Deep Down, Inc.
Form 10-Q
August 08, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2018

OR

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

Commission File No. 000-30351

DEEP DOWN, INC.

(Exact name of registrant as specified in its charter)

Nevada	**75-2263732**
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)
8827 W. Sam Houston Pkwy N., Suite 100	**77040**

Houston, Texas
(Address of Principal Executive Offices) (Zip Code)

Registrant’s telephone number, including area code: **(281) 517-5000**

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer ¨

Non-accelerated filer ¨ Smaller reporting company þ

Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

At August 6, 2018, there were 13,736,243 shares outstanding of Common Stock, par value $0.001 per share.

IMPORTANT INFORMATION REGARDING THIS FORM 10-Q

Unless otherwise indicated, references to “we,” “us,” and “our” in this Quarterly Report on Form 10-Q (“Report”) refer collectively to Deep Down, Inc., a Nevada corporation (“Deep Down”), and its directly and indirectly wholly-owned subsidiaries.

Deep Down is the parent company to the following directly and indirectly wholly-owned subsidiaries: Deep Down, Inc., a Delaware corporation (“Deep Down Delaware”); Deep Down International Holdings, LLC, a Nevada limited liability company (“DDIH”); and Deep Down Brasil - Solucoes em Petroleo e Gas, Ltda, a Brazilian limited liability company (“Deep Down Brasil”).

Our current operations are primarily conducted under Deep Down Delaware.

Readers should consider the following information as they review this Report:

Forward-Looking Statements

The statements contained or incorporated by reference in this Report that are not historical facts are “forward-looking statements” (as such term is defined in the Private Securities Litigation Reform Act of 1995), within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. Forward-looking statements include any statement that may project, indicate or imply future results, events, performance or achievements. The forward-looking statements contained herein are based on current expectations that involve a number of risks and uncertainties. These statements can be identified by the use of forward-looking terminology such as “believes,” “expect,” “may,” “will,” “should,” “intend,” “plan,” “could,” “estimate” or “a the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy that involve risks and uncertainties.

Given the risks and uncertainties relating to forward-looking statements, investors should not place undue reliance on such statements. Forward-looking statements included in this Report speak only as of the date of this Report and are not guarantees of future performance. Although we believe that the expectations reflected in the forward-looking statements are reasonable, such expectations may prove to be incorrect. All subsequent written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by these cautionary statements. The risks and uncertainties mentioned previously relate to, among other matters, the following:

- Economic uncertainty and financial market conditions may impact our customer base, suppliers and backlog;
- Our backlog is subject to unexpected adjustments and cancellations and, therefore, may not be a reliable indicator of our future earnings;
- Our volume of fixed-price contracts and use of percentage-of-completion accounting could result in volatility in our results of operations;
- A portion of our contracts may contain terms with penalty provisions;
- Fluctuations in the price and supply of raw materials used to manufacture our products may reduce our profits and could materially impact our ability to meet commitments to our customers;
- Our operations could be adversely impacted by the continuing effects of government regulations;
- International and political events may adversely affect our operations;
- Our operating results may vary significantly from quarter to quarter;
- We may be unsuccessful at generating profitable internal growth;
- The departure of key personnel could disrupt our business;
- Our business requires skilled labor, and we may be unable to attract and retain qualified employees;
- Unfavorable legal outcomes could have a negative impact on our business; and
- Our previously announced plans to explore and evaluate strategic alternatives to maximize stockholder value.

Document Summaries

Descriptions of documents and agreements contained in this Report are provided in summary form only, and such summaries are qualified in their entirety by reference to the actual documents and agreements filed as exhibits to our Annual Report on Form 10-K for the year ended December 31, 2017, other periodic and current reports we have filed with the SEC or this Report.

Access to Filings

Access to our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments thereto, filed with or furnished to the SEC pursuant to Section 13(a) of the Exchange Act, as well as reports filed electronically pursuant to Section 16(a) of the Exchange Act, may be obtained through our website (http://www.deepdowninc.com) as soon as reasonably practicable after we have filed or furnished such material with the SEC. The contents of our website are not, and shall not be deemed to be, incorporated into this Report.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DEEP DOWN, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share and par value amounts)

	June 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash	$2,423	$3,939
Short term investment (certificate of deposit)	1,026	1,017
Accounts receivable, net of allowance of $10	4,774	4,142
Contract Assets	653	925
Prepaid expenses and other current assets	126	302
Total current assets	9,002	10,325
Property, plant and equipment, net	12,367	12,352
Intangibles, net	60	63
Other assets	1,017	1,230
Total assets	$22,446	$23,970
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$844	$1,511
Contract liabilities	241	612
Current portion of long-term debt	9	–
Total current liabilities	1,094	2,123
Long-term debt	53	–
Total liabilities	1,147	2,123
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Preferred stock, $0.001 par value, 10,000,000 shares authorized, 0 shares issued and outstanding	–	–

