VERITAS DGC INC
Form 10-Q
June 13, 2002

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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FORM 10-Q

(MARK ONE)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED APRIL 30, 2002

OR

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

FOR THE TRANSITION PERIOD FROM ________ TO ________

COMMISSION FILE NUMBER 1-7427

VERITAS DGC INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| DELAWARE<br>(State or other jurisdiction of incorporation or organization) | 76-0343152<br>(I.R.S. Employer Identification No.) |
| 10300 TOWN PARK<br>HOUSTON, TEXAS<br>(Address of principal executive offices) | 77072<br>(Zip Code) |

(832) 351-8300
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

| TITLE OF EACH CLASS | NAME OF EACH EXCHANGE ON WHICH REGISTERED |
|---|---|
| Common Stock, $.01 par Value | New York Stock Exchange |
| Preferred Stock Purchase Rights | New York Stock Exchange |

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

The number of shares of the Company's common stock, $.01 par value, outstanding at May 31, 2002 was 32,540,037 (including 1,446,641 Veritas Energy Services Inc. exchangeable shares which are identical to the Common Stock in all material respects).

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VERITAS DGC INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(UNAUDITED)

| | THREE MONTHS ENDED APRIL 30, | |
|---|---|---|
| | 2002 | 2001 |
| | (In thousands, exce | |
| Revenues | $ 109,267 | $ 126,617 |
| Costs and expenses: | | |
| Cost of services | 67,624 | 84,401 |
| Research and development | 2,846 | 2,701 |
| Depreciation and amortization | 17,458 | 17,128 |
| Selling, general and administrative | 5,854 | 7,026 |
| Merger costs | 1,658 | |
| Argentina devaluation and shutdown costs | (1,324) | |
| Operating income | 15,151 | 15,361 |
| Interest expense | 2,771 | 3,483 |
| Other income-net | (103) | (1,468) |
| Income before provision for income taxes | 12,483 | 13,346 |
| Provision for income taxes | 4,438 | 4,962 |
| Net income | $ 8,045 | $ 8,384 |
| Other comprehensive income (net of tax , $0 in all periods): | | |
| Net income | $ 8,045 | $ 8,384 |
| Foreign currency translation adjustments | 2,557 | (2,438) |
| Unrealized gain (loss) on investments-available for sale | (219) | (1,767) |
| Unrealized gain (loss) on foreign currency hedge | 212 | (488) |
| Total comprehensive income | $ 10,595 | $ 3,691 |
| PER SHARE: | | |
| BASIC: | | |
| Net income per common share | $ .25 | $ .26 |
| Weighted average common shares | 32,446 | 31,860 |
| DILUTED: | | |
| Net income per common share | $ .25 | $ .26 |
| Weighted average common shares | 32,639 | 32,627 |

See Notes to Consolidated Financial Statements

VERITAS DGC INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In thousands, except par value)

ASSETS

Current assets:
  Cash and cash equivalents ..........
  Accounts and notes receivable (net of allowance for doubtful accounts:
   April $1,122;  July $709) ..........
  Materials and supplies inventory ..........
  Prepayments and other ..........
  Income taxes receivable ..........
  Investments -- available for sale ..........

      Total current assets ..........
Property and equipment ..........
Less accumulated depreciation ..........

      Property and equipment -- net ..........
Multi-client data library ..........
Investment in and advances to joint ventures ..........
Goodwill (net of accumulated amortization: April $6,827; July $6,844) ..........
Deferred tax asset ..........
Long term notes receivable (net of allowance: April $996; July 0) ..........
Other assets ..........

      Total ..........

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:
  Accounts payable -- trade ..........
  Accrued interest ..........
  Other accrued liabilities ..........

      Total current liabilities ..........
Non-current liabilities:
  Long-term debt ..........
  Deferred tax liability ..........
  Other non-current liabilities ..........

      Total non-current liabilities ..........
Stockholders' equity:
   Common stock, $.01 par value; authorized: 40,000,000 shares; issued: 31,123,358 shares at
   April and 30,920,550 shares at July (excluding Exchangeable Shares of 1,449,141 at April and
   1,484,948 at July) ..........
  Additional paid-in capital ..........
  Accumulated earnings (from August 1, 1991 with respect to Digicon Inc.) ..........
  Accumulated other comprehensive income:
   Cumulative foreign currency translation adjustment ..........
   Unrealized loss on investments -- available for sale ..........
   Unrealized loss on foreign currency hedge ..........
Unearned compensation ..........

| | |
|---|---|
| Treasury stock, at cost; 74,614 shares at April and 65,296 at July ........................... | |
| Total stockholders' equity ................................................................... | |
| Total ............................................................................... | |

