

Edgar Filing: VERITAS DGC INC - Form 10-Q

VERITAS DGC INC  
Form 10-Q  
March 11, 2003

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED JANUARY 31, 2003

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 76-0343152  
(State or other jurisdiction of (I.R.S. Employer Identification No.)  
incorporation or organization)

10300 TOWN PARK  
HOUSTON, TEXAS 77072  
(Address of principal executive offices) (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  No

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

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## 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 February 28, 2003 was 33,355,833 (including 1,444,411 Veritas Energy Services Inc. exchangeable shares which are identical to the Common Stock in all material respects).

=====

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Certification of Chief Financial Officer

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VERITAS DGC INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME  
(UNAUDITED)

	THREE MONTHS ENDED JANUARY 31,	
	2003	2002
	(In thousands, e	
Revenues .....	\$ 125,321	\$ 119,
Operating expenses:		
Cost of services .....	102,672	90,
Research and development .....	3,045	2,
General and administrative .....	7,810	6,
Merger costs .....		2,
Argentina devaluation and shutdown costs .....		2,
Operating income .....	11,794	14,
Interest expense .....	4,425	3,
Other (income) expense, net .....	(22)	(1,
Income before provision for income taxes .....	7,391	12,
Provision for income taxes .....	2,901	4,
Net income .....	\$ 4,490	\$ 7,
Other comprehensive income (loss) (net of tax, \$0 in all periods):		
Foreign currency translation adjustments .....	1,374	(2,
Unrealized gain (loss) on investments available for sale .....	16	(
Unrealized gain (loss) on foreign currency hedge .....	237	(
Total other comprehensive income (loss) .....	1,627	(3,
Comprehensive income .....	\$ 6,117	\$ 4,
	=====	=====
PER SHARE:		
BASIC:		
Net income per common share .....	\$ .14	\$
Weighted average common shares .....	33,235	32,
DILUTED:		
Net income per common share .....	\$ .14	\$
Weighted average common shares .....	33,249	32,

See Notes to Consolidated Financial Statements

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VERITAS DGC INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
(Dollars in thousands, except par value)

## ASSETS

### Current assets:

Cash and cash equivalents .....	
Restricted cash investments .....	
Accounts and notes receivable (net of allowance: \$4,393 at January; \$4,143 at July) .....	
Materials and supplies inventory .....	
Prepayments and other .....	
Income taxes receivable .....	
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 .....	
Deferred tax asset .....	
Other assets .....	
Total .....	

## LIABILITIES AND STOCKHOLDERS' EQUITY

### Current liabilities:

Trade accounts payable .....	
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: 31,922,839 shares at January and 31,171,988 shares at July (excluding Exchangeable Shares of 1,444,411 at January and 1,444,514 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 gain on foreign currency hedge .....	
Unrealized gain on investments available for sale .....	
Unearned compensation .....	
Treasury stock, at cost; 83,014 shares at January and 76,607 at July .....	

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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)

	SIX
	-----
	2003
	-----
	(I)
Operating activities:	
Net income .....	\$ 6,
Non-cash items included in net income:	
Depreciation and amortization (other than multi-client) .....	37,
Depreciation and amortization capitalized to multi-client library and software ..	(12,
Amortization of multi-client library .....	73,
Impairment of land acquisition equipment .....	1,
Gain on disposition of property and equipment .....	(
Equity in loss of joint venture .....	
Deferred taxes .....	
Amortization of unearned compensation .....	
Change in operating assets/liabilities:	
Accounts and notes receivable .....	(12,
Materials and supplies inventory .....	12,
Prepayments and other .....	(
Income tax receivable .....	3,
Accounts payable and other accrued liabilities .....	(17,
Other non-current liabilities .....	(
Other .....	(
	-----
Total cash provided by operating activities .....	92,
Investing activities:	
Investment in multi-client library, net cash .....	(75,
Purchase of property and equipment .....	(12,
Sale of property and equipment .....	2,
Purchase of Hampson-Russell Software Services Ltd. ....	(9,
	-----
Total cash used by investing activities .....	(95,
Financing activities:	
Borrowings on long-term debt .....	120,
Payments on long-term debt .....	(49,
Net proceeds from sale of common stock .....	1,
	-----
Total cash provided by financing activities .....	71,
Currency loss on foreign cash .....	-----