Common stock, $0.001 par value, 24,500,000 shares authorized, 15,438,660 shares issued	15	15
Treasury stock	(2,040)	(2,040)
Additional paid-in capital	73,256	73,246
Accumulated deficit	(49,932)	(49,374)
Total stockholders' equity	21,299	21,847
Total liabilities and stockholders' equity	$22,446	$23,970

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

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DEEP DOWN, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended June 30,		**Six Months Ended June 30,**	
(In thousands, except per share amounts)	2018	2017	2018	2017
Revenues	$4,104	$5,379	$7,810	$10,987
Cost of sales:				
Cost of sales	2,211	2,393	4,429	5,047
Depreciation expense	242	323	596	633
Total cost of sales	2,453	2,716	5,025	5,680
Gross profit	1,651	2,663	2,785	5,307
Operating expenses:				
Selling, general and administrative	1,745	2,223	3,662	4,732
Depreciation and amortization	58	79	129	158
Total operating expenses	1,803	2,302	3,791	4,890
Operating (loss) income	(152)	361	(1,006)	417
Other income:				
Interest income, net	10	12	19	26
Equity in net income of joint venture	–	94	–	94
Gain on sale of assets	439	14	439	14
Total other income	449	120	458	134
Income (loss) before income taxes	297	481	(548)	551
Income tax expense	(5)	(5)	(10)	(10)
Net income (loss)	$292	$476	$(558)	$541
Net income (loss) per share:				
Basic	$0.02	$0.03	$(0.04)	$0.04
Fully diluted	$0.02	$0.03	$(0.04)	$0.04
Weighted-average shares outstanding:				
Basic	13,436	15,154	13,436	15,264
Fully diluted	13,436	15,154	13,436	15,264

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

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DEEP DOWN, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)	Six Months Ended June 30, 2018	2017
Cash flows from operating activities:		
Net (loss) income	$(558)	$541
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Share-based compensation	10	67
Depreciation and amortization	725	791
Gain on sale of assets	(439)	(14)
Equity in net income of joint venture	–	(94)
Changes in assets and liabilities:		
Accounts receivable, net of allowance	(842)	2,096
Contract Assets	272	890
Prepaid expenses and other current assets	176	134
Other assets	205	(167)
Accounts payable and accrued liabilities	(667)	(481)
Contract Liabilities	(371)	(2,749)
Net cash (used in) provided by operating activities	(1,489)	1,014
Cash flows from investing activities:		
Purchases of property, plant and equipment	(559)	(1,588)
Proceeds from sale of assets	538	18
Repayments on notes receivable	8	13
Short term investment-certificate of deposit	(9)	–
Cash distribution received from joint venture	–	94
Net cash used in investing activities	(22)	(1,463)
Cash flows from financing activities:		
Principal payment on long-term debt	(5)	–
Cash paid for repurchase of our common stock	–	(558)
Net cash used in financing activities	(5)	(558)
Change in cash	(1,516)	(1,007)
Cash, beginning of period	3,939	8,203
Cash, end of period	$2,423	$7,196
Supplemental schedule of investing and financing activities:		
Addition of property, plant and equipment (non-cash)	$317	$–

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

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except per share amounts)

NOTE 1: BASIS OF PRESENTATION

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Deep Down, Inc. and its directly and indirectly wholly-owned subsidiaries (“Deep Down,” “we,” “us” or the “Company”) were prepared in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC” or the “Commission”) pertaining to interim financial information and instructions to Form 10-Q. As permitted under those rules, certain footnotes or other financial information that are normally required by United States generally accepted accounting principles (“US GAAP”) can be condensed or omitted. Therefore, these statements should be read in conjunction with the audited consolidated financial statements, and notes thereto, included in our Annual Report on Form 10-K for the year ended December 31, 2017, filed on March 28, 2018 with the Commission.

Preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, the disclosed amounts of contingent assets and liabilities and the reported amounts of revenues and expenses. If the underlying estimates and assumptions upon which the financial statements are based change in future periods, then the actual amounts may differ from those included in the accompanying unaudited condensed consolidated financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included.

Liquidity

The Company’s primary and potential sources of liquidity include cash and cash equivalents on hand, cash from operating activities, and proceeds from opportunistic sales of non-core equipment. The Company’s cash as of June 30, 2018 and December 31, 2017 was $2,423 and $3,939, respectively. The reduction in cash was caused by cash used in operating activities of $1,489 primarily because of our net loss of $558 and an increase of $632 in accounts receivable during the six months ended June 30, 2018.

The Company’s plans to mitigate its limited liquidity include: closely monitoring capital expenditures planned for the remainder of 2018 and beyond to conserve capital; possibly selling certain non-core equipment; further reducing administrative costs, if necessary; and potentially establishing a line of credit to further supplement our operating requirements.

The Company’s operations are influenced by a number of factors that are beyond its control, including general conditions of the offshore energy sector, oil and gas operators’ willingness to spend development capital, and other factors that could adversely affect the Company’s financial position, results of operations and liquidity.

