on historical volatility over the expected vesting term of 48 months. As the Company has not declared dividends since it became a public entity, no dividend yield is used in the calculation. Actual value realized, if any, is dependent on the future performance of the Company's common stock and overall stock market conditions. There is no assurance the value realized by an optionee will be at or near the value estimated by the Black-Scholes model. There were no stock options granted during the six months period ended March 31, 2006. Option activity for the three months and the six months ended March 31, 2006 are summarized as follows:

	<b>Weighted Average Price</b>	<b>Number of Optioned Shares</b>
Balance as of December 31, 2005	\$ 8.94	218,000
Exercised	\$ 8.57	(21,750)
Balance as of March 31, 2006	\$ 8.98	196,250
Balance as of September 30, 2005	\$ 8.87	224,500
Exercised	\$ 8.10	(28,250)

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Balance as of March 31, 2006	\$	8.98	196,250
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The weighted average grant date fair value of options granted during the first quarter of fiscal 2005 was \$10.18. There were no options granted during the first six months of fiscal 2006. The total intrinsic value of options exercised during the six months ended March 31, 2006 and March 31, 2005 were \$557,286 and \$110,567, respectively.

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In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, which supersedes APB Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS No. 154 changes the requirements for the accounting for and reporting of changes in accounting principles. The statement requires the retroactive application to prior periods financial statements of changes in accounting principles, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 does not change the guidance for reporting the correction of an error in previously issued financial statements or the change in an accounting estimate. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company does not expect the adoption of SFAS No. 154 to have a material impact on its financial position and results of operations and financial condition.

**3. NET INCOME PER COMMON SHARE**

The Company accounts for earnings per share in accordance with Statement of Financial Accounting Standards No. 128, Earnings per Share ( Statement 128 ). Statement 128 replaced the calculation of primary and fully diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options, warrants and convertible securities. Diluted earnings per share is very similar to the previously reported fully diluted earnings per share. All earnings per share amounts for all periods have been presented, and when appropriate, restated to conform to the Statement 128 requirements.

The following table sets forth the computation of basic and diluted net income per common share:

	Three Months Ended March 31		Six Months Ended March 31	
	2006	2005	2006	2005
<b>NUMERATOR:</b>				
Net income and numerator for basic and diluted net income per common share-income available to common shareholders	\$ 4,351,000	\$ 2,327,000	\$ 6,651,000	\$ 3,927,000
<b>DENOMINATOR:</b>				
Denominator for basic net income per common share-weighted average common shares	7,504,811	6,262,794	7,495,499	5,947,148
Effect of dilutive securities-employee stock options	88,382	97,551	88,112	104,265
Denominator for diluted net income per common share-adjusted weighted average common shares and assumed conversions	7,593,193	6,360,345	7,583,611	6,051,413
Net income per common share	\$ 0.58	\$ 0.37	\$ 0.89	\$ 0.66
Net income per common share-assuming dilution	\$ 0.57	\$ 0.37	\$ 0.88	\$ 0.65

**4. DEBT**



On December 22, 2004, the Company entered into a revolving line of credit loan agreement with Western National Bank under which it may borrow, repay and reborrow, from time to time until December 22, 2005, up to \$10.0 million. The Company's obligations under this agreement are secured by a security interest in the Company's accounts receivable and related collateral. Interest on the outstanding amount under the line of credit loan agreement is payable monthly at a rate equal to the greater of (i) the Prime Rate or (ii) 5.0%. The loan agreement contains customary covenants for credit facilities of this type, including limitations on distributions and dividends, disposition of assets and mergers and acquisitions. There are certain financial covenants under the loan

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agreement, including maintaining a minimum tangible net worth (as defined in the loan agreement) of \$40.0 million and maintaining specified ratios with respect to cash flow coverage, current assets and liabilities, and debt to tangible net worth. On January 18, 2006, the Company renewed this revolving line of credit loan agreement for an additional year on the same terms and conditions. The Company is in compliance with all covenants and as of May 8, 2006, no funds have been borrowed under this credit loan agreement.

In connection with equipping and deploying two crews in fiscal 2005 the Company borrowed \$10 million on the revolving line of credit loan agreement. As of March 31, 2005, the Company repaid the \$10 million balance outstanding under the loan agreement and the associated interest as a partial use of proceeds from the public offering of 1,800,000 shares of common stock. The Company did not borrow under the loan agreement during the remainder of fiscal 2005 or during the first or second quarters of fiscal 2006.