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Change in cash and cash equivalents .....	68,
Beginning cash and cash equivalents balance .....	10,
	-----
Ending cash and cash equivalents balance .....	\$ 79,
	=====
Cash paid for:	
Interest .....	\$ 7,9
Taxes .....	\$ 6

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. Depreciation and amortization is now included in cost of services on the "Consolidated Statements of Operations and Comprehensive Income".

RECENT ACCOUNTING PRONOUNCEMENTS

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 adopted the use of this accounting statement in August 2002. Adoption did not have a material effect on our financial position or results of operations.

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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 adopted the use of this accounting statement in August 2002. Adoption did not have a material effect on our financial position or results of operations.

In April 2002, the Financial Accounting Standards Board issued SFAS No. 145 (Rescission of FASB Statement No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections as of April 2002). Among other things, this statement addresses how to report gains or losses resulting from the early extinguishment of debt. Previously, any gains or losses were reported as an extraordinary item. Upon adoption of SFAS No. 145, an entity is required to evaluate whether the debt extinguishment is truly extraordinary in nature, in accordance with Accounting Principles Board Opinion No. 30. We adopted the use of this accounting statement in August 2002. The adoption of this statement will likely preclude extraordinary classification of costs related to early debt extinguishment, and the effect of adoption was immaterial.

In July 2002, the Financial Accounting Standards Board issued SFAS No. 146 (Accounting for Costs Associated with Exit or Disposal Activities). This standard requires recognition of costs associated with exit or disposal activities when they are incurred rather than when management commits to an exit or disposal plan. Examples of costs covered by this guidance include lease termination costs, employee severance costs that are associated with restructuring, discontinued operations, plant closings, or other exit or disposal activities. We adopted the use of this accounting statement for all activities initiated after December 31, 2002. Adoption did not have a material effect on our financial position or results of operations.

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### VERITAS DGC INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) (UNAUDITED)

In December 2002, the FASB issued Interpretation No. 45 (FIN 45), Guarantor's Accounting and Disclosure Requirements. FIN 45 expands required disclosures for certain types of guarantees and recognition of a liability at fair value of such guarantees at the time of issuance. The disclosure requirements are effective for our second fiscal quarter financial statements, while the fair value accounting requirements apply prospectively to guarantees issued or modified after December 31, 2002. Adoption of FIN 45 did not have a material effect on our financial position or results of operations.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. FIN 46 amended ARB 51, Consolidated Financial Statements, and established standards for determining under what circumstances a variable interest entity (VIE) should be consolidated with its primary beneficiary. FIN 46 also requires disclosures about VIE's that the company is not required to consolidate, but in which it has a significant variable interest. Adoption of FIN 46 did not have a material effect on our financial position or results of operations.

## 2. BUSINESS COMBINATIONS

On August 21, 2002, we acquired Hampson-Russell Software Services Ltd.

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("Hampson-Russell"), a Canadian provider of software tools and consulting services related to reservoir interpretation. Under the terms of the agreement, we acquired substantially all of the assets of Hampson-Russell in exchange for a cash payment of \$9,250,000, transfer of 589,623 shares of Veritas common stock (\$12.30 per share), and Hampson-Russell's right to receive a percentage of the revenues generated by the purchased assets over the five years following the closing of the transaction, provided that certain financial targets are obtained. The common stock price of \$12.30 was based on the average closing price for Veritas common stock for a short period up to the transaction close date. Our allocation of the \$16.5 million purchase price was based on fair value as follows: \$13.2 million to software, \$3.9 million to goodwill, of which none is expected to be tax deductible, \$1.1 million to accrued liabilities, \$0.3 million to fixed assets and \$0.2 million to other assets. The software will be amortized over no more than five years. David B. Robson, Veritas DGC's Chairman and Chief Executive Officer, beneficially owns a controlling interest in Vada Industries Ltd., which was a 25% shareholder of Hampson-Russell at the time of the acquisition. The results of operations for Hampson-Russell began to be included in our results of operations as of August 21, 2002.