Principles of Consolidation

The unaudited condensed consolidated financial statements presented herein include the accounts of Deep Down, Inc. and its directly and indirectly wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated.

Segments

For the quarters ended June 30, 2018 and 2017, we had one operating and reporting segment, Deep Down Delaware.

Recently Issued Accounting Standards Not Yet Adopted

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”). The amendments in this update require, among other things, that lessees recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Lessees and lessors must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The amendments are effective for us beginning January 1, 2019. We do not anticipate the adoption of ASU 2016-02 will have a material effect on our results of operations or financial position, but we are still evaluating the impact on both.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except per share amounts)

All other new accounting pronouncements that have been issued but not yet effective are currently being evaluated to determine if they will have a material impact on our financial position or results of operations.

NOTE 2: REVENUES: ADOPTION OF ASC 606, "REVENUE FROM CONTRACTS WITH CUSTOMERS"

On January 1, 2018, we adopted ASC Topic 606 ("ASC 606") using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under Revenue Recognition ASC Topic 605.

There was no significant impact upon the adoption of ASC 606. We did not record any adjustments to opening retained earnings as of January 1, 2018 because the Company's revenue recognition methodologies for both fixed price contracts (over time using cost to cost as an input measure of performance) and for service contracts (over time as services are incurred) do not materially change by the adoption of the new standard.

Revenues are recognized when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services. To determine the proper revenue recognition method for our customer contracts, we evaluate whether two or more contracts should be combined and accounted for as one single contract and whether the combined or single contract should be accounted for as more than one performance obligation. This evaluation requires significant judgment and the decision to combine a group of contracts or separate the combined or single contract into multiple performance obligations could change the amount of revenue and profit recorded in a given period. For most of our fixed price contracts, the customer contracts with us to provide a significant service of integrating a complex set of tasks and components into a single project or capability (even if that single project results in the delivery of multiple units). Hence, the entire contract is accounted for as one performance obligation.

We account for a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

Disaggregation of Revenue

The following table presents our revenues disaggregated by revenue sources of fixed price and service contracts. Sales taxes are excluded from revenues.

Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

	June 30, 2018	June 30, 2017
Fixed Price Contracts	$1,090	$749
Service Contracts	3,014	4,630
Total	$4,104	$5,379

Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017

	June 30, 2018	June 30, 2017
Fixed Price Contracts	$2,933	$2,419
Service Contracts	4,877	8,568
Total	$7,810	$10,987

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except per share amounts)

Fixed price contracts

For fixed price contracts, we generally recognize revenue over time as we perform because of continuous transfer of control to the customer. This continuous transfer of control to the customer is supported by clauses in the contract that allow the customer to unilaterally terminate the contract for convenience, pay us for costs incurred plus a reasonable profit and take control of any work in process. Additionally, in other fixed price contracts, the customer typically controls the work in process as evidenced either by contractual termination clauses or by our rights to payment for work performed to date plus a reasonable profit to deliver products or services that do not have an alternative use to the Company.

Because of control transferring over time, revenue is recognized based on the extent of progress towards completion of the performance obligation. The selection of the method to measure progress towards completion requires judgment and is based on the nature of the products or services to be provided. We generally use the cost-to-cost measure of progress for our contracts because it best depicts the transfer of control to the customer which occurs as we incur costs on our contracts. Under the cost-to-cost measure of progress, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs at completion of the performance obligation. Revenues, including estimated fees or profits, are recorded proportionally as costs are incurred.

Contracts are often modified to account for changes in contract specifications and requirements. We consider contract modifications to exist when the modification either creates new, or changes the existing, enforceable rights and obligations. Most of our contract modifications are for goods or services that are not distinct from the existing contract due to the significant integration service provided in the context of the contract and are accounted for as if they were part of that existing contract. The effect of a contract modification on the transaction price and our measure of progress for the performance obligation to which it relates, is recognized as an adjustment to revenue (either as an increase in or a reduction of revenue) on a cumulative catch-up basis.

We have a companywide standard and disciplined quarterly estimate at completion (EAC) process in which management reviews the progress and execution of our performance obligations. As part of this process, management reviews information including, but not limited to, any outstanding key contract matters, progress towards completion and the related program schedule, identified risks and opportunities and the related changes in estimates of revenues and costs. Changes in estimates of net sales, cost of sales and the related impact to operating income are recognized quarterly on a cumulative catch-up basis, which recognizes in the current period the cumulative effect of the changes on current and prior periods based on a performance obligation's percentage of completion. A significant change in one or more of these estimates could affect the profitability of one or more of our performance obligations. When estimates of total costs to be incurred exceed total estimates of revenue to be earned on a performance obligation related to fixed price contracts, a provision for the entire loss on the performance obligation is recognized in the period the loss is estimated.