See Notes to Consolidated Financial Statements

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VERITAS DGC INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | NINE MONTHS END APRIL 30, | |
|---|---|---|
| | 2002 | 2 |
| | (IN THOUSANDS) | |
| Operating activities: | | |
| Net income ............................................................ | $ 23,367 | $ |
| Non-cash items included in net income: | | |
| Depreciation and amortization (other than multi-client) ........... | 51,499 | |
| Amortization of multi-client library ............................... | 89,567 | |
| Gain on disposition of property and equipment ..................... | (1,655) | |
| Equity in loss of 50% or less-owned companies and joint ventures ... | (267) | |
| Deferred taxes ..................................................... | 170 | |
| Amortization of unearned compensation .............................. | 517 | |
| Change in operating assets/liabilities: | | |
| Accounts and notes receivable ...................................... | 20,541 | ( |
| Materials and supplies inventory ................................... | 648 | |
| Prepayments and other .............................................. | (1,066) | |
| Income tax receivable .............................................. | 4,669 | |
| Accounts payable and other accrued liabilities ..................... | (21,238) | |
| Income taxes payable ............................................... | | |
| Other non-current liabilities ...................................... | 149 | |
| Other assets ....................................................... | 922 | |
| Other .............................................................. | 1,721 | |
| Total cash provided by operating activities ................... | 169,544 | 1 |
| Investing activities: | | |
| Increase in restricted cash investments ............................ | | |
| Investment in multi-client library ................................. | (148,210) | (1 |
| Acquisitions, net of cash received ................................. | | |
| Sale of Brigham Exploration Company Stock .......................... | | |
| Purchase of property and equipment ................................. | (72,060) | ( |
| Sale of property and equipment ..................................... | 4,489 | |
| Total cash used by investing activities ....................... | (215,781) | (1 |
| Financing activities: | | |
| Payments of long-term debt ......................................... | | |
| Net proceeds from sale of common stock ............................. | 2,055 | |

| | | |
|---|---|---|
| Total cash provided by financing activities | 2,055 | |
| Currency loss on foreign cash | (184) | |
| Change in cash and cash equivalents | (44,366) | |
| Beginning cash and cash equivalents balance | 69,218 | |
| Ending cash and cash equivalents balance | $ 24,852 | $ |

See Notes to Consolidated Financial Statements



VERITAS DGC INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

CONSOLIDATION

The accompanying consolidated financial statements include our accounts and the accounts of majority-owned domestic and foreign subsidiaries. Investment in an 80% owned joint venture is accounted for on the equity method due to provisions in the joint venture agreement that give minority shareholders the right to exercise control. All material intercompany balances and transactions have been eliminated. All material adjustments consisting only of normal recurring adjustments that, in the opinion of management, are necessary for a fair statement of the results for the interim periods have been reflected. These interim financial statements should be read in conjunction with our annual consolidated financial statements.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

RECLASSIFICATION OF PRIOR YEAR BALANCES

Certain prior year balances have been reclassified for consistent presentation.

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141 (Business Combinations) and SFAS No. 142 (Goodwill and Other Intangible Assets). We adopted SFAS No. 141 upon its issuance, and we adopted SFAS No. 142 as of August 1, 2001. The main effect of SFAS No. 141 is to require purchase accounting to be used in all future business combinations, disallowing the pooling-of-interests method allowed under APB Opinion No.16. SFAS No. 142

defines the booking and subsequent treatment of goodwill and other intangible assets derived from business combinations and supersedes APB Opinion No.17. This statement requires us to discontinue amortization of goodwill and requires that we test goodwill and other intangible assets for impairment in a specific manner on an annual basis or when certain events trigger such a test. We completed our initial evaluation of goodwill in January 2002 and found no impairment.

In August 2001, the Financial Accounting Standards Board issued SFAS No.143 (Asset Retirement Obligations). This standard requires that obligations associated with the retirement of a tangible long-lived asset be recorded as a liability when those obligations are incurred with the liability being initially measured at fair value. We will adopt the use of this accounting statement in fiscal 2003. We have not yet completed our evaluation of the effect of this statement on our accounting practices.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144 (Accounting for the Impairment or Disposal of Long Lived Assets). This standard develops one accounting model for long-lived assets that are to be disposed of by sale, requiring such assets to be measured at the lower of book value or fair value less cost to sell. The standard also provides guidance on the recognition of liabilities for the obligations arising from disposal activities. We will adopt the use of this accounting statement in fiscal 2003. We have not yet completed our evaluation of the effect of this statement on our accounting practices.

In April 2002, the Financial Accounting Standards Board issued SFAS No. 145 (Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections as of April 2002). We will adopt the use of this accounting statement in fiscal 2003. We have not yet completed our evaluation of the effect of this statement on our accounting practices.