### 3. ASSET IMPAIRMENT

During the first quarter of 2003, we incurred a \$1.8 million loss for the impairment of land equipment. It was determined the fair value of the equipment was zero. The impairment loss is included in cost of services in the "Consolidated Statements of Operations and Comprehensive Income".

### 4. OTHER (INCOME) EXPENSE, NET

Other (income) expense, net consists of the following:

	THREE MONTHS ENDED JANUARY 31,		SIX M JA
	2003	2002	2003
	(IN THOUSANDS)		
Interest income .....	\$ (154)	\$ (271)	\$ (2
Net gain on disposition of property and equipment .....	(659)	(53)	(4
Net gain on sale of Air-Jac subsidiary .....		(658)	
Net foreign currency exchange loss (gain) .....	414	(320)	6
Loss (income) from unconsolidated joint venture .....	349	(6)	9
Other .....	28	(16)	2
	-----	-----	-----
Total .....	\$ (22)	\$ (1,324)	\$ 1,2



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5. EARNINGS PER COMMON SHARE

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

	THREE MONTHS ENDED JANUARY 31,	
	2003	2002
(IN THOUSANDS,		
Net income .....	\$ 4,490	\$ 7,700
Basic:		
Weighted average common shares (including exchangeable shares) .....	33,235	32,235
Net income per share .....	\$ .14	\$ .23
Diluted:		
Weighted average common shares (including exchangeable shares) .....	33,235	32,235
Shares issuable from assumed exercise of options .....	14	14
Total .....	33,249	32,249
Net income per share .....	\$ .14	\$ .23

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 JANUARY 31,		SIX MONTHS ENDED JANUARY 31,
	2003	2002	2003
Number of options .....	3,338,074	1,391,050	3,293,500
Exercise price range .....	\$10.71 - \$55.125	\$16.3125 - \$55.125	\$10.71 - \$55.125
Expiring through .....	March 2012	March 2011	March 2011

6. OTHER ASSETS - SOFTWARE

Software available for sale is included in other assets. A portion of the software was developed internally, and the remaining portion was obtained through the acquisition of Reservoir Characterization Research and Consulting, Inc. and Hampson-Russell. For internally developed software, we capitalize costs associated with the development of the product from the time the product reaches technological feasibility until it is ready for commercial release. The capitalized cost of the software, whether developed or purchased, is charged to cost of services in the period sales occur based on the percentage of total cost to total estimated sales multiplied by actual sales during the period. In no

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case is the cumulative amortization for a product allowed to fall below the amount that would be recorded using straight-line amortization for that product's estimated useful life. Estimated useful lives of our software products range from three to five years.

Amortization expense for the software is as follows:

	THREE MONTHS ENDED JANUARY 31,		SIX MONTHS ENDED JANUARY 31,	
	2003	2002	2003	2002
	(IN THOUSANDS)			
Amortization expense .....	\$ 1,262	\$ 644	\$ 2,663	\$ 1,288

The carrying value of our software is as follows:

	JANUARY 31, 2003			JU
	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET	GROSS CARRYING AMOUNT
	(IN THOUSANDS)			
Software .....	\$ 27,382	\$ 6,514	\$ 20,868	\$ 13,631

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### 7. LONG-TERM DEBT

Long-term debt is as follows:

	JANUARY 31, 2003	JULY 31, 2002
	(IN THOUSANDS)	
Senior Notes due October 2003, at 9 3/4% .....	\$ 130,050	\$ 135,000
Revolving credit agreement, balance due August 2003 ...	81,110	5,000
Total .....	\$ 211,160	\$ 140,000

As of January 31, 2003, we had \$130.1 million in Senior Notes outstanding due in October 2003. The indenture relating to our Senior Notes contains covenants that, among other things, limited our ability to incur additional debt, pay dividends and complete mergers or sales of assets. Additionally, the indenture contained a change of control provision allowing the holders to require us to call all or a portion of the notes under certain

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conditions.

