Deep Down, Inc.
Form 10-Q
November 13, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2013

OR

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

Commission File No. 0-30351

DEEP DOWN, INC.

(Exact name of registrant as specified in its charter)

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

(Address of Principal Executive Office) (Zip Code)

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

Not applicable

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

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

Large accelerated filer ¨ Accelerated filer ¨

Non-accelerated filer ¨ Smaller reporting company þ

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

At November 11, 2013, there were 15,263,744 shares of Common Stock outstanding, par value $0.001 per share.

IMPORTANT INFORMATION REGARDING THIS FORM 10-Q

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

Deep Down is the parent company of the following wholly-owned subsidiaries: Deep Down, Inc., a Delaware corporation (“Deep Down Delaware”); Mako Technologies, LLC, a Nevada limited liability company (“Mako”); Deep Down International Holdings, LLC, a Nevada limited liability company (“DDIH”) and Deep Down Brasil, Ltda., a Brazil limited liability company (“Deep Down Brasil”). In August 2012, we consolidated the operations of Mako into Deep Down Delaware.

Our current operations include Deep Down Delaware. In addition to our strategy of continuing to grow and strengthen our operations, including by expanding our services and products in response to our customers’ demands, we intend to continue to seek strategic acquisitions of complementary service providers, product manufacturers and technologies that are focused primarily on supporting deepwater and ultra-deepwater offshore exploration, development and production of oil and gas reserves and other maritime operations.

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

Forward-Looking Statements

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

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

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

Document Summaries

Descriptions of documents and agreements contained in this Report are provided in summary form only, and such summaries are qualified in their entirety by reference to the actual documents and agreements filed as exhibits to our Annual Report on Form 10-K for the year ended December 31, 2012, other periodic and current reports we file with the SEC or this Report.

Access to Filings

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

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DEEP DOWN, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except par value amounts)		
ASSETS		
Current assets:	September 30, 2013	December 31, 2012
Cash and cash equivalents	$ 5,944	$ 1,523
Accounts receivable, net of allowance of $1,222 and $1,211, respectively	7,024	7,140
Inventory	244	232
Costs and estimated earnings in excess of billings on uncompleted contracts	5,890	2,547
Prepaid expenses and other current assets	430	321
Total current assets	19,532	11,763
Property, plant and equipment, net	12,399	13,103
Investment in joint venture	485	984
Intangibles, net	121	126
Goodwill	4,916	4,916
Other assets	1,061	607
Total assets	$ 38,514	$ 31,499
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 3,290	$ 4,289
Billings in excess of costs and estimated earnings on uncompleted contracts	566	753
Deferred revenues	76	44
Current portion of long-term debt	156	680
Total current liabilities	4,088	5,766
Long-term debt, net	1,918	2,936
Total liabilities	6,006	8,702
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, $0.001 par value, 10,000 shares authorized, 0 shares issued and outstanding	–	–
Common stock, $0.001 par value, 24,500 shares authorized, 15,275 and 10,152 shares issued and outstanding, respectively	15	10
Additional paid-in capital	72,049	63,970
Accumulated deficit	(39,556)	(41,183)
Total stockholders' equity	32,508	22,797

Total liabilities and stockholders' equity	$ 38,514	$ 31,499

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

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DEEP DOWN, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share amounts)	2013	2012	2013	2012
Revenues	$8,639	$9,391	$23,953	$22,168
Cost of sales:				
Cost of sales	5,806	5,894	14,735	13,230
Depreciation expense	358	334	1,057	969
Total cost of sales	6,164	6,228	15,792	14,199
Gross profit	2,475	3,163	8,161	7,969
Operating expenses:				
Selling, general and administrative	2,082	1,966	6,311	5,948
Depreciation and amortization	35	140	100	432
Total operating expenses	2,117	2,106	6,411	6,380
Operating income	358	1,057	1,750	1,589
Other income (expense):				
Interest expense, net	(52)	(34)	(143)	(120)
Equity in net (loss) income of joint venture	–	(39)	1	(179)
Other, net	13	60	27	112
Total other income (expense)	(39)	(13)	(115)	(187)
Income before income taxes	319	1,044	1,635	1,402
Income tax benefit (expense)	62	(74)	(8)	(93)
Net income	$381	$970	$1,627	$1,309
Net income per share:				
Basic	$0.03	$0.10	$0.15	$0.13
Diluted	$0.03	$0.10	$0.15	$0.13
Weighted-average shares outstanding:				
Basic	11,691	10,161	10,728	10,196
Diluted	11,739	10,161	10,729	10,196