Service Contracts

We recognize revenue for service contracts measuring progress toward satisfying the performance obligation in a manner that best depicts the transfer of goods or services to the customer. The control over services is transferred over time when the services are rendered to the customer on a daily basis. Specifically, we recognize revenue as the services are provided as we have the right to invoice the customer for the services performed. Services are billed and paid on a monthly basis. Payment terms for services are usually 30 days from invoice receipt.

Contract balances

Costs and estimated earnings in excess of billings on uncompleted contracts arise when revenues are recorded on a percentage-of-completion basis but cannot be invoiced under the terms of the contract. Such amounts are invoiced upon completion of contractual milestones. Billings in excess of costs and estimated earnings on uncompleted contracts arise when milestone billings are permissible under the contract, but the related costs have not yet been incurred. All contract costs are recognized currently on jobs formally approved by the customer and contracts are not shown as complete until virtually all anticipated costs have been incurred and the risk of loss has passed to the customer.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except per share amounts)

Assets related to costs and estimated earnings in excess of billings on uncompleted contracts, as well as liabilities related to billings in excess of costs and estimated earnings on uncompleted contracts, have been classified as current. The contract cycle for certain long-term contracts may extend beyond one year, thus complete collection of amounts related to these contracts may extend beyond one year, though such long-term contracts include contractual milestone billings as discussed above. As of June 30, 2018, we had no contracts whose term extended beyond one year.

The following table summarizes our contract assets, which are "Costs and estimated earnings in excess of billings on uncompleted contracts" and our contract liabilities, which are "Billings in excess of costs and estimated earnings on uncompleted contracts".

	June 30, 2018	December 31, 2017
Costs incurred on uncompleted contracts	$8,749	$9,564
Estimated earnings on uncompleted contracts	9,019	10,741
	17,768	20,305
Less: Billings to date on uncompleted contracts	(17,356)	(19,992)
	$412	$313
Included in the accompanying unaudited condensed consolidated balance sheets under the following captions:		
Contract Assets	$653	$925
Contract Liabilities	(241)	(612)
	$412	$313

The balance in contract assets at June 30, 2018 and December 31, 2017 consisted primarily of earned but unbilled revenues related to fixed-price contracts.

The balance in contract liabilities at June 30, 2018 and December 31, 2017 consisted primarily of unearned billings related to fixed-price contracts.

Remaining Performance Obligations

Remaining performance obligations represent the transaction price of firm orders for which work has not been performed and excludes unexercised contract options and potential orders and also any remaining performance obligations for any sales arrangements that had not fully satisfied the criteria to be considered a contract with a customer pursuant to the requirements of ASC 606.

As of June 30, 2018, all of our fixed price contracts are short-term in nature with a contract term of one year or less.

Practical Expedients and Exemptions

We generally expense sales commissions when incurred because the amortization period would have been one year or less. These costs are recorded within selling, general and administrative expenses.

Many of our services contracts are short-term in nature with a contract term of one year or less. For those contracts, we have utilized the practical expedient in ASC 606-10-50-14 exempting the Company from disclosure of the transaction price allocated to remaining performance obligations if the performance obligation is part of a contract that has an original expected duration of one year or less.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except per share amounts)

Additionally, our payment terms are short-term in nature with settlements of one year or less. We have, therefore, utilized the practical expedient in ASC 606-10-32-18 exempting the Company from adjusting the promised amount of consideration for the effects of a significant financing component given that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

Further, in many of our service contracts we have a right to consideration from a customer in an amount that corresponds directly with the value to the customer of our performance completed to date (for example, a service contract in which we bill a fixed amount for each hour of service provided). For those contracts, we have utilized the practical expedient in ASC 606-10-55-18, which allows us to recognize revenue in the amount for which we have the right to invoice.

Accordingly, we do not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts for which we recognize revenue at the amount to which we have the right to invoice for services performed.

NOTE 3: PROPERTY, PLANT AND EQUIPMENT

The components of property, plant and equipment, net are summarized below:

	June 30, 2018	**December 31, 2017**	**Range of Asset Lives**
Buildings and improvements	285	285	7 - 36 years
Leasehold improvements	908	908	2 - 5 years
Equipment	17,343	18,933	2 - 30 years
Furniture, computers and office equipment	1,319	1,245	2 - 8 years
Construction in progress	2,867	2,127	–
Total property, plant and equipment	22,722	23,498	
Less: Accumulated depreciation and amortization	(10,355)	(11,146)	
Property, plant and equipment, net	$12,367	$12,352	

NOTE 4: LONG-TERM DEBT

In January 2018, we financed a new Company vehicle. The financed amount was $67 and is for a term of six years with an interest rate of 0.9%, with monthly payments of $1. The financing company will hold a lien on the vehicle until all payments have been made.