2. MERGER

On November 26, 2001, Petroleum Geo-Services ASA, a Norwegian public limited liability company ("PGS"), Veritas DGC Inc., a Delaware corporation ("Veritas"), Venus I, a Cayman Islands exempted company and a direct, wholly owned subsidiary of Veritas ("Caymanco"), Venus Holdco Inc., a Delaware corporation and an indirect, wholly owned subsidiary of Caymanco ("Veritas Holdco"), and Venus Mergerco Inc., a Delaware corporation and a direct, wholly owned subsidiary of Veritas Holdco ("Veritas Merger Sub"), entered into an Agreement and Plan of Merger and Exchange Agreement (the "Agreement"), whereby, subject to the conditions stated therein, (i) Caymanco will make an offer (the "Exchange Offer") to issue ordinary shares, par value $0.01 per share, of Caymanco ("Caymanco Shares") in exchange for the issued and outstanding ordinary shares, nominal value NOK 5 per share, of PGS ("PGS Shares") and all issued and outstanding American Depositary Shares representing such PGS Shares ("PGS ADSs"), at an exchange ratio of 0.47 Caymanco Shares for each PGS Share and each PGS ADS; and (ii) immediately following the closing of the Exchange Offer, Veritas Merger Sub will be merged with and into Veritas (the "Merger" and, together with the Exchange Offer, the "Combination"), pursuant to which shares of common stock, par value $0.01 per share, of Veritas ("Veritas Common Stock") will be converted into Caymanco Shares on a one-for-one basis and certain shares that are exchangeable for shares of Veritas Common Stock will become exchangeable for Caymanco Shares. Upon closing of the Combination, which is expected to occur before the end of fiscal 2002, PGS and Veritas would become subsidiaries of Caymanco. Under the terms of the agreement, PGS shareholders would hold approximately 60% of the shares to be issued by Caymanco, and Veritas shareholders would hold approximately 40% of such shares.

Due to the inability of the parties to meet certain conditions to close, PGS and Veritas have entered into further negotiations and may arrive at an amended merger agreement, which would be subject to approval by the boards of each of the companies involved. There can be no assurance that such an amendment will be developed or approved.

During the nine months ended April 30, 2002, we spent $4.4 million on merger related items, including investment banking, legal and accounting services.

## 3. ARGENTINA DEVALUATION AND SHUTDOWN COSTS

On January 4th, 2002, Argentina devalued its currency, ending a ten-year period of parity with the U.S. dollar. At the same time, the Argentine government instituted sweeping law changes, including outlawing pricing linked to outside currencies and changing significant amounts of dollar-denominated consumer debt into peso-denominated debt on a 1-to-1- basis.

The law eliminating dollar-denominated pricing affected us negatively, as we previously had very little financial exposure to the peso due to our contracting methods. This change put all of our accounts receivable in Argentina at risk during the period of devaluation, resulting in a $0.1 million loss for the nine months ended April 30, 2002. For the current quarter we have recorded a gain of $1.3 million, which reflects recovery of certain receivables that were previously reserved due to their doubtful collection.

Our customers severely curtailed their operations in Argentina leading us to do the same, resulting in the severance of most of our employees and redeployment of our equipment. The severance and redeployment costs are estimated to be $0.9 million and have been included in the operating expense section of our income statement.

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VERITAS DGC INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

## 4. OTHER INCOME-NET

Other income-net consists of the following:

| | THREE MONTHS ENDED APRIL 31, | |
|---|---|---|
| | 2002 | 2001 |
| | (IN THOUSA | |

| | | |
|---|---|---|
| Interest income | $ (169) | $ (1,424) |
| Net (gain) loss on disposition of property and equipment | 38 | 4 |
| Net gain on sale of Air-Jac division | | |
| Net foreign currency exchange gain (loss) | 367 | (141) |
| (Gain)/loss from unconsolidated joint venture | (321) | 127 |
| Other | (18) | (34) |
| Total | $ (103) | $ (1,468) |

5. EARNINGS PER COMMON SHARE

Basic and diluted earnings per common share are computed as follows:

| | THREE MONTHS ENDED APRIL 30, | |
|---|---|---|
| | 2002 | 2001 |
| | (IN THOUSANDS, EX | |
| Net income | $ 8,045 | $ 8,384 |
| Basic: | | |
| Weighted average common shares (including exchangeable shares) | 32,446 | 31,860 |
| Net income per share | $ .25 | $ .26 |
| Diluted: | | |
| Weighted average common shares (including exchangeable shares) | 32,446 | 31,860 |
| Shares issuable from assumed conversion of options | 193 | 767 |
| Total | 32,639 | 32,627 |
| Net income per share | $ .25 | $ .26 |

The following options to purchase common shares have been excluded from the computation assuming dilution because the options' exercise prices exceed the average market price of the underlying common shares.