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

DEEP DOWN, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30,	
(In thousands)	2013	2012
Cash flows from operating activities:		
Net income	$1,627	$1,309
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Equity in net (income) loss of joint venture	(1)	179
Share-based compensation	471	519
Forgiveness of debt	–	(10)
Bad debt (recovery) provision	(19)	92
Depreciation and amortization	1,157	1,401
Gain on disposal of property, plant and equipment	(21)	(112)
Changes in assets and liabilities:		
Accounts receivable	101	(1,297)
Costs and estimated earnings in excess of billings on uncompleted contracts	(3,343)	(1,642)
Prepaid expenses and other current assets	(109)	(60)
Other assets	19	103
Inventory	(12)	(3)
Accounts payable and accrued liabilities	(999)	1,587
Deferred revenues	32	(260)
Billings in excess of costs and estimated earnings on uncompleted contracts	(187)	(1,499)
Net cash (used in) provided by operating activities	(1,284)	307
Cash flows from investing activities:		
Purchases of property, plant and equipment	(451)	(1,520)
Proceeds from sale of property, plant and equipment	33	150
Cash paid for deposits	(446)	–
Cash paid for patents	–	(43)
Cash paid for exclusive product rights	–	(125)
Repayments on notes receivable	9	50
Distribution from joint venture	500	–
Net cash used in investing activities	(355)	(1,488)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net of issuance costs	7,647	–
Cash paid for purchase of our common stock	–	(48)
Proceeds from bank term loan	1,020	–
Cash paid for deferred financing costs	(45)	–
Repayments of long-term debt	(2,562)	(1,552)

Net cash provided by (used in) financing activities	6,060	(1,600)
Change in cash and equivalents	4,421	(2,781)
Cash and cash equivalents, beginning of period	1,523	4,979
Cash and cash equivalents, end of period	$5,944	$2,198
Supplemental schedule of significant noncash transactions:		
Property, plant and equipment acquired via capital lease	$–	$1,200
Shares of common stock surrendered by employees related to payroll taxes on vested restricted stock awards	$34	$41

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

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share amounts)

NOTE 1: BASIS OF PRESENTATION

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Deep Down, Inc. and its wholly-owned subsidiaries ("Deep Down," "we," "us" or the "Company") were prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC" or the "Commission") pertaining to interim financial information and instructions to Form 10-Q. As permitted under those rules, certain footnotes or other financial information that are normally required by United States generally accepted accounting principles ("US GAAP") can be condensed or omitted. Therefore, these statements should be read in conjunction with the audited consolidated financial statements, and footnotes thereto, included in our Annual Report on Form 10-K for the year ended December 31, 2012, filed on March 28, 2013 with the Commission.

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

Principles of Consolidation

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

Segments

For the nine months ended September 30, 2013 and 2012, our operating segments, Deep Down Delaware and Mako, have been aggregated into a single reporting segment. In August 2012, we consolidated the operations of Mako in Morgan City, Louisiana into Deep Down Delaware in Channelview, Texas. While the operating segments have different product lines, they are very similar. They are both service-based operations revolving around our personnel's expertise in the deepwater and ultra-deepwater industry, and any equipment is produced to a customer specified design and engineered using Deep Down personnel's expertise, with installation and project management as part of our service offering to the customer. Additionally, the operating segments have similar customers and distribution methods, and their economic characteristics are similar with regard to their gross margin percentages. Our operations are located in the United States, although we occasionally generate sales to international customers.