NOTE 5: SHARE-BASED COMPENSATION

On May 2, 2017, we granted 30 shares of restricted stock to an independent director. These shares have a fair value grant price of $1.15 per share, based on the closing price of our common stock on that day. These shares vest over three years in equal tranches on the grant date anniversary, subject to continued service on our Board of Directors. We are amortizing the related share-based compensation of $34.50 over the three-year requisite service period.

For the six months ended June 30, 2018 and 2017, we recognized a total of $10 and $67, respectively, of share-based compensation expense related to restricted stock awards, which is included in selling, general and administrative expenses in the accompanying unaudited condensed consolidated statements of operations. The unamortized estimated fair value of nonvested shares of restricted stock awards was $29 at June 30, 2018. These costs are expected to be recognized as expense over a weighted-average period of 1.37 years.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except per share amounts)

NOTE 6: TREASURY STOCK

On March 26, 2018, the Board of Directors authorized the repurchase of up to $1,000 of the Company's outstanding common stock (the "Repurchase Program"). The Repurchase Program will be funded from cash on hand and cash provided by operating activities.

The time of the purchases and amount of stock purchased will be determined at the discretion of management subject to market conditions, business opportunities and other appropriate factors and may include purchases through one or more broker-assisted plans and methods, including, but not limited to, open-market purchases, privately negotiated transactions and Rule 10b-18 trading plans. The Repurchase Program will expire on March 31, 2019.

As of June 30, 2018, no stock repurchases had been made under the Repurchase Program.

NOTE 7: INCOME TAXES

Income tax expense during interim periods is based on applying the estimated annual effective income tax rate to interim period operations. The estimated annual effective income tax rate may vary from the statutory rate due to the impact of permanent items relative to our pre-tax income, as well as by any valuation allowance recorded. We employ an asset and liability approach that results in the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial basis and the tax basis of those assets and liabilities. A valuation allowance is established when it is more likely than not that some of the deferred tax assets will not be realized. At June 30, 2018 and December 31, 2017 management has recorded a full deferred tax asset valuation allowance.

NOTE 8: COMMITMENTS AND CONTINGENCIES

Litigation

From time to time we are involved in legal proceedings arising from the normal course of business. As of the date of this Report, we are involved in one material legal proceeding. On August 6, 2018, GE Oil and Gas UK Ltd (“GE”) requested that the Company mediate a dispute between the parties in the ICC International Centre for ADR. The dispute involves alleged delays and defects in products manufactured by the Company for GE dating back to 2013. The Company disputes GE’s allegations and intends to vigorously defend itself against these allegations. The total amount in controversy is $2,630,261.08. At this point in the legal process, the loss to the Company is not probable; therefore no liability has been recorded in the Company’s consolidated financial statements.

Operating Leases

We lease certain offices, facilities, equipment and vehicles under non-cancellable operating and capital leases expiring at various dates through 2023.

NOTE 9: EARNINGS PER COMMON SHARE

Basic earnings per share (“EPS”) is calculated by dividing net income (loss) by the weighted-average number of common shares outstanding for the period. Diluted EPS is calculated by dividing net income (loss) by the weighted-average number of common shares and dilutive common stock equivalents (warrants, nonvested stock awards and stock options) outstanding during the period. Diluted EPS reflects the potential dilution that could occur if options to purchase common stock were exercised for shares of common stock and all nonvested stock awards vest.

At June 30, 2018 and 2017, there were no potentially dilutive securities outstanding.

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

The following discussion and analysis provides information that management believes is relevant for an assessment and understanding of our results of operations and financial condition. This information should be read in conjunction with our audited historical consolidated financial statements, which are included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, filed with the Securities and Exchange Commission ("SEC") on March 28, 2018 and our unaudited condensed consolidated financial statements, and notes thereto, included with this Quarterly Report on Form 10-Q ("Report") in Part I. Item 1. "Financial Statements," and is available on the SEC's website.

General

We are an oilfield services company specializing in complex deepwater and ultra-deepwater oil production distribution system support services, serving the worldwide offshore exploration and production industry. Our services and technological solutions include distribution system installation support and engineering services, umbilical terminations, loose-tube steel flying leads, buoyancy products and services, remotely operated vehicles ("ROVs") and toolings. We support subsea engineering, installation, commissioning, and maintenance projects through specialized, highly experienced service teams and engineered technological solutions.

Industry and Executive Outlook

We believe industry demand for our specialized equipment and services is in the early stages of an upward trend, driven by major oil companies and independents that are starting to reinvest in new and existing projects following several years of industry challenges. This trend is susceptible to some bumps in the road as we saw in the second quarter, when work we had expected to perform in the period was pushed into the second half of 2018, resulting in lower revenues than expected. Despite the inevitable delays, we are seeing a variety of signs that support our optimism for the future.

In particular, customers are increasingly contacting us to help them address their maintenance needs, which consists of work that had been deferred in prior periods due to budget constraints. With a clearer and more positive outlook for the industry, oil and gas operators are now moving forward with routine maintenance and upgrade projects that we expect will drive increased demand for our solutions. Additionally, we believe the improvement in operating results we are seeing from many oil industry leaders bodes well for their ability to invest in new offshore projects, which we expect will provide future opportunities for us.