As of January 31, 2003, we also had a revolving credit facility due August 2003 from commercial lenders that provides U.S. advances up to \$80 million and non-U.S. advances up to \$20 million. Advances bore interest, at our election, at LIBOR plus a margin or prime rate plus a margin. These margins were based on either certain of our financial ratios or our credit rating. At January 31, 2003, the LIBOR margin was 1.25% and the prime rate margin was 0%. As of January 31, 2003, there were \$81.1 million outstanding advances under the credit facility, and \$5.7 million of the credit facility was utilized for letters of credit.

Subsequent to January 31, 2003, we entered into a new revolving credit facility to replace our existing borrowings with a \$250 million bank facility, including \$195 million term loans and \$55 million available under a revolving credit facility (See Note 12). Because of our intent and ability to refinance the Senior Notes and revolver, as of January 31, 2003, we have classified these debts as long-term in the "Consolidated Balance Sheets".

### 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 gain on the hedge transaction is summarized below:

	JANUARY 31, 2003			
	FORWARD VALUE	UNREALIZED GAIN	FAIR VALUE	FORWARD VALUE
	(IN THOUSANDS)			
Forward contracts .....	\$ 4,397	\$ 1,143	\$ 5,540	\$ 6,032

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### VERITAS DGC INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(UNAUDITED)

### 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:



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\$195 million under term A, term B and term C tranches (the "Term Loans"), revolving loan facilities aggregating \$55 million, including facilities for swing line loans of up to \$10 million and the issuance of letters of credit in an aggregate amount of up to \$40 million. The term A loans are in the original principal amount of \$30 million and mature in three years, or February 2006, and require quarterly interest payments at a variable rate of Libor Plus a spread ranging from 3.5% to 4%. The term B loans are in the original principal amount of \$125 million, mature in four years, or February 2007, and require quarterly interest payments at a variable rate of Libor Plus 5.0%, subject to a 2% Libor floor. The term C loans are in the original principal amount of \$40 million, mature in five years, or February 2008, and require quarterly interest payments at a variable rate of Libor Plus 7.5%, subject to a 3% Libor floor. The term A and term B loans require quarterly principal payments of 0.25% of the Base 4.25

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### VERITAS DGC INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) (UNAUDITED)

outstanding principal balance. Loans made under the revolving loan facilities, including swing line loans, bear interest at a variable rate determined on the date of borrowing, that is related to various base rates and margins depending upon our leverage ratio and the location of the borrowing. The revolver expires in February 2006. The financing is secured by assets, including equipment, vehicles, multi-client data library and stock of certain material subsidiaries, owned by us and certain of our subsidiaries. The Credit Agreement and related documents contain a number of covenants, including financial covenants relating to interest coverage, leverage and net worth. On February 14, 2003, the Term Loans totaling \$195 million were funded and letters of credit in the amount of approximately \$5.7 million then outstanding from the previous credit agreement were transferred to the Credit Agreement. Proceeds from the Term Loans were used to satisfy the obligations under the previous credit agreement and the Senior Notes.

On February 25, 2003, we entered into interest rate swaps in order to reduce our exposure to the variable interest rates of the Credit Facility described above. These swaps, with notional amounts totaling \$80 million, effectively hedge 41% of our exposure to interest rate changes for the two-year terms of the swaps. This is considered a cash flow hedge under FAS 133 for accounting and for the two-year terms of the swaps financial reporting purposes.

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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 2002 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

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For the last few years, Veritas has been engaged in a program designed to expand and upgrade the capabilities of the company. Key elements of this program were the outfitting of the three Viking-class vessels, installation of large computer clusters, and the addition of Arctic-capable land acquisition equipment. These investments are now paying off in terms of increased acceptance in the market. Veritas will continue to invest in its core businesses, especially in assets that advance our technological position. However, in the current market we do not expect to invest significant amounts to expand our overall capacity.