Recently Adopted Accounting Standards

There were no recent accounting pronouncements that materially affected our Company.

NOTE 2: BILLINGS, COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS

The components of billings, costs and estimated earnings on uncompleted contracts are summarized below:

	September 30, 2013	December 31, 2012
Costs incurred on uncompleted contracts	$ 14,680	$ 9,915
Estimated earnings on uncompleted contracts	5,915	4,714
	20,595	14,629
Less: Billings to date on uncompleted contracts	(15,271)	(12,835)
	$ 5,324	$ 1,794
Included in the accompanying consolidated balance sheets under the following captions:		
Costs and estimated earnings in excess of billings on uncompleted contracts	$ 5,890	$ 2,547
Billings in excess of costs and estimated earnings on uncompleted contracts	(566)	(753)
	$ 5,324	$ 1,794

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share amounts)

The balances in costs in excess of billings and estimated earnings on uncompleted contracts at September 30, 2013 and December 31, 2012 consisted of earned but unbilled revenues related to large fixed-price projects.

The balances in billings in excess of costs and estimated earnings on uncompleted contracts at September 30, 2013 and December 31, 2012 consisted of unearned milestone billings related to large fixed-price projects.

NOTE 3: PROPERTY, PLANT AND EQUIPMENT

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

	September 30, 2013	December 31, 2012	Range of Asset Lives
Land	$ 1,582	$ 1,582	-
Buildings and improvements	1,571	1,555	7 - 36 years
Leasehold improvements	221	221	2 - 5 years
Equipment	14,439	14,251	2 - 30 years
Furniture, computers and office equipment	1,292	1,248	2 - 8 years
Construction in progress	658	487	-
Total property, plant and equipment	19,763	19,344	
Less: Accumulated depreciation and amortization	(7,364)	(6,241)	
Property, plant and equipment, net	$ 12,399	$ 13,103	

NOTE 4: LONG-TERM DEBT

Long-term debt consisted of the following:

	September 30, 2013	December 31, 2012
Secured credit agreement - Whitney	$ 1,943	$ 2,909
Capital lease obligations	131	707
Total long-term debt	2,074	3,616
Less: Current portion of long-term debt	(156)	(680)
Long-term debt, net of current portion	$ 1,918	$ 2,936

Whitney Credit Agreement

We originally entered into our credit agreement with Whitney in November 2008 to provide us with revolving and letter of credit facilities for our operations. Our credit facility has been amended and/or restated five times, most recently on March 5, 2013. Under the Fifth Amendment, the Company and Whitney agreed:

- to increase the committed amount under the revolving credit facility (“Revolving Credit Facility”) to $5,000, and extend the maturity date of such Revolving Credit Facility to April 15, 2014;

- to increase the committed amount under the real estate term facility (“RE Term Facility”) to $2,000, extend the maturity date of such RE Term Facility to April 15, 2018, and the Company is obligated to make increasing monthly repayments of principal (along with accrued and unpaid interest thereon) starting at $8, beginning April 1, 2013;

- for Whitney to make a new single-advance term loan to Deep Down in the original principal amount of $250 (“Equipment Term Loan”) for the purpose of effecting a purchase of two tensioners (the “Equipment”). The Equipment Term Loan has an interest rate of 4.0 percent per annum and maturity date of April 15, 2018, and the Company is obligated to make increasing monthly repayments of principal (along with accrued and unpaid interest thereon) starting at $4, beginning April 1, 2013;

- to change the definition of EBITDA to allow a non-recurring expense in the amount of $117 for closing the operations of Mako and consolidating with Deep Down Delaware in the fiscal quarter ended December 31, 2012, and to allow a non-recurring charge of $2,156, for the write-off related to impairment of long-lived assets associated with consolidating the operations of Mako, also in the fiscal quarter ended December 31, 2012.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share amounts)

As of the effective date of the Fifth Amendment, the outstanding principal balance of the RE Term Facility was $1,730. Whitney agreed to make a single advance to the Company in an amount equal to $270 (bringing the balance of the RE Term Facility as of the effective date of the Fifth Amendment to $2,000) to assist in effecting the purchase of the Equipment. As with Deep Down's other outstanding indebtedness under the credit agreement, outstanding amounts of the Equipment Term Loan are secured by a security interest in all of Deep Down's assets. The interest rate on all of the loans remains the same at 4.0 percent per annum.