**5. CONTINGENCY**

From time to time the Company is a party to various legal proceedings arising in the ordinary course of business. Although the Company cannot predict the outcomes of any such legal proceedings, management believes that the resolution of pending legal actions will not have a material adverse effect on the Company's financial condition, results of operations or liquidity.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion should be read in conjunction with the Company's financial statements and notes thereto included elsewhere in this Form 10-Q.

**Forward Looking Statements**

All statements other than statements of historical fact included in this Form 10-Q, including without limitation, statements under Management's Discussion and Analysis of Financial Condition and Results of Operations regarding technological advancements and our financial position, business strategy and plans and objectives of our management for future operations, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. When used in this Form 10-Q, words such as "anticipate", "believe", "estimate", "expect", "intend", and similar expressions, as they relate to us or our management, identify forward-looking statements. Such forward-looking statements are based on the beliefs of our management as well as assumptions made by and information currently available to management. Actual results could differ materially from those contemplated by the forward-looking statements as a result of certain factors, including but not limited to dependence upon energy industry spending, weather interruptions, managing growth, inability to obtain land access rights of way, the volatility of oil and gas prices, and the availability of capital resources. A discussion of these factors, including risks and uncertainties, is set forth under Risk Factors in our Form 10-K and in our other reports filed from time to time with the Securities and Exchange Commission. These forward-looking statements reflect our current views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategies and liquidity. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this paragraph. We assume no obligation to update any such forward-looking statements.

**Overview**

We are the leading provider of onshore seismic data acquisition services in the United States as measured by the number of active data acquisition crews. Substantially all of our revenues are derived from the seismic data acquisition services we provide to our clients, mainly domestic oil and gas companies. Demand for our services depends upon the level of spending by these oil and gas companies for exploration, production, development and field management activities, which activities depend, in part, on oil and natural gas prices. Fluctuations in domestic oil and natural gas exploration activities and commodity prices have affected the demand for our services and our results of operations in years past and continue to be the single most important factor affecting our business and results of operations.

Accordingly, our return to profitability beginning in fiscal 2004 after several years of losses is directly related to an increase in the level of exploration for domestic oil and natural gas reserves by the petroleum industry since 2003. The increased level of exploration is a function of higher prices for oil and natural gas. As a result of the increase in domestic exploration spending, we have experienced an increased demand for our seismic data acquisition and processing services. While the markets for oil and natural gas have historically been volatile and are likely to continue to be so in the future and we can make no assurances as to future levels of domestic exploration or commodity prices, we believe opportunities exist for us to enhance our market position by responding to our clients' desire for higher resolution subsurface images.

In response to the continued high demand for our services, we anticipate placing an additional data acquisition crew, our twelfth crew, into service late in the third quarter of fiscal 2006. The twelfth crew will be equipped with a 5,000 channel ARAM ARIES cable based recording system. We currently operate six I/O RSR radio crews and five I/O II MRX cable based crews. Three of the MRX crews have been upgraded in the last year to I/O Image central electronics which increases the recording channel capacity from 3,000 channels to 6,000 channels. In addition, we have in excess of 60,000 channels and 87 vibrator energy source units with six more units on order.

We continue to focus on increasing revenues from and profitability of our existing crews by increasing our recording capacity and channel count, increasing crew productivity, and securing more favorable contract terms with our clients.. We will also continue to explore new technologies. While our revenues are mainly affected by the level of client demand for our services, our revenues are also affected by the pricing for our services that we negotiate with our

clients and the productivity of our data acquisition crews, including factors such as crew downtime related to inclement weather, delays in acquiring land access permits, or equipment failure. Consequently, our successful efforts to negotiate more favorable weather protection provisions in our supplemental service agreements, to mitigate access permit delays and to improve overall crew productivity may contribute to growth in our revenues.

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Although our clients may cancel their supplemental service agreement with us on short notice, we believe we currently have a sufficient order book to sustain operations at full capacity well into calendar year 2006, with several of the crews booked into calendar year 2007. Our data processing operation continued to show improvement during the first six months of fiscal 2006 due to client recognition of quality performance and our expansion into the Houston market for these services.

We have entered into a letter of intent and are negotiating an agreement with WesternGeco, a subsidiary of Schlumberger, to provide Q-Land seismic data acquisition services in the lower 48 United States. The Q-Land system is a unique integrated acquisition and processing system that is producing superior results throughout the Middle East and North Africa. The Q-Land system uses 30,000 channels of finely spaced point-receivers to correctly sample both signal and noise. By removing the noise, the resolution of the subsurface is dramatically increased. Under the terms of the agreement, we will provide crew personnel, energy source units, necessary vehicles, land access permitting, surveying, and serve as primary contractor. WesternGeco will provide survey design, the seismic recording system with operators, and all Q-Land data processing services. Both companies will share marketing services. We intend to deploy the Q-Land recording system by using an existing crew as demand for the technology requires.