| | THREE MONTHS ENDED APRIL 30, | | |
|---|---|---|---|
| | 2002 | 2001 | 20 |
| Number of options | 1,338,676 | 404,840 | 1 |
| Exercise price range | $16.3125 - $55.125 | $31.50 - $55.125 | $15.625 - |
| Expiring through | March 2011 | March 2011 | M |

VERITAS DGC INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

6. UNREALIZED LOSS ON INVESTMENTS -- AVAILABLE FOR SALE

In April 1999, we exchanged a $4.7 million account receivable from Miller Exploration Company ("Miller"), a publicly traded company, for a long-term note receivable bearing 18% interest. Effective October 15, 2000, the note bears interest at 9-3/4%. Interest is paid in Miller common stock warrants, with an exercise price of $0.01 per share, in advance, at six-month intervals.

| | APRIL 30, 2002 | | | JULY 31, | |
|---|---|---|---|---|---|
| | COST BASIS | UNREALIZED (LOSS)/GAIN | FAIR VALUE | COST BASIS | UNREAL (LOSS) |
| | | | (IN THOUSANDS) | | |
| Miller stock and warrants | 1,501 | (963) | 538 | 1,501 | ( |

7. GOODWILL

In July 2001, the Financial Accounting Standards Board issued SFAS No. 142 (Goodwill and Other Intangible Assets). We adopted SFAS No. 142 as of August 1, 2001. SFAS No. 142 defines the accounting treatment of goodwill and other intangible assets derived from business combinations and supersedes APB Opinion No. 17. This statement requires us to discontinue amortization of goodwill and requires that we test goodwill and other intangible assets for impairment in a specific manner on an annual basis or when certain events trigger such a test. The following is the pro forma effect of implementing SFAS No. 142.

| | THREE MONTHS ENDED APRIL 30, | | NINE MONTHS ENDED APRIL 30, | |
|---|---|---|---|---|
| | 2002 | 2001 | 2002 | 2001 |
| | (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) | | | |
| Reported net income .................. | $ 8,045 | $ 8,384 | $ 23,367 | $ 20, |
| Goodwill amortization ................ | | 521 | | 1, |
| Adjusted net income .................. | $ 8,045 | $ 8,905 | $ 23,367 | $ 22, |
| Earnings per share: | | | | |
| Basic: | | | | |
| Reported net income per share ...... | $ .25 | $ .26 | $ .72 | $ |
| Goodwill amortization per share .... | | .02 | | |
| Adjusted net income per share ...... | $ .25 | $ .28 | $ .72 | $ |
| Diluted: | | | | |
| Reported net income per share ...... | $ .25 | $ .26 | $ .72 | $ |

| | | | | |
|---|---|---|---|---|
| Goodwill amortization per share ... | | .02 | | |
| Adjusted net income per share ...... | $ .25 | .$.28 | $ .72 | $ |



VERITAS DGC INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

8. HEDGE TRANSACTION

In March 2001, we entered into a contract requiring payments in Norwegian kroner to charter the seismic vessel M/V Seisquest. The contract requires 36 monthly payments commencing on June 1, 2001. To protect our exposure to exchange rate risk, we entered into multiple forward contracts as cash flow hedges effectively locking our exchange rate for Norwegian kroner to the U.S. dollar. The unrealized loss on the hedge transaction is summarized below:

| | APRIL 30, 2002 | | | JULY 31, 2001 | | |
|---|---|---|---|---|---|---|
| | FORWARD VALUE | UNREALIZED LOSS | FAIR VALUE | FORWARD VALUE | UNREALIZED LOSS | F |
| | | | (IN THOUSANDS) | | | |
| Forward contracts | $ 7,018 | $ (186) | $ 6,832 | $ 9,183 | $ (421) | $ |

9. SEGMENT INFORMATION

We have two segments, land and marine operations, both of which provide geophysical products and services to the petroleum industry. The two segments have been aggregated, as they are similar in their economic characteristics and the nature of their products, production processes and customers. A reconciliation of the reportable segments' results to those of the total enterprise is given below.

| | THREE MONTHS ENDED APRIL 30, 2002 | | | |
|---|---|---|---|---|
| | SEGMENTS | CORPORATE | TOTAL | SEGME |
| | | | (IN THOUSANDS) | |
| Revenues ................................. | $ 109,267 | | $ 109,267 | $ 126 |
| Operating income (loss) ................... | 24,663 | $ (9,512) | 15,151 | 24 |
| Income (loss) before provision for | | | | |

| | | | | |
|---|---|---|---|---|
| income taxes............................. | 24,686 | (12,203) | 12,483 | 24 |

| | NINE MONTHS ENDED APRIL 30, 2002 | | | |
|---|---|---|---|---|
| | SEGMENTS | CORPORATE | TOTAL | SEGME |
| | | | (IN THOUSANDS) | |
| Revenues .................................. | $ 350,268 | x | $ 350,268 | $ 372 |
| Operating income (loss) ................... | 72,734 | $ (27,687) | 45,047 | 65 |
| Income (loss) before provision for income taxes ............................ | 74,582 | (37,043) | 37,539 | 65 |

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

This report contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of certain factors. These factors are more fully described in other reports filed with the Securities and Exchange Commission, including our fiscal year 2001 Form 10-K, and include changes in market conditions in the oil and gas industry as well as declines in prices of oil and gas.