As of September 30, 2013, the outstanding indebtedness to Whitney under the Fifth Amendment was $1,943 under the RE Term Facility.

Our credit agreement with Whitney obligates us to comply with the following financial covenants:

- *Leverage Ratio* - The ratio of total debt to total consolidated EBITDA for the four most recent quarterly periods must be less than 3.0 to 1.0; actual Leverage Ratio as of September 30, 2013: 0.90 to 1.0.

- *Fixed Charge Coverage Ratio* - The ratio of total consolidated EBITDA for the four most recent quarterly periods to total consolidated net interest expense plus principal payments for the four most recent quarterly periods on total debt must be greater than 1.5 to 1.0; actual Fixed Charge Coverage Ratio as of September 30, 2013: 2.09 to 1.0.

- *Tangible Net Worth* - Our consolidated net worth, after deducting other assets as are properly classified as "intangible assets," plus 50 percent of net income (if positive), after provision for income taxes, for each whole or partial fiscal year completed after June 30, 2011, must be in excess of $13,000; actual Tangible Net Worth as of September 30, 2013*:* $27,471.

- Moreover, we continue to have obligations for other covenants, including, among others, limitations on issuance of common stock, liens, transactions with affiliates, additional indebtedness and permitted investments.

As of September 30, 2013, we were in compliance with all of these financial covenants.

NOTE 5: SHARE-BASED COMPENSATION

We have a share-based compensation plan, the “2003 Directors, Officers and Consultants Stock Option, Stock Warrant and Stock Award Plan” (the “Plan”). Awards of common stock and options to purchase common stock granted under the Plan have vesting periods of three years and options are exercisable for two years once fully vested. Some awards of stock have performance criteria as an additional condition of vesting. Share-based compensation expense related to awards is based on the fair value at the date of grant, and is recognized over the vesting periods, net of estimated forfeitures. The value of performance-based awards is recognized as expense only when it is considered probable that the performance criteria will be met. Under the Plan, the total number of options permitted is 15 percent of issued and outstanding common shares.

Summary of Shares of Restricted Stock

During the nine months ended September 30, 2013 and 2012, we recognized a total of $347 and $203, respectively, of share-based compensation expense related to restricted stock awards, which is included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations. The unamortized portion of the estimated fair value of restricted stock awards was $1,092 at September 30, 2013.

Summary of Stock Options

For the nine months ended September 30, 2013 and 2012, we recognized a total of $124 and $316, respectively, of share-based compensation expense related to outstanding stock option awards, which is included in selling, general and administrative expenses in the accompanying condensed consolidated statements of operations. The unamortized portion of the estimated fair value of non-vested stock options was $70 at September 30, 2013.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share amounts)

NOTE 6: INCOME TAXES

Income tax expense during interim periods is based on applying the estimated annual effective income tax rate to interim period operations. The estimated annual effective income tax rate may vary from the statutory rate due to the impact of permanent items relative to our pre-tax income, as well as by any valuation allowance recorded. We employ an asset and liability approach that results in the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial basis and the tax basis of those assets and liabilities. A valuation allowance is established when it is more likely than not that some of the deferred tax assets will not be realized. Although our future projections indicate that we may be able to realize some of these deferred tax assets, due to the degree of uncertainty of these projections, at September 30, 2013 management has recorded a full deferred tax asset valuation allowance.

NOTE 7: COMMITMENTS AND CONTINGENCIES

Litigation

From time to time we are involved in legal proceedings arising in the normal course of business. As of the date of this Report, we were not involved in any material actual or pending legal proceedings.