### **Highlights of the Quarter Ended March 31, 2006**

Our financial performance from operations for the second quarter of fiscal 2006 significantly improved when compared to our financial performance for the second quarter of fiscal 2005 as a result of continuing high demand for our services due to increased exploration and development activity by domestic oil and gas companies and increases in oil and gas prices. The following are the highlights of our second quarter performance:

We operated eleven acquisition crews during the second fiscal quarter of 2006, as compared to ten crews in the second fiscal quarter of 2005.

We experienced the price improvements and more favorable contract terms in our agreements with clients that we negotiated in calendar 2005. These factors helped improve our revenues during the second quarter of fiscal 2006.

We experienced favorable weather and operating conditions during the second quarter of fiscal 2006 which increased crew productivity.

We continued to grow by upgrading our recording capacity, expanding the channel count of existing crews, adding to our energy source fleet and making technical improvements in all phases of our operations.

### **Results of Operations**

*Operating Revenues.* Our operating revenues for the first six months of fiscal 2006 increased 57% to \$75,535,000 from \$48,074,000 for the first six months of fiscal 2005. For the three months ended March 31, 2006, operating revenues totaled \$40,042,000 versus \$26,515,000 for the same period of fiscal 2005, a 51% increase. These results reflect improved prices and contract terms obtained in calendar 2005, favorable weather conditions, increased crew productivity, and an increase in crew count as well as recording capacity. As a result of the increased demand for our services, we deployed two additional data acquisition crews in fiscal 2005, and we are preparing to deploy our twelfth data acquisition crew in the latter part of our third quarter of fiscal 2006. In addition, our revenues have been positively affected by our ability to obtain price improvements in the markets for our services and negotiate favorable contract provisions. We also experienced favorable weather conditions during the second quarter of fiscal 2006 which increased overall crew productivity.

*Operating Costs.* Operating expenses for the six months ended March 31, 2006 totaled \$57,247,000 versus \$38,222,000 for the same period of fiscal 2005. For the quarter ended March 31, 2006, operating expenses totaled \$29,109,000 versus \$21,378,000 for the quarter ended March 31, 2005. Increases in operating expenses are due to ongoing expenses of the two crews added after the first quarter of fiscal 2005 and the expenses associated with preparation of our twelfth crew.

General and administrative expenses were approximately 3.2% and 3.7% of revenues in the first six months of fiscal 2006 and 2005, respectively. For the quarter ended March 31, 2006, general and administrative expenses were

approximately 3.3% of revenues as compared to 3.7% for the comparable quarter of fiscal 2005. The increase in actual dollars of general and administrative expenses from \$1,783,000 in the first six months of fiscal 2005 to \$2,441,000 in the first six months of fiscal 2006 was due principally to the increase in expenses necessary to support expanded field operations and to maintain compliance with Sarbanes-Oxley reporting requirements. While we strive to maintain a low ratio of general and administrative expenses to revenue, our absolute level of

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general and administrative expenses are expected to continue to increase as we expand operations. In the first quarter of fiscal 2006, we adjusted our allowance for doubtful accounts in response to business activity and accounts receivable. Historically, we have had no significant write-offs of trade accounts receivable; however, we believe that it is prudent to monitor the allowance for doubtful accounts in response to increased demand from new customers.

Depreciation for the six months ended March 31, 2006 totaled \$6,164,000 as compared to \$3,132,000 for the six months ended March 31, 2005. We recognized \$3,188,000 of depreciation expense in the second quarter of fiscal 2006 as compared to \$1,662,000 in the comparable quarter of fiscal 2005 as a result of the significant capital expenditures we made during 2005 and the first quarter of fiscal 2006. Our depreciation expense is also expected to increase during the remaining quarters of fiscal 2006 reflecting our significant capital expenditures in fiscal 2005 and the first six months of fiscal 2006, and our expected capital budget for the remainder of fiscal 2006.

Our total operating costs for the first six months of fiscal 2006 were \$65,852,000, an increase of 52.6% from the first six months of fiscal 2005. For the quarter ended March 31, 2006, our operating expenses were \$33,611,000 representing a 39.9% increase from the comparable quarter of fiscal 2005. These increases in the first six months period and for the second quarter were primarily due to the factors described above.