While cost cutting and operational streamlining have been key focus points during the downturn, there has also been an upturn in industry consolidation activity, spanning companies of all sizes. We are increasingly finding ourselves in discussions with other companies about finding ways to work together, often leading to suggestions of consolidating our operations.

Another outcome of the downturn has been the shift in contracting strategy by the super major operators, where they are now looking to award Engineering, Procurement, Construction and Installation ("EPCI") contracts. These EPCI contracts would be issued to the largest service providers, who would then likely subcontract to companies like ours.

Coupling the interest in our company as a consolidation candidate with the shift towards EPCI contracts, we have determined that it is in our shareholders' and the Company's best interest for us to engage an investment bank to assist us as we evaluate our strategic alternatives. There can be no assurance that the exploration of strategic alternatives will result in any transaction or other alternative. We have not set a timetable for completion of the process, and do not intend to comment further regarding the process unless a specific transaction or other alternative is approved by the Board of Directors, the process is concluded, or it is otherwise determined that further disclosure is appropriate or required by law.

In the meantime, we continue to work with our committed employees and supportive supplier base to provide unique solutions for our customers, while maximizing our shareholders' value, aided in no small part by our continued strong balance sheet. With a committed backlog of about $15 million, we continue to view the future as being exceedingly bright for the company.

Results of Operations

Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

Revenues. Revenues for the three months ended June 30, 2018 were $4,104 compared to revenues of $5,379 for the three months ended June 30, 2017. The $1,275, or 24 percent, decrease was primarily the result of fewer projects in process in 2018.

Gross profit. Gross profit for the three months ended June 30, 2018 was $1,651, or 40 percent of revenues, compared to $2,663, or 50 percent of revenues, for the three months ended June 30, 2017. The $1,012 decrease in gross profit, or 10 percent decrease in gross profit percentage, respectively, was due to lower revenues in the three months ended June 30, 2018, compared to a larger proportion of higher-margin service projects in the three months ended June 30, 2017, which resulted in above average margins.

Selling, general and administrative expenses. Selling, general and administrative (“SG&A”) expenses were $1,745, or 43 percent of revenues, for the three months ended June 30, 2018 compared to $2,223, or 41 percent of revenues, for the three months ended June 30, 2017. The $478 decrease in 2018 resulted primarily from a $313 decrease in SG&A labor as a result of personnel reductions, and a $77 decrease in legal and professional fees, as well as the impact of other cost cutting measures. The increase in SG&A expense as a percent of revenues was due to lower revenues during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017.

Modified EBITDA. Our management evaluates our performance based on a non-GAAP measure which consists of earnings (net income or loss) available to common shareholders before net interest income, income taxes, non-cash share-based compensation expense, non-cash impairments, depreciation and amortization, other non-cash items and one-time charges (“Modified EBITDA”). This measure may not be comparable to similarly titled measures employed by other companies and is not a measure of performance calculated in accordance with US GAAP. The measure should not be considered in isolation or as a substitute for operating income or loss, net income or loss, cash flows provided by operating, investing or financing activities, or other cash flow data prepared in accordance with US GAAP. The amounts included in the Modified EBITDA calculation, however, are derived from amounts included in the accompanying unaudited condensed consolidated statements of operations.

We believe Modified EBITDA is useful to investors in evaluating our operating performance because it is widely used to measure a company’s operating performance, which can vary substantially from company to company depending upon accounting methods and book value of assets, financing methods, capital structure and the method by which assets were acquired. It helps investors more meaningfully evaluate and compare the results of our operations from period to period by removing the impact of our capital structure (primarily interest); asset base (primarily depreciation and amortization); actions that do not affect liquidity (share-based compensation expense from our operating results; and it helps investors identify items that are within our operational control. Depreciation and amortization charges, while a component of operating income, are fixed at the time of the asset purchase or acquisition in accordance with the depreciable lives of the related asset and as such are not a directly controllable period operating charge.

The following is a reconciliation of net income to Modified EBITDA for the three months ended June 30, 2018 and 2017:

	Three Months Ended June 30,	
	2018	2017
Net income	$292	$476
Deduct gain on sale of assets	(439)	(14)
Deduct interest income, net	(10)	(12)
Add depreciation and amortization	300	402
Add income tax expense	5	5
Add share-based compensation	5	33
Modified EBITDA	$153	$890

Modified EBITDA was $153 for the three months ended June 30, 2018 compared to Modified EBITDA of $890 for the three months ended June 30, 2017. The $737 decrease in Modified EBITDA was due primarily to the decrease in net income, which was driven by the previously discussed decreased revenues, an increase in gain on sale of assets, and decreases in depreciation and amortization, and share-based compensation costs during the three months ended June 30, 2018.

Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017

Revenues. Revenues for the six months ended June 30, 2018 were $7,810 compared to revenues of $10,987 for the six months ended June 30, 2017. The $3,177, or 29 percent, decrease was primarily the result of fewer projects in process in 2018.

Gross profit. Gross profit for the six months ended June 30, 2018 was $2,785, or 36 percent of revenues, compared to $5,307, or 48 percent of revenues, for the six months ended June 30, 2017. The $2,522 decrease in gross profit, or 12 percent decrease in gross profit percentage, respectively, was due to lower revenues in the three months ended June 30, 2018, compared to a larger proportion of higher-margin service projects in the six months ended June 30, 2017, which resulted in above average margins.

Selling, general and administrative expenses. SG&A expenses were $3,662, or 47 percent of revenues, for the six months ended June 30, 2018 compared to $4,732, or 43 percent of revenues, for the six months ended June 30, 2017. The $1,070 decrease in 2018 resulted primarily from a $575 decrease in SG&A labor, as a result of personnel reductions, and a $212 decrease in legal and professional fees, as well as the impact of other cost cutting measures. The percent of revenues increase was due to lower revenues during the first six months of 2018 as compared to the first six months of 2017.

Modified EBITDA. As noted above, our management evaluates our performance based on Modified EBITDA. This measure may not be comparable to similarly titled measures employed by other companies and is not a measure of performance calculated in accordance with GAAP. The measure should not be considered in isolation or as a substitute for operating income or loss, net income or loss, cash flows provided by operating, investing or financing activities, or other cash flow data prepared in accordance with GAAP. The amounts included in the Modified EBITDA calculation, however, are derived from amounts included in the accompanying condensed consolidated statements of operations.

The following is a reconciliation of net (loss) income to Modified EBITDA for the six months ended June 30, 2018 and 2017:

	Six Months Ended June 30,	
	2018	2017
Net (loss) income	$(558)	$541

Deduct gain on sale of assets	(439)	(14)
Deduct interest income, net	(19)	(26)
Add depreciation and amortization	725	791
Add income tax expense	10	10
Add share-based compensation	10	67
Modified (EBITDA loss) EBITDA	$(271)	$1,369

Modified EBITDA loss was $(271) for the six months ended June 30, 2018 compared to Modified EBITDA of $1,369 for the six months ended June 30, 2017. The $1,640 decrease in Modified EBITDA was due primarily to the decrease in net income, which was driven by the previously discussed decreased revenues, an increase in gain on sale of assets, and decreases in depreciation and amortization, and share-based compensation costs during the six months ended June 30, 2018.

Liquidity and Capital Resources

During the six months ended June 30, 2018 and June 30, 2017, we primarily financed our operating and capital needs through cash on hand and cash we generated from operations. However, in January 2018, we financed a new company vehicle. The financed amount was $67 and is for a term of six years with an interest rate of 0.9%, with monthly payments of $1. The financing company will hold a lien on the vehicle until all payments have been made.

During the six months ended June 30, 2018, our trade accounts receivable increased by $632, impacting our cash position which declined by $1,516. This increase in trade accounts receivable reflected efforts by some of our larger customers to lengthen vendor payment terms, a situation we expect to be resolved in the coming months. The decline in cash was also a result of a $667 decrease in our accounts payable and accrued liabilities.

Through a combination of cash generated from operations, opportunistic sales of non-core equipment, and reductions in our administrative costs and capital investments budget, we believe we will have adequate liquidity to meet our future operating requirements. However, in light of the decline in our working capital, we are also actively engaged in discussions with different financial institutions, with the intention of establishing a line of credit to further supplement our operating requirements.

To the extent our then current and forecasted liquidity allows, we will continue to repurchase our common stock. See “Share Repurchase Program” below for additional information.

Inflation and Seasonality

We do not believe that our operations are significantly impacted by inflation. Our business is not significantly seasonal in nature.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

Critical Accounting Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. The most significant estimates used in our financial statements relate to revenue recognition where we use percentage-of-completion accounting on our large fixed-price contracts, the allowance for doubtful accounts, and the valuation allowance for deferred income tax assets. These estimates require judgments, which we base on historical experience and on various other assumptions, as well as specific circumstances. Estimates may change as new events occur, additional information becomes available or operating environments change.

Refer to Part II. Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations," in our Annual Report on Form 10-K for the year ended December 31, 2017 for a discussion of our critical accounting policies and estimates.

Recently Issued Accounting Standards

Except as set forth in Note 1 to our unaudited condensed consolidated financial statements, management has not yet determined whether recently issued accounting standards, which are not yet effective, will have a material impact on our condensed consolidated financial statements upon adoption.

Share Repurchase Program

On March 26, 2018, the Board of Directors authorized the repurchase of up to $1,000 of the Company's outstanding common stock (the "Repurchase Program"). The Repurchase Program will be funded from cash on hand and cash provided by operating activities.