GENERAL

We have enjoyed a reasonable quarter in an uncertain environment. While commodity prices have strengthened on tensions in the Middle East, overall economic uncertainty seems to be reducing confidence in the sustainability of those prices. Oil company mergers continue unabated and we believe these are having a short to medium term negative impact on the exploration sector. The general expectation that oil and gas companies will spend less in 2002 on exploration and development activities is still likely to be true.

In the multi-client side of the business, we continue to see excellent results in the Gulf of Mexico and onshore Canada. Other areas, especially the land U.S. market, have been slow despite relatively strong commodity prices. In the contract side of the business, we are seeing some signs of improvement but we continue to see contract work won at substantially below what we consider to be sustainable pricing in certain markets. We are concerned that the current over-capacity in the industry will limit recovery in this area.

Our earnings estimate for fiscal year 2002 is within the range of $1.00 to $1.20 per share, as previously reported, although our current expectation is toward the lower end of the range. This estimate excludes unusual charges for Argentina devaluation and shutdown cost, and costs related to our pending merger with Petroleum Geo-Services ASA.

RESULTS OF OPERATIONS

THREE MONTHS ENDED APRIL 30, 2002 COMPARED WITH THREE MONTHS ENDED APRIL 30, 2001

Revenues. Revenues decreased by 14% overall. The slight multi-client revenue decrease of 2% was due to lower levels of revenue in Canada onshore and the Gulf of Mexico, mostly offset by higher sales from pre-funding of our Brazil survey and licensing of data on the east coast of Canada and offshore Nigeria. Contract revenue decreased by 22% primarily due to declines in activity onshore U.S. and South America. The South American shortfall was due to the economic and political situation in Argentina, where our customers have essentially ceased their exploration activity.

Operating Income. Operating income increased by 1%, from $15.4 million to $15.2 million. The current quarter income includes unusual charges of $1.7 million for costs related to our proposed merger with PGS and income of $1.3 million for recovery of previously reserved Argentine receivables. Excluding these unusual charges, operating income was $15.5 million. Cost of services as a percentage of revenue decreased from 67% to 62% due to a recovery in proprietary pricing, more efficient acquisition operations and a favorable revenue mix. Multi-client revenues represented 48% of total revenue compared with 43% in the prior year.

Other income-net. Other income-net decreased by $1.3 million. This decrease is primarily due to the decrease in interest income by $1.2 million as a result of lower cash balances and lower interest rates. In addition, currency gains decreased from $0.1 million to a loss of $0.4 million. This is offset by an improvement in our Jakarta joint venture from a loss of $0.1 million to income of $0.3 million.

Provision for income taxes. The effective income tax rate decreased from 37% to 36%. This change is due mainly to the cessation of non-deductible goodwill amortization.



NINE MONTHS ENDED APRIL 30, 2002 COMPARED WITH NINE MONTHS ENDED APRIL 30, 2001

Revenues. Revenues decreased 6% overall. Multi-client revenues decreased 2% and contract revenues decreased 9%. The multi-client business has softened in the first quarter followed by strong sales and high activity on well-funded surveys in the second quarter and a decline in the current quarter due to reduced activity onshore Canada and in the Gulf of Mexico. The decrease in contract revenue was mainly driven by weakness in the contract land business in the US and South America during the second and third quarters.

Operating Income. Operating income increased 12%, from $40.1 million to $45.0 million. Without the unusual charges of $5.5 million related to the merger and Argentina, the increase would be 26%. The largest contributors to this increase were a recovery in proprietary pricing, more efficient acquisition operations and a favorable revenue mix. Multi-client revenues represented 49% of total revenue compared with 47% in the prior year.

Other income-net. Other income-net decreased by $3.3 million primarily due to a $2.8 million decrease in interest income as a result of lower cash balances and lower interest rates. Currency gains decreased from $0.5 million to a loss of $0.3 million. In addition, gain on the sale of fixed assets decreased by $0.7 million. A net $0.6 million gain in the current year from the sale of our transition zone shot-hole drilling business, Air-Jac Drilling, partially offset the interest income and foreign exchange reductions.

Provision for income taxes. The effective income tax rate decreased from 41% to 38% is due to fewer unbenefitted losses in non-U.S. entities in the current year, an addition to the effective tax rate in the prior year as a result of the inability to utilize foreign taxes as credits against U.S. profits, and the cessation of goodwill amortization which is generally not tax deductible.