*Taxes.* The provision for income taxes for the first six months of fiscal 2006 was \$0.46 per share as compared to \$0.22 per share during the first six months of fiscal 2005. The increase in expense per share reflects the fact that Dawson fully utilized its federal net operating loss ( NOL ) during the second quarter and started remitting regular tax reduced by alternative minimum tax ( AMT ) credits. We anticipate that we will continue to recognize increased income tax expense in the future as we fully utilize our AMT credits.

**Liquidity and Capital Resources**

*Introduction.* Our principal source of cash is amounts earned from the seismic data acquisition services we provide to our clients. Our principal uses of cash are the amounts used to provide these services, including expenses related to our operations and acquiring new equipment. Accordingly, our cash position depends (as do our revenues) on the level of demand for our services. Historically, cash generated from our operations along with cash reserves and short term borrowings from commercial banks has been sufficient to fund our working capital requirements, and to some extent, our capital expenditures. In March 2005 we completed a public offering of 1,800,000 shares of our common stock that raised net proceeds of approximately \$41 million. We have used these proceeds for continued expansion and to repay borrowing under our revolving line of credit agreement and have invested the remainder in short-term investments.

*Cash Flows.* Net cash provided by operating activities was \$10,309,000 for the first six months of fiscal 2006 and \$9,735,000 for the first six months of fiscal 2005. These amounts primarily reflect results of operations offset by changes in working capital components, depreciation, and other non-cash components, including deferred income tax expense. Cash provided by operating activities in the first six months of fiscal 2006 were impacted by the increase in accounts receivable at March 31, 2006. We received payments with respect to a significant portion of these accounts receivable in April 2006.

Net cash used in investing activities was \$12,883,000 through the six months ended March 31, 2006 and \$42,717,000 through the six months ended March 31, 2005. These results represent capital expenditures and activity in the short-term investment portfolio. Capital expenditures in fiscal 2006 were made with cash generated from operations and the sale of short-term investments. During fiscal 2005 capital expenditures were also made with cash from our revolving line of credit agreement that was repaid with proceeds from our public offering that was completed in March 2005. Additional proceeds from the public offering were used in the acquisition of short-term investments.

Net cash provided by financing activities for the first six months ended March 31, 2006 was \$276,000 and reflects proceeds from the exercise of stock options and the excess tax benefits from disqualifying dispositions in the period.

*Capital Expenditures.* Capital expenditures during the first six months of fiscal 2006 were \$19,713,000, which we used to acquire additional recording channels and energy source units to expand the capabilities of our existing crews and for maintenance capital requirements.

We have approved budgeted capital expenditures of \$35,000,000 for fiscal year 2006, of which approximately \$10,000,000 reflects expenditures used to field and equip our twelfth crew. The remainder will be used to expand and update existing crews and







*Revenue Recognition.* Our services are provided under cancelable service contracts. These contracts are either turnkey or term agreements. The Company recognizes revenues when services are performed under both types of agreements. Services are defined as the commencement of data acquisition or processing operations. Under turnkey agreements, revenue is recognized on a per unit of data acquired rate, as services are performed. Under term agreements, revenue is recognized on a per unit of time worked rate, as services are performed. In the case of a cancelled service contract, we recognize revenue and bill our client for services performed up

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to the date of cancellation. We also receive reimbursements for certain out-of-pocket expenses under the terms of our service contracts. We record amounts billed to clients in revenue at the gross amount including out-of-pocket expenses that are reimbursed by the client.

In some instances, we bill clients in advance of the services performed. In those cases, we recognize the liability as deferred revenue.

*Allowance for Doubtful Accounts.* We prepare our allowance for doubtful accounts receivable based on our past experience of historical write-offs, our current customer base and our review of past due accounts. The inherent volatility of the energy industry's business cycle can cause swift and unpredictable changes in the financial stability of our customers.

*Impairment of Long-lived Assets.* We review long-lived assets for impairment when triggering events occur suggesting deterioration in the assets recoverability or fair value. Recognition of an impairment charge is required if future expected net cash flows are insufficient to recover the carrying value of the asset. Our forecast of future cash flows used to perform impairment analysis includes estimates of future revenues and future gross margins based on our historical results and analysis of future oil and gas prices which is fundamental in assessing demand for our services. If we are unable to achieve these cash flows, an impairment charge would be recorded.