The time of the purchases and amount of stock purchased will be determined at the discretion of management subject to market conditions, business opportunities and other appropriate factors and may include purchases through one or more broker-assisted plans and methods, including, but not limited to, open-market purchases, privately negotiated transactions and Rule 10b5-1 trading plans. The Repurchase Program will expire on March 31, 2019.

As of June 30, 2018, no stock repurchases had been made under the Repurchase Program.

Recent Events

On July 31, 2018, we announced that our Board of Directors had initiated a review of our strategic alternatives to maximize shareholder value, including a potential sale of the Company. We have engaged the GulfStar Group, LLC as financial advisor and Gray, Reed & McGraw, LLP as legal advisor to assist in the process.

There can be no assurance that the exploration of strategic alternatives will result in any transaction or other alternative. We have not set a timetable for completion of the process, and we do not intend to comment further regarding the process unless a specific transaction or other alternative is approved by the Board of Directors, the process is concluded, or it is otherwise determined that further disclosure is appropriate or required by law.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not Applicable

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. The Company's disclosure controls and procedures are designed to ensure that such information required to be disclosed by the Company in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. The Company's disclosure controls and procedures are also designed to ensure that such information is accumulated and communicated to management, including the principal executive and the principal financial officer, as appropriate to allow timely decisions regarding required disclosures. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance that control objectives are attained. The Company's disclosure controls and procedures are designed to provide such reasonable assurance.

The Company's management, with the participation of the principal executive and principal financial officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of June 30, 2018, as required by Rule 13a-15(e) of the Exchange Act. Based upon that evaluation, the principal executive and the principal financial officer have concluded that the Company's disclosure controls and procedures were effective as of June 30, 2018.

Management's Report on Internal Control Over Financial Reporting. The Company's management is responsible for establishing and maintaining adequate internal controls over financial reporting, as defined in Rule 13a-15(f) of the Exchange Act. Although the internal controls over financial reporting were not audited, the Company's management, including the principal executive and principal financial officer, assessed the effectiveness of internal controls over financial reporting as of June 30, 2018, based on criteria issued in 2013 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) entitled *"Internal Control-Integrated Framework."* Upon evaluation, the Company's management has concluded that the Company's internal controls over financial reporting were effective as of June 30, 2018.

Changes in Internal Control Over Financial Reporting. The Company's management, with the participation of the principal executive and principal financial officer, have concluded there were no changes in internal control during the fiscal quarter ended June 30, 2018.

PART II. – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time we are involved in legal proceedings arising from the normal course of business. As of the date of this Report, we are involved in one material legal proceeding. On August 6, 2018, GE Oil and Gas UK Ltd ("GE") requested that the Company mediate a dispute between the parties in the ICC International Centre for ADR. The dispute involves alleged delays and defects in products manufactured by the Company for GE dating back to 2013. The Company disputes GE's allegations and intends to vigorously defend itself against these allegations. The total amount in controversy is $2,630,261.08. At this point in the legal process, the loss to the Company is not probable; therefore no liability has been recorded in the Company's consolidated financial statements.

ITEM 1A. RISK FACTORS

We recently announced a process to explore and evaluate strategic alternatives to maximize stockholder value, which may result in the use of a significant amount of our management resources or significant costs, and we may not be able to achieve any particular outcome or to fully realize the potential benefit of such alternatives.

In July 2018, we announced that the Board of Directors is conducting a process to explore and evaluate strategic alternatives to maximize stockholder value. The Board has not made any decisions related to any strategic alternatives at this time. No assurances can be made with regard to the timeline for completion of the strategic review, or whether the review will result in any particular outcome. This process may divert the attention of management and cause us to incur various expenses, whether or not any particular outcome is achieved. This process could also negatively impact our relationships with our customers and employees.

ITEM 6. EXHIBITS

Exhibits required to be attached by Item 601 of Regulation S-K are listed in the Index to Exhibits of this Quarterly Report on Form 10-Q, which is incorporated herein 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.

DEEP DOWN, INC.
(Registrant)

Date: August 8, 2018

By: /s/ Ronald E. Smith
Ronald E. Smith
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Charles K. Njuguna
Charles K. Njuguna
Chief Financial Officer
(Principal Financial Officer)

By: /s/ Matthew A. Auger
Matthew A. Auger
Controller
(Principal Accounting Officer)

INDEX TO EXHIBITS

31.1*	Certification of Ronald E. Smith, President and Chief Executive Officer, furnished pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2*	Certification of Charles K. Njuguna, Chief Financial Officer, furnished pursuant to Rules 13a-14 and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32*	Statement of Ronald E. Smith, President and Chief Executive Officer and Charles K. Njuguna, Chief Financial Officer, furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Schema Document
101.CAL*	XBRL Calculation Linkbase Document
101.DEF*	XBRL Definition Linkbase Document
101.LAB*	XBRL Label Linkbase Document
101.PRE*	XBRL Presentation Linkbase Document

* Filed or furnished herewith.