Operating Leases

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

Letters of Credit

Certain of our customers could require us to issue a standby letter of credit ("LC") in the ordinary course of business to ensure performance under terms of a contract or as a form of product warranty. The beneficiary could demand payment from the issuing bank for the amount of the outstanding letter of credit. There were $809 and $827 in LC's outstanding at September 30, 2013 and December 31, 2012, respectively.

NOTE 8: EARNINGS PER COMMON SHARE

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

At September 30, 2013 and 2012, there were outstanding warrants convertible to 0 and 6,000 shares of common stock, respectively. At September 30, 2013 and 2012, there were outstanding stock options convertible to 945,000 and 1,045,000 shares of common stock, respectively.

For the nine months ended September 30, 2013 and 2012, respectively, there were 902 and 0 options included in the computation of diluted earnings per share.

NOTE 9: STOCKHOLDERS' EQUITY

Common Stock

The number of shares of common stock outstanding is as follows:

Balance, December 31, 2012	10,151,529
Shares cancelled and retired, April 15, 2013	(33,334)
Restricted shares granted, May 29, 2013	30,000
Restricted shares granted, June 5, 2013	700,000
Shares surrendered for payroll taxes and retired, June 17, 2013	(16,725)
Shares issued in private placement, September 10, 2013	4,085,111
Shares issued in private placement, September 26, 2013	358,500
Balance, September 30, 2013	15,275,081

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

The following discussion and analysis provides information that management believes is relevant for an assessment and understanding of our results of operations and financial condition. This information should be read in conjunction with our audited historical consolidated financial statements, which are included in our Form 10-K for the fiscal year ended December 31, 2012, filed with the Securities and Exchange Commission on March 28, 2013 and our unaudited condensed consolidated financial statements, and notes thereto, included with this Quarterly Report on Form 10-Q ("Report") in Part I. Item 1. "Financial Statements".

General

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

In Part I. Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations," all dollar and share amounts are in thousands of dollars and shares, unless otherwise indicated.

Industry and Executive Outlook

The outlook for deepwater and ultra-deepwater drilling and production continues to be very strong. The Gulf of Mexico continues to strengthen, and as a result, our business is increasing. Our backlog is $27,000 and continues to grow. We expect to see continued growth in the deepwater and ultra-deepwater sectors for the remainder of the year and in 2014.

Our third quarter results were lower than plan because of our financial performance on a significant fixed-price order for a major oil company operating in Brazil and because of increased rent for our new facility. Nevertheless, we are very pleased with our continued success in obtaining new orders. The new facility has enabled us to expand our steel flying lead business, and we believe it will continue to positively impact future growth.

Results of Operations

Three Months Ended September 30, 2013 Compared to Three Months Ended September 30, 2012

Revenues. Revenues for the three months ended September 30, 2013 were $8,639. Revenues for the three months ended September 30, 2012 were $9,391. The $752 decrease (8 percent) occurred primarily due to reduced ROV and topside equipment rental services as a result of the consolidation of Mako's operations into Deep Down Delaware's operating segment in the third quarter of 2012.

Gross Profit. Gross profit for the three months ended September 30, 2013 was $2,475, or 29 percent of revenues. Gross profit for the three months ended September 30, 2012 was $3,163, or 34 percent of revenues. The $688 decrease in gross profit was due primarily to rent expense associated with our new facility as well as a loss recognized on a large fixed-price fabrication project.

Selling, general and administrative expenses. Selling, general and administrative expenses ("SG&A") for the three months ended September 30, 2013 was $2,082, or 24 percent of revenues. SG&A for the three months ended September 30, 2012 was $1,966, or 21 percent of revenues. SG&A remained relatively consistent.

Depreciation and amortization expense not included in cost of sales. Depreciation and amortization expense not included in cost of sales ("D&A") for the three months ended September 30, 2013 was $35. D&A for the three months ended September 30, 2012 was $140. In the fourth quarter of 2012, we fully impaired intangible assets associated with the consolidation of our Morgan City, Louisiana operations. This is the primary cause of the reduction in amortization expense in the 2013 period.