We are continuing to invest in our multi-client library where we can be reasonably assured adequate returns. However, we balance our investment in multi-client libraries with our participation in the contract markets. In 2003, we are increasing our participation in the contract marine acquisition market, with a commensurate reduction in marine multi-client investment. We anticipate this will result in increased cash flow, although potentially at the expense of a lower gross margin.

Based on this environment, for fiscal year 2003, we expect capital expenditures will be about \$35 million, or approximately half of the expected depreciation level, and investment in multi-client will be approximately \$170 million, significantly less than projected multi-client revenue. These factors, along with expense reductions and expected revenues, are projected to result in positive cash flows after investing activities for the year. We set a target of positive cash flow at the beginning of the year and now, half-way through, we are reasonably confident of delivering on that expectation.

### RESULTS OF OPERATIONS

THREE MONTHS ENDED JANUARY 31, 2003 COMPARED WITH THREE MONTHS ENDED JANUARY 31, 2002

**Revenues.** Revenues increased by 5% overall. Multi-client revenues decreased 2% due to decreased activity in the Gulf of Mexico. This was offset by increased activity in U.S. land operations. Contract revenue increased by 13% due to marine acquisition projects in Morocco, Trinidad and Asia. This was partially offset by decreased activity in Canada land acquisition due to warmer than normal weather, which delayed equipment movement early in the current quarter.

**Operating Income.** Operating income decreased by 20%, from \$14.8 million to \$11.8 million due to an unfavorable sales mix. Multi-client margins declined due to a greater proportion of lower margin surveys this year. We expect this trend to continue into the foreseeable future. Contract margins were slightly higher this year, but not enough to offset the unfavorable survey mix. Operating income was also reduced by \$1.8 million of employee severance expense, which was included in general and administrative expense, and bad debt expense of \$1.0 million, included in cost of services. On September 28, 2002, we filed suit in Federal Court against one of our customers in the amount of \$6.8 million for failure to pay past due invoices. We believe the facts in the matter are in our favor, and therefore, we have not made any provision for the related account receivable. We will continue to monitor the financial condition of the customer and, should their condition deteriorate materially, we may need to reserve this amount, either partially or in total. We expect the matter to be tried in court by mid 2004.

**Other (income) expense, net.** Other (income) expense, net decreased from \$1.3 million to \$22,000. The prior year's second quarter included a \$0.7 million gain from the sale of a drilling subsidiary, Air-Jac. In the current quarter, we incurred currency losses of \$0.4 million as opposed to income of \$0.3 million in the prior year's second quarter. Losses were also incurred on the unconsolidated

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joint venture of \$0.3 million as opposed to income of \$6,000 in the prior year's second quarter. These differences were offset by net gains on the sale of fixed assets of \$0.6 million in the current quarter. Included in this gain are \$0.9 million in net gains from insurance proceeds for damaged equipment in Peru.

Provision for income taxes. The provision for income taxes decreased from \$4.9 million to \$2.9 million due to the decrease in earnings in the current year. The effective income tax rate remained approximately the same year to year.

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SIX MONTHS ENDED JANUARY 31, 2003 COMPARED WITH SIX MONTHS ENDED JANUARY 31, 2002

Revenues. Revenues decreased by 9% overall. Multi-client revenues increased by 2% due to high levels of pre-funding in Brazil and Norway, offset by weak land shelf sales and decreased activity in the Gulf of Mexico. Contract revenue increased by 16% due to a large land acquisition project in Peru and marine acquisition projects in Morocco, Trinidad and Asia. This was offset by decreased activity in Canada land acquisition due to warmer than normal weather, which delayed equipment movement during the winter season.