LIQUIDITY AND CAPITAL RESOURCES

SOURCES AND USES

Our internal sources of liquidity are cash, cash equivalents and cash flow from operations. External sources include public financing, equity sales, the unutilized portion of a revolving credit facility, equipment financing and trade credit. We believe that these sources of funds are adequate to meet our liquidity needs for fiscal 2002.

Net cash provided by operating activities increased from $149.8 million in the first nine months of 2001 to $169.5 million in 2002. Major components of this change were a $2.8 million increase in net income and a $24.4 million favorable change in operating assets and liabilities. Net cash used by investing activities increased from $192.9 million in the first nine months of 2001 to $215.8 million in 2002 due to higher capital spending and investments in multi-client library. We are forecasting capital expenditures for fiscal 2002 of approximately $100 million, which includes expenditures of approximately $60 million to expand or upgrade our marine fleet, including the launching of a new Viking class 3-D vessel, the Veritas Vantage. We are forecasting approximately $210 million in gross spending on our multi-client data library.

We will require substantial cash flow to continue our investment in our multi-client data library, complete our capital expenditure and research and development programs and meet our principal and interest obligations with respect to outstanding indebtedness. While we believe that we have adequate sources of funds to meet our liquidity needs, our ability to meet our obligations depends on our future performance, which, in turn, is subject to many factors beyond our control. Key internal factors affecting future results include utilization levels of acquisition and processing assets and the level of multi-client data library licensing, all of which are driven by the external factors of exploration spending and, ultimately, underlying commodity prices.

Net cash provided by financing activities decreased from $95.1 million in the first nine months of 2001 to $2.1 million in 2002. The prior year includes proceeds from a common stock offering of $82.4 million. As of April 30, 2002, we had $135.0 million in senior notes outstanding due in October 2003. These notes contain a change of control provision allowing the holders to require our redemption of the notes under certain conditions. We also have a revolving credit facility due August 2003 from commercial lenders that provides U.S. advances up to $80.0 million and non-U.S. advances up to $20 million. Advances bear interest, at our election, at LIBOR plus a margin or prime rate plus a margin. These margins are based on either certain of our financial ratios or our credit rating. At April 30, 2002 the LIBOR margin was 1.25% and the prime rate margin was 0%. As of April 30, 2002, there were no outstanding advances under the credit facility, but $7.0 million of the credit facility was utilized for letters of credit, leaving $93.0 million available for borrowings.

CRITICAL ACCOUNTING POLICIES

While all of our accounting policies are important in assuring that Veritas adheres to current accounting standards, certain policies are particularly important due to their impact on our financial statements. These are described in detail below.

MULTI-CLIENT DATA LIBRARY

In the portion of our business known as multi-client data library, we collect and process geophysical data for our own account and retain all ownership rights. We license the data to multiple clients on a non-transferable basis. We capitalize costs associated with acquiring and processing the multi-client data on a survey-by-survey basis (versus a pooled basis). The capitalized cost of multi-client data is charged to cost of services in the period revenue is recognized in an amount equal to the period revenue multiplied by the percentage of total estimated costs to total estimated revenue. Therefore, multi-client margins recognized in any given period are the product of estimated costs and estimated sales and may not reflect the ultimate cash margins recognized from a survey. Any costs remaining 36 months after completion of a survey are charged to cost of services over a period not to exceed 24 months. The maximum amortization period of sixty months represents the period over which the majority of revenues from these surveys are expected to be derived. We periodically review the carrying value of the multi-client data library to assess whether there has been a permanent impairment of value and record losses when it is determined that estimated sales will not be sufficient to cover the carrying value of the asset.

DEFERRED TAX ASSET

Deferred taxes result from the effect of transactions that are recognized in different periods for financial and tax reporting purposes. A valuation allowance is established when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The valuation allowance is then adjusted when the realization of deferred tax assets becomes more likely than not. Adjustments are also made to recognize the expiration of net operating loss and investment tax credit carryforwards, with equal and offsetting adjustments to the related deferred tax asset. Should the income projections result in the conclusion that realization of additional deferred tax assets is more likely than not, further adjustments to the valuation allowance are made.

OTHER ACCOUNTING POLICIES

Since our quasi-reorganization on July 31, 1991 with respect to Digicon Inc., the tax benefits of net operating loss carry-forwards existing at the date of the quasi-reorganization have been recognized through a direct addition to additional paid-in capital, when realization is more likely than not. Additionally, the utilization of the net operating loss carry-forwards existing at the date of the quasi-reorganization is subject to certain limitations. For the nine months ended April 30, 2002, we recognized $2.1 million related to these benefits.

We receive some account receivable payments in foreign currency. We currently do not conduct a hedging program for accounts receivable because we do not consider our current exposure to foreign currency fluctuations to be significant. We have hedged certain future charter payments to be made in a foreign currency.