*Depreciable Lives of Property, Plant and Equipment.* Our property, plant and equipment are capitalized at historical cost and depreciated over the useful life of the asset. Our estimation of useful lives is based on circumstances that exist in the seismic industry and information available at the time of the purchase of the asset. The technology of the equipment used to gather data in the seismic industry has historically evolved such that obsolescence does not occur quickly. As circumstances change and new information becomes available, these estimates could change. We depreciate capitalized items using the straight-line method.

*Tax Accounting.* We account for our income taxes in accordance with SFAS No. 109, Accounting for Income Taxes, which requires the recognition of amounts of taxes payable or refundable for the current year and an asset and liability approach in recognizing the amount of deferred tax liabilities and assets for the future tax consequences of events that have been recognized in our financial statements or tax returns. We determine deferred taxes by identifying the types and amounts of existing temporary differences, measuring the total deferred tax asset or liability using the applicable tax rate and reducing the deferred tax asset by a valuation allowance if, based on available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Our methodology for recording income taxes requires judgment regarding assumptions and the use of estimates, including determining our annual effective tax rate and the valuation of deferred tax assets, which can create variance between actual results and estimates. The process involves making forecasts of current and future years' taxable income and unforeseen events may significantly affect these estimates. Those factors, among others, could have a material impact on our provision or benefit for income taxes.

*Stock Based Compensation.* In prior periods we accounted for share-based compensation utilizing the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees ( ABP 25 ) and related interpretations. No compensation expense was recorded for stock options or other stock-based awards that were granted with an exercise price equal to or above the common stock market price on the grant date. Pro forma disclosures were made as required by Statement of Financial Accounting Standards No. 123 Accounting for Stock-Based Compensation ( SFAS 123 ), as amended by Statement of Financial Accounting Standards No. 148 ( SFAS 148 ), presenting net income and earnings per share information as if the stock options issued since February 2, 1999 were accounted for using the fair value method. The fair value of stock options issued for each year was estimated at the date of grant using the Black-Scholes option pricing model.

Without making modifications to outstanding share options, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment ( SFAS 123(R) ) as of October 1, 2005. SFAS 123(R) requires us to recognize compensation expense for all share-based payment arrangements based on the fair value of the share-based payment on the date of grant. We elected the modified prospective application method of adoption, which requires compensation expense to be recorded for all stock-based awards granted after October 1, 2005 and for all unvested stock options outstanding as of October 1, 2005, beginning in the first quarter of adoption. For all unvested options outstanding as of October 1, 2005, the remaining previously measured but unrecognized compensation

expense, based on the fair value at the original grant date, will be recognized as wages in the Statements of Operations on a straight-line basis over the remaining vesting period. For share-based payments granted subsequent to October 1, 2005, compensation expense, based on the fair value on the date of grant, will be recognized in the Statements of Operations in wages on a straight-line basis over the vesting period. We did not grant stock options in the quarter or the six months ended March 31, 2006. In determining the fair value of stock options that may be granted in the future, we plan to continue to use the Black-Scholes option pricing model that employs the following assumptions:

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Expected volatility of our stock price on historical volatility over the expected term of the option.

Expected term of the option based on historical employee stock option exercise behavior, the vesting term of the respective option and the contractual term.

Risk-free interest rate for periods within the expected term of the option.

Dividend yield.

Our stock price volatility and expected option lives are based on management's best estimates at the time of grant, both of which impact the fair value of the option calculated under the Black-Scholes methodology and, ultimately, the expense that will be recognized over the vesting term of the option.

SFAS 123(R) also requires that we recognize compensation expense for only the portion of share-based payment arrangements that are expected to vest. Therefore, we apply estimated forfeiture rates that are based on historical employee termination behavior. We periodically adjust the estimated forfeiture rates so that only the compensation expense related to share-based payment arrangements that vest are included in wages. If the actual number of forfeiture differs from those estimated by management, additional adjustments to compensation expense may be required in future periods.

**Recently Issued Accounting Pronouncements**

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, which supersedes APB Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS No. 154 changes the requirements for the accounting for and reporting of changes in accounting principles. The statement requires the retroactive application to prior periods' financial statements of changes in accounting principles, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 does not change the guidance for reporting the correction of an error in previously issued financial statements or the change in an accounting estimate. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We do not expect the adoption of SFAS No. 154 to have a material impact on our financial position and results of operations and financial condition.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

The primary sources of market risk include fluctuations in commodity prices which affect demand for and pricing of our services and interest rate fluctuations. At March 31, 2006, we had no indebtedness. Our short-term investments were fixed-rate and we do not necessarily intend to hold them to maturity, and therefore, the short-term investments expose us to the risk of earnings or cash flow loss due to changes in market interest rates. As of March 31, 2006, the carrying value of our investments approximates fair value. We have not entered into any hedge arrangements, commodity swap agreements, commodity futures, options or other derivative financial instruments. We do not currently conduct business internationally, so we are generally not subject to foreign currency exchange rate risk.