Operating Income. Operating income decreased by 33%, from \$29.9 million to \$19.9 million. Margins declined due to several operational disruptions in land acquisition in the first quarter of the current year and lower margins from multi-client revenue caused by a greater mix of lower margin surveys. The operational disruptions included two lightning strikes, two hurricanes, and civil unrest, all of which resulted in declarations of contractual force majeure provisions. Reduced revenue and increased expense associated with these projects reduced profit by approximately \$2.1 million. Additionally, we recognized an impairment of \$1.8 million of assets in the land acquisition business. General and administrative expense increased by \$3.5 million from the prior year due to severance and other items.

Other (income) expense, net. Other (income) expense, net decreased from income of \$2.2 million to expense of \$1.2 million primarily due to several factors. The prior year's results included a \$0.7 million gain from the sale of a drilling subsidiary, Air-Jac. In the current year, we incurred currency losses of \$0.7 million as opposed to income of \$88,000 in the prior year. Our unconsolidated joint venture in Indonesia incurred a loss of \$0.9 million compared to a minimal loss in the first half of the prior year.

Provision for income taxes. The provision for income taxes decreased from \$9.7 million to \$4.3 million due to the decrease in earnings in the current year. The effective income tax rate increased from 39% to 41% as a result of un-benefited losses in foreign jurisdictions.

### 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, equipment financing and trade credit. We believe these sources of funds are adequate to meet our liquidity needs for fiscal 2003.

Net cash provided by operating activities remained relatively the same for the first six months of 2003 compared to 2002, however, the 2003 period includes a merger termination payment of \$7.5 million to Petroleum Geoservices

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ASA. Net cash used by investing activities decreased from \$136.7 million in the first six months of 2002 to \$95.6 million in 2003 due to lower capital spending and investments in multi-client library, partially offset by the purchase of Hampson-Russell. Our capital expenditure budget for fiscal 2003 is approximately \$35- \$40 million, which is mostly allocated to replacement and upgrading of existing equipment. In fiscal year 2003, we are forecasting \$150-\$160 million of cash investments in our data library. We expect to fund these investments from internally generated cash flows.

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Net cash provided by financing activities increased from \$1.3 million in the first six months of 2002 to \$71.2 million in the first six months of 2003. The current year includes net proceeds from the revolving credit facility of \$75.6 million, offset by redemptions of our Senior Notes of \$5.0 million. As of January 31, 2003, we had \$130.1 million in Senior Notes outstanding due in October 2003. The indenture on our Senior Notes contained covenants that, among other things, limited our ability to incur additional debt, pay dividends and complete mergers or sales of assets. Additionally, the indenture contained a change of control provision allowing the holders to require us to call all or a portion of the notes under certain conditions.

We had a revolving credit facility due August 2003 from commercial lenders that provided U.S. advances up to \$80 million and non-U.S. advances up to \$20 million. Advances bore interest, at our election, at LIBOR plus a margin or prime rate plus a margin. These margins were based on either certain of our financial ratios or our credit rating. At January 31, 2003, the LIBOR margin was 1.25% and the prime rate margin was 0%. As of January 31, 2003, there were \$81.1 million outstanding advances under the credit facility, and \$5.7 million of the credit facility was utilized for letters of credit. Beginning November 1, 2002, provisions in our Senior Notes precluded us from incurring any additional borrowings, other than issuance of letters of credit, due to our failure to meet a fixed charge coverage provision in the indenture. Subsequent to quarter end, we entered into a new credit facility to replace our existing borrowings with a \$250 million bank facility, including \$195 million term loans and \$55 million available under a revolving credit facility (See Note 12). Because of our intent and ability to refinance the Senior Notes and revolver, as of January 31, 2003, we have classified these debts as long-term in the "Consolidated Balance Sheets".

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.

The following represents our financial contractual obligations and commitments for the fiscal period ending July 31, 2003 through 2007 and thereafter.