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141 (Business Combinations) and SFAS No. 142 (Goodwill and Other Intangible Assets). We adopted SFAS No. 141 upon its issuance, and we adopted SFAS No. 142 as of August 1, 2001. The main effect of SFAS No. 141 is to require purchase accounting to be used in all future business combinations, disallowing the pooling-of-interests method allowed under APB Opinion No.16. SFAS No. 142 defines the booking and subsequent treatment of goodwill and other intangible assets derived from business combinations and supersedes APB Opinion No.17. This statement requires us to discontinue amortization of goodwill and requires that we test goodwill and other intangible assets for impairment in a specific manner on an annual basis or when certain events trigger such a test. We completed our initial evaluation of goodwill in January 2002 and found no impairment.

In August 2001, the Financial Accounting Standards Board issued SFAS No.143 (Asset Retirement Obligations). This standard requires that obligations associated with the retirement of a tangible long-lived asset be recorded as a liability when those obligations are incurred with the liability being initially measured at fair value. We will adopt the use of this accounting statement in fiscal 2003. We have not yet completed our evaluation of the effect of this statement on our accounting practices.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144 (Accounting for the Impairment or Disposal of Long Lived Assets). This standard develops one accounting model for long-lived assets that are to be disposed of by sale,



requiring such assets to be measured at the lower of book value or fair value less cost to sell. The standard also provides guidance on the recognition of liabilities for the obligations arising from disposal activities. We will adopt the use of this accounting statement in fiscal 2003. We have not yet completed our evaluation of the effect of this statement on our accounting practices.

In April 2002, the Financial Accounting Standards Board issued SFAS No. 145 (Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections as of April 2002). We will adopt the use of this accounting statement in fiscal 2003. We have not yet completed our evaluation of the effect of this statement on our accounting practices.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES REGARDING MARKET RISK

At April 30, 2002, we had limited market risk related to foreign currencies. In March 2001, we entered into a contract requiring payments in Norwegian kroner to charter the seismic vessel M/V Seisquest. The contract requires 36 monthly payments commencing on June 1, 2001. To protect our exposure to exchange rate risk, we entered into multiple forward contracts as cash flow hedges fixing our exchange rates for Norwegian kroner to the U.S. dollar. The total fair value of the open forward contracts at April 30, 2002 in U.S. dollars is $6.8 million.

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

No items were submitted during the quarter.

# PART II. OTHER INFORMATION

## ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a) EXHIBITS FILES WITH THIS REPORT:

| EXHIBIT NO. | | DESCRIPTION |
|---|---|---|
| 2-A | -- | Agreement and Plan of Merger and Exchange Agreement dated November 26, 2001, among Petroleum Geo-Services ASA, Veritas DGC Inc., Venus I, Venus Holdco Inc. and Venus Mergerco Inc. (Exhibit 2.1 to Veritas DGC Inc.'s Current Report on Form 8-K filed November 28, 2001 is incorporated herein by reference.) |
| 3-A | -- | Restated Certificate of Incorporation with amendments Of Veritas DGC Inc. dated August 30, 1996. (Exhibit 3.1 to Veritas DGC Inc.'s Current Report on Form 8-K filed September 16, 1996 is incorporated herein by reference.) |
| 3-B | -- | Certificate of Ownership and Merger of New Digicon Inc. And Digicon Inc. (Exhibit 3-B to Digicon Inc.'s Registration Statement No. 33-43873 dated November 12, 1991 Is incorporated herein by reference.) |
| 3-C | -- | Certificate of Amendment to Restated Certificate of Incorporation of Veritas DGC Inc. dated September 30, 1999. (Exhibit 3-D to Veritas DGC Inc.'s For 10-K for the year ended July 31, 1999 is incorporated herein by reference.) |
| 3-D | -- | By-laws of Veritas DGC Inc. as amended and restated March 7, 2000 (Exhibit 3-E to Veritas DGC Inc.'s Form 10-Q for the quarter ended January 31, 2000 is incorporated herein by reference.) |
| 4-A | -- | Specimen certificate for Senior Notes (Series A). (Included as part of Section 2.2 of Exhibit 4-B to Veritas DGC Inc.'s Registration Statement No. 333-12481 dated September 20, 1996 is incorporated herein by reference.) |
| 4-B | -- | Form of Trust Indenture relating to the 9-3/4% Senior Notes due 2003 of Veritas DGC Inc. between Veritas DGC Inc. and Fleet National Bank, as trustee. (Exhibit 4-B to Veritas DGC Inc.'s Registration Statement No. 333-12481 dated September 20, 1996 is incorporated herein by reference.) |