Interest expense, net. Interest expense, net was $52 for the three months ended September 30, 2013. Interest expense, net was $34 for the three months ended September 30, 2012. Net interest expense for each period was generated by outstanding debt, offset by interest income earned on cash and short-term investments. The $18 increase in the 2013 period is due primarily to the Company having higher average interest-bearing obligations in the 2013 period.

Equity in net income (loss) of joint venture. Equity in net income of joint venture was $0 for the three months ended September 30, 2013. Equity in net loss of joint venture was $39 for the three months ended September 30, 2012. The CFT joint venture is in the liquidation process. Therefore, current period activity is limited.

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

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

The following is a reconciliation of net income to Modified EBITDA for the three months ended September 30, 2013 and 2012:

	Three Months Ended September 30,	
	2013	2012

Net income	$381	$970
Add back interest expense, net of interest income	52	34
Add back depreciation and amortization	393	474
Add back income tax (benefit) expense	(62)	74
Add back share-based compensation	196	142
Add back non-recurring operational consolidation expense	–	200
Add back equity in net loss of joint venture	–	39
Modified EBITDA	$960	$1,933

Modified EBITDA for the three months ended September 30, 2013 was $960. Modified EBITDA for the three months ended September 30, 2012 was $1,933. Modified EBITDA decreased $973 primarily due to decreased gross profit before depreciation expense of $664. Additionally, there was a $200 reduction in operational consolidation expense.

Nine Months Ended September 30, 2013 Compared to Nine Months Ended September 30, 2012

Revenues. Revenues for the nine months ended September 30, 2013 were $23,953. Revenues for the nine months ended September 30, 2012 were $22,168. The $1,785 increase (8 percent) has occurred primarily due to increased demand by our customers for our technologically innovative solutions as a result of our consistently successful project execution.

Gross Profit. Gross profit for the nine months ended September 30, 2013 was $8,161, or 34 percent of revenues. Gross profit for the nine months ended September 30, 2012 was $7,969, or 36 percent of revenues. The gross profit percentage is consistent between periods and with our expectations.

Selling, general and administrative expenses. Selling, general and administrative expenses ("SG&A") for the nine months ended September 30, 2013 was $6,311, or 26 percent of revenues. SG&A for the nine months ended September 30, 2012 was $5,948, or 27% of revenues. SG&A remained relatively consistent as a percentage of revenues.

Depreciation and amortization expense not included in cost of sales. Depreciation and amortization expense not included in cost of sales ("D&A") for the nine months ended September 30, 2013 was $100. D&A for the nine months ended September 30, 2012 was $432. In the fourth quarter of 2012, we fully impaired intangible assets associated with the consolidation of our Morgan City, Louisiana operations. This is the primary cause of the reduction in amortization expense in 2013 period.

Interest expense, net. Interest expense, net was $143 for the nine months ended September 30, 2013. Interest expense, net was $120 for the nine months ended September 30, 2012. Net interest expense for each period was generated by outstanding debt, offset by interest income earned on cash and short-term investments. The $23 increase in the 2013 period is due primarily to the Company having higher average interest-bearing obligations in the 2013 period.

Equity in net income (loss) of joint venture. Equity in net income of joint venture was $1 for the nine months ended September 30, 2013. Equity in net loss of joint venture was $179 for the nine months ended September 30, 2012. The CFT joint venture is in the liquidation process. Therefore, current period activity is limited.