CONTRACTUAL CASH OBLIGATIONS	TOTAL	2003	2004	2005
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Lease obligations .....	\$ 160,329	\$ 41,710	\$ 30,738	\$ 23,963	\$
Long-term debt(1)(2) .....	211,160		211,160		
Forward exchange contracts .....	5,756	3,259	2,497		
Standby letters of credit .....	5,730	1,137	4,500	93	
(1) The new long-term debt facility payments are scheduled as follows .....	195,000	775	1,550	1,550	

(2) Because of our intent and ability to refinance the Senior Notes and revolver, as of January 31, 2003, we have classified these debts as long-term in the "Consolidated Balance Sheets".

### 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

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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 carry-forwards, 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

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Since our quasi-reorganization on July 31, 1991 with respect to Digicon Inc., the tax benefits of net operating loss carryforwards 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 six months ended January 31, 2003, we recognized \$2.0 million related to these benefits.

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

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 adopted the use of this accounting statement in August 2002. Adoption did not have a material effect on our financial position or results of operations.

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 adopted the use of this accounting statement in August 2002. Adoption did not have a material effect on our financial position or results of operations.

In April 2002, the Financial Accounting Standards Board issued SFAS No. 145 (Rescission of FASB Statement No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections as of April 2002). Among other things, this statement addresses how to report gains or losses resulting from the early extinguishment of debt. Previously, any gains or losses were reported as an extraordinary item. Upon adoption of SFAS No. 145, an entity is required to evaluate whether the debt extinguishment is truly extraordinary in nature, in accordance with Accounting Principles Board Opinion No. 30. We adopted the use of this accounting statement in August 2002. The adoption of this statement will likely preclude extraordinary classification of costs related to early debt extinguishment, and the effect of adoption was immaterial.

In July 2002, the Financial Accounting Standards Board issued SFAS No. 146 (Accounting for Costs Associated with Exit or Disposal Activities). This standard requires recognition of costs associated with exit or disposal activities when they are incurred rather than when management commits to an exit or disposal plan. Examples of costs covered by this guidance include lease termination costs, employee severance costs that are associated with restructuring, discontinued operations, plant closings, or other exit or disposal activities. We adopted the use of this accounting statement for all activities initiated after December 31, 2002. Adoption did not have a material effect on our financial position or results of operations.

In December 2002, the FASB issued Interpretation No. 45 (FIN 45), Guarantor's Accounting and Disclosure Requirements. FIN 45 expands required disclosures for certain types of guarantees and recognition of a liability at fair value of such guarantees at the time of issuance. The disclosure requirements are effective for our second fiscal quarter financial statements,

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while the fair value accounting requirements apply prospectively to guarantees issued or modified after December 31, 2002. Adoption of FIN 45 did not have a material effect on our financial position or results of operations.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. FIN 46 amended ARB 51, Consolidated Financial Statements, and established standards for determining under what circumstances a variable interest entity (VIE) should be consolidated with its primary beneficiary. FIN 46 also requires disclosures about VIE's that the company is not required to consolidate, but in which it has a significant variable interest. Adoption of FIN 46 did not have a material effect on our financial position or results of operations.

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

At January 31, 2003, 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 January 31, 2003 in U.S. dollars was \$5.5 million.

As of February 14, with the signing of the new Term Loan agreement, we are exposed to interest rate risk based upon fluctuations in the Libor rate. To partially mitigate this risk we entered into interest rate swaps in the notional amount of \$80 million, effectively hedging 41% of our exposure to interest rate fluctuations for the two-year terms of the swaps.

### ITEM 4. CONTROLS AND PROCEDURES

Our management, including the Chief Executive Officer and Chief Financial Officer, has conducted an evaluation of the effectiveness of disclosure controls and procedures within ninety days of the filing of this report pursuant to Exchange Act Rule 13a-14. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective in ensuring that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission (SEC) rules and forms. There have been no significant changes in internal controls, or in factors that could significantly affect internal controls, subsequent to the date our management, including its Chief Executive Officer and Chief Financial Officer, completed its evaluation.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

On September 28, 2002 we filed suit in Federal Court against one of our customers in the amount of \$6.8 million for failure to pay past due invoices. We believe the facts in the matter are in our favor, and therefore, we have not made any provision for the related account receivable. We will continue to monitor the financial condition of the customer and, should their condition deteriorate materially, we may need to reserve this amount, either partially or in total. We expect the matter to be tried in court by mid 2004.