| | | |
|---|---|---|
| 4-C | -- | Specimen Veritas DGC Inc. Common Stock certificate. (Exhibit 4-C to Veritas DGC Inc.'s Form 10-K for the year ended July 31, 1996 is incorporated herein by reference.) |
| 4-D | -- | Rights Agreement between Veritas DGC Inc. and ChaseMellon Shareholder Services, L.L.C. dated as of May 15, 1997. (Exhibit 4.1 to Veritas DGC Inc.'s Report on Form 8-K filed May 27, 1997 is incorporated herein by reference.) |
| 4-E | -- | Form of Restricted Stock Grant Agreement. (Exhibit 4.8 to Veritas DGC Inc.'s Registration Statement No. 333-48953 dated March 31, 1998 is incorporated herein by reference.) |
| 4-F | -- | Restricted Stock Plan as amended and restated March 7, 2000. (Exhibit 4-F to Veritas DGC Inc.'s Form 10-Q for the quarter ended April 30, 2000 is incorporated herein by reference.) |
| 4-G | -- | Key Contributor Incentive Plan as amended and restated March |

9, 1999. (Exhibit 4.9 to Veritas DGC Inc.'s Registration Statement No. 333-74305 dated March 12, 1999 is incorporated herein by reference.)

4-H -- Specimen for Senior Notes (Series C). (Exhibit 4-K to Veritas DGC Inc.'s Form 10-Q for the quarter ended January 31, 1999 is incorporated herein by reference.)

4-I -- Indenture relating to the 9-3/4% Senior Notes due 2003, Series B and Series C of Veritas DGC Inc. between Veritas DGC Inc. and State Street Bank and Trust Company dated October 28, 1998. (Exhibit 4.3 to Veritas DGC Inc.'s Current Report on Form 8-K dated November 12, 1998 is incorporated herein by reference.)

4-J -- Employee Stock Purchase Plan (As Amended and Restated December 11, 2001) (Exhibit 4.1 to Veritas DGC Inc.'s Form S-8 dated February 26, 2002 is incorporated herein by reference.)

10-A -- Amended and Restated Employment Agreement between Veritas DGC Inc. and Matthew D. Fitzgerald. (Exhibit 10-A to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)

10-B -- Amendment No. 1 to Amended and Restated Employment Agreement between Veritas DGC Inc. and Matthew D. Fitzgerald. (Exhibit 10-B to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)

10-C -- Amended and Restated Employment Agreement between Veritas DGC Inc. and Stephen J. Ludlow. (Exhibit 10-C to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)

10-D -- Amendment No. 1 to Amended and Restated Employment Agreement between Veritas DGC Inc. and Stephen J. Ludlow. (Exhibit 10-D to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)

10-E -- Amended and Restated Employment Agreement between Veritas DGC Inc. and David B. Robson. (Exhibit 10-E to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)

10-F -- Amendment No. 1 to Amended and Restated Employment Agreement between Veritas DGC Inc. and David B. Robson. (Exhibit 10-F to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)

10-G -- Amended and Restated Employment Agreement between Veritas DGC Inc. and Anthony Tripodo. (Exhibit 10-G to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)



10-H -- Amendment No. 1 to Amended and Restated Employment Agreement between Veritas DGC Inc. and Anthony Tripodo. (Exhibit 10-H to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)

10-I -- Amended and Restated Employment Agreement between Veritas DGC Inc. and Rene M.J. VandenBrand. (Exhibit 10-I to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)

10-J -- Amendment No. 1 to Amended and Restated Employment Agreement between Veritas DGC Inc. and Rene M.J. VandenBrand. (Exhibit 10-J to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)

10-K -- Amended and Restated Employment Agreement between Veritas DGC Inc. and Timothy L. Wells. (Exhibit 10-K to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)

10-L -- Amendment No. 1 to Amended and Restated Employment Agreement between Veritas DGC Inc. and Timothy L. Wells. (Exhibit 10-L to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)

10-M -- Employment Agreement between Veritas DGC Inc. and Larry L. Worden. (Exhibit 10-M to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)

10-N -- Amendment No. 1 to Employment Agreement between Veritas DGC Inc. and Larry L. Worden. (Exhibit 10-N to Veritas DGC, Inc.'s Form 10-Q for the quarter ended October 31, 2001 is incorporated herein by reference.)

b) REPORTS ON FORM 8-K

On May 26, 2002, we filed a report on Form 8-K regarding the treatment of Veritas DGC Inc. as the accounting acquirer in the proposed combination of Veritas DGC Inc. and Petroleum Geo-Services ASA.



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, on the 12th day of June 2002.

VERITAS DGC INC.

By: /s/ David B. Robson

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DAVID B. ROBSON
Chairman of the Board and
Chief Executive Officer

/s/ Matthew D. Fitzgerald
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MATTHEW D. FITZGERALD
Executive Vice President, Chief Financial Officer
and Treasurer