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

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

The following is a reconciliation of net income to Modified EBITDA for the nine months ended September 30, 2013 and 2012:

	Nine Months Ended September 30,	
	2013	2012
Net income	$1,627	$1,309
Add back interest expense, net of interest income	143	120
Add back depreciation and amortization	1,157	1,401
Add back income tax expense	8	93
Add back share-based compensation	471	519
Add back non-recurring operational consolidation expense	–	200
Add back equity in net (income) loss of joint venture	(1)	179
Modified EBITDA	$3,405	$3,821

Modified EBITDA for the nine months ended September 30, 2013 was $3,405. Modified EBITDA for the nine months ended September 30, 2012 was $3,821. Modified EBITDA decreased $416 primarily due to increased SG&A before share-based compensation expense of $411 and decreased operational consolidation expense of $200, partially offset by a $280 increase in gross profit before depreciation expense.

Liquidity and Capital Resources

Overview

Historically, we have supplemented the financing of our capital needs primarily through debt financings. Most significant in this regard has been the debt facility we have maintained with Whitney Bank, a state chartered bank (and successor to Whitney National Bank, a national banking association) (“Whitney”). Our loans outstanding under the Amended and Restated Credit Agreement with Whitney (the “Restated Credit Agreement”) were to become due on April 15, 2013.

On March 5, 2013, we entered into the Fifth Amendment to Amended and Restated Credit Agreement (“Fifth Amendment”) with Whitney. Under the Fifth Amendment, the Company and Whitney agreed:

- to increase the committed amount under the revolving credit facility (“Revolving Credit Facility”) to $5,000, and extend the maturity date of such Revolving Credit Facility to April 15, 2014;
- to increase the committed amount under the real estate term facility (“RE Term Facility”) to $2,000, extend the maturity date of such RE Term Facility to April 15, 2018, and the Company is obligated to make increasing monthly repayments of principal (along with accrued and unpaid interest thereon) starting at $8, beginning April 1, 2013;
- for Whitney to make a new single-advance term loan to Deep Down in the original principal amount of $250 (“Equipment Term Loan”) for the purpose of effecting a purchase of two tensioners (the “Equipment”). The Equipment Term Loan has an interest rate of 4.0 percent per annum and maturity date of April 15, 2018, and the Company is obligated to make increasing monthly repayments of principal (along with accrued and unpaid interest thereon) starting at $4, beginning April 1, 2013;
- to change the definition of EBITDA to allow a non-recurring expense in the amount of $117 for closing the operations of Mako and consolidating with Deep Down Delaware in the fiscal quarter ended December 31, 2012, and to allow a non-recurring charge of $2,156, for the write-off related to impairment of long-lived assets associated with consolidating the operations of Mako, also in the fiscal quarter ended December 31, 2012.

As of the effective date of the Fifth Amendment, the outstanding principal balance of the RE Term Facility was $1,730. Whitney agreed to make a single advance to the Company in an amount equal to $270 (bringing the balance of the RE Term Facility as of the effective date of the Fifth Amendment to $2,000) to assist in effecting the purchase of the Equipment. As with Deep Down’s other outstanding indebtedness under the credit agreement, outstanding amounts of the Equipment Term Loan are secured by a security interest in all of Deep Down’s assets. The interest rate on all of the loans remains the same at 4.0 percent per annum.

As of September 30, 2013, the outstanding indebtedness to Whitney under the Fifth Amendment was $1,943 under the RE Term Facility.

Our credit agreement with Whitney obligates us to comply with the following financial covenants:

- *Leverage Ratio* - The ratio of total debt to total consolidated EBITDA for the four most recent quarterly periods must be less than 3.0 to 1.0;
- *Fixed Charge Coverage Ratio* - The ratio of total consolidated EBITDA for the four most recent quarterly periods to total consolidated net interest expense plus principal payments for the four most recent quarterly periods on total debt must be greater than 1.5 to 1.0;
- *Tangible Net Worth* - Our consolidated net worth, after deducting other assets as are properly classified as "intangible assets," plus 50 percent of net income (if positive), after provision for income taxes, for each whole or partial fiscal year completed after June 30, 2011, must be in excess of $13,000;
- Moreover, we continue to have obligations for other covenants, including, among others, limitations on issuance of common stock, liens, transactions with affiliates, additional indebtedness and permitted investments.

As of September 30, 2013, we were in compliance with all of these financial covenants.