**ITEM 4. CONTROLS AND PROCEDURES**

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Under the supervision and with the participation of management, including our chief executive officer and chief financial officer, we evaluated the effectiveness of our internal controls over financial reporting as of March 31, 2006 using the criteria set forth in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that, as of March 31, 2006, our internal control over financial reporting was effective. There have not been any changes in our internal controls over financial reporting (as defined in Rule 13a-15(f) of the Securities Exchange Act) during the

quarter ended March 31, 2006 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

From time to time we are a party to various legal proceedings arising in the ordinary course of business. Although we cannot predict the outcomes of any such legal proceedings, our management believes that the resolution of pending legal actions will not have a material adverse effect on our financial condition, results of operations or liquidity.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Annual Meeting of Stockholders was held on January 24, 2006.

The following proposals were adopted by the margins indicated:

1. To elect a Board of Directors to hold office until the next annual meeting of shareholders and until their successors are elected and qualified.

	<b>Number of Shares</b>	
	<b>For</b>	<b>Withheld</b>
Paul H. Brown	6,154,505	193,380
L. Decker Dawson	6,302,993	44,892
Gary M. Hoover	6,081,589	266,296
Stephen C. Jumper	6,230,677	117,208
Tim C. Thompson	6,154,305	193,580

2. To amend the Restated Articles of Incorporation to increase the authorized common stock from 10,000,000 shares to 50,000,000 shares.

For	5,543,199
Against	1,321,950
Abstain	9243
Broker Non-Votes	0

3. To ratify the appointment of KPMG LLP as the Company's independent registered public accounting firm for the fiscal year ending September 30, 2006.

For	6,383,070
Against	50,136
Abstain	282,578
Broker Non-Votes	0

The following proposal was not adopted by the margins indicated:

1. To amend the Dawson Geophysical Company 2004 Incentive Stock Plan to increase the number of shares of common stock available for allocation under such plan by 250,000 shares.

For	2,688,113
Against	747,599
Abstain	282,578
Broker Non-Votes	0

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**ITEM 6. EXHIBITS**

The information required by this Item 6 is set forth in the Index to Exhibits accompanying this Form 10-Q and is hereby incorporated by reference.



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DAWSON GEOPHYSICAL  
COMPANY

DATE: May 9, 2006

By: /s/ Stephen C. Jumper

Stephen C. Jumper  
President and Chief Executive Officer

DATE: May 9, 2006

By: /s/ Christina W. Hagan

Christina W. Hagan  
Executive Vice President, Treasurer,  
Secretary and Chief Financial Officer

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**INDEX TO EXHIBITS**

<b>Number</b>	<b>Exhibit</b>
3.1	Restated Articles of Incorporation of the Company (filed on December 10, 2004 as Exhibit 3.1 to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2004 (File No. 000-10144) and incorporated herein by reference).
3.2	Bylaws of the Company, as amended (filed on December 11, 2003 as Exhibit 3 to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2003 (File No. 000-10144) and incorporated herein by reference).
4.1	Rights Agreement by and between the Company and Mellon Investor Services, LLC (f/k/a Chasemellon Shareholder Services, L.L.C.), as Rights Agent, dated July 13, 1999 (filed on December 11, 2003 as Exhibit 4 to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2003 (File No. 000-10144) and incorporated herein by reference).
10.1*	First Amendment to Loan Agreement, dated January 18, 2006, between the Company and Western National Bank.
31.1*	Certification of Chief Executive Officer of Dawson Geophysical Company pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
31.2*	Certification of Chief Financial Officer of Dawson Geophysical Company pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
32.1*	Certification of Chief Executive Officer of Dawson Geophysical Company pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and Section 1350 of Chapter 63 of Title 18 of the United States Code. Pursuant to SEC Release 34-47551, this Exhibit is furnished to the SEC and shall not be deemed to be filed.
32.2*	Certification of Chief Financial Officer of Dawson Geophysical Company pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and Section 1350 of Chapter 63 of Title 18 of the United States Code. Pursuant to SEC Release 34-47551, this Exhibit is furnished to the SEC and shall not be deemed to be filed.

\* Filed herewith.