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

On December 3, 2002, at the Annual Meeting of Stockholders, the stockholders voted, as follows, to elect six directors of Veritas DGC Inc. Former board members, Mr. Larry Fichtner and Mr. Steven Gilbert did not stand for reelection.

Name	Votes For	Votes Withheld
Clayton P. Cormier	24,418,575	1,135,252
James R. Gibbs	24,420,170	1,133,657
Stephen J. Ludlow	25,252,390	301,437
Brian F. MacNeill	25,254,081	299,746
Jan Rask	24,395,585	1,158,242
David B. Robson	25,241,605	312,222

The stockholders voted, as follows, for approval of the adoption of our Share Incentive Plan.

Votes For	18,658,367
Votes Withheld	3,106,512
Abstentions	62,452

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

#### a) EXHIBITS FILED WITH THIS REPORT:

EXHIBIT NO.	DESCRIPTION
10.1	-- Credit Agreement among Veritas DGC Inc., as borrower, and Wells Fargo, Inc., as a bank and agent for the banks named therein, dated July 19, 2001. (Exhibit 10-W to Veritas DGC Inc.'s Form 10-K for the year ended July 31, 2001 is incorporated herein by reference.)
10.2	-- Second Amendment to Credit Agreement, effective as of July 1, 2002, by and among Veritas DGC Inc., Veritas DGC Limited, Veritas Energy Services Inc., Veritas Energy Services Partnership, certain Banks party thereto, Wells Fargo Bank Texas, N.A., as agent, and HSBC Bank Canada, as agent. (Exhibit 10.1 to Veritas DGC Inc.'s Current Report on Form 8-K dated September 27, 2002 is incorporated herein by reference.)

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- 10.2 -- Second Amendment to Credit Agreement, effective as of July 1, 2002, by and among Veritas DGC Inc., Veritas DGC Limited, Veritas Energy Services Inc., Veritas Energy Services Partnership, certain Banks party thereto, Wells Fargo Bank Texas, N.A., as agent, and HSBC Bank Canada, as agent. (Exhibit 10.1 to Veritas DGC Inc.'s Current Report on Form 8-K dated September 27, 2002 is incorporated herein by reference.)
- 10.3 -- Credit Agreement, dated as of February 14, 2003, among Veritas DGC Inc., Veritas DGC Limited, Veritas Energy Services Inc., Veritas Energy Services Partnership, Deutsche Bank AG, New York Branch, as Administrative Agent, Deutsche Bank AG, Canada Branch, as Canadian Administrative Agent, and the various lending institutions named therein. (Exhibit 10-1 to Veritas DGC Inc.'s Current Report on Form 8-K dated February 19, 2003 is incorporated herein by reference.)
- \*10.4 -- Letter of Agreement between Veritas DGC Inc. and Anthony Tripodo dated November 8, 2003
- \*99.1 -- Veritas DGC Inc. Audit Committee Charter, as adopted December 3, 2002
- \*99.2 -- Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by David B. Robson.
- \*99.3 -- Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Matthew D. Fitzgerald.

b) REPORTS ON FORM 8-K

On February 5, 2003, we filed a Form 8-K regarding the anticipated redemption of our 9 3/4% Senior Notes.

On February 19, we filed a Form 8-K regarding our credit agreement with Deutsche Bank AG.

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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, on the 10th day of March 2003.

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

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### CERTIFICATIONS

I, David B. Robson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Veritas DGC Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

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Date: March 10, 2003

/s/ David B. Robson

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David B. Robson  
Chief Executive Officer

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CERTIFICATIONS

I, Matthew D. Fitzgerald, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Veritas DGC Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls

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subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 10, 2003

/s/ Matthew D. Fitzgerald

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Matthew D. Fitzgerald  
Chief Financial Officer

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