During the third quarter of 2013, we issued an additional 4,444 shares of common stock resulting in a cash increase of $7,647. As a result of the stock issuance, amended terms of the Fifth Amendment, and cash we expect to generate from operations, we believe we will have adequate liquidity to meet our future operating requirements.

We had working capital of $15,444 at September 30, 2013.

Inflation and Seasonality

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

Off-Balance Sheet Arrangements

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

Critical Accounting Estimates

The discussion and analysis of our financial condition and results of operations is based on our unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements in accordance with US GAAP requires us to make estimates and judgments that may affect assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition and related allowances, costs and estimated earnings incurred in excess of billings on uncompleted contracts, impairments of long-lived assets, including intangibles and goodwill, income taxes including the valuation allowance for deferred tax assets, billings in excess of costs and estimated earnings on uncompleted contracts, contingencies and litigation, and share-based payments. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions.

Refer to Part II. Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” in our Annual Report on Form 10-K for the year ended December 31, 2012 for a discussion of our Critical Accounting Policies.

Recently Issued Accounting Standards

Management believes that recently issued accounting standards, which are not yet effective, will not have a material impact on our condensed consolidated financial statements upon adoption.

ITEM 4. CONTROLS AND PROCEDURES

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

The Company's management, with the participation of the principal executive and principal financial officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2013, as required by Rule 13a-15(e) of the Exchange Act. Based upon that evaluation, the principal executive and the principal financial officer have concluded that the Company's disclosure controls and procedures were effective as of September 30, 2013.

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

Changes in Internal Control Over Financial Reporting. The Company's management, with the participation of the principal executive and principal financial officer, has concluded that there were no changes in internal control over financial reporting during the fiscal quarter ended September 30, 2013.

At December 31, 2012, the Company reported a material weakness ("Material Weakness") related to percentage-of-completion ("POC") accounting for fixed-price contracts. During the fiscal quarter ended March 31, 2013, in order to begin to remediate the Material Weakness, the Company created and filled a financial management position within its project operations function, the primary responsibilities of which are to ensure: (a) that initial and updated detailed cost estimates and POC accounting schedules for fixed-price contracts are timely and accurately prepared; (b) proper segregation of accounting for time and materials aspects from POC aspects of contracts containing both; (c) effective financial management review of contract terms; (d) effective communication with accounting personnel, and (e) along with accounting personnel, effective financial management review of the POC accounting revenue recognition calculations.

Based on this remediation effort, the Company's management, with the participation of the principal executive and principal financial officer, has concluded that, although significant progress toward remediation of the Material Weakness has been achieved, the Material Weakness still existed during the fiscal quarter ended September 30, 2013. It is our belief that we will be able to have the Material Weakness fully remediated by the end of the fiscal year ending December 31, 2013.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are involved in legal proceedings arising in the normal course of business. As of the date of this Quarterly Report on Form 10-Q, we were not involved in any material actual or pending legal proceedings.

ITEM 6. EXHIBITS

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

3.1	Articles of Incorporation of Deep Down, Inc. (conformed to include the amendment of the Articles of Incorporation filed with the Secretary of State of the State of Nevada on September 29, 2008) (incorporated by reference from Exhibit A to our Schedule 14C filed on August 15, 2008).
3.2	Amended and Restated ByLaws of Deep Down, Inc. (incorporated by reference from Exhibit B to our Schedule 14C filed on August 15, 2008).
31.1*	Certification of Ronald E. Smith, President and Chief Executive Officer, furnished pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2*	Certification of Eugene L. Butler, Chief Financial Officer, furnished pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32*	Statement of Ronald E. Smith, President and Chief Executive Officer and Eugene L. Butler, Chief Financial Officer, furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.DEF	XBRL Definition Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

* Filed or furnished herewith.

SIGNATURES

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

DEEP DOWN, INC.
(Registrant)

Date: November 13, 2013

/s/ Eugene L. Butler
Eugene L. Butler
Executive Chairman and Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

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